

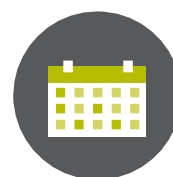
2020 Annual Report

Providing
our customers
with financial
security for
retirement



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Key dates

29 October 2020
2020 Annual General Meeting

9 February 2021
Half year financial results

23 March 2021
Interim dividend payment date

10 August 2021
Full year financial results

22 September 2021
Final dividend payment date

28 October 2021
2021 Annual General Meeting

Full listing of key dates available at

› [challenger.com.au/shareholder/
shareholder-information/key-dates](https://challenger.com.au/shareholder/shareholder-information/key-dates)

Dates may be subject to change. Any change in dates will be advised to the Australian Securities Exchange.

About this Annual Report

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

› challenger.com.au/shareholder

2020 Annual Review

The 2020 Annual Review is intended to provide you with useful information about your company in an easy-to-read document. Included in the Annual Review is an operational and financial performance update, reports from the Chair and the Chief Executive Officer, and information on the environmental, social and governance matters that affect your company. The Annual Review can be viewed online at:

› [challenger.com.au/
annualreview2020](https://challenger.com.au/annualreview2020)

2020 Corporate Governance Report

The 2020 Corporate Governance Report can be viewed online at:

› [challenger.com.au/
corporategovernance2020](https://challenger.com.au/corporategovernance2020)

2020 Sustainability Report

The 2020 Sustainability Report can be viewed online at:

› [challenger.com.au/
sustainabilityreport2020](https://challenger.com.au/sustainabilityreport2020)

2020 Annual General Meeting

Location

To be determined and subject to COVID-19 pandemic requirements.

Date

29 October 2020

Time

9.30am (Sydney time)

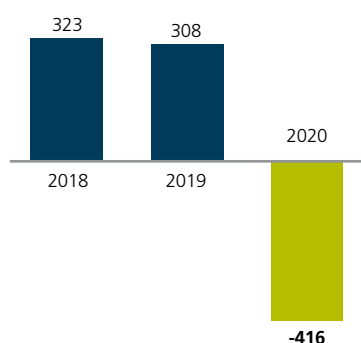
Full details of the meeting will be included in your Notice of Annual General Meeting, which will be sent to shareholders in September 2020.

Board nominations

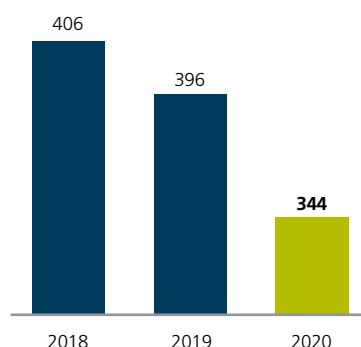
The closing date for receipt of nominations for the Challenger Limited Board is 9 September 2020.

Group performance highlights

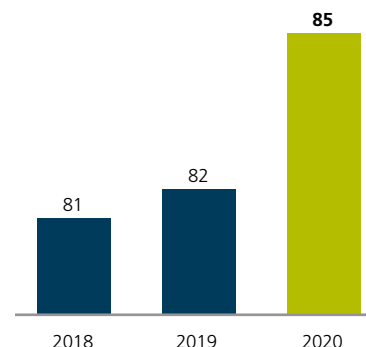
Statutory net profit after tax (\$m)



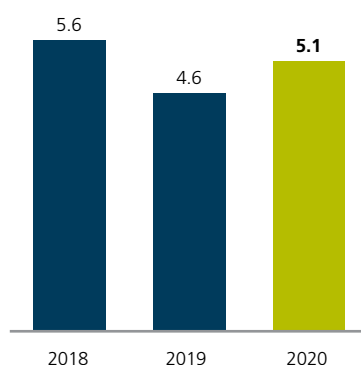
Normalised net profit after tax (\$m)



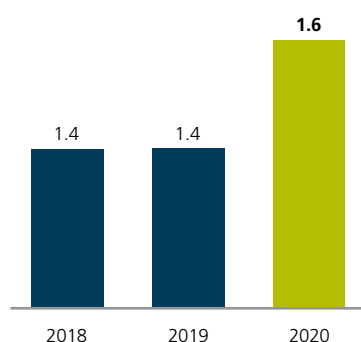
Group AUM (\$bn)



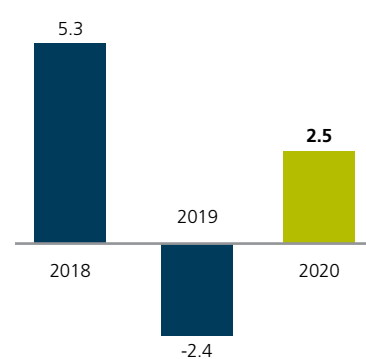
Life sales (\$bn)



Challenger Life Company excess regulatory capital (\$bn)



Funds Management net flows (\$bn)



Responding to COVID-19 pandemic

Our people	Our customers and partners	Balance sheet strength
 <p>PROTECT THE HEALTH AND WELLBEING OF OUR PEOPLE</p>	 <p>SUPPORT CUSTOMERS AND BUSINESS PARTNERS</p>	 <p>STRONGLY CAPITALISED WITH FLEXIBILITY</p>

Operating and financial review

1 About Challenger

Challenger Limited (Challenger, CGF, the Group or the Company) is an investment manager founded in 1985. Challenger is the largest annuity provider and one of the largest¹ fund managers in Australia.

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

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

Challenger's assets under management were \$85.2 billion, up 4.2% (30 June 2019: \$81.8 billion). Normalised net profit before tax was \$506.5 million, down \$41.8 million or 7.6% (30 June 2019: \$548.3 million). Earnings were directly impacted by the investment market volatility caused by COVID-19 which resulted in lower asset returns in the Life business following the sale of assets in March 2020 which was partially offset by higher Funds Management performance fees. See sections 2 and 8 for a description of Challenger's operating segments and its normalised cash operating earnings framework.

Normalised net profit after tax was down \$52.4 million or 13.2% to \$343.7 million (30 June 2019: \$396.1 million). Statutory net loss after tax, which includes investment experience, being the valuation movements on assets and liabilities supporting the Life business, was \$416.0 million (30 June 2019: profit of \$307.8 million), down \$723.8 million due to the investment market volatility as a result of the impact of COVID-19.

Challenger has total equity of \$3.2 billion as at 30 June 2020 and employs 735 people on a full-time equivalent (FTE) basis.

2 Operating segments and principal activities

For internal reporting and risk management purposes, Challenger's principal activities are divided into two operating segments, Life and Funds Management. The Life operating segment is serviced by the Distribution, Product and Marketing team, which is responsible for ensuring the appropriate marketing and distribution of Life's products. Both operating segments and the Distribution, Product and Marketing team are supported by centralised operations which are responsible for appropriate processes and systems and for providing the necessary resources to meet regulatory, compliance, financial reporting, legal and risk management requirements.

Life – the Life segment comprises Challenger Life Company Limited (CLC), Australia's leading provider of annuities and guaranteed retirement income products.

As Australia's largest annuity provider, Life provides reliable guaranteed² incomes to Australian retirees.

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

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

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

Life is the market leader in Australian retirement incomes, with a 75%³ annuity market share and has won the Association of Financial Advisers 'Annuity Provider of the Year' for twelve consecutive years.

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

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

As one of Australia's largest¹ asset managers, Funds Management invests across a broad range of asset classes including fixed income, commercial property and Australian and global equities. The Funds Management segment comprises two business divisions, Fidante Partners and CIP Asset Management (CIPAM).

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

¹ Consolidated FUM for Australian Fund Managers – Rainmaker Roundup, March 2020.

² The word 'guaranteed' means payments are guaranteed by Challenger Life Company Limited from the assets of its relevant statutory fund.

³ Plan for Life – March 2020 – based on annuities under administration at 30 March 2020.

2 Operating segments and principal activities (continued)

CIPAM develops and manages assets for CLC and on behalf of third-party institutional investors. The investments managed by CIPAM

are predominantly in fixed income and commercial property.

The Funds Management business is growing strongly, with funds under management (FUM) increasing by more than 40% over the last five years to \$81 billion.

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

3 Challenger's vision and strategy

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

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

4 Risk management

The management of risk is fundamental to Challenger's business and to building shareholder value. At Challenger, risk is everyone's business. The Board's Risk Appetite Statement outlines the level of risk that is acceptable in striving to achieve Challenger's strategic goals and financial objectives. This is combined with an effective risk management framework which monitors, mitigates and manages the risks to which Challenger is exposed.

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

An integral part of risk management for Challenger is the maintenance of a strong risk culture amongst its employees. Challenger's expectations of its employees are encapsulated in the 'Challenger IACT' values of:

- Act with integrity;
- Aim high;
- Collaborate; and
- Think customer.

All employees are assessed against the Challenger IACT values as part of the annual performance review process, and this outcome contributes to the overall performance rating and remuneration outcomes.

5 Challenger's 2020 strategic progress

2020 strategic progress

Progress in 2020 against our strategic priorities is set out below:

Increase the use of secure retirement income streams

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

2020 progress

- Total Life sales up 13%, with annuity sales down 12% and more than offset by a 101% increase in Other Life sales;
- Annuity sales were driven by the following outcomes in Australia and Japan:
 - Australian annuity sales down 27%:
 - Domestic term annuity sales down 19% and impacted by structural changes to the Australian wealth management market and sales disruption from the COVID-19 pandemic. Refer below for additional information.
 - Domestic Lifetime annuity sales down 51%, in addition to the structural changes to the Australian wealth management market, lifetime sales were also impacted by transition to new means test rules and sales disruption from the COVID-19 pandemic. Refer below for additional information.
 - Japan annuity sales up 177%, driven by an expansion to the reinsurance agreement with MS Primary, which included extending reinsurance to include US dollar annuities in addition to Australian dollar annuities.
 - Other Life sales, representing Challenger's Index Plus Fund, increased by 101% to \$2.0 billion and benefited from a focus on building out the institutional channel and increased client demand.

Structural change to Australian financial advice market

Following the public hearings and completion of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) in 2019, there has been significant structural change across the Australian wealth management and financial adviser market.

There have been a range of regulatory changes that have had a significant impact on the economics for many financial advice practices. Regulatory changes include a shift away from commissions to fee-for-service, resulting in lower revenue per client, and the best interests duty which is increasing focus on holistic advice over transaction advice. Advisers are also increasing education and compliance activities, which is reducing focus on the acquisition of new clients and servicing of their existing book.

There have been significant withdrawals of advisers from the market through the major banks generally exiting or reducing their exposure to wealth management, which is contributing to a reduction in the number of financial advisers aligned to the wealth management operations of the major banks.

There has been higher adviser turnover with advisers either migrating from licensees aligned to the major banks to independent adviser networks, switching licensees in the network, becoming self-licensed, or leaving the industry altogether.

As a result, the Australian financial advice market continues to undergo significant structural change, with adviser numbers reducing by 16% year-on-year and advisers moving from the major banks to Independent Financial Advisers (IFA) networks. At 30 June 2020, IFAs accounted for approximately 72% of the advice market, up from 60% five years ago¹.

Representing the shift away from major hubs to privately owned licensees, in 2020 62% of all advisers were licensed to a privately owned licensee, up from 32% five years ago. Institutionally owned and aligned advisers, which has traditionally been the largest segment represented 38% of the total advice market, down from 63% five years ago¹.

These industry changes are impacting Challenger's annuity sales, especially term annuity sales which were well supported by advisers aligned to the major banks.

Challenger believes in the need for financial advice, particularly in the retirement phase of superannuation and is supporting advisers as they move across licensees and ensuring Challenger products are widely available on investment and administration platforms.

Transition to new means test rules

Challenger's 2020 lifetime annuity sales were affected by transition to new age pension means test rules that commenced on 1 July 2019.

The new rules are designed to support the take-up of lifetime income stream products.

¹ ASIC Adviser Register June 2020.

5 Challenger's 2020 strategic progress (continued)

2020 strategic progress (continued)

Increase the use of secure retirement income streams (continued)

Australian lifetime annuity sales decreased 51% on 2019, with sales of Liquid Lifetime down 48% in 2020. Sales of CarePlus, a lifetime annuity specifically designed for aged care customers, were down 57% in 2020.

For Liquid Lifetime, under the new means test rules the Flexible and Enhanced product options are more attractive and the Regular product option is generally less attractive.

Advisers are transitioning from the Regular to the Flexible and Enhanced options and a new cohort of advisers writing the Flexible and Enhanced options is emerging. In 2020, 56% of advisers recommending Liquid Lifetime annuities did not recommend any in the previous financial year.

Despite the social disruption from COVID-19 in the fourth quarter of 2020, lifetime annuity sales remained relatively stable on the proceeding three quarters, reflecting an increase in the number of advisers recommending the product, offsetting the impact from COVID-19.

There are over 200 specialist aged care advisers that support the CarePlus product. CarePlus was reviewed and updated in late 1H20 following commencement of new means test rules in order to ensure it provided the best overall outcome for aged care customers. Following the product refresh, sales momentum is building with 2H20 CarePlus sales up 12% on 1H20 despite the COVID-19 disruption during the fourth quarter.

The new means test rules have been designed to support the take up of longevity protection and lifetime income streams. Challenger remains confident over the long-term that lifetime sales will increase under the new means test rules.

Sales disruption from COVID-19 pandemic

From March 2020, the COVID-19 pandemic has impacted financial advisers' ability to meet new clients, and their focus has been on servicing their existing client base, rather than on-boarding new clients. New clients on-boarded at the point of retirement represents an opportunity to recommend annuities.

Lower new client acquisition by financial advisers during the fourth quarter, due to the pandemic, contributed to domestic annuity sales being 34% lower than the prior corresponding quarter.

CarePlus is a lifetime annuity specifically designed for aged care customers. During the pandemic, there has been a delay in retirees entering aged care. These delays have impacted CarePlus sales in the fourth quarter, which were 16% lower than the third quarter.

Throughout 2020, and particularly during the pandemic related market sell-off, Challenger has received numerous customer testimonials noting their annuity is providing peace of mind in volatile and uncertain times. Significant market sell-offs highlight the benefits of annuities and guaranteed income relative to market-linked account-based pension products.

Over the past year, Challenger has paid out approximately \$3.8 billion in guaranteed annuity payments to its customers, with payments to customers not impacted by the COVID-19 pandemic or related market sell-off.

New RBA Cash Linked lifetime annuity option

In order to increase the take-up of secure retirement income streams by Australian retirees, Challenger is focused on ensuring its products remain contemporary and are effective for retirees.

In June 2020 the RBA Cash Linked option was added to Challenger's Liquid Lifetime product range.

This innovation allows retirees to link future lifetime annuity payments to prevailing interest rates, with regular payments reset each month based on movements in the RBA cash rate. The RBA Cash Linked monthly payment comprises a fixed component and a variable RBA cash rate component.

The RBA Cash Linked option has been specifically designed for customers and advisers who may be concerned with investing in a lifetime annuity in a low interest rate environment. The RBA Cash Linked option seeks to address these concerns and can be applied to either the immediate or deferred lifetime annuity.

Diversifying distribution channels

Challenger is focused on diversifying its distribution channels and reducing reliance on retail financial advisers. In 2020, the following initiatives were undertaken:

- commenced reinsuring US dollar annuities issued by MS Primary in Japan. As a result, MS Primary 2020 sales increased by 177% and represented 24% of total annuity sales, up from 8% in 2019; and

5 Challenger's 2020 strategic progress (continued)

2020 strategic progress (continued)

Increase the use of secure retirement income streams (continued)

- expanded institutional relationships and product offering. The Challenger Index Plus product was refreshed, with sales increasing by 101% on 2019. Sales benefited from new annuity and Challenger Index Plus clients, including a new institutional annuity client investing \$300 million across a range of term annuities.

Life sales mix and focus on long-term products

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

- In 2020, long-term annuity sales, which include Australian lifetime annuities and 20-year fixed term annuities distributed through MS Primary in Japan, represented 37% of total annuity sales, up from 32% in 2019.

The annuity book continues to shift toward long-term annuities, with the long-term annuity book now representing 53% of the total annuity book, up from 28% five years ago.

Engaging and educating customers

In May 2020, Challenger launched a 'Retirement Made Simple' hub on its website, with the goal to educate retirees on the different sources of income in retirement and benefits of lifetime income and annuities.

Challenger also launched a 'Retire with Confidence' retirement income tool to help retirees and pre-retirees better understand the financial realities of retirement. The tool is available on Challenger's website and is designed to help retirees understand how long their superannuation will last and demonstrates how an annuity can be part of a comprehensive retirement solution.

Adviser support and focus

Challenger believes in the value of financial advice, particularly in retirement. As the financial advice market transitions to more IFA networks, Challenger is enhancing its focus on IFAs and ensuring its products are available on leading independent platforms.

Challenger is also supporting customers and potential customers seeking high quality retirement financial advice and commenced an adviser referral pilot. Customers have reported that this has reduced the effort of finding an adviser and are feeling well supported by Challenger.

Challenger is also supporting advisers through increased education and thought leadership. In 2020 the number of advisers attending Challenger retirement planning or aged care webinars doubled.

Retirement reforms engagement and advocacy

The Australian Government is considering a range of superannuation reforms aimed at enhancing the retirement phase of superannuation. Reforms include the new pension means test rules for lifetime income stream products that commenced on 1 July 2019, and the Retirement Income Framework.

The Government has also commissioned an independent review of the retirement income system (the Retirement Income Review) to improve understanding of its operation and the outcomes it is delivering for Australian retirees.

Maintaining thought leadership position

As an Australian retirement income thought leader, Challenger works with a broad range of industry, consumer and Government organisations to assist in developing retirement income policy outcomes that help provide Australians with financial security for retirement.

Challenger partnered with National Seniors Australia in 2020 to measure retirees' attitudes and confidence in managing the financial aspects of retirement. Challenger also partnered with the Council on the Ageing (COTA) New South Wales to explore consumer-related retirement income issues and understand how COVID-19 is impacting older workers.

Lead the retirement incomes market and be the partner of choice

Challenger's strategy includes being the partner of choice for superannuation fund advisers, wealth managers and investment platforms in providing retirement income solutions. Challenger is the market leader in annuities with 75%¹ market share.

2020 progress

Leading adviser ratings

Despite structural changes in the Australian financial advice market and new competitors entering the retirement income market, Challenger has remained the dominant retirement income brand.

¹ Plan for Life – March 2020 – based on annuities under administration at 30 March 2020.

5 Challenger's 2020 strategic progress (continued)

2020 strategic progress (continued)

Lead the retirement incomes market and be the partner of choice (continued)

Among Australian financial advisers, Challenger continues to be the most recognised retirement income provider with 93%¹ of financial advisers rating Challenger as a leader in retirement income. Challenger's retirement income leadership position, which supports new distribution and product relationships, is 41 percentage points above its nearest competitor.

New integrated brand campaign

In June 2019, Challenger launched a new integrated brand campaign, 'Look forward with confidence' based on extensive adviser and customer research. The campaign focused on building brand awareness and familiarity, with a strong emphasis on educating customers and advisers on annuities being an important component when creating confidence in retirement.

Following the campaign launch, several educational initiatives were undertaken, aimed to get more retirees to understand the role annuities can play as part of a comprehensive retirement income plan. Challenger also sponsored the NSW Seniors Expo and developed the 'Retire with Confidence' tool to support customer education and engagement.

Campaign performance indicators show an increase in brand awareness and familiarity, with both measures above target for retirees aged 65 to 74, Challenger's target audience.

Investing in Distribution, Product and Marketing (DPM) growth initiatives

The Australian wealth management and financial advice market is undergoing significant structural change.

To help drive additional demand for annuities and guaranteed income products, Challenger is investing in a range of Distribution, Product and Marketing (DPM) initiatives.

The initiatives focus on increasing direct customer engagement and education, evolving Challenger's product range, supporting advisers and building more diversified distribution networks, including institutional partnerships.

Building institutional partnerships

Challenger's institutional guaranteed annuity business is growing strongly, with sales increasing by 101% to \$2.0 billion in 2020. Sales are benefiting from a number of new institutional relationships and a focus on solutions-led strategies for profit-for-member and superannuation fund clients.

Clients are increasing their focus on providing retirement income solutions for their members and how Challenger's capabilities can support them in building comprehensive retirement solutions.

Life Risk (wholesale longevity and mortality) progress

Life is undertaking wholesale longevity and mortality transactions, principally in the established United Kingdom market. Life has specialised expertise and commenced this business in 2013.

The present value of future profits arising from the Life Risk portfolio was \$829 million at 30 June 2020, an increase of 67% (\$334 million) from \$495 million at 30 June 2019. The increase in the present value of future profits was due to three longevity risk transactions completed in the UK pension market.

Provide customers with excellent funds management solutions

Challenger is focused on providing excellent funds management solutions in order to help build retirement savings.

2020 progress

Maintaining superior investment performance

Funds Management has a long track record of achieving superior investment performance, which has helped attract strong net flows over many years.

Long-term investment performance for Fidante Partners Australian boutiques remains strong with 85% of FUM outperforming benchmark over five years. Since fund inception, 84% of Fidante Partners' funds have achieved either first or second quartile investment performance².

CIP Asset Management's fixed income capability also continues to achieve strong investment performance. All of CIP Asset Management's third party fixed income mandates and funds beat their investment performance benchmark over three and five years.

¹ Marketing Pulse Adviser Study December 2019.

² Mercer as at 30 June 2020.

5 Challenger's 2020 strategic progress (continued)

2020 strategic progress (continued)

Provide customers with excellent funds management solutions (continued)

Award-winning investment strategies

Fidante Partners' investment managers continue to be externally recognised. During 2020, the following funds won investment manager awards:

- Ardea Investment Management – Zenith Fund Awards Australian Fixed Income winner (2019);
- Ardea Investment Management – Kanganews Australian Rates Fund Manager of the Year (2019);
- Kapstream – Kanganews Australian Credit Fund Manager of the Year (2019).

Highly rated retail investment products

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

- 37% of ratings are the top rating (e.g. 'Highly Recommended' or 'Gold') compared to an average of approximately 12% across the Australian funds management industry; and
- 90% of ratings are a 'buy' rating compared to an average of approximately 75% across the Australian funds management industry.

The quality and performance of Fidante Partners' investment managers and funds continue to receive strong independent validation. During 2020, two of Alphinity Investment Management's Australian share funds were upgraded from Recommended to Highly Recommended by a primary research house. This same research house upgraded the Alphinity Global Fund to Recommended. Eiger Capital was also awarded a 'Highly Recommended' rating by Zenith. Greencape Capital continues to be the only Australian large cap equities manager to hold the top rating across all three major Australian retail research consultants.

Adding new boutiques and investment strategies

Fidante Partners continues to expand its product offering by forming new partnerships and developing new investment strategies for existing managers.

In September 2019, Fidante Partners and global alternative asset manager Ares Management Corporation (NYSE: ARES) established a new strategic joint venture, Ares Australia Management. The joint venture will provide Australian investors with access to alternative investment products managed in the United States by Ares Management Corporation.

In May 2020, Ares Management Australia launched its first product, the Ares Global Credit Income Fund, which offers Australian investors access to a higher income strategy with a focus on capital preservation. The Ares Global Credit Income Fund targets a return of between 3% and 4% per annum, with distributions paid monthly.

During 2020, Fidante Partners expanded its boutique product offering:

- launching Ardea Pure Alpha, which is a higher returning version of the flagship Ardea Real Outcome Fund;
- launching a retail share class for the Kapstream Absolute Return Income Plus strategy, which targets an absolute return of 3–4% above the cash rate;
- launching the Whitehelm Global Listed Infrastructure Fund for Australian investors which has previously only been available in Europe; and
- launching the Nikko AM Developed Countries Government Bond Relative Value Strategy managed by Ardea. The strategy targets the Japanese institutional market and is an institutional Toshin Fund marketed by Nikko to their large institutional client base.

Expanding distribution channels through active ETF market

There continues to be strong demand from investors for simple and easy-to-access liquid investment products. Exchange Traded Funds (ETFs) continue to experience strong growth in a number of markets as they provide the ability to deliver diversified investment strategies in a liquid and easy-to-execute format. While ETFs have historically focused on passive or factor-based investments, the demand for more actively managed products continues to grow. In 2019, active ETFs accounted for approximately half of all new Australian ETF market listings¹.

In December 2018, Fidante Partners launched one of Australia's first active fixed income ETFs, the ActiveX Ardea Real Outcome Bond Fund (ASX: XARO), managed by Ardea Investment Management. In October 2019, Fidante Partners launched its second active ETF in the ActiveX Series, the ActiveX Kapstream Absolute Return Income Fund. The fund aims to provide a steady stream of income and capital stability over the medium term while outperforming its benchmark through different market cycles.

¹ BetaShares Australian ETF Review – 2019.

5 Challenger's 2020 strategic progress (continued)

2020 strategic progress (continued)

Provide customers with excellent funds management solutions (continued)

Fidante Partners is committed to growing the ActiveX Series and expects to launch more active ETFs. Total Fidante Partners FUM invested in ETF strategies at 30 June 2020 was \$202m and increased by \$186m for the year.

CIP Asset Management rebrand

Challenger Investment Partners has been rebranded CIP Asset Management as it starts to target more retail FUM. Challenger Investment Partners was formed over 20 years ago, with the business evolving from servicing just Challenger Life to providing solutions to a broad range of third party clients. At 30 June 2020, third party clients represented 25% of CIP Asset Management FUM.

The rebrand demonstrates Challenger's commitment to growing the business and building on the breadth of investment expertise.

CIP Asset Management fixed income and Credit Income Fund

The CIP Asset Management Fixed Income team manage funds and investment mandates across multiple strategies, comprising both public and private credit investments.

The CIP Asset Management Credit Income Fund, launched in October 2017, is a floating rate, multi-sector credit income strategy that invests across high quality, predominantly investment grade public and private debt investments. With an investment-grade average portfolio credit rating¹, the fund provides investors with a higher income, defensive and diversified portfolio without taking excessive levels of credit or interest rate risk.

In 2020, the CIP Asset Management Credit Income Fund continued to attract interest from third party institutions and expanded distribution to target Australian high-net-worth individual investors.

The fund continues to perform strongly and, since inception, has outperformed the bank bill rate by 2.3% p.a.

The CIP Asset Management Credit Income Fund FUM at 30 June 2020 was \$282 million and increased by 73% for the year.

CIP Asset Management Multi-Sector Private Lending Credit Income Fund

The CIP Asset Management Multi Sector Private Lending Fund, which is an open-ended fund targeting a net return of the bank bill swap rate (BBSW) plus a margin of 5% was launched in February 2020. The Fund is a multi-sector credit strategy which invests across Australian and New Zealand private securitised, corporate and real estate lending.

The fund had ~\$190 million of FUM at 30 June 2020 and despite significant market turmoil since launch, the fund has provided positive returns over its first five months.

CIP Asset Management appointed investment manager by AOFM

In December 2019, the Australian Office of Financial Management (AOFM) appointed CIP Asset Management as the investment adviser to assist with the evaluation of investment proposals and provide ongoing portfolio management for the Federal Government's Australian Business Securitisation Fund (ABSF). The ABSF was established to improve access to credit for Australian small businesses. CIP Asset Management will provide advisory services and generate transaction and investment management fees from the ABSF. During 2H20, the first ABSF transaction was approved.

CIP Asset Management Real Estate

The CIP Asset Management Real Estate team manage real estate mandates across Australia and Japan on behalf of Australian and international investors. Through 2020 CIP Asset Management expanded its Japanese real estate portfolio, targeting non-discretionary retail and retail related logistics assets. CIP Asset Management continues to explore domestic opportunities in Japan including partnering with Japanese investors to invest in Australian real estate investment strategies.

During the COVID-19 pandemic CIP Asset Management has been actively managing both its fixed income and property portfolios. For Real Estate, this has included working closely with approximately 60% of its tenants who have been directly impacted by the COVID-19 disruption.

Maintain leading operational and people practices

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

¹ Based on Moody's Investors Service inc. weighted average rating factors.

5 Challenger's 2020 strategic progress (continued)

2020 strategic progress (continued)

Maintain leading operational and people practices (continued)

2020 progress

Redefining Challenger's values and new employee Code of Conduct

Challenger's values are integral to its culture and linked to everything employees do.

They set out the behaviours needed to meet community expectations and ensure Challenger can deliver on its vision and strategy, now and into the future.

In 2020 Challenger redefined and launched new values. Challenger's values are:

- Act with integrity;
- Aim high;
- Collaborate; and
- Think customer.

The new Challenger values are clear, meaningful and memorable and define what is expected of all employees.

In 2020, Challenger also launched a new employee Code of Conduct. The Code of Conduct sets out expectations for employees on how to act, solve problems and make fair and balanced decisions. It brings together Challenger's values and links them to Group policies and statements.

Health and wellbeing of our people during the COVID-19 pandemic

Looking after the health of our employees during the COVID-19 pandemic is a key business priority.

Almost all of Challenger's employees have worked from home since mid-March 2020 and have adapted well with business continuity maintained throughout the period.

Internal employee surveys show high employee engagement, with the majority feeling positive towards Challenger, notwithstanding the difficult working environment. An employee survey in May 2020 showed 94% of our staff felt Challenger cared, and 98% were confident in the Leadership Team's ability to navigate through the disruption. Importantly it showed 97% of employees felt positive about their ability to adjust to work-from-home arrangements, and 94% felt well connected to their teams during this time.

Employee engagement

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

Challenger measures employee engagement through a biennial survey, which was last conducted by Willis Towers Watson in March 2019. The survey recorded a sustainable employee engagement score of 84%. The result is above both the Australian company and global financial services average.

Diversity and inclusion

Challenger believes that diversity and inclusion deliver better outcomes for its people, its business and the community.

In July 2019, Challenger updated its diversity and inclusion strategy to focus on three key areas:

1. Providing a diverse and inclusive workplace;
2. Gender equality; and
3. Supporting employment outcomes for people aged over 50.

New employee-led diversity and inclusion working groups have been established to develop and support age, culture, LGBTQI+ and gender inclusion in the company.

To encourage greater representation of women at senior levels of the organisation, Challenger continues to develop initiatives targeted at improving gender equality, including setting gender diversity targets. As at 30 June 2020, 38% of leadership roles were held by women, compared to Challenger's 2020 target for women in management roles of 40%, representing an 11 percentage point increase since targets were first introduced in 2016.

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

In 2020, Challenger was recognised as an Employer of Choice for Gender Equality (Workplace Gender Equality Agency) for the third year running. Reflecting continued commitment and progress towards achieving gender equality, Challenger was recognised for the first time as a global top 100 employer for gender equality in the 2019 Equileap Global Gender Equality rankings, and was also included on the Bloomberg Global Gender Equality Index, positioning Challenger among the leading organisations globally making progress towards gender equality in the workplace.

5 Challenger's 2020 strategic progress (continued)

2020 strategic progress (continued)

Maintain leading operational and people practices (continued)

Flexible work practices

Challenger has a focus on providing employees with flexible work arrangements.

At 30 June 2020, 92 employees, representing approximately 12% of Challenger employees, have formal flexible working arrangements. Thirty percent are men.

The number of employees with flexible working arrangements is expected to increase significantly following the COVID-19 pandemic. Challenger is well positioned to support this shift in work practices.

Enhancing sustainability capability

Considering environmental, social and governance (ESG) risks and opportunities supports Challenger in delivering on its vision to provide financial security for retirement. Throughout 2020, Challenger made significant progress on implementing its sustainability strategy.

Challenger's long-term sustainable returns are achieved through the integration of ESG practices across the business.

Challenger continued to develop its ESG practices and supported Fidante Partners to develop ESG practices within their boutique fund managers. Most boutiques are now signatories to the United Nations Principles for Responsible Investment (PRI) and many boutique managers have developed standalone ESG policies.

During the year, Challenger held internal presentations to provide opportunities for employees and boutiques to further understand ESG risks and opportunities. External experts also provided insights on climate risk and considerations under the modern slavery legislation.

Challenger is well progressed in its assessment of supply chain and investment processes against new modern slavery regulatory reporting requirements

Challenger continues to be a constituent of the FTSE4Good Index and a signatory to the United Nations PRI.

Supporting the community

In September 2019, Challenger announced a strategic three-year partnership with the Council on the Ageing (COTA) New South Wales. Through this partnership, Challenger will deliver a community program aimed at addressing the underemployment of people aged over 50. Challenger understands that continuing to work as you age is a key driver for financial security in retirement. The program will celebrate the value older Australians bring to the workplace and improve workplace practices to attract and retain older employees.

Challenger also aims to contribute to the communities in which it operates. Through its workplace giving program, company matching, fundraising events and other initiatives, Challenger donated over \$250,000 to charitable and not-for-profit organisations throughout the year. This included raising \$45,000 for the 2020 bushfire appeal.

6 Market overview and outlook

Australia's superannuation system commenced in 1992 and is now the third largest pension system globally and the fastest growing, with assets increasing by 11% per annum over the past 20 years¹.

Critical features that have contributed to Australia having the fastest growing pension system globally, include Government-mandated contributions, a competitive institutional model and a system based on defined contributions.

Australia's superannuation system growth is underpinned by contributions, which are mandated by the Government and scheduled to increase from the current rate of 9.5% of gross salaries to 12.0% by 2025. Growth in the superannuation system is also supported by changing demographics and the Government's focus on enhancing the retirement phase of superannuation.

The superannuation system is forecast to grow from \$2.7 trillion today² to almost \$7 trillion³ over the next 15 years.

Challenger's Life and Funds Management businesses are both expected to benefit from long-term growth in Australia's superannuation system.

Life outlook

Life focuses on the retirement spending phase of superannuation by providing products that convert retirement savings into safe and secure income. Challenger Life is Australia's leading provider of annuities⁴ and focuses on retirees and the retirement phase of superannuation, which is expected to grow strongly, driven by demographic changes and a maturing of the retirement system.

¹ Willis Towers Watson Global Pension Study 2020.

² APRA, as at March 2020.

³ Rice Warner 2019 superannuation projections.

⁴ Plan for Life – March 2020 – based on annuities under administration at 30 March 2020.

6 Market overview and outlook (continued)

Life outlook (continued)

The number of Australians over the age of 65, which is Life's target market, is expected to increase by over 50% over the next 20 years¹.

Reflecting these demographic changes, and growth in the superannuation system, the annual transfer from the retirement savings phase of superannuation to the retirement spending phase was estimated to be approximately \$70bn² in 2019.

Annuities represent only a small part of the retirement phase, with lifetime annuities representing less than 2% of the annual transfer.

The purpose of the superannuation system is to provide income in retirement to substitute or supplement the Government-funded age pension. With the transition from Government-funded age pensions to private pensions, retirees are demanding safe, secure retirement income products that convert savings into income and provide financial security.

Australians now have very meaningful superannuation balances when they retire, with an estimated average total financial wealth at retirement of \$680,000³, despite the system being in place for only half the working life of today's retirees.

The Australian Government is progressing a range of retirement income regulatory reforms that are designed to enhance the retirement phase and better align it with the overall objective of the superannuation system to provide income in retirement to substitute or supplement the Government-funded age pension. These reforms provide a significant opportunity to increase the proportion of retirement savings invested in products that deliver stable income, which lasts a lifetime.

As Australia's leading provider of annuities, Challenger Life is expected to continue to benefit from the long-term growth in Australia's superannuation system and regulatory reforms designed to enhance the retirement phase and increase the allocation of retirement savings made to annuities.

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

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

Challenger has been recognised as a retirement income product innovator and has won the Association of Financial Advisers 'Annuity Provider of the Year' for the last 12 years. Challenger remains the dominant retirement income brand in Australia and is recognised by 93%⁴ of financial advisers as a leader in retirement incomes.

Life relies on third party financial advisers, both independent and part of the major advice hubs⁵, to distribute its products to retail customers in Australia.

Following the public hearings and completion of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) in 2019, there has been significant structural change across the Australian wealth management and financial adviser market. Domestic annuity sales have been impacted by the structural change to the wealth management and adviser markets, with 2020 domestic annuity sales down 27% from 2019.

To help drive additional demand for annuities and guaranteed income products, Challenger is investing in a range of Distribution, Product and Marketing (DPM) initiatives. Initiatives are focused on increasing direct customer engagement and education, evolving Challenger's product range and supporting advisers.

The profit-for-member sector of the superannuation system is growing strongly and currently represents ~37% of total superannuation assets⁶. As members transition to retirement, focus by profit-for-member funds to provide comprehensive retirement income solutions to their members will continue to increase. The profit-for-member sector provides a significant growth opportunity for Life.

In Japan, Life commenced an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary) to provide Australian-dollar annuities in November 2016. MS Primary is a leading provider of annuity products in Japan and part of MS&AD Insurance Group Holdings Inc. (MS&AD).

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

Under an expanded reinsurance arrangement, which commenced on 1 July 2019, MS Primary will provide Life an annual amount of reinsurance, across both Australian and US-dollar annuities, of at least ¥50 billion (~A\$670 million) per year for a minimum of five years⁷. This is subject to review in the event of a material adverse change for either MS Primary or Challenger Life.

At 30 June 2020, MS&AD held ~15% of Challenger's issued capital. A representative from MS&AD, Mr Masahiko Kobayashi, was appointed as a Non-Executive Director of Challenger Limited in August 2019 and an Alternate Director, Mr Hiroyuki Iio, was appointed on 13 December 2019.

¹ 2020 – 2040 comparison based on Australian Bureau of Statistics Population Projections Series B, cat no. 3222.0.

² Australian Taxation Office.

³ Australian Bureau of Statistics Household Income and Wealth 2017-18 cat no. 6523.0. Average household wealth includes superannuation and non-superannuation assets and excludes the family home.

⁴ Market Pulse Adviser Study December 2019.

⁵ Major advice hubs include AMP and the wealth management operations of the major Australian banks.

⁶ APRA Quarterly Superannuation Performance Statistics, March 2020.

⁷ Challenger Life entered into a new agreement with MS Primary to commence reinsuring the US dollar version of the 20-year term product from July 2019. Challenger will provide a guaranteed interest rate and assume the investment risk in relation to those policies issued by MS Primary and reinsured by Challenger.

⁸ Based on the exchange rate as at 30 June 2020.

6 Market overview and outlook (continued)

Funds Management outlook

Funds Management focuses on building savings for retirement by providing investment strategies that seek to deliver superior investment returns. Funds Management has operations in Australia, the United Kingdom and Japan and is one of Australia's largest active fund managers¹.

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

Funds Management comprises Fidante Partners and CIP Asset Management.

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

Challenger's Fidante Partners business model has allowed it to attract and build successful active equity, active fixed income and alternative investment managers.

Fidante Partners continues to expand its product offering by adding new boutiques and accessing new distribution channels. Recent examples include launching the ActiveX Series of actively managed Exchange Traded Funds (ETFs) targeting the growing popularity of actively traded exchange products and forming a new strategic joint venture with global alternative asset manager, Ares Management Corporation (NYSE: ARES). The joint venture will provide Australian investors with access to alternative investment products managed by Ares.

Challenger Investment Partners has been rebranded CIP Asset Management as it transitions from an internally focused to an externally focused asset manager. The rebrand demonstrates Challenger's commitment to growing the business and building on the breadth of investment expertise.

CIP Asset Management is an institutional manager that principally originates and manages fixed income and commercial real estate for leading global and Australian institutions, including Challenger Life.

Funds Management is also expanding its presence in Japan and directly manages real estate investments on behalf of Life and is developing funds management distribution and product opportunities in the region.

COVID-19 pandemic

The COVID-19 pandemic has presented significant challenges to global economies and investment markets.

Looking after the health of our people during this time has been a key business priority for Challenger, which has transitioned almost all its employees to working from home arrangements from mid-March 2020.

Challenger has also been supporting its customers and business partners through the pandemic, which has included supporting advisers, superannuation fund clients and commercial property tenants.

Investment market conditions have been significantly disrupted by the COVID-19 pandemic, resulting in a market sell-off and increased market volatility. This has impacted both Challenger Life's statutory earnings and excess capital position, which both include \$750.3 million (post-tax) of realised and unrealised investment experience losses.

Following the pandemic related market sell-off, Challenger Life has actively managed its investment portfolio and repositioned it to be more defensive, which reduced its capital intensity and subsequently increased its excess capital position.

In order to further strengthen Life's capital position and provide flexibility to enhance returns, a \$270 million institutional equity placement was undertaken in June 2020 and a retail Share Purchase Plan was completed in July 2020 raising \$35 million. Challenger is prioritising maintaining a strong capital position and has not declared a final 2020 dividend.

Challenger Life is maintaining a strong capital position, which is well above internal capital targets, and there is flexibility to redeploy up to \$3 billion of Life's cash and liquids into higher yielding investments. Once fully deployed, these investments are expected to enhance both Life's earnings and RoE.

Given the uncertain economic outlook, Life expects to continue to maintain a more defensive portfolio setting and Challenger will maintain a disciplined focus on expense management.

Risks

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

- Investment market volatility;
- ongoing impact of the COVID-19 pandemic on the global economy and the ability of individuals, businesses, and governments to operate;
- general uncertainty around the global economy and its impact on markets in which Challenger operates and invests;
- regulatory and political changes impacting financial services participants;
- demand for and competition with Challenger products, including annuities and managed funds; and
- operational risk.

Other risks to which Challenger's businesses are exposed are summarised in section 4 Risk Management and in the Corporate Governance summary on page 26.

¹ Consolidated FUM for Australian Fund Managers – Rainmaker Roundup March 2020.

7 Key performance indicators (KPIs)

7.1 Profitability and growth

KPIs for the year ended 30 June 2020 (with the year to 30 June 2019 being the prior comparative period (PCP), unless otherwise stated) include:

	2020	2019	Change %
Profitability			
Statutory (loss)/profit attributable to equity holders (\$m)	(416.0)	307.8	(large)
Normalised NPBT (\$m)	506.5	548.3	(7.6)
Normalised NPAT (\$m)	343.7	396.1	(13.2)
Statutory EPS (cents)	(68.4)	50.9	(large)
Normalised EPS (cents)	56.5	65.5	(13.9)
Total dividend (cents)	17.5	35.5	(50.7)
Total dividend franking	100%	100%	-
Normalised cost: Income ratio	35.7%	32.6%	3.1
Statutory RoE after tax	(12.1%)	8.9%	(large)
Normalised RoE pre-tax	14.8%	15.8%	(1.0)
Normalised RoE after tax	10.0%	11.4%	(1.4)
Growth			
Total Life sales (\$m)	5,151.4	4,550.0	13.2
Total Life net flows (\$m)	315.8	474.8	(33.5)
Total Life net book growth (%)	2.1%	3.4%	(1.3)
Total FM net flows (\$bn)	2.5	(2.4)	(large)
Total AUM (\$bn)	85.2	81.8	4.2

During March 2020, COVID-19 was declared a global pandemic. COVID-19, and the resulting impact on economic activity, had a significant impact on world debt and equity markets. The deterioration of market conditions in March 2020 resulted in Challenger lowering exposure to certain asset classes to protect its capital position. This action resulted in a reduction in Life's assets and losses on investments being incurred. This was coupled with nationwide lockdowns for much of the fourth quarter which also impacted Life annuity sales in that time. The KPIs for the period have been materially impacted by these circumstances and conditions.

As a result, Challenger's statutory profit attributable to equity holders was substantially lower for the year ended 30 June 2020. Statutory profit decreased as a result of lower pre-tax normalised earnings together with the impact of the large fair value changes on Challenger Life Company Limited's (CLC's) assets and liabilities as a result of the investment market volatility associated with COVID-19.

Normalised net profit after tax decreased by 13.2%, and normalised EPS decreased by 13.9% compared to 2019, reflecting lower earnings in Life and lower earnings in the Funds Management business, offset by a higher effective tax rate in the period and a higher share count as a result of additional capital being issued to satisfy the DRP and the reduction in Treasury shares.

As a result of the uncertain economic conditions caused by COVID-19, and to continue to protect the capital position of the Life business, no final dividend was declared resulting in the total dividend for 2020 being 17.5 cents franked at 100%, which is 18.0 cents lower than the prior year (100% franked).

Challenger's normalised cost to income ratio of 35.7% is higher than the ratio in 2019 (32.6%). This was due to increased costs associated with the growth initiatives in Distribution, Product and Marketing together with the reduced income as a result of the investment market volatility caused by COVID-19.

The normalised pre-tax RoE was 14.8% in 2020 compared to 15.8% in the prior year due to the reduced income combined with higher average capital levels. The RoE outcome was above the target of the Reserve Bank of Australia (RBA) cash rate plus a margin of 14%.

Statutory RoE after tax of negative 12.1% has decreased substantially compared to the prior year (2019: 8.9%) as a result of the materially lower after-tax statutory profit primarily as a result of the fair value movements on Challenger's assets and liabilities experienced as a result of the investment market volatility caused by COVID-19. Normalised RoE after tax decreased from 11.4% in the prior period to 10.0%, primarily reflecting the higher effective tax rate, increased share count and the reduced normalised net profit after tax.

7.2 Capital management

Challenger's capital position is managed at both the Group and the prudentially-regulated CLC level, with the objective of maintaining the financial stability of the Group and CLC while ensuring that shareholders earn an appropriate risk-adjusted return. Refer to Note 12 Contributed equity for further information on the Group's Internal Capital Adequacy Assessment Process.

On 22 June 2020, Challenger announced an underwritten institutional placement of equity in the amount of \$270 million together with a non-underwritten share purchase plan (SPP) for retail shareholders which was targeting to raise up to \$30 million. The institutional placement of \$270 million was completed on 23 June 2020, while the SPP was completed on 24 July 2020, raising \$35 million.

7 Key performance indicators (KPIs) (continued)

7.2 Capital management (continued)

The decision to raise additional capital was taken to further protect CLC's capital position in the wake of COVID-19 while at the same time being used to further enhance returns once deployed.

The \$270 million proceeds of the institutional placement were injected directly into CLC on 26 June 2020 and form part of the capital base for CLC for the period. The majority of the SPP proceeds (\$30 million) were also subsequently injected into CLC on 31 July 2020.

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

Capital	2020	2019	Change
Net assets attributable to equity holders (\$m)	3,249.6	3,600.3	(350.7)
CLC excess capital over PCA (\$m)	1,584.7	1,377.1	207.6
Group cash (\$m) ¹	146.1	91.5	54.6
CLC excess capital over PCA + Group cash (\$m)	1,730.8	1,468.6	262.2
CLC PCA ratio (times)	1.81	1.53	0.28
CLC CET1 ratio (times)	1.20	1.06	0.14

¹ Includes \$50 million of the Group corporate debt facility drawn.

CLC regulatory capital base

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

CLC maintains a level of capital representing the Prescribed Capital Amount (PCA) plus a target surplus. The target surplus is a level of excess capital that CLC seeks to carry over and above APRA's minimum requirement in order to provide a buffer against adverse market conditions, having regard to CLC's credit rating.

CLC uses internal capital models to determine its target surplus, which are risk-based and are responsive to changes in CLC's asset allocation and market conditions. While CLC does not target a specific PCA ratio, CLC's internal capital models result in a PCA ratio under current circumstances in the range of 1.3 to 1.6 times. This range may change over time and is dependent on a number of factors.

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level which can be used to meet regulatory capital requirements. Challenger further maintains a Group corporate debt facility of \$400 million in order to provide additional financial flexibility. The facility was drawn in full in March 2020 in response to the investment market volatility caused by COVID-19. \$350 million was subsequently repaid in June 2020 leaving \$50 million drawn at the end of the period. These drawn proceeds remain at the Group level and will be used to provide financial flexibility throughout 2021.

APRA's Level 3 (conglomerate) proposals

The Group is a Level 3 Head (as defined in Prudential Standard 3PS 001) under the APRA conglomerates framework. Level 3 groups are groups of companies that perform material activities across more than one APRA-regulated industry and/or in one or more non-APRA regulated industries. APRA's non-capital conglomerate prudential standards relating to measurement, management, monitoring and reporting aggregate risk exposures and intragroup transactions and exposures came into effect 1 July 2017.

In March 2016, APRA announced that it would defer the implementation of conglomerate capital requirements until a number of other domestic and international policy initiatives were further progressed. There has been no further update from APRA in relation to this position.

Dividends and dividend reinvestment plan

Dividends	2020	2019	Change
Interim dividend (cents) ¹	17.5	17.5	-
Final dividend (cents)	-	18.0	(18.0)
Total dividend (cents)	17.5	35.5	(18.0)
Interim dividend franking	100%	100%	-
Final dividend franking	-	100%	-

¹ Interim dividend declared on 11 February 2020 and paid on 24 March 2020 in respect of the half year ended 31 December 2019.

In April 2020 following the immediate impact of COVID-19, APRA wrote to all authorised deposit taking institutions (ADIs) and insurers noting APRA's expectation that ADIs and insurers limit dividends given the uncertain outlook.

The dividend payout ratio for the year ended 30 June 2020 was 31.0% (30 June 2019: 54.2%).

The payout ratio is currently below the target range of 45% to 50% reflecting the Board's decision not to pay a final dividend as a result of the uncertain economic conditions caused by COVID-19 and the decision to continue to protect Life's capital position. Notwithstanding this, the target dividend payout ratio range will continue to be maintained at 45% to 50% of normalised net profit after tax going forward.

The Company also seeks to frank its dividend to the maximum extent possible and expects future dividends over the medium term to be fully franked. However, the actual dividend payout ratio and franking will depend on prevailing market conditions and capital allocation priorities at the time.

The Company continued to operate its DRP during the period. The DRP participation rate for the 2019 final dividend was 2.3% of all issued shares, and 364,482 ordinary shares were issued to satisfy the DRP requirements on 25 September 2019. The participation rate for the 2020 interim dividend was 2.6%, and 338,871 ordinary shares were issued to satisfy DRP requirements on 24 March 2020.

With no final dividend being paid, the DRP is not in operation. It is expected that the DRP will continue for any dividends paid in 2021.

No shares were bought back during the year.

7 Key performance indicators (KPIs) (continued)

7.3 Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In March 2020, S&P reaffirmed both CLC and Challenger Limited's credit ratings but revised the outlook from positive to stable as a result of the uncertainty caused by COVID-19.

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, S&P noted that CLC has a robust capital position which was protected through active management of its investment asset portfolio following the investment market impact of COVID-19. S&P also noted that while earnings will likely be impacted by the investment losses, it considers CLC's strong capital position, liquidity profile and position in Australia's annuities market to be supportive of the published ratings.

8 Normalised profit and investment experience

Normalised framework (Non-IFRS)

CLC and its consolidated entities are required by AASB 1038 *Life Insurance Contracts* to value all assets and liabilities at fair value where permitted by other accounting standards.

This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss in CLC and on consolidation in Challenger Limited. CLC is generally a long-term holder of assets, due to holding assets to match the term of life contract liabilities. As a result, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements. Investment experience represents the difference between actual investment gains/losses (both realised and unrealised) and expected gains/losses based on CLC's medium to long-term expected returns together with the new business strain¹ that results from writing new annuities. Investment experience also includes any impact from changes in economic and other actuarial assumptions.

A reconciliation between statutory revenue and the management view of revenue and net income is included in the financial report as part of Note 3 Segment information.

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

Management analysis – normalised results

	2020 \$m	2019 \$m	Change \$m	Change %
Net income ¹	797.4	821.0	(23.6)	(2.9)
Comprising:				
– Life normalised COE	638.9	670.1	(31.2)	(4.7)
– FM net income	158.1	149.9	8.2	5.5
– Corporate and other income	0.4	1.0	(0.6)	(60.0)
Operating expenses ¹	(284.4)	(267.4)	(17.0)	6.4
Normalised EBIT	513.0	553.6	(40.6)	(7.3)
Comprising:				
– Life normalised EBIT	524.7	563.6	(38.9)	(6.9)
– FM normalised EBIT	57.7	50.9	6.8	13.3
– Corporate and other normalised EBIT	(69.4)	(60.9)	(8.5)	14.0
Interest and borrowing costs	(6.5)	(5.3)	(1.2)	(22.6)
Tax on normalised profit	(162.8)	(152.2)	(10.6)	(6.9)
Normalised NPAT	343.7	396.1	(52.4)	(13.2)
Investment experience after tax	(750.3)	(88.3)	(662.0)	(large)
Significant items after tax	(9.4)	-	(9.4)	(large)
Statutory net profit after tax attributable to equity holders	(416.0)	307.8	(723.8)	(large)

¹ 'Net income' and 'Operating expenses' are internal classifications and are defined in Note 3 Segment information in the financial report. These differ from the statutory revenue and expenses classifications, as certain costs (including distribution expenses, property expenses, management fees, special purpose vehicle expenses and finance costs) are netted off against gross revenues. These classifications have been made in the Directors' report and in Note 3 Segment information to reflect how management measures business performance. While the allocation of amounts to the above items and investment experience differ to the statutory view, both approaches result in the same total net profit after tax attributable to equity holders.

Life normalised cash operating earnings (COE) and earnings before interest and tax (EBIT) decreased as a result of lower Life investment assets and capital base following the investment experience losses and asset sales undertaken in March 2020 in response to the impact of COVID-19. Life's closing investment assets decreased by 3.7% as a result of the asset sales in March 2020 combined with valuation movements on those assets offset by increased total Life net book growth.

Funds Management net income increased (up \$8.2 million) due to increased Fidante Partners fee income (primarily performance fees) offset by reduced CIP Asset Management income. Funds Management average FUM increased by 4.0%.

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

8 Normalised profit and investment experience (continued)

Management analysis – normalised results (continued)

Operating expenses increased (up \$17.0 million), following increased costs primarily associated with the growth initiatives undertaken in Distribution, Product and Marketing during the period.

In 2020, Challenger's full-time equivalent employee numbers increased by 48 (or 7.0%) to 735.

Normalised tax for the year was \$162.8 million, up \$10.6 million (or 6.9%) from 2019 mainly due to a higher normalised effective tax rate. The normalised effective tax rate for the period increased to 32.1% (27.8% at 30 June 2019).

Management analysis – investment experience

	2020 \$m	2019 \$m
Actual capital growth¹		
– Cash and fixed income	(528.8)	9.4
– Infrastructure	(114.9)	116.9
– Property (net of debt)	(155.3)	43.5
– Equity and other investments	(269.3)	(90.7)
Total actual capital growth	(1,068.3)	79.1
Normalised capital growth²		
– Cash and fixed income	(46.4)	(42.0)
– Infrastructure	28.0	30.2
– Property (net of debt)	66.6	72.1
– Equity and other investments	72.0	94.8
Total normalised capital growth	120.2	155.1
Investment experience		
– Cash and fixed income	(482.4)	51.4
– Infrastructure	(142.9)	86.7
– Property (net of debt)	(221.9)	(28.6)
– Equity and other investments	(341.3)	(185.5)
– Policy liability experience ³	86.1	5.8
Asset and policy liability experience	(1,102.4)	(70.2)
New business strain ⁴	31.9	(33.3)
Investment experience before tax	(1,070.5)	(103.5)
Tax benefit/(expense)	320.2	15.2
Investment experience after tax	(750.3)	(88.3)

¹ Actual capital growth represents net realised and unrealised capital gains or losses and includes the attribution of interest rate, inflation and foreign exchange derivatives that are used to hedge exposures.

² Normalised capital growth is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised capital growth rates represent Challenger's expectations for each asset class over the investment cycle. The normalised growth rate is +3.5% for equity and other investments, +4.0% for infrastructure, +2.0% for property and -0.35% for cash and fixed income in order to allow for credit defaults. The rates have been set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing market experience.

³ Policy liability experience represents the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions and other factors applied in the valuation of life contract liabilities.

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

Investment experience after tax relates to changes in the fair value of Life's assets and liabilities. Investment experience is a mechanism employed to remove the volatility arising from asset and liability valuation movements and new business strain from Life business earnings so as to more accurately reflect the underlying performance of the Life business.

Pre-tax investment experience in 2020 comprised an asset and policyholder liability experience loss of \$1,102.4 million and a gain of \$31.9 million from Life's new business strain. Life's asset portfolio experienced losses and significant negative fair value movements as a result of the impact of COVID-19 and this was experienced across all asset classes.

9 Life segment results

The Life segment includes CLC, Australia's leading provider of annuities and guaranteed retirement income products. CLC has won the Association of Financial Advisers/Plan for Life annuity provider of the year for the past twelve consecutive years.

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

Life normalised results	2020 \$m	2019 \$m	Change \$m	Change %
Normalised COE	638.9	670.1	(31.2)	(4.7)
– Cash earnings	518.7	515.0	3.7	0.7
– Normalised capital growth	120.2	155.1	(34.9)	(22.5)
Operating expenses	(114.2)	(106.5)	(7.7)	7.2
Normalised EBIT	524.7	563.6	(38.9)	(6.9)

Life normalised EBIT decreased by \$38.9 million (down 6.9%) due to lower normalised COE (down \$31.2 million or 4.7%), which was combined with higher operating expenses increasing by \$7.7 million (or 7.2%). The lower normalised COE was mainly a result of lower investment assets and capital base following the investment experience losses and asset sales undertaken in March 2020 in response to the impact of COVID-19. Cash operating earnings were lower across all major asset classes in the June quarter as a result.

Life generated a normalised RoE (pre-tax) of 15.5%, down by 2.2 percentage points from the prior year as a result of lower earnings together with the lower average net assets caused by the impact of COVID-19.

Life annuity sales declined from the prior period (down 11.7%), with reduced lifetime sales (down 51.4%) offset by increased fixed term sales (up 0.9%) and increased other Life sales (up 101.0%).

9 Life segment results (continued)

In November 2016, Life began issuing Australian dollar fixed rate annuities with a 20-year term in support of Challenger's reinsurance agreement with MS Primary. It was announced in March 2019 that Challenger would commence a quota share reinsurance of US dollar denominated annuities issued in the Japanese market by MS Primary from 1 July 2019. It was agreed with MS Primary that the arrangement would provide CLC with an annual amount of reinsurance across both Australian and US dollar annuities of at least ¥50 billion (approximately A\$670.0 million as at 30 June 2020)¹ each year for a minimum of five years. The MS Primary reinsured sales comprised 23.8% of Life's total annuity sales in the period, which is a substantial increase on the prior year (7.6%).

Life sales	2020 \$m	2019 \$m	Change \$m	Change %
Fixed-term annuities	2,712.8	2,689.8	23.0	0.9
Lifetime annuities	414.6	853.3	(438.7)	(51.4)
Total Life annuity sales	3,127.4	3,543.1	(415.7)	(11.7)
Other Life sales	2,024.0	1,006.9	1,017.1	101.0
Total Life sales	5,151.4	4,550.0	601.4	13.2
Annuity net flows	(251.1)	685.8	(936.9)	(large)
Other Life net flows	566.9	(211.0)	777.9	(large)

Annuity net flows (new annuity sales less capital repayments) decreased by 136.6% to a net outflow of \$251.1 million. Based on the opening Life annuity book for the 2020 financial year (\$12,870.2 million), annuity net book growth for the period was (2.0%), down from 5.8% in the prior period.

Other Life sales represents Challenger's Guaranteed Index Return (GIR) and Challenger Index Plus products (disclosed in Note 9 External unit holders' liabilities). Other Life sales increased by \$1,017.1 million (up 101.0%) as a result of increased new client sales and reinvestments of maturities.

Other Life net flows for the period were \$566.9 million, increasing by \$777.9 million compared to negative \$211.0 million in the prior period. Total Life net flows were \$315.8 million, representing, total Life net book growth of 2.1% (30 June 2019: \$474.8 million or 3.4% book growth).

10 Funds Management segment results

Challenger's Funds Management segment is one of Australia's largest² active investment managers.

Fidante Partners' multi-boutique platform comprises a number of separately branded funds management businesses. The model seeks to align the interests of investors, boutique investment managers and Fidante Partners.

The Funds Management model is delivering superior investment performance, with approximately 84% of Fidante Partners' funds achieving first or second quartile performance since inception³.

CIP Asset Management develops and manages assets for CLC and third party institutional investors.

FM normalised results	2020 \$m	2019 \$m	Change \$m	Change %
Net income	158.1	149.9	8.2	5.5
– Fidante Partners	96.3	86.7	9.6	11.1
– CIP Asset Management	61.8	63.2	(1.4)	(2.2)
Operating expenses	(100.4)	(99.0)	(1.4)	1.4
Normalised EBIT	57.7	50.9	6.8	13.3

Funds Management normalised EBIT increased by 13.3% in the period, with increased net income primarily as a result of increased performance fees offset with higher expenses during the period.

Fidante Partners' net income includes distribution fees, transaction fees, administration fees and a share in the equity accounted profits for the boutique fund managers in which it has an equity interest.

Fidante Partners' net income improved for the period primarily as a result of performance fees (up \$11.3 million).

CIP's net income decreased due to lower transaction fees (down \$3.9 million) offset by higher net management fees (up \$2.4 million).

Funds Management's normalised RoE (pre-tax) for the year was 24.3%, up by 0.8 percentage points from the prior year. This increase comes largely as a result of increased performance fees earned during the year. RoE in Funds Management continues to see the benefits of scale and increased earnings flexibility.

FM FUM and flows	2020 \$bn	2019 \$bn	Change \$bn	Change %
Total FUM	81.4	79.0	2.4	3.0
– Fidante Partners	62.4	58.9	3.5	5.9
– CIP	19.0	20.1	(1.1)	(5.3)
Net flows	2.5	(2.4)	4.9	large
– Fidante Partners	3.8	(3.6)	7.4	large
– CIP	(1.3)	1.2	(2.5)	large

Fidante Partners' FUM increase (\$3.5 billion) was driven by net inflows (\$3.8 billion) and negative impact from investment markets (down \$0.3 billion).

CIP FUM growth (down \$1.1 billion) is primarily a result of the asset sales undertaken by CLC in response to the impact of COVID-19 in March 2020 (down \$1.3 billion) and positive impact from investment markets (up \$0.2 billion).

¹ This is subject to review in the event of a material adverse change for either MS Primary or Challenger.

² Consolidated FUM for Australian Fund Managers – Rainmaker Roundup, March 2020.

³ Marketing Pulse Adviser Study December 2019.

11 Corporate and other segment results

The Corporate and other segment comprises central functions such as the Group executive, finance, treasury, legal, human resources, risk management and strategy.

The financial results also include interest received on Group cash balances and any interest and borrowing costs associated with Group debt facilities.

Corporate and other normalised results	2020 \$m	2019 \$m	Change \$m	Change %
Net income	0.4	1.0	(0.6)	(60.0)
Operating expenses	(69.8)	(61.9)	(7.9)	12.8
Normalised EBIT	(69.4)	(60.9)	(8.5)	14.0
Interest and borrowing costs	(6.5)	(5.3)	(1.2)	22.6
Normalised loss before tax	(75.9)	(66.2)	(9.7)	14.7

Normalised EBIT for the Corporate and other segment was lower (down \$8.5 million) as a result of higher operating expenses. The higher corporate expense base included one-off restructuring costs and accelerated depreciation of capitalised software in response to the COVID-19 environment.

12 Guidance for the 2021 financial year

While Challenger continues to be well-positioned with strong product offerings, positive retirement market demographics and highly efficient operations, the losses suffered in 2020 and the uncertain economic conditions caused by COVID-19 will pose some challenges for the business into 2021.

As a result, for 2021, Challenger is targeting normalised net profit before tax of between \$390 million and \$440 million. This profit range reflects the impact of a lower capital base following losses incurred in 2020, together with the prudent and progressive deployment of the capital raised in June 2020. It also reflects a changed asset allocation plan relative to 2020 with a higher weighting towards investment grade fixed income and away from higher yielding equity investments.

COVID-19 and the response to it by governments creates an inherently uncertain environment. This could, among other things, impact the speed of deployment of the capital raised in June 2020 and therefore impact guidance.

Challenger will maintain a disciplined focus on expense management as a result of the reduced income expected to be earned in 2021 while continuing to maintain an appropriate amount of investment to support growth initiatives in Distribution, Product and Marketing.

Challenger continues to target a normalised RoE of RBA cash rate plus 14% (pre-tax) over the medium term.

Notwithstanding no final dividend for 2020 being paid, the Board expects to maintain the same target normalised dividend payout ratio of 45 – 50% of normalised profit for 2021 (subject to prevailing market conditions and capital allocation priorities at the time).

Five-year history

	2020	2019	2018	2017	2016
Earnings (\$m)					
Normalised cash operating earnings	638.9	670.1	669.6	631.4	592.4
Net fee income	158.1	149.9	151.2	134.0	127.7
Other income	0.4	1.0	1.0	0.8	1.0
Total net income	797.4	821.0	821.8	766.2	721.1
Personnel expenses	(174.0)	(185.3)	(187.8)	(179.3)	(172.8)
Other expenses	(110.4)	(82.1)	(80.6)	(76.6)	(76.8)
Total expenses	(284.4)	(267.4)	(268.4)	(255.9)	(249.6)
Normalised EBIT	513.0	553.6	553.4	510.3	471.5
Interest and borrowing costs	(6.5)	(5.3)	(6.1)	(5.3)	(4.1)
Normalised profit before tax	506.5	548.3	547.3	505.0	467.4
Normalised tax	(162.8)	(152.2)	(141.2)	(120.1)	(105.7)
Normalised profit after tax	343.7	396.1	406.1	384.9	361.7
Investment experience after tax	(750.3)	(88.3)	(76.0)	12.7	(56.1)
Significant items after tax	(9.4)	-	(7.6)	-	22.1
Profit attributable to equity holders	(416.0)	307.8	322.5	397.6	327.7
Normalised cost to income ratio (%)	35.7%	32.6%	32.7%	33.4%	34.6%
Normalised effective tax rate (%)	32.1%	27.8%	25.8%	23.8%	22.6%
Statutory effective tax rate (%)	28.9%	29.2%	22.7%	23.3%	20.0%
Earnings per share (EPS) (cents)					
Basic EPS – normalised profit	56.5	65.5	68.1	68.5	64.6
Basic EPS – statutory profit	(68.4)	50.9	54.0	70.7	58.5
Diluted EPS – normalised profit	46.9	56.0	64.2	65.8	60.9
Diluted EPS – statutory profit	(68.4)	44.8	52.2	67.8	55.4
Capital management (%)					
Normalised return on equity – pre-tax	14.8%	15.8%	16.5%	18.3%	17.8%
Normalised return on equity – post-tax	10.0%	11.4%	12.2%	14.0%	13.7%
Statutory return on equity – post-tax	(12.1%)	8.9%	9.7%	14.4%	12.5%
Statement of financial position (\$m)					
Total assets	28,461.6	27,457.5	25,300.5	23,026.7	21,256.6
Total liabilities	25,212.0	23,834.7	21,814.7	20,125.4	18,572.6
Net assets ¹	3,249.6	3,622.8	3,485.8	2,901.3	2,684.0
Net assets ²	3,249.6	3,600.3	3,485.4	2,888.1	2,680.9
Net assets ² – average ³	3,424.4	3,462.1	3,323.3	2,753.8	2,630.7
Net tangible assets ⁴	2,619.2	3,019.1	2,892.5	2,299.7	2,097.0
Net assets per basic share (\$)	4.90	5.94	5.79	5.14	4.80
Net tangible assets per basic share (\$)	3.95	4.98	4.81	4.09	3.75

¹ Including minority interests.

² Excluding minority interests.

³ Calculated on a monthly basis.

⁴ Excludes right-of-use lease asset.

Five-year history (continued)

	2020	2019	2018	2017	2016
Underlying operating cash flow (\$m)	194.7	236.9	197.4	299.9	297.1
Dividends per share (cents)					
Dividend – interim	17.5	17.5	17.5	17.0	16.0
Dividend – final	-	18.0	18.0	17.5	16.5
Total dividend	17.5	35.5	35.5	34.5	32.5
Dividend payout ratio – normalised profit (%)	31.0%	54.2%	52.1%	50.4%	50.3%
Dividend payout ratio – statutory profit (%)	n/a	69.7%	65.7%	48.8%	55.6%
Sales and annuity book net flows (\$m)					
Annuity sales	3,127.4	3,543.1	4,000.7	4,011.2	3,351.2
Other Life sales	2,024.0	1,006.9	1,554.9	941.2	998.5
Total Life sales	5,151.4	4,550.0	5,555.6	4,952.4	4,349.7
Life annuity net flows	(251.1)	685.8	1,392.7	900.4	740.4
Life annuity book	12,581.2	12,870.2	11,728.3	10,322.2	9,558.5
Life annuity net book growth (%)	(2.0%)	5.8%	13.5%	9.4%	8.5%
Total Life flows	315.8	474.8	1,796.3	1,312.9	1,068.3
Total Life book	14,997.0	14,836.4	13,863.3	12,010.0	10,874.0
Total Life net book growth (%)	2.1%	3.4%	15.0%	12.1%	11.1%
Funds Management – net flows	2,540.9	(2,438.4)	5,301.2	6,220.6	(2,517.2)
Assets under management (\$m)					
Life	18,303	19,010	18,085	15,677	14,112
Funds Management	81,435	79,029	77,984	66,906	56,662
Elimination of cross-holdings ¹	(14,501)	(16,269)	(14,926)	(12,595)	(10,723)
Total assets under management	85,237	81,770	81,143	69,988	60,051
Other					
Headcount – closing full-time employees	735	687	676	655	635
Weighted average number of ASX-listed basic shares on issue (m)	608.3	605.0	596.7	562.2	560.2
Number of shares on issue – closing (m)	667.5	611.6	610.9	572.0	571.2
Share price – closing (\$)	4.41	6.64	11.83	13.34	8.63
Market capitalisation at 30 June (\$m) ²	2,943.7	4,061.0	7,226.9	7,630.5	4,929.5

¹ Life assets managed by Funds Management.² Calculated as share price multiplied by ordinary share capital.

Directors' report

The Directors of Challenger Limited (the Company) submit their report, together with the financial report of the Company and its controlled entities (the Group or Challenger), for the year ended 30 June 2020.

The information appearing on pages 1 to 21 forms part of the Directors' report for the financial year ended 30 June 2020 and is to be read in conjunction with the following information.

1 Directors

The names and details of the Directors of the Company holding office during the financial year ended 30 June 2020 and as at the date of this report are listed below. Directors were in office for the entire period, unless otherwise stated.

Peter L Polson **(appointed 6 November 2003)**

Independent Chair.

Chair of Nomination Committee.

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

Experience and qualifications:

Bachelor of Commerce (Witwatersrand University, South Africa), Master of Business Leadership (University of South Africa), Management Development Program (Harvard Graduate School of Education).

Mr Polson's experience spans international and domestic markets in banking, insurance and funds management.

Mr Polson previously held the positions of Group Executive, Investment and Insurance Services at Commonwealth Bank and Chief Executive of Colonial First State Limited.

Directorships of other listed companies:

Chair of IDP Education Limited (appointed 21 March 2007).

Richard J Howes **(appointed 2 January 2019)**

Managing Director and Chief Executive Officer.

Experience and qualifications:

Bachelor of Commerce (Hons) and Bachelor of Economics (University of Queensland).

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

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

John M Green **(appointed 6 December 2017)**

Independent Non-Executive Director.

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

Experience and qualifications:

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

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

Directorships of other listed companies:

Non-executive director of QBE Insurance Group Limited (appointed 1 March 2010, appointed Deputy Chair on 1 January 2015).

Steven Gregg **(appointed 8 October 2012)**

Independent Non-Executive Director.

Chair of Group Audit Committee.

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

Experience and qualifications:

Bachelor of Commerce (University of New South Wales).

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

Directorships of other listed companies:

Non-executive director of Tabcorp Holdings Limited (appointed 18 July 2012) and Ampol Limited (formerly Caltex Australia Limited) (appointed 9 October 2015; appointed Chair on 18 August 2017).

Masahiko Kobayashi **(appointed 26 August 2019)**

Non-Executive Director.

Experience and qualifications:

Master of Business Administration (Questrom School of Business, Boston University), Bachelor of Law (Kyoto University) and is a Certified Internal Auditor.

Mr Kobayashi has over 30 years' expertise in general and life insurance and is currently Director and Managing Executive Officer (Corporate Planning, Risk Management and Finance) of MS Primary, a subsidiary of MS&AD Insurance Group Holdings Inc. Prior to joining MS Primary, he held a number of executive and director roles within the MS&AD Group including in Singapore and the United Kingdom.

Directorships of other listed companies:

Nil.

1 Directors (continued)

JoAnne M Stephenson (appointed 8 October 2012)

Independent Non-Executive Director.

Chair of Remuneration Committee.

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

Experience and qualifications:

Bachelor of Commerce and Bachelor of Laws (Honours) (University of Queensland), member of Chartered Accountants Australia and New Zealand and member of the Australian Institute of Company Directors.

Ms Stephenson has extensive experience in financial services both in Australia and in the United Kingdom. Ms Stephenson was previously a partner with KPMG and has significant experience in internal audit, risk management and consulting.

Directorships of other listed companies:

Non-executive director of Asaleo Care Limited (appointed 30 May 2014) and Japara Healthcare Ltd (appointed 1 September 2015) and Myer Holdings Limited (appointed 28 November 2016).

Duncan G West (appointed 10 September 2018)

Independent Non-Executive Director.

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

Experience and qualifications:

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

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

Directorships of other listed companies:

Non-executive Director of Genworth Mortgage Insurance Australia Limited (appointed on 1 September 2018).

Melanie V R Willis (appointed 6 December 2017)

Independent Non-Executive Director.

Chair of Group Risk Committee.

Member of Group Audit Committee and Nomination Committee.

Experience and qualifications:

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

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

Directorships of other listed companies:

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

Hiroyuki Iioka (appointed 13 December 2019)

Non-Executive Director (alternate for Masahiko Kobayashi).

Experience and qualifications:

Master of Business Administration (Duke University) and Bachelor of Economics (Kobe University).

Mr Iioka is currently Senior General Manager (Business Development Department) at MS&AD Insurance Group Holdings, Inc. (MS&AD) in Japan.

Directorships of other listed companies:

Nil

2 Company Secretary

Michael Vardanega (Bachelor of Commerce and Bachelor of Laws) is the General Counsel and Chief Executive, Group Strategy. He is a qualified solicitor and was appointed as Company Secretary on 1 March 2011. Mr Vardanega's responsibilities at Challenger encompass the Group's strategy, legal, regulatory, corporate governance and company secretarial functions. Mr Vardanega joined Challenger in 2006 from commercial law firm Ashurst, where he was a member of the corporate advisory practice. He is admitted to practise as a solicitor in New South Wales, and is a member of the Law Council of Australia, the Association of Corporate Counsel and a member of the Australian Institute of Company Directors.

Andrew Brown (Diploma in Law), a Fellow of the Governance Institute of Australia and a member of the Australian Institute of Company Directors. Mr Brown has over 22 years' experience in the financial services industry and was appointed to the position of Company Secretary on 25 October 2012. Prior to joining the Company in 2003, Mr Brown held senior compliance management positions at MLC.

3 Corporate governance summary

3.1 Roles and responsibilities of Board and management

The role of the Board and delegations

The Board is accountable to shareholders for the activities and performance of Challenger by overseeing the creation of sustainable shareholder value within an appropriate risk framework and having regard for stakeholder interests and community expectations.

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

Directors are actively involved in setting, approving and regularly monitoring Challenger's strategic priorities and holding management accountable for progress.

This process includes one annual Board strategy offsite, regular Board reporting and meetings, and discussion and review with management. Similarly, the Board ensures that rigorous governance processes operate effectively to guide decision-making across the business.

The Board's responsibilities are set out in the Board Charter, which is available at:

› challenger.com.au/about-us

The Board's role and responsibilities include:

- establishing, promoting and maintaining the strategic direction of Challenger;
- approving business plans, budgets and financial policies;
- considering management recommendations on strategic business matters;
- establishing, promoting and maintaining proper processes and controls to maintain the integrity of accounting and financial records and reporting;
- fairly and responsibly rewarding executives, having regard to the performance of the executives, Challenger's risk management framework and culture, the interests of shareholders, market conditions and Challenger's overall performance;
- adopting and overseeing of implementation of corporate governance practices;
- overseeing the establishment, promotion and maintenance of effective risk management policies and processes;
- determining and adopting Challenger's dividend policy;
- reviewing Board composition and performance;
- appointing, evaluating and remunerating the Chief Executive Officer (CEO) and approving the appointment of the Chief Financial Officer (CFO), Chief Risk Officer (CRO), General Counsel and Company Secretary; and
- determining the CEO's delegated authority.

The Board has established committees to assist in carrying out its responsibilities and to consider certain issues and functions in detail. The Board committees are discussed on page 25.

Management responsibility

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

3.2 Directors' skills matrix

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

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

The Board's competencies are assessed annually and the results of the most recent assessment are shown in the table on page 25.

The Board skills matrix shows that Board members have a high level of competency across the areas of expertise relevant to Challenger's business.

3 Corporate governance summary (continued)

3.2 Directors' skills matrix (continued)

Leadership & Strategy

Leadership, effective communication and influencing skills.
Strategic thinking capability and transactional expertise.



Corporate Governance

Public company corporate governance literacy.



Financial Acumen

Financial reporting literacy including exposure to Accounting Standards.



Risk & Compliance

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



Sectoral Exposure

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



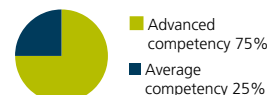
Investment & Credit Expertise

Credit risk management and investment expertise including asset class literacy and exposure (eg: property, fixed income, equities etc).



Customer

Experience in distribution, marketing and fostering key institutional customer relationships.



Public Policy

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



IT and Digital

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



People & Remuneration

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



3.3 Board committees

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

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

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

» challenger.com.au

Directors' meetings

The charters specify the composition, responsibilities, duties, reporting obligations, meeting arrangements, authority and resources available to the committees and the provisions for review of the charter.

Details of Directors' membership of each committee and those eligible members' attendance at meetings throughout the period from 1 July 2019 to 30 June 2020 are set out below.

Director	Board		Group Risk Committee		Group Audit Committee		Remuneration Committee		Nomination Committee	
	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
P Polson	14	14	4	4	4	4	6	6	2	2
R Howes ¹	14	14	-	-	-	-	-	-	-	-
J M Green	14	14	4	4	4	4	6	6	2	2
S Gregg	14	14	4	4	4	4	6	6	2	2
M Kobayashi ²	13	12	-	-	-	-	-	-	1	1
J Stephenson	14	14	4	4	4	4	6	6	2	2
D West	14	14	4	4	4	4	-	-	2	2
M Willis	14	13	4	4	4	4	-	-	2	2
L Zwier ³	1	1	-	-	-	-	-	-	1	0

¹ The Managing Director and CEO attends the Group Risk Committee, Group Audit Committee, Remuneration Committee and Nomination Committee meetings at the invitation of these committees.

² Mr Kobayashi was appointed a Director, and joined the Nomination Committee, on 26 August 2019.

³ Mr Zwier ceased to be a Director on 31 October 2019.

There are no management representatives appointed as members of any Board Committee.

3 Corporate governance summary (continued)

3.4 Risk management framework

Challenger's Board is responsible, in conjunction with senior management, for the management of risks associated with the business and implementing structures and policies to adequately monitor and manage these risks.

The Board has established the Group Risk Committee (GRC) and the Group Audit Committee (GAC) to assist in discharging its risk management responsibilities. In particular, these committees assist the Board in setting the appropriate risk appetite and for ensuring that there is an effective risk management framework that is able to manage, monitor and control the various risks to which the business is exposed.

The Executive Risk Management Committee (ERMC) is an executive committee chaired by the Chief Risk Officer which assists the GRC, GAC and Board in discharging their risk management obligations by implementing the Board-approved risk management framework. On a day-to-day basis, the Risk division, which is separate from the operating segments of the business, has the responsibility for monitoring the implementation of the risk framework, including the monitoring, reporting and analysis of the various risks faced by the business, and providing effective challenge to activities and decisions that may materially affect Challenger's risk profile.

Challenger has a robust risk management framework which supports its operating segments, and its risk appetite distinguishes risks from which Challenger will seek to make an economic return from those which it seeks to minimise and which it does not consider will provide a return. The management of these risks is fundamental to Challenger's business, customers and to building long-term shareholder value. Challenger is also prudentially supervised by APRA, which prescribes certain prudential standards that must be met by Challenger and its life insurance subsidiary, CLC.

In addition to having a separate risk management function, Challenger recognises that a requirement for an effective risk management framework is for there to be a strong risk culture throughout the organisation, where risk is everybody's business. The foundation of this risk culture is a set of values, the Challenger IACT values. All employees are assessed against the Challenger IACT values as part of the annual performance review process, and this outcome contributes to the overall performance rating and remuneration outcomes. In addition to this, Challenger regularly assesses its risk culture with a combination of external audits and internal staff surveys to ensure that the management of risk and day-to-day compliance remains entrenched within the way in which Challenger operates. Challenger's risk appetite statement provides that, subject to earning acceptable economic returns, it can retain exposure to credit risk, property risk, equity risk and life insurance risk.

- Credit default risk – is the risk of loss in the value of an asset due to a counterparty failing to discharge its contractual obligations when they fall due;
- Property risk – is the potential impact of movements in the market value of property investments on Challenger's income and includes leasing risk which may impact the cash flows from these investments;
- Equity risk – is the potential impact of movements in the market value of listed equity investments, unlisted equity investments and investments in absolute return strategies. Returns for unlisted equity and absolute return strategies are generally uncorrelated to listed equity market returns. Challenger holds equities as part of its investment portfolio in order to provide diversification across the investment portfolio; and
- Life insurance risk – represents both longevity risk and mortality risk. Through selling lifetime annuities and assuming wholesale reinsurance agreements, CLC takes longevity risk, which is the risk that customers who have bought a lifetime annuity live longer, in aggregate, than expected. This is in contrast to mortality risk, which is the risk that people die earlier than expected. CLC is exposed to mortality risk on its wholesale mortality reinsurance business.

Challenger seeks to minimise or hedge the risks for which it does not consider an appropriate return can be generated. These risks include:

- Foreign exchange risk – is the risk of a change in asset values as a result of movements in foreign exchange rates;
- Interest rate risk – is the risk of fluctuations in Challenger's earnings arising from movements in interest rates;
- Inflation risk – is the risk of a change in asset values and Challenger's earnings as a result of movements in inflation both in Australia and jurisdictions in which Challenger owns assets;
- Operational risk – is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events; and
- Regulatory and compliance risk – is the risk of legal or regulatory sanctions or loss as a result of Challenger's failure to comply with laws, regulations or regulatory policy applying to its business.

Further details on Challenger's approach to risk management are included in both the 2020 Sustainability Report and Section 5 of the financial report.

4 Remuneration report

Letter from the Chair

Dear Shareholders

Financial year 2020 has been a period of unprecedented events. While we were making good progress addressing systemic changes in our market during the first half, our performance has been impacted by an exceptionally challenging operating environment, with the second half dominated by the global health and economic crisis created by the COVID-19 pandemic.

As shareholders would expect, our performance and the broader economic outlook is reflected in the remuneration outcomes for employees this year, particularly Key Management Personnel (KMP).

Impact of COVID-19 pandemic on performance

The events of 2020 have underscored the importance of our vision to provide financial security for our customers, with our annuity-holders benefiting from reliable and stable income during this period of uncertainty. To enable us to continue to fulfil this vision, in 2020 we made good progress implementing our strategy for long-term growth, building deeper customer connections, expanding our distribution channels, launching new products and building on our brand leadership.

Reflecting our progress, in February 2020 we lifted our normalised net profit before tax (NNPBT) guidance to the top of the \$500 to \$550 million range. However, the COVID-19 pandemic severely impacted Challenger's performance, resulting in NNPBT towards the lower end of the range, with significant negative investment experience and a large statutory loss. Our defensively positioned portfolio and active investment approach enabled us to maintain a strong capital position throughout the market rout. We also undertook a successful equity raise in June to further bolster our capital position and to provide flexibility to enhance future earnings through accretive investment opportunities.

While we have ensured Challenger remains strongly capitalised and well positioned for the longer term, there is no question the events of the year have had a significant impact on our business and our shareholders.

2020 reward outcomes

The Board has responded by exercising its discretion to materially reduce reward outcomes this year, including:

- total short term incentives (STIs) for KMP are down 56% on 2019 with the CEO's STI down 60%;
- on average, STIs for all KMP are 33% of maximum with the CEO at 20% of maximum; and
- there are no cash STIs for KMP for 2020 (100% is deferred into equity vesting over four years).

No long term incentives (LTIs) vested in September 2019 and LTIs will not vest in September 2020. This demonstrates strong alignment of executives' realised reward with shareholder outcomes.

In addition, there are no fixed pay increases for KMP in line with a Group-wide salary freeze, deferral of STIs is increased across the Group, and the Board has reduced its base fees by 20% for at least six months.

The Board considers these outcomes strike the right balance - reflecting the impacts of this challenging environment on shareholders and our business, while recognising the criticality of having a talented team to manage Challenger through the cycle.

Approach for 2021

We made significant changes to our reward framework in 2019 following a comprehensive review and in response to stakeholder feedback. These changes were designed to drive long-term performance and support retention, while providing alignment and transparency for shareholders.

No major changes are proposed for 2021 as we allow time for the 2019 reward framework to become embedded in the organisation and await further regulatory developments. We continue to engage with shareholders, proxy advisers and other stakeholders on this important matter.

In the meantime, building on the changes made last year, in this report we have sought to provide greater transparency on reward opportunities and outcomes, clearly demonstrating the link between performance and reward.

Yours sincerely



Peter Polson
Independent Chair

4 Remuneration report (continued)

4.1 Contents

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4.2 Key Management Personnel (KMP)

Challenger's executive KMP for 2020 are detailed in the table below:

Name	Role	Term as KMP in 2020
Richard Howes	Managing Director & Chief Executive Officer	Full year
Nick Hamilton ¹	Chief Executive, Funds Management	From 23 September 2019
Angela Murphy	Chief Executive, Distribution, Product & Marketing	Full year
Chris Plater	Chief Executive & Chief Investment Officer, Life	Full year
Ian Saines ²	Chief Executive, Funds Management	Until 22 September 2019
Andrew Tobin	Chief Financial Officer	Full year

¹ Mr Hamilton was appointed to the role of Chief Executive, Funds Management on 23 September 2019 and was designated as KMP from the date of appointment.

² Mr Saines retired and ceased employment on 20 November 2019. Mr Saines was designated as KMP until 22 September 2019.

Challenger's Non-Executive Directors for 2020 are detailed in the table below:

Name	Term as Non-Executive Director in 2020
Peter Polson (Chair)	Full year
John M Green	Full year
Steven Gregg	Full year
Masahiko Kobayashi ¹	Appointed 26 August 2019
JoAnne Stephenson	Full year
Duncan West	Full year
Melanie Willis	Full year
Leon Zwier	Until 31 October 2019

¹ Hiroyuki Iioka was appointed as an alternate director to Masahiko Kobayashi on 13 December 2019.

The term KMP is used throughout the Remuneration Report to refer to executive KMP only.

4 Remuneration report (continued)

4.3 2020 at a glance

Impact of COVID-19 pandemic on performance and reward

In 2020, we continued to make good progress implementing our strategy for long-term growth, expanding our distribution channels, launching new products and building on our brand leadership.

While significant changes in financial advice and superannuation continued to present challenges for our business, in February 2020 we lifted our NNPBT guidance to the top of the \$500 to \$550 million range. Our financial performance and strategic progress are summarised on page 31, including our performance against our balanced scorecard.

However, the COVID-19 pandemic impacted Challenger's performance, resulting in NNPBT at the lower end of the range, a significant negative investment experience and a large statutory loss. In response, we have taken a range of actions in relation to reward, including materially reducing our variable reward pool and remuneration outcomes for KMP, freezing salaries across the whole Group and reducing Non-Executive Directors' fees.

Reward outcomes

No fixed remuneration increases for KMP	<ul style="list-style-type: none"> No increases were applied for KMP for financial year 2020 and no increases are planned for financial year 2021. A salary freeze was put in place for all employees from April 2020. The rebasing of remuneration arrangements for new appointments has continued with the appointment of Mr Hamilton as Chief Executive, Funds Management (fixed remuneration is 30% lower than his predecessor).
Material reduction to variable reward pool	<ul style="list-style-type: none"> Pool is materially reduced to the lowest level in the past five years – 8% of normalised net profit before variable reward and tax (NNPBVRT). This is well below our target range of 10% to 15%. The number of employees has increased by more than 10%.
Materially reduced STI outcomes for KMP	<ul style="list-style-type: none"> Total KMP STIs are down 56% on 2019 (where outcomes were down by 36% on 2018). The CEO's STI is down 60% on 2019 (annualised) and is 20% of the maximum STI opportunity. STIs for other employees across the Group are materially down on 2019 with a greater impact on more senior employees.
No cash STI for KMP and increased use of equity	<ul style="list-style-type: none"> In addition to reduced quantum, 100% of STIs for KMP will be deferred into equity which will vest over four years. The use of equity across the whole Group has been increased through greater deferral of STIs.
No vesting of LTIs in 2019 and 2020 and significantly reduced likelihood of future vesting	<ul style="list-style-type: none"> No LTIs vested in September 2019. LTIs awarded in September 2015, September 2016 and September 2017 will not meet the performance hurdle and so will not vest in September 2020. All LTIs which remain 'on foot' face a significantly reduced likelihood of vesting in future periods.
20% reduction in Non-Executive Directors' fees	<ul style="list-style-type: none"> The Board decided to reduce its base fees for an initial period of six months, starting 1 June 2020. After six months, the position will be reviewed.

4.4 Performance and remuneration outcomes for 2020

This section provides performance information including five-year trends and key financial and operational outcomes for the year.

For the year ended	30 June 2016	30 June 2017	30 June 2018	30 June 2019	30 June 2020
Normalised NPAT ¹ (\$m)	361.7	384.9	406.1	396.1	343.7
Normalised EPS (cents)	64.6	68.5	68.1	65.5	56.5
Closing share price (\$)	8.63	13.34	11.83	6.64	4.41
Dividends per share (cents)	32.5	34.5	35.5	35.5	17.5

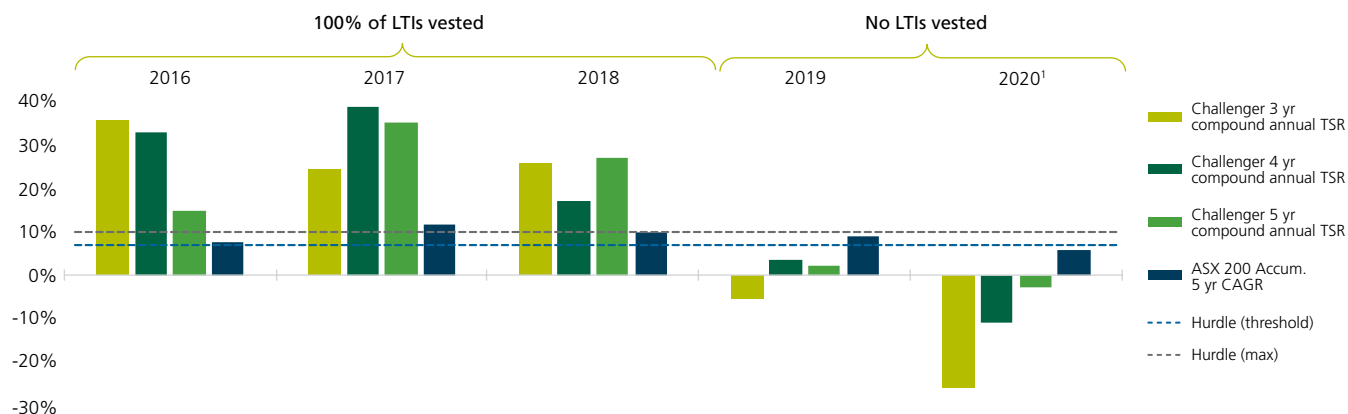
¹ Normalised NPAT excludes asset or liability valuation movements that are above or below expected long-term trends and significant items that may positively or negatively impact financial results. Refer to the Operating and financial review section for further information.

4 Remuneration report (continued)

4.4 Performance and remuneration outcomes for 2020 (continued)

Challenger Total Shareholder Return (TSR) performance and LTI vesting outcomes

No LTIs vested in 2019 and LTIs will not vest in September 2020 demonstrating the strong alignment between executives' realised reward and shareholder outcomes. The chart below illustrates Challenger's compound annual TSR performance over time versus the ASX 200 Accumulation Index five year compound annual growth rate (CAGR).

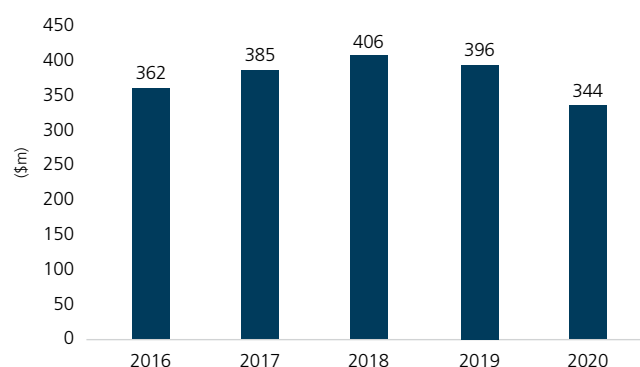


¹ Indicative outcomes based on Challenger's share price as at 30 June 2020.

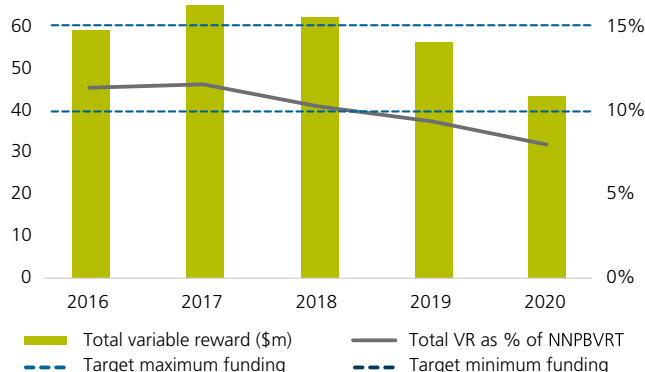
Normalised profit and Variable Reward pool

The 2020 variable reward pool is down materially on 2019 and represents 8% of NNPBVRT, below the target range of 10-15% of NNPBVRT. This reflects the impact of the COVID-19 pandemic on Challenger's performance and outcomes for shareholders.

Normalised NPAT

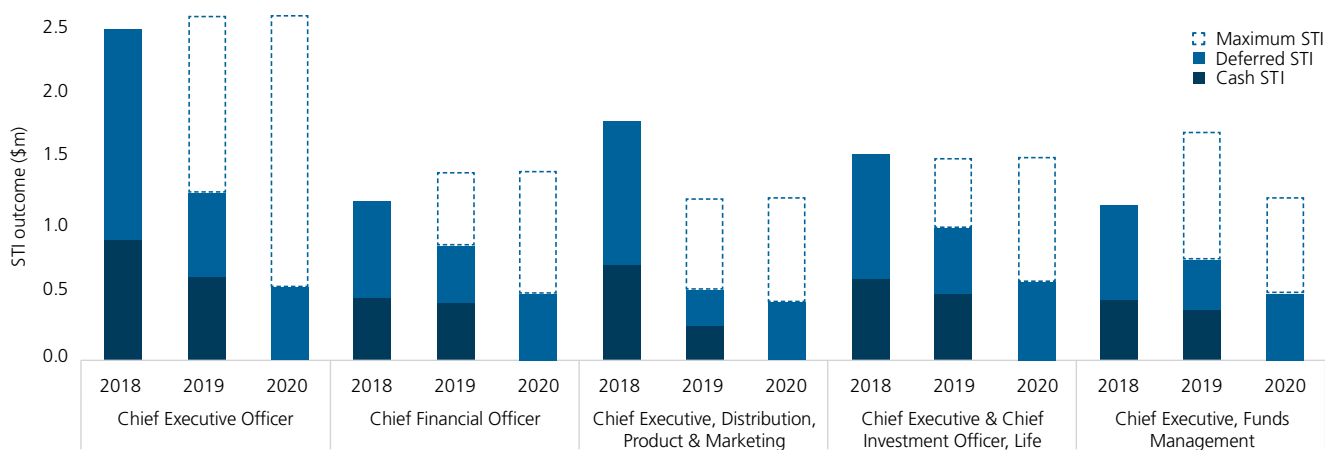


Group Variable Reward pool



Short term incentive outcomes

STI outcomes for 2020 are significantly down again on 2019 (where KMP outcomes were reduced by 36%) and there is no cash STI. On average, STIs for all KMP are 33% of the maximum opportunity which was introduced in 2019 (200% of fixed pay), with the CEO at 20% of maximum. Historical STI outcomes for prior incumbents are included in the chart below for reference.



4 Remuneration report (continued)

4.4 Performance and remuneration outcomes for 2020 (continued)

2020 balanced scorecard outcomes

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

Measure	Weight	Performance	Outcome
Financial	50%	<ul style="list-style-type: none"> Group normalised NPBT of \$507 million (30 June 2019: \$548 million). This was within the guidance range of \$500 million to \$550 million, although below expectations set in February 2020 (to be at the top end of the range), due to the COVID-19 market impacts. Statutory loss after tax of \$416 million, including negative investment experience of \$750 million. Pre-tax normalised ROE 14.8%, 20bps above target of RBA cash rate plus 14%. Strong capital position with 1.81 times APRA's prescribed capital amount (PCA) and well above target range of 1.3 to 1.6 times. AUM \$85.2 billion (2019: \$81.8 billion) up 4%, however below target due to COVID-19 market impact. Total Life sales of \$5.2 billion up 13%, with Japan and institutional sales well above target and domestic annuity sales below target due to structural change in Australian wealth management industry and disruption from COVID-19. Significant progress diversifying Life's revenue, with 67% increase in Life risk (wholesale longevity and mortality business) present value of future earnings to \$829 million and contributed 8% of normalised NPBT (up from 5%). Funds Management net inflows of \$2.5 billion with industry-leading Fidante Partners net flows of +\$3.8 billion and CIP AM -\$1.3 billion. CIP AM outflows reflect changes in Life's asset allocation following the COVID-19 market sell-off. Normalised cost to income ratio of 35.7%, above target range of 30% to 34%, due to investment in growth initiatives and lower earnings. Excluding the distribution growth initiatives, expenses increased by 1%. 	Partially met
Profitability			
Capital			
AUM			
People and culture	20%	<ul style="list-style-type: none"> Regular risk pulse checks show strong risk culture. Launched new values and code of conduct. Maintained high employee engagement and productivity through disrupted COVID-19 period, consistently scoring above 90% on regular employee surveys. Recognised as global top 100 employer for gender equality in 2019 Equileap Global Gender Equality rankings. 	Met
Risk culture			
Employee engagement			
Customer	15%	<ul style="list-style-type: none"> High customer satisfaction – 95% of surveyed annuity customers satisfied or very satisfied. New resources provided to support better retirement outcomes for customers – 'Retirement Made Simple' website hub and 'Retire with Confidence' retirement income tool. Supported advisers and their customers through the pandemic with educational webinars, with adviser participation more than doubling. Maintained strong investment performance with 84% of Fidante Partners Australia funds either first or second quartile since inception. Rated leader in retirement income by financial advisers and number one for overall adviser satisfaction. 	Met
Customer satisfaction			
Customer support			
Strategic	15%	<ul style="list-style-type: none"> Made significant progress on a range of initiatives designed to drive longer term growth, noting major disruption caused by COVID-19 which impacted progress of some strategic initiatives. Continued to diversify distribution through new institutional relationships, with both institutional and Japan sales increasing by more than 100%. In response to the low interest rate environment, launched an innovative and Australia's first floating rate lifetime annuity. Funds Management expanded its product offering with four new strategies for existing managers, a new joint venture with global alternatives manager Ares, a new ETF, and CIP fixed income offerings. Significant progress on Funds Management Japanese growth strategy with new partnership with Nikko Asset Management. 	Partially met
Diversify distribution by channel and geography			
Expand product offering			
Total	100%		Partially met

4 Remuneration report (continued)

4.4 Performance and remuneration outcomes for 2020 (continued)

2020 awarded KMP remuneration

Awarded remuneration represents the value of remuneration that has been awarded for the financial year as determined by the Board and includes fixed remuneration, STIs (cash and deferred), and LTIs. The actual value realised will depend on future performance outcomes, and LTIs will only deliver value to executives in the future if shareholder return hurdles are achieved. This ensures strong alignment with shareholder interests.

Challenger's remuneration strategy is focused on the alignment between performance, prudent risk management and reward outcomes. As a result of Challenger's performance, as reflected in the balanced scorecard outcomes, and to reflect the significant community-wide impact of the COVID-19 pandemic, STI awards have decreased significantly for the 2020 financial year.

- The CEO's STI for 2020 is 60% lower than 2019 and 20% of the maximum.
- Total KMP STIs for 2020 are 56% lower than in 2019 (where outcomes were 36% lower than in 2018).

Awarded remuneration for KMP has been decreasing over time. This is driven by reductions to STI outcomes, reflecting the impact of challenging conditions on performance in 2019 and 2020, and the rebasing of remuneration arrangements as incumbents have been replaced, in line with broader market trends.

KMP	Year	Short term incentive					Long term incentive		
		Fixed ¹ \$	Total STI \$	% of max	Cash STI \$	Deferred STI ² \$	Other ³ \$	Face value ² \$	Fair value ² \$
R Howes ⁴	2020	1,275,000	500,000	20%	-	500,000	25,709	2,868,750	1,199,138
	2019	993,551	1,250,000	49%	625,000	625,000	71,450	2,868,750	1,176,188
B Benari ⁵	2020	-	-	-	-	-	-	-	-
	2019	679,891	1,020,000	75%	510,000	510,000	56,930	-	-
N Hamilton ⁶	2020	464,286	367,560	40%	-	367,560	3,696	1,044,643	436,661
	2019	-	-	-	-	-	-	-	-
A Murphy ⁷	2020	583,298	400,000	34%	-	400,000	5,959	1,350,000	564,300
	2019	333,333	291,666	44%	145,833	145,833	7,797	750,000	307,500
C Plater	2020	750,000	525,000	35%	-	525,000	20,519	1,687,500	705,375
	2019	741,667	988,000	67%	494,000	494,000	58,369	1,687,500	691,875
I Saines ⁸	2020	192,262	-	-	-	-	-	-	-
	2019	815,439	745,000	46%	372,500	372,500	43,677	1,361,000	558,010
A Tobin	2020	700,000	470,000	34%	-	470,000	17,079	1,575,000	658,350
	2019	700,000	850,000	61%	425,000	425,000	46,707	1,575,000	645,750
Total	2020	3,964,846	2,262,560	-	-	2,262,560	72,962	8,525,893	3,563,823
	2019	4,263,882	5,144,666	-	2,572,333	2,572,333	284,930	8,242,250	3,379,323

¹ Includes base salary and superannuation.

² To be formally granted in September 2020 and allocated based on the five-day volume weighted average price (VWAP) prior to the grant date. Mr Howes' LTI will be granted following shareholder approval which will be sought at Challenger's 2020 Annual General Meeting and allocated based on the same five-day VWAP as other KMP. The fair value of 2020 LTIs has been estimated at 41.8% of face value based on the average fair value relative to the face value of awards over the past three years. The fair value of 2019 LTIs was estimated at 41.0% of face value.

³ Values represent estimated distributions from the CPP Trust.

⁴ Mr Howes was appointed Managing Director & Chief Executive Officer on 2 January 2019. The percentage of maximum STI opportunity for 2019 is based on Mr Howes' fixed remuneration as CEO.

⁵ Mr Benari transferred to a non-KMP role on 2 January 2019 as transition to retirement. The 2019 disclosure is pro rata for the period in which he was a KMP.

⁶ Mr Hamilton transferred to a KMP role on 23 September 2019. The 2020 disclosure is pro-rata for the period in which he was KMP.

⁷ Ms Murphy transferred to a KMP role on 12 December 2018. The 2019 disclosure is pro-rata for the period in which she was KMP.

⁸ Mr Saines ceased to be KMP on 22 September 2019. The 2020 disclosure is pro-rata for the period in which he was KMP.

4 Remuneration report (continued)

4.5 Remuneration strategy and structure

Our vision and strategy



Remuneration strategy – guiding principles

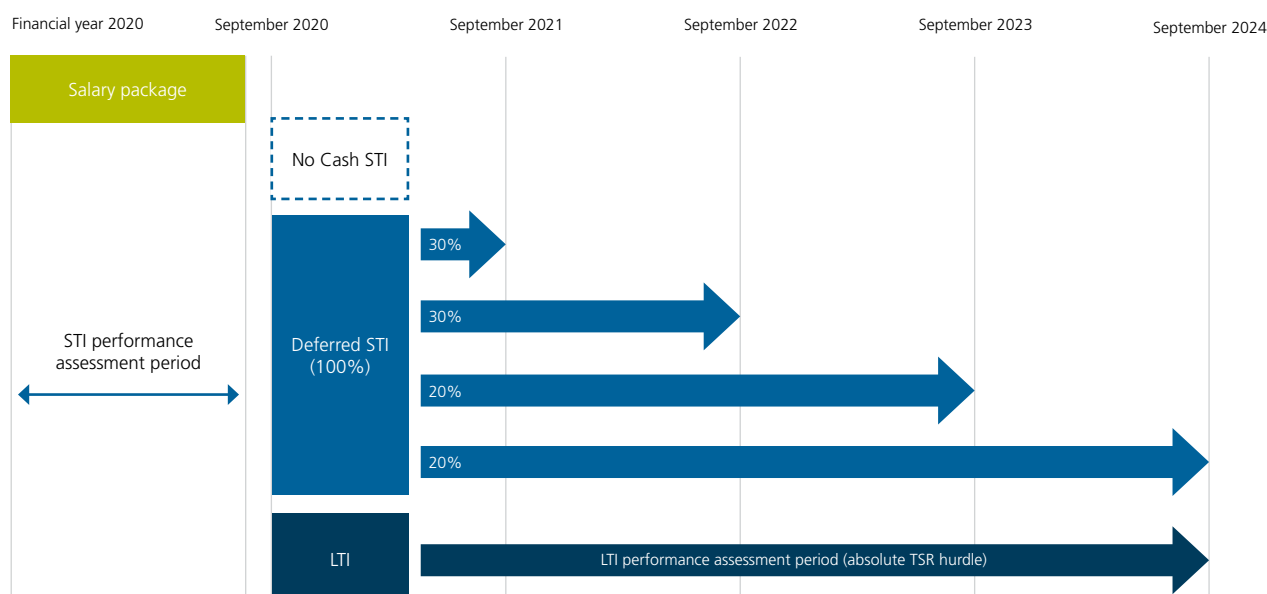
Market-competitive	Performance-based and equitable	Aligned with shareholders	Underpinned by sound risk management
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Remuneration structure for KMP

Fixed remuneration	Variable remuneration	
Base salary, salary-sacrificed benefits and applicable fringe benefits tax. Employer superannuation contributions. Positioned around the market median using appropriate benchmarks, reflecting size and complexity of role, responsibilities, experience and skills.	Short term incentives	Long term incentives
	Up to 200% of fixed remuneration. Annual 'at risk' remuneration, rewarding Challenger performance and individual performance and behaviours. Ordinarily, 50% is deferred into share rights vesting over four years, subject to forfeiture provisions. For 2020, 100% is deferred.	225% of fixed remuneration at face value. Longer-term 'at risk' remuneration. Awarded as hurdle share rights vesting up to five years. Awards are subject to a cumulative absolute TSR hurdle tested after four or five years and subject to forfeiture provisions.

Delivery of remuneration for 2020

Reward is realised over an extended period supporting a focus on strong risk management and long-term performance.



4 Remuneration report (continued)

4.5 Remuneration strategy and structure (continued)

Fixed remuneration

When determining fixed remuneration for KMP, the Board considers market pay benchmarks for roles with:

- similar responsibilities and complexity; and
- roles requiring similar experience and skills.

Variable remuneration

Variable remuneration comprises short term incentives, delivered as cash and equity, and long-term incentives in the form of hurdle share awards.

In 2019, as part of a comprehensive review and in response to stakeholder feedback, a range of changes were made, including:

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

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

Short term incentive

Awards are determined by the Board and consider the performance of Challenger, individual performance and behaviour, and market pay benchmarks.

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

A significant portion of STIs is deferred into equity to provide strong alignment with shareholder interests and support retention. For financial year 2020, 100% is deferred.

STI terms are set out in the table below:

Performance period	Annual in line with Challenger's financial year.										
Award determination and quantum	STIs are discretionary with quantum based on the performance of Challenger, individual performance and behaviours, and market pay benchmarks. Individual performance is evaluated based on: <ul style="list-style-type: none"> • a balanced scorecard comprising financial, people and culture, customer and strategic KPIs and application of, and adherence to, the risk management framework; and • behaviour in line with the Challenger values. 										
Maximum	200% of fixed remuneration.										
Delivery	Ordinarily, 50% of the STI award is delivered as cash and 50% is deferred into equity. For 2020, there is no cash STI for KMP as 100% is deferred into equity. Deferred STI awards are delivered as Deferred Performance Share Rights (DPSRs) which represent the right to receive a fully-paid ordinary Challenger share for nil consideration subject to continued employment at the time of vesting.										
Allocation methodology	Face value with the number of DPSRs granted based on the five-day VWAP of shares prior to grant date.										
Vesting period	DPSRs vest over a four-year period in accordance with the schedule below: <table> <tr> <th>At the end of year</th><th>% of grant vesting</th></tr> <tr> <td>1</td><td>30%</td></tr> <tr> <td>2</td><td>30%</td></tr> <tr> <td>3</td><td>20%</td></tr> <tr> <td>4</td><td>20%</td></tr> </table> <p>Awards made prior to September 2019 vested in two equal tranches after one and two years.</p>	At the end of year	% of grant vesting	1	30%	2	30%	3	20%	4	20%
At the end of year	% of grant vesting										
1	30%										
2	30%										
3	20%										
4	20%										
Vesting conditions	Vesting is subject to continued service.										
Termination treatment	Termination for cause will result in forfeiture of all unvested equity awards. Awards issued from 1 July 2019 onwards are subject to specific good leaver conditions specified at the time of grant, which apply unless the Board exercises its discretion to do otherwise. Where the 'good leaver' treatment applies, unvested equity remains 'on foot' i.e. it will vest on the original vesting date. Board discretion applies in relation to unvested awards issued prior to 30 June 2019.										
Forfeiture (malus)	The Board has the ability to adjust unvested equity (including to zero) in a range of circumstances, including to protect financial soundness or respond to unexpected or unintended consequences that were significant and unforeseen by the Board (such as material risk management breaches, unexpected financial losses, reputational damage or regulatory non-compliance).										

4 Remuneration report (continued)

4.5 Remuneration strategy and structure (continued)

Long term incentives

LTIs are awarded annually to support a continued focus on long-term performance outcomes. Executives only realise value if total shareholder returns exceed the absolute TSR hurdles. The meaningful weighting to LTI ensures a significant proportion of total reward is 'at risk' and directly linked to shareholder outcomes.

The Board considers that TSR is an effective measure of shareholder outcomes and that an absolute rather than a relative TSR performance measure is appropriate because:

- there are no other listed companies in the Australian market with a retirement income business that are directly comparable to Challenger;
- a broader index is generally not considered an appropriate peer group, as the outcome can result in a misalignment between remuneration and shareholder value creation; and
- if the absolute TSR threshold performance target is set at a level above average market returns over the long term, vesting will be directly linked to the delivery of superior returns to shareholders.

The Board reviews the absolute TSR thresholds annually to ensure it is appropriately challenging, supports retention and represents a compelling outcome for shareholders.

For 2020, the Board has determined to retain the absolute TSR thresholds of 7% to 10% (compounded annually) on the basis they continue to be challenging in a low growth and low interest rate environment and represent a relatively strong return for shareholders. By contrast, the ASX 200 Accumulation Index has seen a compound annual growth rate of 6% over the last five years ending 30 June 2020.

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

Where the hurdle is not satisfied at four years, a higher test is applied in year five (requiring total shareholder returns above the annual thresholds compounded over five years). Any unvested awards lapse after five years.

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

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

LTI terms are set out in the table below.

Quantum for KMP	Percentage of fixed remuneration at face value, being 225% for 2020 (consistent with 2019).									
Delivery	Hurdled Performance Share Rights (HPSRs) which represent the right to receive a fully-paid ordinary Challenger share for nil consideration subject to satisfaction of an employment condition and a performance hurdle.									
Allocation methodology	Face value with the number of HPSRs granted based on the five-day VWAP of shares prior to grant date. HPSRs for the CEO are granted following shareholder approval at the Annual General Meeting using the same allocation price as other KMP. Prior to September 2019, Challenger used a fair value allocation methodology.									
Vesting period and conditions	<p>LTI awards vest after four or five years subject to satisfaction of an employment condition and Challenger satisfying the absolute TSR performance hurdle. Awards are tested after four years with any unvested HPSRs subject to a final cumulative test after five years.</p> <p>Awards made prior to September 2019 will continue to be tested after three or four years and subject to a final cumulative test after five years. Two-thirds of an award is eligible to commence vesting after three years and the final third after four years.</p>									
Performance hurdle	<p>Vesting is subject to an absolute TSR performance hurdle set out in the table below:</p> <table><tr><th>Absolute TSR hurdle</th><th>% of HPSRs that vest</th></tr><tr><td>Less than 7% p.a.</td><td>0%</td></tr><tr><td>7% to 10% p.a.</td><td>Straight-line vesting between 50% and 100%</td></tr><tr><td>10% p.a. and above</td><td>100%</td></tr></table> <p>HPSR awards made prior to September 2016 are assessed against the previous performance thresholds of 8% to 12% compounded annually.</p> <p>The start and end price for absolute TSR performance testing is calculated using a 90-day VWAP leading up to the relevant performance start or end date. A 90-day VWAP eliminates the potential for short-term price volatility to impact vesting outcomes.</p>		Absolute TSR hurdle	% of HPSRs that vest	Less than 7% p.a.	0%	7% to 10% p.a.	Straight-line vesting between 50% and 100%	10% p.a. and above	100%
Absolute TSR hurdle	% of HPSRs that vest									
Less than 7% p.a.	0%									
7% to 10% p.a.	Straight-line vesting between 50% and 100%									
10% p.a. and above	100%									
Termination treatment	<p>Termination for cause will result in forfeiture of all unvested equity awards.</p> <p>Awards issued from 1 July 2019 onwards are subject to specific good leaver conditions specified at the time of grant, which apply unless the Board exercises its discretion to do otherwise. Where the 'good leaver' treatment applies, unvested equity remains 'on foot', i.e. it will vest on the original vesting date, subject to satisfaction of the performance hurdle. Board discretion applies in relation to unvested awards issued prior to 30 June 2019.</p>									
Forfeiture (malus)	As above.									

4 Remuneration report (continued)

4.5 Remuneration strategy and structure (continued)

Challenger Performance Plan (CPP) Trust

The CPP Trust is an employee share trust established to satisfy Challenger's employee equity obligations arising from DPSRs and HPSRs.

Trust distributions

Challenger shares held by the CPP Trust generate dividend income. The CPP Trust does not receive dividends from forward share purchase agreements.

The Trustee of the CPP Trust has absolute discretion to determine whether any net income earned from shares held by the CPP Trust is distributed to beneficiaries.

Any undistributed income at the end of the year is taxed at the maximum marginal tax rate (which exceeds the company tax rate) and carries no franking credits.

Distributions are generally made by the Trustee annually. In 2019, the distribution was allocated to DPSRs (equal to Challenger's dividend per share) with the remainder allocated to an approved charity.

As a result of recent changes to the taxation of employee share trusts, no distribution has been made during the 2020 financial year.

Any income distributed to KMP from the CPP Trust is considered by the Remuneration Committee and the Board when considering remuneration recommendations. CPP Trust distributions paid or payable to KMP are disclosed within the remuneration tables.

Tax Exempt Share Plan

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

The Tax Exempt Share Plan provides permanent Australian employees a means to acquire Challenger shares at no cost, and to participate in the future growth and performance of Challenger. Eligible employees are offered \$1,000 worth of fully-paid Challenger ordinary shares on an annual basis, subject to a three-year minimum holding period.

4.6 Remuneration governance

Challenger's remuneration governance structures, outlined in the table below, provide strong oversight of remuneration practices and policies. Detailed information concerning the scope of the Board and the Remuneration Committee's responsibilities can be found under the corporate governance section of Challenger's website.

Remuneration governance arrangements promote compliance with the provisions of the ASX Listing Rules, the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, the *Corporations Act 2001* and, in respect of CLC and Challenger Retirement and Investment Services Limited, the principles contained in the Australian Prudential Regulation Authority standards CPS 510 and SPS 510 respectively.

Board	<ul style="list-style-type: none"> The Board is responsible for ensuring effective remuneration governance and related risk management practices. Board approves remuneration principles and structures and ensures that they are competitive and equitable and that they support the long-term interests of Challenger. The Board receives recommendations from the Remuneration Committee and approves these remuneration recommendations, where appropriate.
Remuneration Committee	<ul style="list-style-type: none"> The Board convenes a Remuneration Committee comprising at least three independent Directors to assist the Board in discharging its responsibilities. The Remuneration Committee meets at least five times during the year, with additional meetings scheduled as required. For the year ended 30 June 2020, six meetings were held. The Remuneration Committee determines and recommends to the Board various principles and policies (including remuneration, recruitment, retention, termination and diversity), Managing Director & CEO and KMP remuneration, incentives, superannuation and life insurance arrangements, and the Directors' remuneration framework.
Independent remuneration advisers	<ul style="list-style-type: none"> The Board, independent of management, appoints an adviser to the Remuneration Committee. In 2020, the Board continued its engagement of KPMG. This engagement is based on a defined set of protocols. The Board is satisfied with KPMG's remuneration structure and quantum related advice and that such advice is free from undue influence. During 2020, KPMG attended all the Remuneration Committee meetings and provided advice with respect to KMP remuneration arrangements, updates on regulatory developments, tax advice and a review of sales incentive plans. No 'remuneration recommendations', as defined by the <i>Corporations Act 2001</i>, were provided by KPMG. Mercer was retained in 2020 to independently value DPSRs and HPSRs and test HPSR vesting outcomes.

4 Remuneration report (continued)

4.6 Remuneration governance (continued)

Remuneration benchmarking

Challenger's remuneration strategy is supported by a strong focus on benchmarking remuneration against the external market to roles with comparable financial services, banking, insurance and capital markets skills.

Annually, the Board approves the peer groups to be used when benchmarking KMP remuneration, and in 2020 approved the following peer groups:

1. Financial Industry Remuneration Group survey:

This peer group supports consideration of roles with comparable financial services, banking, insurance and capital markets skills to Challenger's KMP.

2. Financial services publicly disclosed data:

Data is comprised of publicly disclosed KMP remuneration data for select financial services companies. This peer group supports consideration of roles with comparable skills to Challenger's KMP.

In July 2020, the Board considered remuneration benchmark data as an input when determining 2020 remuneration outcomes for KMP and is confident that awarded remuneration reflects performance and is positioned and structured at a market-competitive level reflective of the markets in which Challenger competes for talent, and the specialist nature of the skills and experience of Challenger KMP.

Variable remuneration governance

The Board determines a pool for total variable remuneration (cash STI and share-based) annually and targets a funding range of between 10% and 15% of normalised net profit before variable reward and tax (NNPBVRT).

While generally working within the targeted range, the Board considers several financial and non-financial factors when determining the size of the pool. Examples of factors that the Board considers include overall business results, external remuneration levels and movements, progress on short and long-term strategic objectives, the cost and amount of capital employed, factors beyond management's control, and management of risk.

For 2020, the Board approved a variable remuneration pool of 8% of NNPBVRT which is significantly below the targeted range. The Board considers that the 2020 variable remuneration pool reflects a reasonable and equitable distribution between shareholders and employees and provides a clear line of sight to, and a strong relationship between, performance and remuneration outcomes.

Minimum shareholding guidelines

The Board reviews KMP and Non-Executive Director minimum shareholding guidelines annually in order to ensure alignment with shareholders and market practice. The 2020 review determined that no changes were required to the guidelines at this time. Challenger's minimum shareholding guidelines do not count unvested deferred equity towards minimum holdings; however, for completeness the shareholding disclosures in Section 4.8 Key Management Personnel remuneration arrangements also show unvested DPSR equity awards.

Minimum shareholding requirements are detailed in the following table:

Group	Requirement	Implied value ¹
Non-Executive Directors (NEDs)	One times base fees	Chair: \$525,500 NEDs: \$179,000
Managing Director & CEO	Two times fixed remuneration	\$2,550,000
Other KMP	One times fixed remuneration	\$600,000 to \$750,000

¹ Based on fees and remuneration at 30 June 2020.

A five-year transitional period in which to acquire the required shareholding applies for Non-Executive Directors and KMP. The Board retains discretion to allow Non-Executive Directors and KMP to vary from this guideline. Where fees are paid to the employer of the Non-Executive Director, the minimum shareholding guidelines do not apply.

The shareholdings of Non-Executive Directors and KMP at 30 June 2020 are set out in Sections 4.8 Key Management Personnel remuneration arrangements and 4.9 Non-Executive Director disclosures.

Employee share trading policy

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

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

Challenger prohibits KMP and employees from taking out margin loans on Challenger shares, with any exceptions to this rule requiring Board approval. There have been no requests for exceptions to this policy for the year ended 30 June 2020 (no requests in 2019).

Employee share ownership

As at 30 June 2020, 77% of permanent employees hold unvested Challenger equity (76% in 2019). This constitutes 2% of Challenger's issued capital as at 30 June 2020 (2% in 2019).

4 Remuneration report (continued)

4.7 Risk and reward

The Board seeks to align remuneration with effective risk management, the generation of appropriate risk-based returns and Challenger's risk appetite.

The Board has agreed a risk management framework which sets out the Board's tolerance to risk exposures and the management of risk. Challenger's risk profile is continuously monitored and managed against its risk appetite and any divergence is resolved within Challenger through a series of escalations and delegated authorities culminating with the Board. All business activities are carried out in accordance with this risk management framework, regardless of potential remuneration outcomes.

During the year, the Risk Committee provides reports to the Remuneration Committee and the Board summarising risk management and risk outcomes, including any breaches of the risk management framework or other compliance policies. The Remuneration Committee and the Board consider these reports when finalising remuneration pools and individual allocations.

All employees are required to comply with Challenger's policies and other risk management and regulatory requirements as they apply to their role and business area. Breaches of compliance with these policies and other requirements are taken seriously and may result in a range of potential consequences including disciplinary action and termination of employment. During 2020, the Board approved a new Conduct Risk and Consequence Management framework to support the fair and consistent application of consequences. In addition, risk management behaviours and outcomes, including any breaches, are considered when determining remuneration outcomes each year.

All employees are assessed against the Challenger values as part of the annual performance review process, and this outcome contributes to the overall performance rating and remuneration outcomes. Satisfactory assessment of behaviours against the Challenger values is treated as a gate-opener for variable reward and behaviours can either increase or decrease reward outcomes.

The Remuneration Committee and the Board consider potential risk implications of performance targets when setting performance measures for variable reward plans.

The Board also places significant focus on risk culture and monitors and assesses Challenger's risk culture. In 2020, this included:

- risk culture pulse check surveys sent to employees through the year;
- as part of its internal audit program, KPMG provided an assessment of risk culture arising from interviews and control findings;
- Ernst & Young undertook a separate review of Challenger's risk culture through a series of interviews and focus groups; and
- a range of key risk indicator metrics are monitored and assessed throughout the year.

Variable reward forfeiture provisions

Under the terms of the CPP, both DPSRs and HPSRs may be reduced or forfeited should the Board determine that a KMP or employee:

- has committed an act of dishonesty;
- is ineligible to hold their office for the purposes of Part 2D.6 Disqualification from managing corporations of the *Corporations Act 2001*; or
- is found to have acted in a manner that the Board considers to be gross misconduct or is dismissed with cause.

In addition, the Board may resolve that an award of DPSRs or HPSRs should be reduced or forfeited in order to:

- protect financial soundness;
- respond to unexpected or unintended consequences that were significant and unforeseen by the Board (such as material risk management breaches, unexpected financial losses, reputational damage or regulatory non-compliance); and
- respond to any examples of misconduct, risk events, acts or omissions or breaches of law or regulation.

4 Remuneration report (continued)

4.8 Key Management Personnel remuneration arrangements

This audited remuneration report describes Challenger's KMP and Non-Executive Director remuneration arrangements as required by the *Corporations Act 2001*.

Statutory remuneration

Statutory remuneration represents the accounting expense of remuneration in the financial year. It includes fixed remuneration, cash STI awards, the fair value amortisation expense of deferred share awards granted, distributions from the CPP Trust, long service leave entitlements and insurance.

KMP	Year	Short-term employee benefits		Long-term employee benefits			Total \$
		Salary ¹ \$	Super- annuation \$	Cash STIs \$	Other ² \$	Share-based payments ³ \$	
R Howes ⁴	2020	1,256,195	21,003	-	46,552	1,750,168	3,073,918
	2019	975,009	20,531	625,000	88,910	1,929,641	3,639,091
B Benari ⁵	2020	-	-	-	-	-	-
	2019	673,510	10,340	510,000	64,367	1,600,128	2,858,345
N Hamilton ⁶	2020	449,799	16,252	-	13,793	325,659	805,503
	2019	-	-	-	-	-	-
A Murphy ⁷	2020	565,863	21,003	-	20,083	435,196	1,042,145
	2019	323,721	11,406	145,833	15,840	206,528	703,328
C Plater	2020	730,970	21,003	-	32,571	1,332,901	2,117,445
	2019	722,922	20,531	494,000	70,873	1,497,129	2,805,455
I Saines ⁸	2020	187,511	4,751	-	2,278	263,185	457,725
	2019	810,605	20,531	372,500	54,899	1,220,782	2,479,317
A Tobin	2020	688,605	21,003	-	28,296	1,141,362	1,879,266
	2019	688,674	20,531	425,000	59,924	1,268,220	2,462,349
Total	2020	3,878,943	105,015	-	143,573	5,248,471	9,376,002
	2019	4,194,441	103,870	2,572,333	354,813	7,722,428	14,947,885

¹ Includes the cost of death, total permanent disability and salary continuance insurances.

² Values represent distributions paid or payable from the CPP Trust and long service leave accruals.

³ Calculated on the basis outlined in Note 29 Employee entitlements and reflects the fair value of the benefit derived at the date at which they were granted. Fair value is determined using an option pricing model and is undertaken by an independent third party. The HPSRs included in share-based payments are subject to market-based performance conditions; consequently, no adjustment to the fair valuation following grant date is permitted to be made for the likelihood of performance conditions not being met. As a result, the value of the share-based payments included in the table may not necessarily have vested during the financial year.

⁴ Mr Howes was appointed Managing Director & Chief Executive Officer on 2 January 2019.

⁵ Mr Benari transferred to a non-KMP role on 2 January 2019 as transition to retirement. The 2019 disclosure is pro-rata for the period in which he was KMP.

⁶ Mr Hamilton transferred to a KMP role on 23 September 2019. The 2020 disclosure is pro-rata for the period in which he was a KMP.

⁷ Ms Murphy transferred to a KMP role on 12 December 2018. The 2019 disclosure is pro-rata for the period in which she was KMP.

⁸ Mr Saines ceased to be KMP on 22 September 2019. The 2020 disclosure is pro-rata for the period in which he was KMP.

Split of statutory remuneration components

The splits of KMP statutory remuneration are set out below:

KMP	Year	Fixed remuneration	Cash STIs	Share-based payments	Other	Total
R Howes ¹	2020	41%	0%	57%	2%	100%
	2019	28%	17%	53%	2%	100%
B Benari ²	2020	-	-	-	-	-
	2019	24%	18%	56%	2%	100%
N Hamilton ³	2020	58%	0%	40%	2%	100%
	2019	-	-	-	-	-
A Murphy ⁴	2020	56%	0%	42%	2%	100%
	2019	47%	21%	29%	3%	100%
C Plater	2020	35%	0%	63%	2%	100%
	2019	26%	18%	53%	3%	100%
I Saines ⁵	2020	42%	0%	57%	1%	100%
	2019	33%	15%	49%	3%	100%
A Tobin	2020	37%	0%	61%	2%	100%
	2019	28%	17%	52%	3%	100%

¹ Mr Howes was appointed Managing Director & Chief Executive Officer on 2 January 2019.

² Mr Benari transferred to a non-KMP role on 2 January 2019 as transition to retirement. The 2019 disclosure is pro-rata for the period in which he was KMP.

³ Mr Hamilton transferred to a KMP role on 23 September 2019. The 2020 disclosure is pro-rata for the period in which he was KMP.

⁴ Ms Murphy transferred to a KMP role on 12 December 2018. The 2019 disclosure is pro-rata for the period in which she was KMP.

⁵ Mr Saines ceased to be KMP on 22 September 2019. The 2020 disclosure is pro-rata for the period in which he was KMP.

4 Remuneration report (continued)

4.8 Key Management Personnel remuneration arrangements (continued)

Share Rights granted

Deferred Performance Share Rights

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

DPSRs granted to KMP during the year ended 30 June 2020 are detailed below:

KMP ¹	Awarded DPSR value from 2019 \$	Face value allocation price \$	Total number of DPSRs granted	Date of grant	Vesting			
					Tranche 1 1 September 2020	Tranche 2 1 September 2021	Tranche 3 1 September 2022	Tranche 4 1 September 2023
					Number ²	Number ²	Number ²	Number ²
R Howes	625,000	6.6332	94,220	9/9/19	28,266	28,266	18,844	18,844
A Murphy	262,500	6.6332	39,572	9/9/19	11,872	11,872	7,914	7,914
C Plater	494,000	6.6332	74,472	9/9/19	22,342	22,342	14,894	14,894
I Saines	372,500	6.6332	56,156	9/9/19	16,847	16,847	11,231	11,231
A Tobin	425,000	6.6332	64,070	9/9/19	19,221	19,221	12,814	12,814

¹ Mr Hamilton transferred to a KMP role on 23 September 2019; grant and vesting outcomes prior to that are not required to be disclosed.

² The number of DPSRs granted is determined by dividing the dollar value of the award by the face value allocation price which is based on the VWAP in the five days prior to grant date. The fair value of each tranche was \$6.73 for Tranche 1, \$6.45 for Tranche 2, \$6.19 for Tranche 3 and \$5.93 for Tranche 4. The fair value is independently calculated and is used to determine the accounting value, which is amortised over future vesting periods. The fair value differs to the face value allocation price, as the DPSRs do not carry a dividend entitlement, and reflects the deferred nature of the award.

Hurdled Performance Share Rights

The table below includes the awarded face value of the granted HPSRs as well as the fair value which takes into account the likelihood of vesting and is in line with accounting standards.

HPSRs granted to KMP during the year ended 30 June 2020 are detailed below:

KMP ¹	Awarded HPSR face value from 2019 ⁴ \$	Grant date	Face value allocation price \$	Vesting			Awarded HPSR fair value from 2019 \$
				Tranche 1			
				1 September 2023			
				Total number of HPSRs granted ³	TSR start price ² \$	Fair value at grant date ⁴ \$	
R Howes	2,868,750	9/12/19	6.6332	432,483	6.7294	4.22	1,825,078
N Hamilton ¹	601,100	11/11/19	6.6332	90,618	6.7294	4.42	400,532
A Murphy	1,350,000	9/9/19	6.6332	203,521	6.7294	3.10	630,915
C Plater	1,687,500	9/9/19	6.6332	254,402	6.7294	3.10	788,646
I Saines	1,361,000	9/9/19	6.6332	205,180	6.7294	3.10	636,058
A Tobin	1,575,000	9/9/19	6.6332	237,441	6.7294	3.10	736,067

¹ Mr Hamilton transferred to a KMP role on 23 September 2019; grant and vesting outcomes prior to that are not required to be disclosed.

² The TSR start price is the VWAP in the 90 calendar days prior to 9 September 2019.

³ The number of HPSRs granted is determined by dividing the dollar value of the award by the face value allocation price. This is the VWAP in the five days prior to 9 September 2019.

⁴ The fair value is independently calculated and is also used to determine the accounting value which is amortised over future vesting periods. The fair value differs to the face value and the TSR start price as the HPSR vesting events are subject to achieving future TSR hurdles, do not carry a dividend entitlement and reflects the deferred nature of the award.

4 Remuneration report (continued)

4.8 Key Management Personnel remuneration arrangements (continued)

Share Rights vested

The following tables show the short and long-term incentives that vested during the year ended 30 June 2020.

Deferred Performance Share Rights

DPSRs which vested to KMP during the year ended 30 June 2020 are detailed below:

KMP ¹	Date of grant	Number	Face value at grant \$	Vesting date	Vested value \$
R Howes	12/9/16	33,930	312,499	1/9/19	224,173
	11/9/17	31,596	387,500	1/9/19	208,752
	11/9/18	34,360	356,241	1/9/19	227,014
A Murphy	12/9/16	9,500	87,496	1/9/19	62,766
	11/9/17	8,765	107,496	1/9/19	57,910
	11/9/18	6,631	68,750	1/9/19	43,811
C Plater	12/9/16	24,429	224,994	1/9/19	161,401
	11/9/17	27,519	337,499	1/9/19	181,816
	11/9/18	29,538	306,247	1/9/19	195,155
I Saines	12/9/16	17,643	162,494	1/9/19	116,566
	11/9/17	17,326	212,490	1/9/19	114,472
	11/9/18	21,701	224,994	1/9/19	143,377
A Tobin	12/9/16	21,715	199,997	1/9/19	143,469
	11/9/17	19,365	237,496	1/9/19	127,943
	11/9/18	22,304	231,246	1/9/19	147,361

¹ Mr Hamilton transferred to a KMP role on 23 September 2019; grant and vesting outcomes prior to that are not required to be disclosed.

Hurdled Performance Share Rights

No HPSR awards vested to KMP during the year ended 30 June 2020 as the minimum absolute TSR performance hurdles were not achieved. It should also be noted that no HPSRs will vest in September 2020.

KMP ¹	Grant details				Vesting details			
	Grant date	Number	Fair value at grant ² \$	Vesting date	Number vested	Compound annual TSR outcome	Number vested or lapsed in prior years	Number yet to vest or lapse
R Howes	13/9/15	101,233	287,502	1/9/19	-	3%	-	101,233
	12/9/16	226,577	937,493	1/9/19	-	-5%	-	226,577
A Murphy	13/9/15	26,409	75,002	1/9/19	-	3%	-	26,409
	12/9/16	63,441	262,496	1/9/19	-	-5%	-	63,441
C Plater	13/9/15	39,613	112,501	1/9/19	-	3%	-	39,613
	12/9/16	163,136	674,998	1/9/19	-	-5%	-	163,136
I Saines	13/9/15	101,233	287,502	1/9/19	-	3%	-	101,233
	12/9/16	117,820	487,496	1/9/19	-	-5%	-	117,820
A Tobin	13/9/15	70,422	199,998	1/9/19	-	3%	-	70,422
	12/9/16	145,009	599,995	1/9/19	-	-5%	-	145,009

¹ Mr Hamilton transferred to a KMP role on 23 September 2019; grant and vesting outcomes prior to that are not required to be disclosed.

² The fair value is independently calculated and has been determined by the Board as the best estimate of the awarded financial value at the grant date.

4 Remuneration report (continued)

4.8 Key Management Personnel remuneration arrangements (continued)

Share Rights held

Performance Share Rights held

Details of KMP DPSRs and HPSRs held as at 30 June 2020 are set out below:

KMP	Instrument	Number held at 1 July 2019	Number granted as remuneration	Number forfeited	Number vested	Number held at 30 June 2020
R Howes	DPSRs	201,267	94,220	-	(99,886)	195,601
	HPSRs	678,870	432,483	-	-	1,111,353
N Hamilton ¹	DPSRs	-	-	-	-	38,191
	HPSRs	-	-	-	-	282,935
A Murphy	DPSRs	39,536	39,572	-	(24,896)	54,212
	HPSRs	131,998	203,521	-	-	335,519
C Plater	DPSRs	164,420	74,472	-	(81,486)	157,406
	HPSRs	483,736	254,402	-	-	738,138
I Saines ²	DPSRs	123,034	56,156	-	(56,670)	122,520
	HPSRs	453,853	205,180	(453,853)	-	205,180
A Tobin	DPSRs	131,574	64,070	-	(63,384)	132,260
	HPSRs	456,203	237,441	-	-	693,644

¹ Mr Hamilton transferred to a KMP role on 23 September 2019; grant and vesting outcomes prior to that are not required to be disclosed.

² Upon termination of employment, Mr Saines' unvested DPSRs remained 'on foot' subject to the applicable time based vesting conditions. In addition, HPSRs awarded to Mr Saines in 2019 remain 'on foot' subject to the specified performance hurdles and applicable time based vesting conditions. HPSRs awarded between 2015 and 2018 lapsed in accordance with the terms of the award.

Key Management Personnel and their affiliates' shareholdings in Challenger Limited

Details of KMP and their affiliates' shareholdings in Challenger Limited as at 30 June 2020 are detailed below, along with the number of unvested DPSRs. The CEO and other KMP are required to have a minimum shareholding equal to two times, and one times, their fixed remuneration respectively. From the date of appointment, KMP have a five-year transition period to reach the minimum shareholding. Mr Tobin held substantially more than the minimum requirement as at 30 June 2020 and all other current KMP remain within their transition period.

KMP	Year	Opening balance	Number of vested DPSRs and HPSRs	Number of shares sold	Closing balance of shares	Number of unvested DPSRs	Shareholding as a multiple of fixed remuneration ¹	
							Fully-owned shares	Shares and DPSRs
R Howes ²	2020	461,592	99,886	-	561,478	195,601	1.9	2.6
	2019	100,000	361,592	-	461,592	201,267	3.1	4.4
N Hamilton ³	2020	-	-	-	-	38,191	-	0.3
	2019	-	-	-	-	-	-	-
A Murphy ⁴	2020	-	24,896	-	24,896	54,212	0.2	0.6
	2019	-	-	-	-	39,536	-	0.5
C Plater ⁵	2020	54,845	81,486	-	136,331	157,406	0.8	1.7
	2019	27,347	177,498	(150,000)	54,845	164,420	0.5	2.0
I Saines ⁶	2020	-	-	-	-	-	-	-
	2019	171,498	326,792	(498,290)	-	123,034	-	1.0
A Tobin	2020	364,765	63,384	-	428,149	132,260	2.7	3.5
	2019	320,880	243,885	(200,000)	364,765	131,574	3.5	4.7
Total	2020	881,202	269,652	-	1,150,854	577,670		
	2019	619,725	1,109,767	(848,290)	881,202	659,831		

¹ Shareholding multiple based on 30 June 2020 closing share price of \$4.41 (30 June 2019: \$6.64).

² Mr Howes was appointed Managing Director & Chief Executive Officer on 2 January 2019 and has a five year transition period from the date of appointment in which to reach the two times holding requirement. It is noted that Mr Howes significantly exceeds the one times holding requirement which applied in his former KMP role.

³ Mr Hamilton transferred to a KMP role on 23 September 2019 and has a five year transition period in which to acquire the required shareholding.

⁴ Mrs Murphy transferred to a KMP role on 12 December 2018 and has a five year transition period in which to acquire the required shareholding.

⁵ Mr Plater transferred to a KMP role on 13 February 2017 and has a five year transition period in which to acquire the required shareholding.

⁶ Mr Saines ceased to be KMP on 22 September 2019.

4 Remuneration report (continued)

4.8 Key Management Personnel remuneration arrangements (continued)

Richard Howes – Managing Director & CEO

Mr Howes was appointed Managing Director & CEO effective 2 January 2019. All equity awards for the Managing Director & CEO are satisfied by the purchase of shares on market. The following table summarises the notice periods and payments which apply to Mr Howes upon termination.

	Notice period	Payment in lieu of notice	Eligibility for STI	Treatment of unvested performance rights
Bad leaver termination¹	Employee initiated: 6 months Employer initiated (Poor performance): 12 months Employer initiated (Misconduct): None	The Board may elect to make a payment of salary package in lieu of notice None	No	Lapse
Good leaver termination²	Employee initiated: 6 months Employee initiated (Material Change ³): 1 month Employer initiated: 12 months	The Board may elect to make a payment of salary package in lieu of notice	Eligible for a pro rata STI payable at the usual payment date	Continued vesting ⁴

¹ Bad leaver termination will occur where employment is terminated by Challenger for poor performance, misconduct or resignation without the prior approval of the Board.

² Good leaver termination will occur if employment ends in any circumstances that do not constitute a bad leaver termination.

³ Material Change means where there is a substantial diminution of Mr Howes' duties, status, responsibilities and/or authority arising without his agreement.

⁴ Unvested performance rights will remain on foot subject to the specified time based vesting conditions and/or performance hurdles and to the rules of the CPP.

Brian Benari – former Managing Director & CEO

Mr Benari transferred to a non-KMP role on 2 January 2019 as transition to retirement and ceased employment on 1 July 2020. No termination payments were made to Mr Benari on ceasing employment.

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

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

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

Loans and other transactions

There were no loans made to Directors or key executives as at 30 June 2020 (30 June 2019: nil). From time to time, Directors of the Company or their Director related entities may purchase products from the Company. These purchases are on the same arm's length terms and conditions as those offered to other employees or customers.

4 Remuneration report (continued)

4.9 Non-Executive Director disclosures

Fee pool

The maximum aggregate amount of annual fees is approved by shareholders in accordance with the requirements of the *Corporations Act 2001*.

The current fee pool of \$2,500,000 was approved by shareholders in 2016.

Fee framework and review

Challenger aims to attract and retain suitably skilled and experienced Non-Executive Directors to serve on the Board and to reward them appropriately for their time and expertise.

Non-Executive Directors are remunerated by way of fees paid in recognition of membership of the Board and its committees.

Additional fees are paid to the Chair of the Board and sub-committee members to reflect added responsibilities.

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

On recommendation from the Remuneration Committee, the Board approves the fee structure within the bounds of the overall maximum fee pool.

The fee structure is benchmarked annually to align with the market and to attract, retain and appropriately reward quality independent directors. Board and committee fees remain unchanged for the year ended 30 June 2020, noting the temporary reduction outlined below.

The following table summarises the fees applicable to membership and chairmanship of the Board and its sub-committees, inclusive of services provided at a subsidiary board level, for the year ended 30 June 2020. All amounts are inclusive of superannuation, where applicable.

Reduction to Board fees

In response to the impact of the COVID-19 pandemic on Challenger's performance, the Board determined to reduce its base fees by 20% for an initial period of six months, commencing 1 June 2020. After six months, it will review the position.

Board/Committee	2020 fee structure ³		2019 fee structure	
	Chair fee ² \$	Member fee \$	Chair fee ² \$	Member fee \$
Board ¹	525,500	179,000	525,500	179,000
Group Risk	47,000	14,000	47,000	14,000
Group Audit	47,000	14,000	47,000	14,000
Remuneration	47,000	23,500	47,000	23,500

¹ Board fees include Nomination Committee fees.

² The Board Chair fees reported in the table are inclusive of committee fees paid to the Board Chair.

³ In May 2020, the Board determined to reduce the Board Chair fee and Member base fees by 20% for a period of six months from 1 June 2020.

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

4 Remuneration report (continued)

4.9 Non-Executive Director disclosures (continued)

Non-Executive Director fees for the year ended 30 June 2020

The following table summarises Non-Executive Director fees for the year ended 30 June 2020.

Non-Executive Director	Year	Director fees \$	Superannuation \$	Total \$
P Polson	2020	495,739	21,003	516,742
	2019	504,969	20,531	525,500
G Cubbin ^{1,2}	2020	-	-	-
	2019	86,638	-	86,638
J M Green	2020	207,778	19,739	227,517
	2019	203,660	19,348	223,008
S Gregg	2020	245,514	21,003	266,517
	2019	236,631	20,398	257,029
M Kobayashi ³	2020	-	-	-
	2019	-	-	-
J Stephenson	2020	245,014	21,003	266,017
	2019	245,280	20,531	265,811
D West ^{1,4}	2020	204,017	-	204,017
	2019	146,569	-	146,569
M Willis	2020	217,367	20,650	238,017
	2019	210,198	19,772	229,970
L Zwier ^{1,5}	2020	44,750	-	44,750
	2019	179,000	-	179,000
Total	2020	1,660,179	103,398	1,763,577
	2019	1,812,945	100,580	1,913,525

¹ Mr Cubbin, Mr West and Mr Zwier provide services through companies. Fees exclude GST.

² Mr Cubbin retired from the Board on 26 October 2018. The 2019 remuneration reflects fees earned on a pro-rata basis.

³ Mr Kobayashi was appointed as Director on 26 August 2019 and as a shareholder representative, does not receive fees. Similarly his alternate director, Mr Iioka, does not receive fees.

⁴ Mr West was appointed as a director on 10 September 2018. The 2019 remuneration reflects fees earned on a pro-rata basis.

⁵ Mr Zwier retired from the Board on 31 October 2019. The 2020 remuneration reflects fees earned on a pro-rata basis.

Superannuation

Non-Executive Directors receive superannuation contributions where required by Superannuation Guarantee legislation.

Equity participation

Non-Executive Directors do not receive equity as part of their remuneration and do not participate in any incentive arrangements.

4 Remuneration report (continued)

4.9 Non-Executive Director disclosures (continued)

Non-Executive Director shareholdings in Challenger Limited at 30 June 2020

Details of the Non-Executive Directors' and their affiliates' shareholdings in Challenger Limited are set out below:

Non-Executive Director	Year	Shares held at the beginning of the year	Movements	Shares held at the end of the year
P Polson	2020	122,000	-	122,000
	2019	122,000	-	122,000
J M Green ¹	2020	10,000	-	10,000
	2019	-	10,000	10,000
G Cubbin ²	2020	-	-	-
	2019	97,878	(97,878)	-
S Gregg ³	2020	14,000	-	14,000
	2019	14,000	-	14,000
M Kobayashi ⁴	2020	-	-	-
	2019	-	-	-
J Stephenson ³	2020	15,000	2,000	17,000
	2019	15,000	-	15,000
D West ¹	2020	18,957	-	18,957
	2019	-	18,957	18,957
M Willis	2020	149,892	-	149,892
	2019	149,892	-	149,892
L Zwier ⁵	2020	7,360	(7,360)	-
	2019	7,360	-	7,360
Total	2020	337,209	(5,360)	331,849
	2019	406,130	(68,921)	337,209

¹ Mr Green and Mr West are within the five-year transitional period in which to acquire the required shareholding.

² Mr Cubbin retired from the Board on 26 October 2018.

³ Due to significant share price movement during 2020, Mr Gregg and Ms Stephenson's shareholdings as at 30 June 2020 did not satisfy the minimum shareholding requirements.

⁴ Mr Kobayashi is exempt from the minimum shareholding requirements. His alternate director, Mr Ilioka, is exempt also.

⁵ Mr Zwier retired from the Board on 31 October 2019, so his holding disclosure is removed under 'movements'.

Total remuneration of KMP and Non-Executive Directors

	Short-term benefits	Post-employment benefits	Share-based payments	Other benefits	Termination benefits	Total
KMP and Non-Executive Directors	\$	\$	\$	\$	\$	\$
Non-Executive Directors						
2020	1,660,179	103,398	-	-	-	1,763,577
2019	1,812,945	100,580	-	-	-	1,913,525
KMP						
2020	3,878,943	105,015	5,248,471	143,573	-	9,376,002
2019	6,766,774	103,870	7,722,428	354,813	-	14,947,885
All KMP and Non-Executive Directors						
2020	5,539,122	208,413	5,248,471	143,573	-	11,139,579
2019	8,579,719	204,450	7,722,428	354,813	-	16,861,410

4 Remuneration report (continued)

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

Key term	Description
Awarded remuneration	Represents the value of remuneration that has been awarded for the financial year. This includes fixed remuneration, STI (cash and deferred) and LTI.
Board	The Board of Directors of Challenger Limited is the main body responsible for the implementation of effective remuneration governance and related risk management practices at Challenger.
CPP	<i>Challenger Performance Plan</i> . Deferred equity awards are issued under the CPP.
CPP Trust	<i>Challenger Performance Plan Trust</i> . The CPP Trust was established in 2006 for the purpose of acquiring, holding and transferring shares to employees upon the vesting of their equity awards.
DPSR	<i>Deferred Performance Share Right</i> . Deferred STI awards are delivered as DPSRs under the CPP. DPSRs represent the right to receive a fully-paid ordinary Challenger share for zero consideration subject to continued employment at the time of vesting. DPSRs do not provide an entitlement to vote or a right to dividends; however, employees with unvested DPSRs may receive a distribution of income from the CPP Trust. The Board has discretion to amend or withdraw DPSRs at any point.
Face value	The number of DPSRs granted to KMP is determined based on the face value of the shares using a five-day Volume Weighted Average Price (VWAP) prior to the grant date. The number of HPSRs granted to KMP from 1 July 2019 is determined based on the face value of the shares using a five-day VWAP prior to the grant date.
Fair value	The number of HPSRs awarded to KMP prior to 1 July 2019 was calculated by reference to the fair value. The fair value for HPSRs is calculated on the basis outlined in Note 29 Employee entitlements and reflects the fair value of the benefit derived at the date at which they were granted. An independent third party determines the fair value using an option pricing model and discounted cash flow methodology, as appropriate.
HPSR	<i>Hurdled Performance Share Right</i> . HPSR awards are delivered under the CPP and are linked to the long-term performance of Challenger. HPSRs represent the right to receive a fully-paid ordinary Challenger share for zero consideration subject to satisfying an employment condition and Challenger satisfying the absolute TSR performance hurdle. HPSRs do not provide an entitlement to vote or a right to dividends. HPSR awards are provided to KMP as their responsibilities provide them with the opportunity to materially influence long-term performance, strategy and shareholder value. The Board has discretion to amend or withdraw HPSRs at any point.
KMP	<i>Key Management Personnel</i> . Persons having authority and responsibility for planning, directing and controlling the activities of an entity, directly or indirectly, including any Director (whether executive or otherwise) as defined in AASB 124 <i>Related Party Disclosures</i> .
LTI	<i>Long term incentive</i> . LTIs are awarded annually to KMP to support a continued focus on long-term performance outcomes. Executives will only realise value from LTIs if total shareholder returns exceed the hurdles set, ensuring a direct link between executive reward and shareholder outcomes.
Normalised NPAT	<i>Normalised net profit after tax</i> . Excludes asset or liability valuation movements that are above or below expected long-term trends and significant items that may positively or negatively impact financial results. Refer to the Operating and financial review section for further information.
Normalised RoE (pre-tax)	<i>Normalised return on equity (pre-tax)</i> . Normalised profit before tax divided by average net assets.
Normalised NPBVRT	<i>Normalised net profit before variable reward and tax</i> . Excludes any asset or liability valuation movements that are above or below expected long-term trends and any significant items that may positively or negatively impact the financial results, and excludes STI expense, employee share award expense and tax.
Remuneration Committee	The Board convenes a Remuneration Committee comprising independent Non-Executive Directors and which is a delegated committee of the Board to assist the Board in discharging its responsibilities.
Statutory remuneration	Represents the accounting expense of remuneration for the financial year. This includes fixed remuneration, cash STI awards, the fair value amortisation expense of share-based awards granted up to balance sheet date, distributions from the CPP Trust, long service leave entitlements and insurance.
STI	<i>Short-term incentive</i> . STIs are used to reward KMP and employees for significant contributions to Challenger's results over the course of the financial year. Individual STI awards are allocated on the basis of annual contribution and with reference to market benchmarks. The Board has discretion to amend or withdraw the STI at any point. STIs may be awarded in the form of cash and/or DPSRs.
TSR	<i>Total shareholder return</i> . TSR represents the change in share price plus dividends received over a given timeframe. Challenger uses absolute TSR as the measure of performance for HPSRs.
Variable remuneration	Consists of cash STI and share-based awards (DPSRs and HPSRs).
VWAP	<i>Volume weighted average price</i> . Ratio of the value of shares traded to total volume traded over a time horizon. A five-day VWAP is used to calculate the number of DPSRs per dollar of deferred STIs. A five-day VWAP is used to calculate the number of HPSRs per dollar of LTIs. A 90-day VWAP is also used for absolute TSR performance testing (start and end price) for HPSR awards.

5 Indemnification and insurance of Directors and officers

In accordance with its Constitution, and where permitted under relevant legislation or regulation, the Company indemnifies the Directors and officers against all liabilities to another person that may arise from their position as Directors or officers of the Company and its subsidiaries, except where the liability arises out of conduct that is fraudulent, dishonest, criminal, malicious or a reckless act, error or omission.

In accordance with the provisions of the *Corporations Act 2001*, the Company has insured the Directors and officers against liabilities incurred in their role as Directors and officers of the Company. The terms of the insurance policy, including the premium, are subject to confidentiality clauses and therefore the Company is prohibited from disclosing the nature of the liabilities covered and the premium paid.

6 Indemnification of auditor

To the extent permitted by law, the Company has agreed to indemnify its auditor, Ernst & Young, as part of the terms of its audit engagement agreement. The primary purpose of the indemnity is to indemnify Ernst & Young for any loss that it may suffer as a result of a false representation given by Challenger management where a claim is made against Ernst & Young by a third party.

There is a caveat if Ernst & Young's loss results from its own negligence or wrongful or wilful acts or omissions. No payment has been made to indemnify Ernst & Young during or since the financial year.

7 Environmental regulation and performance

Some members of the Group act as a trustee or responsible entity for a number of trusts that own assets both in Australia and overseas. Some of these assets are subject to environmental regulations under Commonwealth, state and offshore legislation. The Directors are satisfied that adequate systems are in place for the management of the Group's environmental responsibilities and compliance with various legislative, regulatory and licence requirements. Further, the Directors are not aware of any breaches of these requirements, and to the best of their knowledge all activities have been undertaken in compliance with environmental requirements.

8 Significant events after the balance date

Subsequent to the balance date the Company completed a non-underwritten share purchase plan (SPP) raising \$35.0 million with 8.1 million shares issued to retail shareholders at a price of \$4.32 per share. Of the proceeds received from the SPP on 30 July 2020, \$30.0 million was injected into CLC as Common Equity Tier 1 capital on 31 July 2020 with the remaining \$5.0 million retained by the Group.

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

9 Rounding

The amounts contained in this report and the financial report have been rounded to the nearest \$100,000, unless otherwise stated, under the option available to the Group under Australian Securities and Investments Commission (ASIC) Corporations Instrument 2016/191.

10 Non-audit services

The Audit Committee has reviewed details of the amounts paid or payable for non-audit services provided to Challenger during the year ended 30 June 2020 by the Company's auditor, Ernst & Young.

The Directors are satisfied that the provision of those non-audit services by the auditor is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001* and did not compromise the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services were approved in accordance with the Auditor Independence Policy that outlines the approval process that must occur for all non-audit services and which involves the Challenger CEO, CFO or delegate, depending on size and circumstances; and
- no non-audit services were carried out which were specifically excluded by the Auditor Independence Policy.

For details of fees for non-audit services paid to the auditors, refer to Note 30 Remuneration of auditor of the financial report.

11 Authorisation

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



P Polson
Independent Chair

Sydney
10 August 2020



R Howes
Managing Director & Chief Executive Officer

Sydney
10 August 2020

12 Auditor's independence declaration

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



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

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

Auditor's independence declaration to the Directors of Challenger Limited

As lead auditor for the audit of the financial report of Challenger Limited for the financial year ended 30 June 2020, I declare to the best of my knowledge and belief, there have been:

- a. no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- b. no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Challenger Limited and the entities it controlled during the financial year.



Ernst & Young



T Johnson
Partner

Sydney
10 August 2020

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Sustainability

Challenger's approach to sustainability addresses environmental, social and governance (ESG) risks and opportunities that have the potential to affect its vision to provide financial security for customers.

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

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

Challenger's 2020 Sustainability Report outlines its approach to sustainability and is available from the company website:

› challenger.com.au/about-us

This report covers Challenger's key areas of focus, highlights achievements and demonstrates progress in delivering its sustainability strategy.

Challenger frames its report through the lens of its most material matters. These are identified through engagement with internal and external stakeholders and with consideration of importance to both the business and its stakeholders. Responding to the material matters identified, supports the delivery of the UN Sustainable Development Goals (SDGs).

Material matters

Trust and confidence

Challenger's ability to continue to deliver value for its stakeholders relies on trust and confidence in our business. This is gained through setting and maintaining high standards, and participating in industry-wide commitments. This also includes how Challenger has conducted itself through the COVID-19 pandemic and the decisions made as a result of it.

Economic uncertainty

As an investment management company, Challenger is impacted by market volatility and uncertainty as well as the low interest rate trend. The need for diversification and ensuring access to appropriate assets remains an important focus for its business and stakeholders. The impact of the COVID-19 pandemic and Government measures put in place will impact its ongoing approach.

Long-term risk management

Identifying and managing long-term risks is critical to providing secure and stable incomes for Challenger's customers. This includes ensuring it has resilient business practices to mitigate risks. Challenger's ability to continue to deliver on its long term promises to its customers through the COVID-19 pandemic demonstrates the strength in its approach.

Responsible investment

Effective investment strategies need to consider environmental, social and governance issues. By considering non-financial risks, Challenger makes its business more resilient and this supports long term returns. Stakeholders are increasingly considering investment in technologies that will support a low-carbon transition or will support a key social issue.

Climate change

The risks related to climate change, if not considered, will have financial impacts. Physical risks will impact real assets and transition risks will be felt more widely through investment portfolios. There have also been growing expectations and increased regulator encouragement for companies to review and disclose climate-related financial risks.

Great place to work

To attract and retain top talent, companies need to meet evolving employee expectations. Employees want to work for organisations that share their values. This includes a focus on diversity and inclusion as well as health and wellbeing. Providing the tools and technology to enable employees can lead to increased engagement.

Changing operating environment

Challenger's operating environment is complex, impacted by regulatory shifts. As recommendations from the Royal Commission come into effect, further regulatory pressure will also arise from other external events. The ability to keep pace with changing requirements is essential for sustainable success.

Public policy settings

Many businesses and individuals are impacted by the public policy debate that drives financial security for retirement. The retirement income system is under review and findings from the review will underscore key considerations. Challenger is engaging broadly and leveraging its research to contribute to the public policy debate. This will be an ongoing focus.

Better customer outcomes

Customer preferences and expectations are changing. With advances in technology and communication channels, businesses have the opportunity to provide better outcomes for them. Understanding customer needs and delivering appropriate products and services are key to helping provide Challenger's customers with confidence in retirement.

Community connection and resilience

Society holds the business community to a high standard and expects them to do the right thing for the community. To demonstrate genuine support, businesses are moving their strategies to focus on partnerships to address key social issues. To enhance employee engagement, volunteering and workplace giving remain important aspects to business engagement in the community.

Providing a great workplace

Challenger has strong programs in place to celebrate diversity and inclusion and create engagement throughout its business. A focus on health and wellbeing and flexible work practices, has assisted Challenger to support employees in times of crisis.

Through the COVID-19 pandemic, with all employees working from home, Challenger provided continuous communications to ensure employees remained engaged. As a result, pulse surveys throughout this period indicated that 98% of employees were confident in the Leadership Team's ability to navigate through the disruption.

Sustainability (continued)

Providing a great workplace (continued)

During this time, the health and wellbeing of employees was a top priority. Challenger's holistic approach to wellbeing supports employees inside and outside of work. Highlights this year include:

- delivering career development lunch and learn sessions;
- providing access to free flu shots;
- creating a Working from Home Wellbeing hub;
- promoting voluntary superannuation contributions that are matched (up to \$500) by Challenger; and
- supporting the community through fundraising, including contributing to the Australian bushfire and drought relief appeals.

Diversity and inclusion

Challenger prides itself on attracting and retaining people with the diverse skills and experience it needs to succeed. Creating a diverse and inclusive workplace supports this and in July 2019 Challenger launched its new Diversity and Inclusion strategy. The strategy focuses on three key areas:

- **Diverse and inclusive workplace** – where differences are valued and employees have a strong sense of belonging;
- **Gender equality** – improving business outcomes through equal representation, opportunities and reward for women and men; and
- **Employment opportunities for people aged over 50** – supporting employment outcomes for mature age employees.

This new strategy is complemented by four employee-led diversity networks. These networks were developed by employees and focus on the areas of diversity and inclusion that matter most to them, including gender, culture, LGBTQI+ and age diversity. The initiatives from these networks are supported by the Leadership Team who promote them throughout the business. In addition, targets have been established for gender diversity and are monitored and reported to the Board, who have overall oversight of diversity and inclusion.

In 2020, Challenger was recognised as an Employer of Choice for Gender Equality (WGEA) for the third year running. Reflecting continued commitment and progress towards achieving gender equality, Challenger was recognised for the first time as a global top 100 employer for gender equality in the 2019 Equileap Global Gender Equality rankings, and was also included on the Bloomberg Global Gender Equality Index.

Risk is everybody's business

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

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

The Board is committed to ensuring effective risk management. The Leadership Team is accountable for managing identified key risks and is required to manage risk as part of business objectives with risk management integrated across business processes. There are clear accountabilities for risk management for all employees and this is measured through Challenger's performance management process.

The Board understands the broad range of risks Challenger faces as a participant in the financial services industry, including: licence and regulatory risk; investment and pricing risk; climate change risk; strategic, business and reputation risk; operational risk; funding and liquidity risk and conduct risk.

Sustainability issues are an important part of Challenger's risk management framework. There are a range of policies and practices to carefully consider sustainability risks when making key business decisions.

More detailed information about Challenger's risk management approach is provided in the 2020 Sustainability Report.

Investing in the community

Challenger's approach to supporting the community focuses on two primary goals – to address a key social issue aligned to its strategy and to enhance employee engagement.

In September 2019, Challenger announced a strategic three-year partnership with COTA New South Wales. Through this partnership it aims to deliver a program to address the underemployment of Australians over 50. An initial research phase is currently underway with outcomes used to inform an ongoing program and related initiatives.

Employees at Challenger are encouraged to use workplace giving when making charitable donations. Each employee has one paid day of leave for volunteering every year and they are given opportunities to support charities throughout the year.

Managing Challenger's impact on the environment

Challenger's sustainability strategy has a focus on delivering improved environmental impacts. This is achieved through consideration in investment decision-making and through a commitment to reducing its own operational impact on the environment.

Challenger's impact from its direct operations are calculated and offset each year. In offsetting its emissions, Challenger supports projects that improve the environment in Australia and around the world. Continuing its commitment to accuracy and transparency, Challenger engaged with an external party to compile a scope 1, 2 and 3 greenhouse gas emissions profile, which was audited by a third party.

Challenger's full commitment to sustainability is outlined in the 2020 Sustainability Report, which can be viewed at:

➤ challenger.com.au/sustainabilityreport2020

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

Statement of comprehensive income

For the year ended 30 June	Note	2020 \$m	2019 \$m
Revenue	1	1,132.8	2,372.6
Expenses	2	(1,538.9)	(1,571.4)
Finance costs	15	(213.8)	(385.6)
Share of profits of associates	23	29.3	22.2
(Loss)/profit before income tax		(590.6)	437.8
Income tax benefit/(expense)	4	169.5	(127.1)
(Loss)/profit for the year after income tax		(421.1)	310.7
(Loss)/profit attributable to shareholders of Challenger Limited		(416.0)	307.8
(Loss)/profit attributable to non-controlling interests		(5.1)	2.9
(Loss)/profit for the year after income tax		(421.1)	310.7
Other comprehensive income			
Items that may be reclassified to profit and loss, net of tax			
Translation of foreign entities	14	1.6	35.4
Hedge of net investment in foreign entities	14	0.5	(34.7)
Cash flow hedges – SPV ¹	14	-	(0.2)
Other comprehensive income for the year		2.1	0.5
Total comprehensive income for the year after tax		(419.0)	311.2
Comprehensive income attributable to shareholders of Challenger Limited		(413.9)	308.3
Comprehensive income attributable to non-controlling interests		(5.1)	2.9
Total comprehensive income for the year after tax		(419.0)	311.2
Earnings per share attributable to ordinary shareholders of Challenger Limited			
		Cents	Cents
Basic	17	(68.4)	50.9
Diluted	17	(68.4)	44.8

¹ SPV = Special Purpose Vehicles.

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

Statement of financial position

As at 30 June	Note	2020 \$m	2019 \$m
Assets			
Cash and cash equivalents	11	603.9	725.4
Cash and cash equivalents – SPV	7	58.0	66.5
Receivables		594.1	580.0
Current tax assets	4	-	2.7
Derivative assets	10	1,112.5	762.5
Financial assets – fair value through profit and loss	5	20,834.0	19,929.6
Investment property held for sale	6	-	166.5
Investment and development property	6	3,685.9	3,562.7
Mortgage assets – SPV	7	706.6	860.6
Finance leases		31.7	49.5
Property, plant and equipment		25.9	28.6
Investment in associates	23	63.0	58.1
Other assets		65.8	76.6
Right-of-use lease assets ¹	27	32.4	-
Goodwill	25	579.9	557.3
Deferred tax assets	4	49.8	7.0
Other intangible assets	25	18.1	23.9
Total assets of shareholders of Challenger Limited and non-controlling interests		28,461.6	27,457.5
Liabilities			
Payables		1,640.9	1,168.2
Current tax liability	4	1.0	-
Derivative liabilities	10	725.4	569.2
Interest bearing financial liabilities	13	7,278.2	6,313.1
Interest bearing financial liabilities – SPV	7	460.7	763.4
External unit holders' liabilities	9	2,415.8	1,966.2
Provisions		35.5	19.2
Lease liabilities ¹		67.6	-
Deferred tax liabilities	4	5.7	165.2
Life contract liabilities	8	12,581.2	12,870.2
Total liabilities of shareholders of Challenger Limited and non-controlling interests		25,212.0	23,834.7
Net assets of shareholders of Challenger Limited and non-controlling interests		3,249.6	3,622.8
Equity			
Contributed equity	12	2,377.6	2,093.7
Reserves	14	(50.9)	(52.4)
Retained earnings	14	922.9	1,559.0
Total equity of shareholders of Challenger Limited		3,249.6	3,600.3
Non-controlling interests		-	22.5
Total equity of shareholders of Challenger Limited and non-controlling interests		3,249.6	3,622.8

¹ Reflects the adoption of AASB 16 on 1 July 2019. As permitted by the standard, the Group has not restated the comparative financial reporting periods.

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

Statement of changes in equity

		Attributable to shareholders of Challenger Limited								
		Contributed equity	Share-based payment reserve	Cash flow hedge reserve –SPV	Foreign currency translation reserve	Adjusted controlling interest reserve	Retained earnings	Total shareholder equity	Non-controlling interests	Total equity
For the year ended 30 June 2019	Note	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Balance at 1 July 2018		2,051.7	(43.0)	0.3	(3.3)	12.7	1,467.0	3,485.4	0.4	3,485.8
Profit for the year	14	-	-	-	-	-	307.8	307.8	2.9	310.7
Other comprehensive income for the year		-	-	(0.2)	0.7	-	-	0.5	-	0.5
Total comprehensive income for the year		-	-	(0.2)	0.7	-	307.8	308.3	2.9	311.2
Other equity movements										
Ordinary shares issued	12	6.8	-	-	-	-	-	6.8	-	6.8
Treasury shares purchased	12	(32.8)	-	-	-	-	-	(32.8)	-	(32.8)
Treasury shares vested	12	42.7	-	-	-	-	-	42.7	-	42.7
Deferred Treasury share purchases	12	(7.5)	-	-	-	-	-	(7.5)	-	(7.5)
Settled forward purchases of Treasury shares	12	32.8	-	-	-	-	-	32.8	-	32.8
Share-based payment expense net of tax less releases	14	-	(14.7)	-	-	-	-	(14.7)	-	(14.7)
Dividends paid	16	-	-	-	-	-	(215.8)	(215.8)	-	(215.8)
Other movements		-	-	-	-	(4.9)	-	(4.9)	19.2	14.3
Balance at 30 June 2019 and 1 July 2019		2,093.7	(57.7)	0.1	(2.6)	7.8	1,559.0	3,600.3	22.5	3,622.8
For the year ended 30 June 2020										
Transition of new leasing standard net of tax		-	-	-	-	-	(3.7)	(3.7)	-	(3.7)
Restated balance at 1 July 2019		2,093.7	(57.7)	0.1	(2.6)	7.8	1,555.3	3,596.6	22.5	3,619.1
Loss for the year	14	-	-	-	-	-	(416.0)	(416.0)	(5.1)	(421.1)
Other comprehensive income for the year		-	-	-	2.1	-	-	2.1	-	2.1
Total comprehensive income for the year		-	-	-	2.1	-	(416.0)	(413.9)	(5.1)	(419.0)
Other equity movements										
Ordinary shares issued	12	269.4	-	-	-	-	-	269.4	-	269.4
Treasury shares purchased	12	(8.8)	-	-	-	-	-	(8.8)	-	(8.8)
Treasury shares vested	12	14.5	-	-	-	-	-	14.5	-	14.5
Deferred Treasury share purchases	12	-	-	-	-	-	-	-	-	-
Settled forward purchases of Treasury shares	12	8.8	-	-	-	-	-	8.8	-	8.8
Share-based payment expense net of tax less releases	14	-	1.5	-	-	-	-	1.5	-	1.5
Dividends paid	16	-	-	-	-	-	(216.4)	(216.4)	-	(216.4)
Other movements		-	-	-	-	(2.1)	-	(2.1)	(17.4)	(19.5)
Balance at 30 June 2020		2,377.6	(56.2)	0.1	(0.5)	5.7	922.9	3,249.6	-	3,249.6

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

Statement of cash flows

For the year ended 30 June	Note	2020 \$m	2019 \$m
Operating activities			
Receipts from customers		630.0	673.8
Annuity and premium receipts	8	3,162.9	3,565.4
Annuity and claim payments	8	(3,747.0)	(3,246.0)
Payments to reinsurer	8	-	(58.7)
Receipts from external unit holders		2,024.0	1,006.9
Payments to external unit holders		(1,670.9)	(1,388.8)
Payments to vendors and employees		(593.3)	(600.3)
Dividends received		66.0	105.6
Interest received		733.6	804.2
Interest paid		(104.6)	(154.4)
Income tax paid		(15.8)	(55.4)
Net cash inflows from operating activities	11	484.9	652.3
Investing activities			
Payments on net purchases of investments		(1,623.4)	(1,096.2)
Net proceeds from sale of controlled entities		-	255.9
Payments for purchase of controlled entities		(10.2)	-
Net mortgage loan repayments		164.7	145.0
Payments for net purchases of property, plant and equipment		(9.3)	(59.9)
Payments for purchase of associate interest		-	(5.1)
Net cash outflows from investing activities		(1,478.2)	(760.3)
Financing activities			
Proceeds from issue of ordinary shares		275.3	6.8
Net proceeds from borrowings – interest bearing financial liabilities	13	823.7	317.4
Payments for lease liabilities ¹		(5.1)	-
Payments for Treasury shares		(8.3)	(47.5)
Net dividends paid		(216.4)	(215.8)
Costs associated with issue of ordinary shares		(5.9)	-
Net cash inflows from financing activities		863.3	60.9
Net decrease in cash and cash equivalents		(130.0)	(47.1)
Cash and cash equivalents at the beginning of the year		791.9	839.0
Cash and cash equivalents at the end of the year		661.9	791.9

¹ Reflects the adoption of AASB 16 on 1 July 2019. As permitted by the standard, the Group has not restated the comparative financial reporting periods.

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

Section 1: Basis of preparation and overarching significant accounting policies

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

The financial report for Challenger Limited and its controlled entities (the Group or Challenger) for the year ended 30 June 2020 was authorised for issue in accordance with a resolution of the Directors of the Company on 10 August 2020.

(i) Basis of preparation and statement of compliance

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

Unless otherwise stated, amounts in this financial report are presented in Australian dollars and have been prepared on an historical cost basis. The assets and liabilities disclosed in the statement of financial position are grouped by nature and listed in an order that reflects their relative liquidity. In the disclosure, the current/non-current split is between items expected to be settled within 12 months (current) and those expected to be settled in greater than 12 months (non-current).

(ii) Significant accounting judgements, estimates and assumptions

The carrying values of amounts recognised on the statement of financial position are often based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the recognised amounts within the next annual reporting period are disclosed individually within each of the relevant notes to the financial statements. The impact of COVID-19 has been considered in relation to the disclosures made in these financial statements.

Coronavirus (COVID-19) impact

Background

COVID-19, which is a respiratory illness caused by a new virus, was declared a worldwide pandemic by the World Health Organisation in March 2020. COVID-19, as well as measures to slow the spread of the virus, have since had a significant impact on global economies and equity and debt markets. The Group has considered the impact of COVID-19 and associated market volatility in preparing its financial statements. The impact of COVID-19 has resulted in the application of further judgement in the areas in which significant judgement already occurs. Given the dynamic and evolving nature of COVID-19, limited recent experience of the economic and financial impacts of such a pandemic, and the relatively short period of time between the declaration of the pandemic and the

preparation of these financial statements, changes to the estimates and outcomes that have been applied in the measurement of the Group's assets and liabilities may arise in the future.

Processes applied

As a consequence of COVID-19 and in preparing these consolidated financial statements, management:

- re-evaluated whether there were any additional areas of judgement or estimation uncertainty;
- reviewed external market communications to identify other COVID-19-related impacts;
- reviewed public forecasts and experience from previous downturns and conducted several internal processes to ensure consistency in the application of the expected impact of COVID-19 across all asset classes;
- assessed the carrying values of its assets and liabilities and determined any impact that may occur as a result of market inputs and variables impacted by COVID-19;
- ran multiple stress-testing scenarios, which are an integral component of the Group's risk management framework and a key input to the capital adequacy assessment process, to assess the potential impacts of the COVID-19 pandemic on its portfolio to assist in the organisation's prudent risk management; and
- considered the impact of COVID-19 on the Group's financial statement disclosures.

As a result of applying these processes, the Group has made additional disclosures in respect of the impact of COVID-19 on accounting judgements and estimates for the following:

- Basis of preparation and overarching significant accounting policies; (xi) Receivables;
- Note 6 Investment and development property;
- Note 7 Special Purpose Vehicles;
- Note 19 Fair values of financial assets and liabilities; and
- Note 25 Goodwill and other intangible assets.

(iii) New and revised accounting standards and policies

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

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

There were amendments to existing accounting standards that were effective from 1 July 2019. The following new accounting standards have been applied from 1 July 2019.

AASB 16 *Leases*

AASB 16 *Leases* amends the accounting standard for leases and replaces AASB 117 *Leases*. The standard removes the distinction between operating and finance leases and requires lessees to bring all leases on to the statement of financial position.

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

AASB 16 *Leases* (continued)

The effect of adopting AASB 16 as at 1 July 2019 (increase/(decrease)) is as follows¹:

	1 July 2019 \$m
Assets	
Right-of-use lease asset	36.7
Deferred tax asset	1.6
Total assets	38.3
Liabilities	
Lease liabilities	72.9
Total liabilities	72.9
Total adjustment on equity of shareholders	(3.7)
Retained earnings¹	(3.7)

¹ Existing balances under AASB 117 *Leases* were utilised to derive the take-on position as at 1 July 2019.

This mainly relates to the lease obligations of 5 Martin Place, Sydney, which is the Group's principal place of business. Lessor accounting remains largely unchanged.

Prior to the adoption of AASB 16, the Group classified each of its leases (where acting as a lessee) at the inception date as either a finance lease or an operating lease. A lease was classified as a finance lease if it transferred substantially all of the risks and rewards incidental to ownership of the leased asset to the Group; otherwise it was classified as an operating lease.

Finance leases were capitalised at the commencement of the lease at the inception date fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments were then apportioned between interest (recognised as finance costs) and reduction of the lease liability.

In an operating lease, the leased property was not capitalised and the lease payments were recognised as a rent expense in the statement of comprehensive income on a straight-line basis over the lease term. Any prepaid rent or accrual was recognised under other assets or payables.

Upon adoption of AASB 16, the Group applied a single recognition and measurement approach for all leases, except for short term leases and leases of low-value assets.

Finance Leases

There was no material impact to the Group for leases classified as finance leases where the Group acted as a lessee.

Operating Leases

The Group adopted AASB 16 using the modified retrospective method of adoption effective from 1 July 2019. Under this method, the standard is applied retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application. The Group elected to use the 'transition practical expedient' method, allowing the standard to be applied only to contracts that were previously identified as leases under AASB 117 *Leases* and Interpretation 4 *Determining whether an Arrangement Contains a Lease* at the date of initial application.

The Group also elected to use the recognition exemptions for lease contracts that, at the commencement date, have a lease term of 12 months or less and do not contain a purchase option ('short-term leases'), and lease contracts for which the underlying asset is of low value ('low-value assets').

The right-of-use lease asset for 5 Martin Place was recognised based on the carrying amount as if the standard had always been applied, apart from the use of incremental borrowing rate at the date of initial application. For other leases, the right-of-use lease assets were recognised based on the amount equal to the lease liabilities, adjusted for any related prepaid and accrued lease payments previously recognised.

The adoption of the modified retrospective method avoids any restatement of prior year comparative information, including profit and loss and cash flow reporting.

AASB Interpretation 23 *Uncertainty over Income Tax Treatment*

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

The Interpretation specifically addresses the following:

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

An entity is required to determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The Interpretation is effective for annual reporting periods beginning on or after 1 July 2019. The Interpretation did not have a material impact on the consolidated financial statements of the Group.

Accounting standards and interpretations issued but not yet effective

AASB 17 *Insurance Contracts*

AASB 17 *Insurance Contracts* replaces AASB 4 *Insurance Contracts*, AASB 1038 *Life Insurance Contracts* and AASB 1023 *General Insurance Contracts* and is effective for Challenger from 1 July 2021. The International Accounting Standards Board has deferred the effective date to periods commencing on or after 1 January 2023 and the AASB is expected to adopt the same effective date. The Group is not expected to early adopt the standard. AASB 17 *Insurance Contracts* establishes globally consistent principles for the recognition, measurement, presentation and disclosure of life insurance contracts issued. Life investment contracts are currently measured under the financial instruments standard and will continue to be recognised under this standard.

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

AASB 17 Insurance Contracts (continued)

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

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

- insurance contract portfolios will be disaggregated to more granular levels and will be required to be evaluated by risk type, issue year and profitability;
- although conceptually similar, the Contractual Service Margin recognises profit on a different basis to the current Margin on Services approach and therefore the profit signature is likely to change for portfolios with positive profit margins;
- a new risk adjustment for non-financial risk will be introduced which reflects the compensation that the Group requires for bearing the uncertainty in relation to the amount and timing of cash flows. The confidence level used to determine the risk adjustment will need to be disclosed;
- additional disclosures will be more extensive, requiring increased granularity and more analysis of movements.

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

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

Existing standards and interpretations not yet effective

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

(iv) Comparatives

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

(v) Rounding of amounts

Unless otherwise stated, amounts contained in this report and the financial report have been rounded to the nearest \$100,000 under the option available to the Group under ASIC Corporations Instrument 2016/191.

(vi) Foreign currency

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

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

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the transaction.

Non-monetary items measured at fair value in a foreign currency are translated to the functional currency using the exchange rates at the date when the fair value was determined. Derivatives are used to hedge the foreign exchange risk relating to certain transactions. Refer to Note 10 Derivative financial instruments.

Foreign controlled entities

On consolidation, the assets and liabilities of foreign subsidiaries whose functional currency differs from the presentation currency are translated into Australian dollars at the rate of exchange at the statement of financial position date. Exchange differences arising on the retranslation are taken directly to the foreign currency translation reserve in equity.

The change in fair value of derivative financial instruments designated as a hedge of the net investment in a foreign controlled entity is also recognised in the foreign currency translation reserve.

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

(vii) Finance leases

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

(viii) Property, plant and equipment

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

(viii) Property, plant and equipment (continued)

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

Any impairment losses recognised in prior periods are reversed through the Statement of Comprehensive Income if there has been a change in the estimated useful life used to determine the asset's recoverable amount since the last impairment loss was recognised.

The increased carrying amount of an asset attributable to a reversal of an impairment loss would not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

(ix) Provisions

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

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

(x) Goods and services tax (GST)

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

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

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

(xi) Receivables

Receivables are recognised at amortised cost using the effective interest method, less any allowance for expected credit losses. The entity has applied a simplified approach to measuring expected credit losses, which uses a lifetime expected loss allowance. To measure the expected credit losses, receivables have been grouped based on days overdue. The modelling methodology applied in estimating expected credit losses in these financial statements is consistent with that applied in the financial statements for the year ended 30 June 2019. The impact of COVID-19 on the global economy and how governments, businesses and consumers respond is uncertain. This uncertainty is reflected in the Group's assessment of expected credit losses from its receivables portfolio which are subject to a number of management judgements and estimates.

The judgements and associated assumptions have been made within the context of the impact of COVID-19, and reflect historical experience and other factors that are considered to be relevant, including expectations of future events that are believed to be reasonable under the circumstances. In relation to COVID-19, judgements and assumptions include the extent and duration of the pandemic, the impacts of actions of governments and other authorities, and the responses of businesses and consumers in different industries, along with the associated impact on the global economy. Accordingly, the Group's expected credit losses estimates are inherently uncertain and, as a result, actual results may differ from these estimates.

(xii) Payables

Payables represent unsecured non-derivative, non-interest bearing financial liabilities in respect of goods and services provided to the Group prior to the end of the financial year. They include accruals, trade and other creditors and are recognised at amortised cost, which approximates fair value.

Section 2: Key numbers

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

Note 1 Revenue

	30 June 2020 \$m	30 June 2019 \$m
Investment revenue		
Fixed income securities and cash		
Interest revenue ¹	774.2	890.9
Net realised and unrealised (losses)/gains on fixed income securities	(90.5)	714.0
Investment property and property securities		
Property rental revenue	283.9	318.6
Dividend revenue	2.0	8.0
Net realised and unrealised (losses)/gains on investment property and property securities	(112.1)	60.7
Equity and infrastructure investments		
Dividend revenue	37.9	51.4
Net realised and unrealised (losses)/gains on equity investments	(12.7)	0.7
Net realised and unrealised (losses)/gains on infrastructure investments	(96.7)	128.1
Other		
Net realised and unrealised (losses)/gains on foreign exchange translation and hedges	(39.7)	26.5
Net realised and unrealised losses on interest rate derivatives	(99.8)	(186.8)
Net realised and unrealised losses on equity swap derivatives	(214.1)	(25.3)
Net realised and unrealised (losses)/gains on credit default swap derivatives	(199.7)	13.1
Fee revenue		
Management and performance fee revenue	183.3	176.2
Transaction fee revenue	41.2	47.6
Other revenue		
Life insurance contract premiums and related revenue	1,192.7	1,143.5
Change in life insurance contract liabilities	(502.1)	(916.5)
Change in life investment contract liabilities	(15.4)	(98.3)
Change in reinsurance contract liabilities	0.4	20.2
Total revenue	1,132.8	2,372.6

¹ Interest revenue earned for items measured at amortised cost using the effective interest method \$41.0 million (30 June 2019: \$57.1 million) and interest revenue earned for items measured at fair value through profit and loss \$733.2 million (30 June 2019: \$833.8 million).

Accounting policy

Revenue is recognised at an amount that reflects the consideration to which the Group expects to be entitled in exchange for transferring services to a customer. Revenues and expenses are recognised on an accrual basis. The following specific policies are applied:

- Interest revenue is recognised as it accrues using an effective interest rate method, taking into account the effective yield of the financial asset. The effective interest rate is the rate that discounts estimated future cash flows through the expected life of a financial instrument, or where appropriate, a shorter period.
- Interest revenue on finance leases is recognised on a basis that reflects a constant periodic return on the net investment in the finance lease.
- Gains or losses arising from changes in the fair value of financial instruments classified as fair value through profit and loss are recognised as revenue in the statement of comprehensive income when the change in value is recognised in the statement of financial position.
- Property rental revenue is accounted for on a straight line basis over the lease term. Contingent rental income is recognised as income in the period in which it is earned.
- Lease incentives granted are recognised as part of the total rental income. Operating lease rental income is recognised on a straight line basis over the life of the contract.

Note 1 Revenue (continued)

Accounting policy (continued)

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

The Company recognises revenue from performance fees over the contract period, but only to the extent that it is highly probable that a significant reversal of revenue will not occur in subsequent periods.

- Transaction fee revenue is accrued when the transaction is executed.
- Life insurance contract premiums are recognised as revenue when risk is transferred to the Group.
- Changes in life insurance and investment contract liabilities arising from discount rates, inflation rates and other assumptions are recognised as revenue, with other movements being included in Note 2 Expenses. Refer to Note 8 Life contract liabilities for more details on the accounting policy of life contract liabilities.

Note 2 Expenses

	30 June 2020 \$m	30 June 2019 \$m
Life insurance contract claims and expenses	749.6	634.0
Cost of life insurance contract liabilities	99.2	179.9
Cost of life investment contract liabilities	121.9	214.2
Reinsurance contracts	-	2.0
Investment property related expenses ¹	85.1	109.5
Management fee expense	163.1	107.5
Distribution expenses	47.6	47.8
Employee expenses	142.1	156.8
Employee share-based payments and superannuation	23.6	30.1
Occupancy expense – operating lease	6.0	12.2
Depreciation of right-of-use lease asset ²	4.7	-
Depreciation and amortisation expense	10.6	15.3
Technology and communications	26.7	25.2
Professional fees	24.3	18.4
Other expenses	34.4	18.5
Total expenses	1,538.9	1,571.4

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

² Reflects the adoption of AASB 16 on 1 July 2019. As permitted by the standard, the Group has not restated the comparative financial reporting period.

Accounting policy

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

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

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

Refer to Note 8 Life contract liabilities for more details on the accounting policy of life contract liabilities.

Note 3 Segment information

The reporting segments¹ of the Group have been identified as follows:

	Life		Funds Management		Total reporting segments		Corporate and other ²		Total	
For the year ended 30 June	2020 \$m	2019 \$m	2020 \$m	2019 \$m	2020 \$m	2019 \$m	2020 \$m	2019 \$m	2020 \$m	2019 \$m
Net income	638.9	670.1	158.1	149.9	797.0	820.0	0.4	1.0	797.4	821.0
Operating expenses	(114.2)	(106.5)	(100.4)	(99.0)	(214.6)	(205.5)	(69.8)	(61.9)	(284.4)	(267.4)
Normalised EBIT	524.7	563.6	57.7	50.9	582.4	614.5	(69.4)	(60.9)	513.0	553.6
Interest and borrowing costs	-	-	-	-	-	-	(6.5)	(5.3)	(6.5)	(5.3)
Normalised net profit/(loss) before tax	524.7	563.6	57.7	50.9	582.4	614.5	(75.9)	(66.2)	506.5	548.3
Tax on normalised profit									(162.8)	(152.2)
Normalised net profit after tax									343.7	396.1
Investment experience after tax									(750.3)	(88.3)
Significant items after tax									(9.4)	-
Profit attributable to the shareholders of Challenger Ltd									(416.0)	307.8
Other statutory segment information										
Revenue from external customers ³	148.4	1,305.5	210.2	176.2	358.6	1,481.7	-	-	358.6	1,481.7
Interest revenue	772.6	889.9	-	-	772.6	889.9	1.6	1.0	774.2	890.9
Interest expense	(172.8)	(343.7)	(0.5)	-	(173.3)	(343.7)	(40.5)	(41.9)	(213.8)	(385.6)
Intersegment revenue	(43.6)	(46.4)	43.6	46.4	-	-	-	-	-	-
Depreciation and amortisation	(3.4)	(5.7)	(2.3)	(0.6)	(5.7)	(6.3)	(4.9)	(9.0)	(10.6)	(15.3)
As at 30 June										
Segment assets	19,481.7	19,712.8	291.7	253.3	19,773.4	19,966.1	8,688.2	7,468.9	28,461.6	27,435.0
Segment liabilities	(16,543.3)	(16,393.9)	(36.0)	(27.3)	(16,579.3)	(16,421.2)	(8,632.7)	(7,413.5)	(25,212.0)	(23,834.7)
Net assets attributable to shareholders	2,938.4	3,318.9	255.7	226.0	3,194.1	3,544.9	55.5	55.4	3,249.6	3,600.3

¹ Refer below for definitions of the terms used in the management view of segments.

² Corporate and other includes corporate companies, corporate SPV, non-controlling interests and Group eliminations.

³ Funds Management revenue from external customers is predominantly management fees.

Definitions

Operating segments

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

Life

The Life segment principally includes the annuity and life insurance business carried out by CLC and Accurium Pty Limited (provision of self-managed superannuation fund actuarial certificates). CLC offers fixed rate retirement and superannuation products that are designed for Australian

investors who are seeking a low-risk, fixed term or lifetime investment and reliable income. CLC also offers fixed term and lifetime investments to investors in Japan through its reinsurance arrangement with MS Primary. CLC invests in assets providing long-term income streams for customers.

Funds Management

Funds Management earns fees from its Fidante Partners and Challenger Investment Partners operations, providing an end-to-end funds management business. Funds Management has equity investments in a number of the Fidante Partners boutique fund managers and, through the Challenger Investment Partners business, offers a range of managed investments across fixed income and property.

Note 3 Segment information (continued)

Definitions (continued)

Corporate and other

The corporate segment, which is not considered an operating segment of the Group, is used to reconcile the total segment results back to the consolidated results and consists of other income and costs that fall outside the day-to-day operations of the reportable segments. These include the costs of the Group CEO and CFO, shared services across the Group, long-term incentive costs, Directors' fees, corporate borrowings and associated borrowing costs and shareholder registry services.

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

Transactions between segments

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

Normalised vs. statutory results

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

- Normalised cash operating earnings (Life segment).
- Net income (Funds Management segment).
- Other income (Corporate and other segment).

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

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

Normalised cash operating earnings

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

Normalised EBIT

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

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

Tax on normalised profit

This represents the consolidated statutory tax expense or benefit for the period, less tax attributable to non-controlling interests, investment experience and significant items.

Investment experience after tax

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

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

Normalised capital growth

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

The normalised growth rates for the period are +3.5% for equity and other investments (30 June 2019: +4.5%), +4.0% for infrastructure (30 June 2019: +4.0%), +2.0% for property (30 June 2019: +2.0%) and -0.35% for cash and fixed income (30 June 2019: -0.35%). The rates are set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing market conditions.

Reflecting changes made to the investment portfolio asset allocation in response to COVID-19, the investment classification and normalised growth rates have been revised from 1 July 2020 as follows: +3.5% for equity and infrastructure investments, 0.0% for alternatives, +2.0% for property and -0.35% for cash and fixed income.

Annuity valuation experience

Life contract valuation assumption changes represent the impact of changes in macroeconomic variables including bond yields and inflation factors, expense assumptions and other factors applied in the valuation of life contract liabilities. It also includes the attribution of the corresponding interest rate, foreign exchange and inflation derivatives used for hedging.

New business strain is a non-cash valuation adjustment recognised when annuity rates on new business are higher than the risk-free rate used to fair value life contracts.

Note 3 Segment information (continued)

Definitions (continued)

Annuity valuation experience (continued)

Maintenance expense allowances over the expected future term of the new business are also included in the life contract valuation. New business strain reported in the period represents the valuation loss on new sales generated in the current period net of the reversal of new business strain of prior period sales.

Significant items after tax

The Group presents additional non-IFRS financial information to the market to provide meaningful insights into the financial condition of the business. Due consideration has been given to ensure that disclosure of Challenger's normalised profit framework is explained, reconciled and calculated consistently period-on-period. Within this framework, Challenger defines significant items as non-recurring or abnormal income or expense items. For the period ended 30 June 2020, significant items were negative \$9.4 million (after tax). They include the impairment of an intangible asset recognised in relation to the revenue share interest owned in respect of Latigo Investment Partners (\$6.6 million), and a boutique impairment charge and wind-up costs following the closure of FME Asset Management (\$2.8 million).

Major customers

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

Geographical areas

The Group operates predominantly in Australia; hence no geographical split is provided to the chief operating decision maker. Reinsurance of annuities issued by MS Primary accounted for \$742.6 million of the Group's life insurance premium income in 2020 out of total life insurance premium income of \$1,157.1 million (2019: \$268.0 million out of a total of \$1,121.1 million) and comprised 13.7% of total policy liabilities outstanding as at 30 June 2020 (2019: 9.5%). While the underlying annuitant resides in Japan, the reinsurance service provided by CLC is considered to be Australian business and is therefore not recognised as a geographically separate segment.

	30 June 2020 \$m	30 June 2019 \$m
Reconciliation of management to statutory view of after-tax profit		
Operating segments normalised net profit before tax	582.4	614.5
Corporate and other normalised net loss before tax	(75.9)	(66.2)
Normalised net profit before tax (management view of pre-tax profit)	506.5	548.3
Tax on normalised profit	(162.8)	(152.2)
Normalised net profit after tax	343.7	396.1
Investment experience after tax	(750.3)	(88.3)
Significant items after tax	(9.4)	-
(Loss)/profit attributable to the shareholders of Challenger Limited	(416.0)	307.8
(Loss)/profit attributable to non-controlling interests excluded from management view	(5.1)	2.9
Statutory view of (loss)/profit after tax	(421.1)	310.7
Reconciliation of management view of revenue to statutory revenue		
Operating segments	797.0	820.0
Corporate and other	0.4	1.0
Net income (management view of revenue)	797.4	821.0
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	11.1	23.1
Distribution expenses offset against related income	47.6	47.8
Change in life contract liabilities and reinsurance contracts recognised in expenses	970.7	1,030.1
Property related expenses offset against property income	85.1	109.5
Interest and loan amortisation costs	160.3	320.5
Management fee expenses	163.1	107.5
Adjustment for non-controlling interests and other items	(32.0)	16.6
Difference between management view of investment experience and statutory recognition		
Actual capital growth	(1,067.3)	79.1
Normalised capital growth	(120.2)	(155.1)
Life contract valuation experience	85.1	5.8
New business strain	31.9	(33.3)
Statutory revenue (refer Note 1 Revenue)	1,132.8	2,372.6

Note 4 Income tax

	30 June 2020 \$m	30 June 2019 \$m
Reconciliation of income tax benefit/(expense)		
(Loss)/profit before income tax	(590.6)	437.8
Prima facie income tax based on the Australian company tax rate of 30%	177.2	(131.3)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
– Challenger Capital Notes distributions	(8.3)	(9.9)
– non-assessable and non-deductible items	(5.3)	12.4
– tax rate differentials	5.9	4.5
– tax adjustment in respect of non-controlling interests	(1.5)	0.9
– other items	1.5	(3.7)
Income tax benefit/(expense)	169.5	(127.1)
Underlying effective tax rate¹	28.9%	29.2%

¹ The calculation of the underlying effective tax rate excludes the non-controlling interests' loss of \$5.1 million (30 June 2019: profit \$2.9 million).

	30 June 2020 \$m	30 June 2019 \$m
Analysis of income tax benefit/(expense)		
Current income tax expense for the year	(28.6)	(65.6)
Current income tax benefit prior year adjustment	3.9	4.9
Deferred income tax benefit/(expense)	198.3	(57.8)
Deferred income tax expense prior year adjustment	(4.1)	(8.6)
Income tax benefit/(expense)	169.5	(127.1)
Income tax benefit/(expense) on translation of foreign entities	5.0	(14.3)
Income tax (expense)/benefit on hedge of net investment in foreign operations	(0.2)	14.9
Income tax benefit from other comprehensive income	4.8	0.6

	Statement of financial position		Statement of comprehensive income	
	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m
Analysis of deferred tax				
Deferred tax assets				
Accruals and provisions	49.4	39.1	10.2	10.9
Employee entitlements	5.1	4.0	1.2	0.1
Losses	92.1	11.3	80.9	(14.0)
Other	16.6	9.7	3.6	(2.8)
Total deferred tax assets	163.2	64.1	95.9	(5.8)
Set off of deferred tax assets	(113.4)	(57.1)		
Net deferred tax assets recognised in statement of financial position	49.8	7.0		
Deferred tax liabilities				
Unrealised foreign exchange movements	(1.9)	(19.0)	12.3	(20.0)
Unrealised net gains on investments	(114.6)	(183.1)	68.4	(35.0)
Other	(2.6)	(20.2)	17.6	(5.6)
Total deferred tax liabilities	(119.1)	(222.3)	98.3	(60.6)
Set off of deferred tax liabilities	113.4	57.1		
Net deferred tax liabilities recognised in statement of financial position	(5.7)	(165.2)		
Deferred income tax benefit/(expense) recognised in statement of comprehensive income			194.2	(66.4)

Note 4 Income tax (continued)

Tax Transparency Code Disclosures

	30 June 2020 \$m	30 June 2019 \$m	Change \$m
Australia and overseas tax benefit/(expense)			
Total Australia	176.6	(117.6)	294.2
Total overseas	(7.1)	(9.5)	2.4
Income tax benefit/(expense)	169.5	(127.1)	296.6

	30 June 2020 \$m	30 June 2019 \$m
Analysis of current tax liability/(asset)		
Opening balance	(2.7)	0.9
Current income tax expense for the year	28.6	65.6
Current income tax prior year adjustment	(3.9)	(4.9)
Tax in equity	(1.8)	(5.5)
Income tax paid	(15.8)	(55.4)
Other	(3.4)	(3.4)
Closing balance	1.0	(2.7)

	30 June 2020 \$m	30 June 2019 \$m
Unrecognised deferred tax balances		
Non-tax consolidated group revenue losses – tax effected	7.4	2.9
Tax consolidated group capital losses – tax effected	56.2	54.8

Accounting policy

Income tax expense

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

Current tax assets and liabilities

Current tax assets and liabilities for the current and prior periods are the amounts expected to be recovered from or paid to the taxation authorities based on the respective period's taxable income. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted as at the statement of financial position date. Current tax assets and liabilities have been offset where there is a legally enforceable right to set off.

Deferred income tax assets and liabilities

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

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

settle on a net basis. Deferred tax assets are recognised for the carryforward of unused tax losses to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilised.

Tax consolidation

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

Tax effect accounting by members of the tax group

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

Key estimates and assumptions

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

Section 3: Operating assets and liabilities

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

Note 5 Financial assets – fair value through profit and loss

	30 June 2020 \$m	30 June 2019 \$m
Domestic sovereign bonds and semi-government bonds	8,610.3	5,554.5
Floating rate notes and corporate bonds	4,915.6	7,730.8
Residential mortgage and asset-backed securities	5,809.2	4,044.4
Non-SPV mortgage assets	139.8	272.8
Fixed income securities	19,474.9	17,602.5
Shares in listed and unlisted corporations	97.8	96.1
Unit trusts, managed funds and other	804.9	1,236.1
Equity securities	902.7	1,332.2
Units in listed and unlisted infrastructure trusts	55.9	542.5
Other infrastructure investments	324.2	324.6
Infrastructure investments	380.1	867.1
Indirect property investments in listed and unlisted trusts	76.3	127.8
Property securities	76.3	127.8
Total financial assets – fair value through profit and loss	20,834.0	19,929.6
Current	8,339.2	9,985.2
Non-current	12,494.8	9,944.4
	20,834.0	19,929.6

Accounting policy

The Group categorises its financial assets as financial assets – fair value through profit and loss (being initially designated as such). Assets designated as fair value through profit and loss consist of fixed income, equity, infrastructure, and property securities. They are carried at fair value with unrealised gains and losses being recognised through the Statement of comprehensive income.

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

The fair value of financial assets that are actively traded in organised financial markets are determined by reference to quoted market bid prices at the close of business on the statement of financial position date. Assets backing life contract liabilities of the statutory fund are required to be designated at fair value through profit and loss in accordance with AASB 1038 *Life Insurance Contracts* when permitted by other Australian Accounting Standards.

Key estimates and assumptions

Unlisted investment valuations

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

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

Refer to Note 18 Financial risk management for further disclosure.

Note 6 Investment and development property

	30 June 2020 \$m	30 June 2019 \$m
Investment property held for sale ¹	-	166.5
Investment property in use	3,679.7	3,384.3
Investment property under development	6.2	178.4
Total investment property	3,685.9	3,729.2

¹ No properties were held for sale at 30 June 2020 (30 June 2019: Next Hotel, Aulnay sous Bois and TRE Data Centre).

	Investment property held for sale		Investment property in use		Investment property under development		Development property held for resale	
	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m
Reconciliation of carrying amounts								
Balance at the beginning of the year	166.5	452.2	3,384.3	3,328.6	178.4	254.4	-	0.7
Movements for the year								
– acquisitions ¹	-	-	105.1	-	-	1.8	-	-
– disposals	(155.9)	(236.2)	-	(443.6)	-	-	-	(0.7)
– net transfers to/(from) investment property held for sale	(10.7)	(60.0)	10.7	60.0	-	-	-	-
– transfers to/(from) investment property under development	-	10.5	173.7	239.3	(173.7)	(249.8)	-	-
– capital expenditure	0.1	-	72.8	102.3	0.2	164.6	-	-
– net revaluation gain/(loss)	-	-	(78.4)	39.5	1.3	7.4	-	-
– foreign exchange gain	-	-	11.5	58.2	-	-	-	-
Balance at the end of the year	-	166.5	3,679.7	3,384.3	6.2	178.4	-	-

¹ Investment property acquisitions: Acquisition of remaining 50% of Lennox, NSW \$33.5 million, Aeon Matsusaka XD, Japan \$14.7 million, Kotesashi Towers, Japan \$25.2 million and Yorktown Toride, Japan \$31.7 million during the year (30 June 2019: Acquisition of 839 Collins EXO Car Park \$1.8 million).

Accounting policy

Investment and development property is initially recognised at cost, including transaction costs. Subsequent to initial recognition, investment and development property is recognised at fair value.

Investment property is classified as held for sale if its carrying value will be recovered principally through a sale transaction rather than through continuing use. This condition is met only when management is committed to the sale, and the sale is highly probable to occur in the next 12 months. Investment property held for sale is carried at fair value, being the latest valuation available, or agreed sale price.

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

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

Where properties are debt financed, that finance is provided either by secured mortgages or by funding that contains a number of negative undertakings (including undertakings not

to create or allow encumbrances, and undertakings not to incur financial indebtedness which ranks in priority to existing debt).

Impact of COVID-19

Across all sectors, particularly retail, some tenants are seeking rent relief as a result of the impact of the COVID-19 pandemic. Rent relief is granted after considering various factors and individual tenant circumstances. Rent relief occurs in respect of three categories: (i) current rent due and payable now; (ii) deferred rent, payable at a later date; or (iii) waived rent, not payable.

If relief is given for current and deferred rent, income will continue to be recognised on a straight line basis over the term of the lease. The resulting rent receivable assets recognised in the statement of financial position as at 30 June 2020 have been assessed for impairment. The methodology adopted for determining whether these rent receivable assets should be impaired is aligned to the requirements of AASB 9 *Financial Instruments*.

Any waived rent is capitalised and recognised on the statement of financial position from the effective date of the lease modification and amortised over the remaining lease term.

Note 6 Investment and development property (continued)

Accounting policy (continued)

Investment property under development

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

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

Development property held for resale

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

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

Key estimates and assumptions

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

Each independent valuer is appointed in line with the valuation policy, which requires that valuers are authorised to practise under the law of the relevant jurisdiction where the valuation takes place and have at least five years of continuous experience in the valuation of property of a similar type to the property being valued and on the basis that they are engaged for no longer than two consecutive years on an individual property.

The valuer must have no pecuniary interest that could conflict with the valuation of the property, must be suitably indemnified, and must comply with the Australian Property Institute (API) Code of Ethics and Rules of Conduct (or foreign equivalent). An internal valuation is undertaken for all investment properties every six months unless they have been independently valued during the current reporting period. In certain circumstances an independent valuation might be obtained.

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

Impact of COVID-19

As at 30 June 2020 the real estate markets to which the Group's investment properties belong were impacted by significant uncertainty caused by the COVID-19 pandemic. This has created valuation uncertainty and had an impact on the value of investment property as at 30 June 2020.

The valuation uncertainty has affected key inputs, assumptions and processes used in the valuation of the Group's investment properties, being:

- estimating the net income that a property can produce; and
- converting that income to value by applying investment rates of return which are derived from analysis of recent market transactions.

Income uncertainty

The impact of COVID-19 on the income earning potential of the Group's properties is uncertain. The Group leases commercial space to a range of businesses from where they conduct their operations. Restrictions imposed by Government to combat COVID-19 has, in a majority of cases, impacted the ability for these businesses to operate effectively from their premises, or has affected their ability to operate in the usual manner prior to the onset of COVID-19.

In response to this and the Government's Code of Conduct for commercial tenancies, the Group is currently working through a cost sharing program in compliance with the Code of Conduct for each tenant that has been affected. This involves the Group either deferring or waiving rent owed by the tenant depending on the individual circumstances. This program has had an impact for this reporting period and will continue to have an impact for the year ending 30 June 2021.

Rent receivable balances in respect of current and deferred rent recognised in the statement of financial position for the reporting period, have been assessed for impairment. An approach has been adopted which applies a lifetime expected credit loss and assesses all possible default events over the expected life of the receivables balance. An appropriate loss rate has then been determined after considering the following factors:

- the asset sector in which the affected rent receivable is recognised. Each sector is affected differently by COVID-19 and this needs to be reflected in any loss assumption;
- the ranking of tenants by most to least affected by COVID-19 impacts; and
- the ageing of rent receivables.

After taking these factors into consideration and assessing the overall progress of the cost sharing programme underway with tenants, an impairment of \$2.2 million was recognised in the Statement of comprehensive income as at 30 June 2020 in relation to the rent receivable gross asset value of \$12.7 million. This assessment was conducted based on reasonable and supporting information readily available and considering current and expected future economic conditions.

Note 6 Investment and development property (continued)

Valuation uncertainty

Valuation uncertainty has also arisen from an inactive property investment market. An inactive market means a lack of transactional evidence demonstrating current market pricing. In these circumstances, the only inputs and metrics available to reliably estimate fair value relate to the market before COVID-19 occurred and the impact of COVID-19 on prices cannot be known with certainty until the market stabilises.

As a result of these income and investment uncertainties, the Group's independent valuers noted the difficulty in undertaking valuations at this time and, in the absence of relevant market evidence, they have adjusted valuation inputs and estimates to reflect the impact of COVID-19 on investment property value.

While these estimates have been formed by valuers after careful consideration and consultation with a range of reliable

sources, it must be recognised that COVID-19 is a unique, rapidly evolving situation and critical events that could help determine the duration and depth of its impact remain unknown at the date of valuation.

In response to this valuation uncertainty, the Group determined that all directly held investment properties would be independently valued by external valuers at 30 June 2020. To reflect the impact of COVID-19 on investment property value, the valuers have generally adopted softer valuation inputs including expanded capitalisation and discount rates, lower growth rates in the near term, lower market rental levels, increased vacancy rates and increased rental allowances. The valuers have also made deductions for the costs of estimated rent relief to tenants for occupancy disruption resulting from COVID-19 related impacts.

Analysis of investment property as at 30 June	Acquisition date ¹	Total cost ² \$m	Carrying value 2020 \$m	Cap rate 2020 ³ %	Last external valuation date	Carrying value 2019 \$m	Cap rate 2019 ³ %
Investment property in use and held for sale							
Australia							
6 Chan Street (formerly DIBP Building), ACT	01-Dec-01	121.0	202.0	5.50	30-Jun-20	156.7	5.50
14 Childers Street, ACT	01-Dec-17	97.5	91.0	6.50	30-Jun-20	92.5	6.50
21 O'Sullivan Circuit, NT	27-Jan-16	47.7	32.1	8.50	30-Jun-20	36.7	8.00
31 O'Sullivan Circuit, NT	27-Jan-16	29.2	23.5	8.50	30-Jun-20	26.5	8.25
35 Clarence Street, NSW	15-Jan-15	153.6	235.0	5.00	30-Jun-20	220.0	5.13
45 Benjamin Way (formerly ABS Building), ACT	01-Jan-00	148.6	223.0	5.75	30-Jun-20	219.2	5.75
82 Northbourne Avenue, ACT	01-Jun-17	61.0	53.3	6.00	30-Jun-20	55.4	6.00
215 Adelaide Street, QLD	31-Jul-15	252.0	230.5	6.13	30-Jun-20	245.5	6.00
565 Bourke Street, VIC	28-Jan-15	106.1	147.5	5.00	30-Jun-20	142.0	5.00
839 Collins Street, VIC	22-Dec-16	212.0	238.5	4.75	30-Jun-20	232.5	4.88
Bunbury Forum, WA	03-Oct-13	155.7	82.0	7.50	30-Jun-20	90.0	6.75
Channel Court, TAS	21-Aug-15	84.2	76.0	7.75	30-Jun-20	80.0	7.00
Cosgrave Industrial Park, Enfield, NSW	31-Dec-08	92.3	131.9	5.00	30-Jun-20	122.0	5.50
County Court, VIC	30-Jun-00	218.4	326.0	n/a	30-Jun-20	323.9	n/a
Discovery House, ACT	28-Apr-98	102.6	152.5	5.63	30-Jun-20	148.5	5.63
Executive Building, TAS	30-Mar-01	34.5	46.5	7.00	30-Jun-20	45.3	7.00
Gateway, NT	01-Jul-15	122.2	105.1	6.34	30-Jun-20	118.5	5.85
Golden Grove, SA	31-Jul-14	157.6	147.0	6.25	30-Jun-20	171.4	5.75
Karratha, WA	28-Jun-13	55.9	44.3	7.50	30-Jun-20	49.0	7.25
Kings Langley, NSW	29-Jul-01	16.2	23.0	6.25	30-Jun-20	23.9	6.25
Lennox, NSW ⁴	27-Jul-13	62.8	61.0	6.75	30-Jun-20	31.5	6.50
Next Hotel, QLD ⁵	25-Mar-15	-	-	-	-	145.3	6.11
North Rocks, NSW	18-Sep-15	185.1	171.1	6.25	30-Jun-20	-	-
TRE Data Centre, ACT ⁵	14-Apr-10	-	-	-	-	10.5	-
Total Australia		2,516.2	2,842.8			2,786.8	

¹ Acquisition date represents the date of initial acquisition or consolidation of the investment vehicle holding the asset.

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

³ The capitalisation rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regard to market evidence.

⁴ Lennox, NSW was 50% owned in 2019 with the remaining share acquired during 2020.

⁵ Classified as 'held for sale' in 2019 and sold during 2020.

Note 6 Investment and development property (continued)

Analysis of investment property as at 30 June (continued)	Acquisition date ¹	Total cost \$m ²	Carrying value 2020 \$m	Cap rate 2020 ³ %	Last external valuation date	Carrying value 2019 \$m	Cap rate 2019 ³ %
Europe							
Avenue de Savigny, Aulnay sous Bois ⁴	31-Dec-08	20.3	10.1	7.33	30-Jun-20	10.7	6.53
Japan							
Aeon Kushiro	31-Jan-10	30.5	38.5	5.40	30-Jun-20	37.8	5.40
Aeon Matsusaka XD	26-Sep-19	14.7	14.5	5.80	30-Jun-20	-	-
Carino Chitosedai	31-Jan-10	118.4	138.6	4.50	30-Jun-20	138.9	4.50
Carino Tokiwadai	31-Jan-10	77.0	85.9	4.70	30-Jun-20	85.3	4.60
DeoDeo Kure	31-Jan-10	32.2	35.3	5.60	30-Jun-20	34.4	5.50
Fitta Natalie Hatsukaichi	28-Aug-15	11.4	14.8	6.00	30-Jun-20	14.7	5.90
Izumiya Hakubaicho	31-Jan-10	69.4	78.0	5.00	30-Jun-20	79.8	4.80
Kansai Super Saigo	31-Jan-10	13.2	14.7	5.30	30-Jun-20	14.4	5.50
Kojima Nishiarai	31-Jan-10	12.2	16.4	4.40	30-Jun-20	16.1	4.40
Kotesashi Towers	28-Nov-19	25.2	24.3	5.10	30-Jun-20	-	-
Life Asakusa	31-Jan-10	27.8	38.6	4.30	30-Jun-20	38.0	4.30
Life Higashi Nakano	31-Jan-10	32.9	40.7	4.40	30-Jun-20	40.9	4.40
Life Nagata	31-Jan-10	25.2	30.3	4.20	30-Jun-20	30.0	4.20
MaxValu Tarumi	28-Aug-15	16.9	20.6	5.60	30-Jun-20	20.0	5.70
Seiyu Miyagino	31-Jan-10	9.8	12.0	5.20	30-Jun-20	11.8	5.20
TR Mall Ryugasaki	30-Mar-18	86.7	98.7	5.60	30-Jun-20	98.4	5.70
Valor Takinomizu	31-Jan-10	26.9	26.5	5.50	30-Jun-20	25.5	5.80
Valor Toda	31-Jan-10	42.5	46.3	5.10	30-Jun-20	45.9	5.20
Yaoko Sakato Chiyoda	31-Jan-10	19.7	22.8	4.90	30-Jun-20	21.4	4.80
Yorktown Toride	05-Mar-20	31.9	29.3	5.30	30-Jun-20	-	-
Total international		744.8	836.9			764.0	
Total investment property in use and held for sale⁵		3,261.0	3,679.7			3,550.8	
Investment property under development							
Maitland, NSW	6-Dec-06	5.6	6.2	n/a	30-Jun-20	4.7	n/a
North Rocks, NSW ⁶	18-Sep-15	-	-	-	-	173.7	6.50
Total investment property under development		5.6	6.2			178.4	

¹ Acquisition date represents the date of initial acquisition or consolidation of the investment vehicle holding the asset.

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

³ The capitalisation rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regard to market evidence.

⁴ Avenue de Savigny, Aulnay sous Bois was classified as 'held for sale' in 2019 and subsequently withdrawn from sale in 2020. Classified as 'investment property in use' in 2020.

⁵ At 30 June 2020, the investment property portfolio occupancy rate for Australia was 90.7% (30 June 2019: 92.6%) with a weighted average lease expiry of 5.5 years (30 June 2019: 6.1 years), Europe 100% (30 June 2019: 100.0%) with a weighted average lease expiry of 0.1 years (30 June 2019: 0.1 years) and Japan 99.5% (30 June 2019: 100%) with a weighted average lease expiry of 9.7 years (30 June 2019: 10.3 years).

⁶ Transferred to investment property in use.

Note 7 Special Purpose Vehicles

	30 June 2020 \$m	30 June 2019 \$m
Consolidated		
Cash and cash equivalents	58.0	66.5
Mortgage assets ¹	706.6	860.6
Derivative assets	0.4	0.5
Total assets	765.0	927.6
Payables	303.9	163.7
Derivative liabilities	0.3	0.3
Interest bearing financial liabilities ¹	460.7	763.4
Total liabilities	764.9	927.4
Net assets	0.1	0.2
Cash flow hedge reserve	0.1	0.2
Total equity attributable to residual income unit holders	0.1	0.2

¹ \$137.7 million (30 June 2019: \$209.7 million) of the Mortgage assets balance is considered current, and \$89.8 million (30 June 2019: \$186.0 million) of the Interest bearing financial liabilities balance is considered current.

Accounting policy

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

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

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

SPV cash and cash equivalents are financial assets and comprise cash at bank and in hand plus short-term deposits with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents are initially recognised at fair value and subsequently carried at amortised cost.

SPV mortgage assets are non-derivative financial loan assets with fixed or determinable payments that are not quoted in an active market. They are recognised net of any credit loss provision.

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

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

SPV interest bearing financial liabilities are initially recognised at fair value calculated net of directly attributable transaction costs, and subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in the statement of comprehensive income over the period of the contract using the effective interest rate method.

Key estimates and assumptions

The Group continues to apply the historical provisioning methodology which is considered to be materially consistent with the provision estimated under the ECL impairment model. In estimating ECL for individual mortgage loans, the Group makes judgements and assumptions in relation to expected repayments, the realisable value of the secured property, the prospects of the customer, the value of any mortgage insurance and the likely cost and duration of the work-out process. Judgements and assumptions in respect of these matters have been updated to reflect the potential impact of COVID-19. The Group has also considered historical probabilities of default, the relative age of the mortgage loan portfolio and the loan to valuation ratios applicable to the mortgage loans and has determined that the current provision estimated by the ECL impairment model is adequate and no further overlay for the impact of COVID-19 is required.

	30 June 2020 \$m	30 June 2019 \$m
Analysis of SPV mortgage assets impairment provision		
Balance at the beginning of the year	10.2	13.6
Increase/(decrease) in provisions	0.9	(3.9)
Utilisation of provision against incurred losses and adjustments to estimates	0.4	0.5
Balance at the end of the year	11.5	10.2

Note 8 Life contract liabilities

	30 June 2020 \$m		30 June 2019 \$m	
Fair value of life contract liabilities				
Life investment contract liabilities – at fair value	5,867.8		6,757.7	
Life insurance contract liabilities – at margin on services value	6,714.4		6,113.1	
Reinsurance contract liabilities – at margin on services value	(1.0)		(0.6)	
Total life contract liabilities	12,581.2		12,870.2	

	Life investment contract liabilities		Life insurance contract liabilities		Outward reinsurance contract liabilities		Total life contract liabilities	
Movement in life contract liabilities	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m
Balance at the beginning of the year	6,757.7	6,635.3	6,113.1	5,016.7	(0.6)	76.3	12,870.2	11,728.3
Deposits and premium receipts	1,970.2	2,421.9	1,192.7	1,143.5	-	-	3,162.9	3,565.4
Payments and withdrawals	(2,997.4)	(2,612.0)	(749.6)	(634.0)	-	(58.7)	(3,747.0)	(3,304.7)
Revenue per Note 1	15.4	98.3	(690.6)	(227.0)	(0.4)	(20.2)	(675.6)	(148.9)
Expense per Note 2	121.9	214.2	848.8	813.9	-	2.0	970.7	1,030.1
Balance at the end of the year	5,867.8	6,757.7	6,714.4	6,113.1	(1.0)	(0.6)	12,581.2	12,870.2

	30 June 2020 \$m	30 June 2019 \$m
Analysis of life insurance and reinsurance contract liability and expenses		
Best estimate liability		
Value of future life insurance contract benefits	6,435.1	5,849.8
Value of future expenses	171.3	159.8
Value of future acquisition expenses	166.9	134.9
Value of future premiums	(889.3)	(526.6)
Total best estimate liability	5,884.0	5,617.9
Value of future profit margins	829.4	494.6
Net life insurance and reinsurance contract liability	6,713.4	6,112.5
Life insurance and reinsurance contract operating expenses		
Maintenance expenses	54.9	43.7
Total life insurance and reinsurance contract operating expenses	54.9	43.7
Analysis of life contract profit		
Profit margin release on life insurance contracts	27.8	19.9
Loss recognition in respect of life insurance contracts ¹	(43.5)	(76.8)
Loss recognition in respect of life investment contracts	(54.2)	(68.9)
Difference in actual and assumed experience in respect of life insurance contracts	(74.5)	176.0
Difference in actual and assumed experience in respect of life investment contracts	(68.6)	174.1
(Loss)/profit arising from difference between actual and assumed experience	(213.0)	224.3
Investment earnings on assets in excess of life contract liabilities	(123.6)	172.2
Life contract (loss)/profit after tax	(336.6)	396.5

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

Note 8 Life contract liabilities (continued)

Accounting policy

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

Life investment contract liabilities

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

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

Life insurance contract liabilities

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

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

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

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

Life insurance premium revenue

Life insurance premiums are recognised as revenue when risk is transferred to the Group.

Life insurance claims expense

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

Inwards reinsurance

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

Valuation

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

Key assumptions applied in the valuation of life contract liabilities

Tax rates

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

Discount rates

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

Life investment contract liabilities are calculated under the fair value through profit and loss provisions of AASB 9 *Financial Instruments*. The discount rates are determined based on the current observable, objective rates that relate to the nature, structure and term of the future liability cash flows.

For both insurance and investment contracts the approach is the same as adopted at 30 June 2019. Discount rates applied for Australian liabilities were between 0.9%-2.4% (30 June 2019: 1.5%-2.5%) per annum.

Note 8 Life contract liabilities (continued)

Valuation (continued)

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

Expenses

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

Inflation

Inflation estimates are based on long-term expectations and reviewed at least annually for changes in the market environment based on a comparison of real and nominal yields of instruments of equivalent term and credit risk. The current assumption for Australia is -0.2% per annum for short-term inflation and 1.8% per annum for long-term inflation (30 June 2019: 1.2% short-term, 1.6% long-term).

Surrenders

For life investment contracts, no surrenders or voluntary discontinuances are assumed. For Australian life insurance contracts where a surrender value is payable on withdrawal, a rate of surrenders is assumed in line with Challenger's own experience on these products, currently between 0.0%-2.1% per annum (30 June 2019: 1.3%-1.7%). For inwards reinsurance of Japanese business, a rate of surrenders is assumed in line with local experience in relation to similar contracts, currently 3.5% per annum (30 June 2019: 3.5%).

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

Mortality

Base mortality rates for individual lifetime annuities are determined as a multiple of annuitant experience based on LML08 and LFL08 tables, adjusted for Challenger's own recent experience. LML08 and LFL08 are mortality tables developed by the Continuous Mortality Investigation (CMI) based on United Kingdom annuitant lives experience from 2007–2010. The tables refer to male and female lives respectively. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. For the age ranges and cash flow projection periods that contribute the majority of CLC's exposure, rates of future mortality improvement applied are between 0.3%-2.5% per annum (30 June 2019: 0.3%-2.6%).

Base mortality rates for wholesale mortality and longevity reinsurance are determined as a multiple of pensioner mortality rates (based on the self-administered pension schemes or SAPS2 tables mortality investigation developed by the Institute and Faculty of Actuaries (UK) using United Kingdom data collected between 2004–2012). Rates are adjusted for expected future mortality improvements based on observed and expected improvements.

For the age ranges and cash flow projection periods that contribute the majority of CLC's exposure, rates of future mortality improvement applied are between 0.6%-2.1% per annum (30 June 2019: 0.6%-2.1%). Base mortality rates for the inwards reinsurance of Japanese business are determined as a multiple of Japanese population mortality rates.

Mortality assumptions have been reviewed but not adjusted in light of the COVID-19 pandemic.

Impact of changes in assumptions on life insurance contracts

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

Restrictions on assets

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

Statutory fund information

The life contract operations of CLC are conducted within four separate statutory funds. Both the shareholders' and policyholders' interests in these statutory funds are reported in aggregate in the financial report of the Group. Fund 1 is a non-investment-linked fund and Fund 3 is investment-linked. Both of these are closed to new business. Funds 2 and 4 are the principal operating funds of the Group. Fund 2 contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related outwards reinsurance, plus the wholesale mortality, wholesale morbidity and longevity inwards reinsurance. Fund 4 contains inwards reinsurance of annuity business written in Japan.

Life contract liabilities for Funds 1, 2, 3 and 4 are \$1.5 million, \$10,854.4 million, \$2.6 million and \$1,722.7 million respectively (30 June 2019: \$2.0 million, \$11,649.0 million, \$2.9 million, and \$1,216.3 million).

Current/non-current split for total life contracts

There is a fixed settlement date for the majority of life contract liabilities. Approximately \$2,661.5 million on a discounted basis (30 June 2019: \$2,428.7 million) of life contract liabilities have a contractual maturity within 12 months of the reporting date.

Note 8 Life contract liabilities (continued)

Current/non-current split for total life contracts (continued)

Based on assumptions applied for the 30 June 2020 valuation of life contract liabilities, \$3,392.9 million of principal payments on fixed term and lifetime business are expected in the year to 30 June 2021 (expected in the year to 30 June 2020: \$3,046.8 million).

Life insurance risk

The Group is exposed to longevity risk on its individual lifetime annuities (both direct and reinsured) and wholesale longevity reinsurance. Longevity risk is the risk that policyholders may live longer than expectations. The Group is exposed to mortality risk on the wholesale mortality reinsurance and reinsurance of fixed term business written in Japan. This is the risk that death rates in the reference portfolios exceed expectations. The Group is also exposed to morbidity risk on the wholesale morbidity reinsurance. That is the risk that morbidity rates in the reference portfolios exceed expectation. The Group manages the longevity risk by regular reviews of the portfolio to confirm continued survivorship of policyholders receiving income plus regular reviews of longevity experience to ensure that longevity assumptions remain appropriate.

In addition, the Group maintained reinsurance arrangements to manage longevity risk in respect of part of the closed book of individual lifetime annuities.

The Group manages the mortality and morbidity risk by regular reviews of the portfolio to ensure that mortality and morbidity assumptions remain appropriate. The Company's insurance risk policy is approved by the Board and sets out the relevant risk limits for insurance exposures, to ensure the insurance risk portfolio is appropriately diversified and contains no significant concentrations of insurance risk.

Insurance risk sensitivity analysis

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

Insurance risk sensitivity analysis	Increase in life insurance contract liabilities				Loss after tax and equity impact			
	Gross		Net		Gross		Net	
	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m
50% increase in the rate of mortality improvement	51.0	32.3	50.8	32.2	(35.7)	(22.6)	(36.6)	(22.5)
10% increase in maintenance expenses	16.3	15.2	16.3	15.2	(11.4)	(10.6)	(11.4)	(10.6)

Liquidity risk for insurance contracts

The following table summarises the undiscounted maturity profile of the Group's life insurance contract liabilities. The analysis is based on undiscounted estimated cash outflows,

including interest and principal payments. The undiscounted maturity profile of life investment contracts is disclosed in Note 18 Financial risk management.

Undiscounted life insurance contract liabilities	1 year or less \$m	1-3 years \$m	3-5 years \$m	>5 years \$m	Total \$m
2020	775.4	1,272.1	1,014.4	4,574.9	7,636.8
2019	672.7	1,129.0	871.6	4,449.5	7,122.8

Actuarial information

Mr A Kapel FIAA, as the Appointed Actuary of CLC, is satisfied as to the accuracy of the data used in the valuations of life contract liabilities in the financial report and the tables in this note. The life contract liabilities have been determined at the

reporting date in accordance with the Life Act, APRA Prudential Standards, AASB 1038 *Life Insurance Contracts*, and AASB 9 *Financial Instruments*.

Note 9 External unit holders' liabilities

	30 June 2020 \$m	30 June 2019 \$m
Current	1,587.3	1,356.4
Non-current	828.5	609.8
Total liabilities to external unit holders	2,415.8	1,966.2

Accounting policy

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

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

Note 10 Derivative financial instruments

	30 June 2020			30 June 2019		
	Notional value \$m	Net fair value assets \$m	Net fair value liabilities \$m	Notional value \$m	Net fair value assets \$m	Net fair value liabilities \$m
Analysis of derivative financial instruments						
Non-SPV						
Interest rate swaps						
Less than one year	7,511.9	7.1	(5.2)	5,597.8	8.2	(3.2)
One to three years	8,962.4	34.7	(38.3)	9,363.0	23.6	(13.6)
Three to five years	8,739.3	100.7	(72.0)	5,415.3	61.0	(29.5)
Greater than five years	37,974.2	539.0	(434.0)	25,152.0	352.4	(272.2)
Total interest rate swaps	63,187.8	681.5	(549.5)	45,528.1	445.2	(318.5)
Inflation-linked swaps						
Less than one year	211.0	7.6	(1.4)	51.0	1.7	-
One to three years	243.0	10.1	-	211.0	6.3	-
Three to five years	72.0	3.0	(7.8)	245.6	5.8	-
Greater than five years	1,407.0	164.0	(43.0)	1,394.1	111.6	(36.9)
Total inflation-linked swaps	1,933.0	184.7	(52.2)	1,901.7	125.4	(36.9)
Futures contracts						
Less than one year	18,101.9	-	(0.6)	10,838.2	-	(0.9)
Total futures contracts	18,101.9	-	(0.6)	10,838.2	-	(0.9)
Forward currency contracts						
Less than one year	2,947.5	63.2	(46.9)	2,005.7	16.6	(9.9)
Total forward currency contracts	2,947.5	63.2	(46.9)	2,005.7	16.6	(9.9)
Cross-currency swaps						
Less than one year	1,268.7	29.2	(44.0)	1,546.1	26.7	(113.4)
One to three years	2,332.3	69.8	(15.3)	1,762.6	10.4	(55.7)
Three to five years	1,332.1	36.6	(10.5)	2,140.6	17.7	(19.3)
Greater than five years	825.4	25.3	(5.5)	1,041.5	10.5	(6.5)
Total cross-currency swaps	5,758.5	160.9	(75.3)	6,490.8	65.3	(194.9)
Equity swaps						
Less than one year	596.6	20.0	-	1,451.0	11.0	(7.7)
One to three years	-	-	-	846.8	8.0	-
Total equity swaps	596.6	20.0	-	2,297.8	19.0	(7.7)
Infrastructure swaps						
Less than one year	-	-	-	200.0	-	-
Total infrastructure swaps	-	-	-	200.0	-	-

Note 10 Derivative financial instruments (continued)

Analysis of derivative financial instruments (continued)	30 June 2020			30 June 2019		
	Notional value \$m	Net fair value assets \$m	Net fair value liabilities \$m	Notional value \$m	Net fair value assets \$m	Net fair value liabilities \$m
Credit default swaps						
Less than one year	-	-	-	10.0	-	(0.1)
One to three years	67.9	1.2	(0.6)	66.9	1.0	-
Three to five years	-	-	-	1,638.8	88.9	-
Total credit default swaps	67.9	1.2	(0.6)	1,715.7	89.9	(0.1)
Options						
Less than one year	2.5	0.6	-	1.1	-	-
One to three years	-	-	-	2.5	0.6	-
Total options	2.5	0.6	-	3.6	0.6	-
Total non-SPV	92,595.7	1,112.1	(725.1)	70,981.6	762.0	(568.9)
SPV						
Interest rate swaps – SPV						
Less than one year	5.1	-	(0.1)	6.5	-	(0.1)
One to three years	7.6	-	(0.1)	5.7	-	(0.1)
Three to five years	0.5	-	-	0.2	-	-
Total interest rate swaps – SPV	13.2	-	(0.2)	12.4	-	(0.2)
Cross-currency swaps – SPV						
Greater than five years	261.0	0.4	(0.1)	320.3	0.5	(0.1)
Total cross-currency swaps – SPV	261.0	0.4	(0.1)	320.3	0.5	(0.1)
Total – SPV	274.2	0.4	(0.3)	332.7	0.5	(0.3)
Total derivative financial instruments¹	92,869.9	1,112.5	(725.4)	71,314.3	762.5	(569.2)

¹ The Group's derivative financial instruments are subject to enforceable netting arrangements under International Swaps and Derivatives Association (ISDA) Master Agreements with derivative counterparties, allowing for net settlement as a single arrangement of multiple instruments with a counterparty in the event of default or other specified circumstances. If applied to the derivative portfolio, the derivative assets would reduce by \$474.1 million (30 June 2019: \$342.2 million) and the derivative liabilities would reduce by \$474.1 million (30 June 2019: \$342.2 million).

Accounting policy

The Group uses derivative financial instruments predominantly to hedge its risks associated with interest rate and foreign currency fluctuations and to gain exposure to different markets. All derivative financial instruments are stated at fair value. Gains or losses arising from fair value changes on derivatives that do not qualify for hedge accounting are recognised in the Statement of comprehensive income. For the purpose of hedge accounting, hedges are classified as:

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

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

Such hedges are expected to be highly effective in achieving

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

Cash flow hedges

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

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

If the forecast transaction is no longer expected to occur, amounts previously recognised in equity are transferred to the Statement of comprehensive income.

If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, amounts previously recognised in equity remain in equity until the forecast transaction occurs.

Note 10 Derivative financial instruments (continued)

Accounting policy (continued)

Hedges of net investments in foreign operations

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

Derivatives designated as hedges of net investment in foreign currency operations

The Group hedges its exposure to accounting gains and losses arising from translation of foreign-controlled entities from their functional currency into the Group's presentation currency on consolidation. At 30 June 2020, a post-tax gain of \$0.5 million (30 June 2019: post-tax loss of \$34.7 million) was recognised in Other comprehensive income (OCI) for the hedging of exposure to the net investment in foreign currency operations.

Derivatives designated as cash flow hedges

The Group applies hedge accounting when it can demonstrate that all, or a portion of, the value movements of a derivative financial instrument effectively hedges the variability in cash flows attributable to a specific risk associated with a recognised asset or liability or probable future transaction. As described in Note 18 Financial risk management, SPVs enter into interest rate swap agreements to hedge the interest rate risk between variable rate loans, which generally reprice with changes in official interest rates, and issued RMBS that reprice with changes in the 30-day and 90-day bank bill swap rates. Cross-currency swaps are also used to hedge currency movements on foreign denominated RMBS. The SPVs apply hedge accounting to both types of transactions, with the fair value change on the effective portion of the derivative being recognised in OCI.

For the year ended 30 June 2020, a post-tax result of nil (30 June 2019: post-tax loss of \$0.2 million) was recognised in OCI for cash flow hedges with no Statement of comprehensive income impact in relation to any ineffective portions during either the current or prior comparative period.

Note 11 Notes to statement of cash flows

	30 June 2020 \$m	30 June 2019 \$m
Reconciliation of profit to operating cash flow		
(Loss)/profit for the year	(421.1)	310.7
Adjusted for		
Net realised and unrealised losses/(gains) on investment assets	866.6	(731.0)
Share of associates' net profit	(29.3)	(22.2)
Change in life contract liabilities ¹	295.1	881.2
Depreciation and amortisation expense	15.3	15.3
Impairment in intangible assets, associates and other investments	12.8	(20.4)
Share-based payments	14.2	21.4
Dividends from associates	22.4	31.6
Change in operating assets and liabilities		
Decrease in receivables	7.9	36.9
Increase in other assets	(9.2)	(6.4)
Increase/(decrease) in payables	27.0	(21.8)
Increase/(decrease) in provisions	16.3	(1.4)
(Decrease)/increase in life contract liabilities	(584.1)	260.7
Increase/(decrease) in external unit holders' liabilities	449.6	(168.8)
(Decrease)/increase in net tax liabilities	(198.6)	66.5
Net cash flows from operating activities	484.9	652.3

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

	30 June 2020 \$m	30 June 2019 \$m
Reconciliation of cash		
Cash at bank and on hand	603.9	725.4
Cash at bank and on hand – SPV	58.0	66.5
Total cash and cash equivalents¹	661.9	791.9

¹ All cash and cash equivalents are considered current.

Accounting policy

Cash and cash equivalents are financial assets and comprise cash at bank and on hand plus short-term deposits with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash and cash equivalents are recognised and carried at fair value. For the purposes of the statement of cash flows, cash and cash equivalents are stated net of bank overdrafts.

Section 4: Capital structure and financing costs

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

Note 12 Contributed equity

	30 June 2020		30 June 2019	
	No. of shares m	Value of shares \$m	No. of shares m	Value of shares \$m
Analysis of contributed equity				
Ordinary shares issued and fully paid	667.5	2,424.7	611.6	2,155.3
CPP Trust shares treated as Treasury shares	(2.4)	(24.8)	(3.0)	(30.5)
CPP deferred share purchases treated as Treasury shares	(2.0)	(22.3)	(2.8)	(31.1)
Total contributed equity	663.1	2,377.6	605.8	2,093.7
Movements in contributed equity				
Ordinary shares				
Balance at the beginning of the year	611.6	2,155.3	610.9	2,148.5
Equity placement	55.2	264.1	-	-
Issued under dividend reinvestment plan	0.7	5.3	0.7	6.8
Balance at the end of the year	667.5	2,424.7	611.6	2,155.3
CPP Trust				
Balance at the beginning of the year	3.0	30.5	4.4	40.4
Shares purchased (including settled forwards)	0.8	8.8	2.8	32.8
Vested shares released to employees	(1.4)	(14.5)	(4.2)	(42.7)
Balance at the end of the year	2.4	24.8	3.0	30.5
CPP deferred share purchases				
Balance at the beginning of the year	2.8	31.1	4.8	56.4
CPP deferred share purchases	-	-	0.8	7.5
Settled forward purchases	(0.8)	(8.8)	(2.8)	(32.8)
Balance at the end of the year	2.0	22.3	2.8	31.1

Accounting policy

Ordinary shares are classified as equity and have no par value. Issued capital in respect of ordinary shares is recognised as the fair value of the consideration received by the parent entity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Treasury shares are ordinary shares in the Company held by the Challenger Performance Plan (CPP) Trust or under CPP deferred share purchase agreements in respect of equity incentive plan awards to employees. Refer to Note 29 Employee entitlements for further details.

Terms and conditions of contributed equity

Ordinary shares

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

Challenger Performance Plan (CPP) Trust

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

CPP deferred share purchases

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

Note 12 Contributed equity (continued)

Capital management

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

The Group manages capital via an Internal Capital Adequacy Assessment Process (ICAAP) at both the Group and the prudentially-regulated Challenger Life Company Limited (CLC) level. The objective of the ICAAP is to maintain financial stability of the Group and CLC while ensuring the shareholders earn an appropriate risk-adjusted return through optimisation of the capital.

There were no material changes to the Group's capital management process during the period. All of the Group regulated entities have at all times during the current and prior financial year complied with the externally imposed capital requirements to which they are subject.

Equity placement

On 22 June 2020, the Company conducted an underwritten institutional share placement, raising \$270.0 million with 55.2 million ordinary shares issued to institutional investors at a price of \$4.89 per share. This represented an 8.1% discount to Challenger's last traded price on 19 June 2020. Total issue costs (net of tax) were \$5.9 million resulting in net proceeds of \$264.1 million. The full \$270.0 million proceeds from the institutional share placement were injected into CLC as Common Equity Tier 1 (CET1) capital.

In addition, subsequent to balance date the Company conducted a non-underwritten share purchase plan (SPP) raising \$35.0 million with 8.1 million shares issued to retail shareholders at a price of \$4.32 per share. The proceeds from the SPP were received on 30 July 2020 and \$30.0 million of the proceeds from the SPP were injected into CLC as CET1 capital on 31 July 2020.

Internal Capital Adequacy Assessment Process (ICAAP) Summary Statement – Challenger Limited

The Group is a Level 3 Head (as defined in Prudential Standard 3PS 001) under the APRA conglomerates framework. Level 3 groups are groups of companies that perform material activities across more than one APRA-regulated industry and/or in one or more non-APRA regulated industries. APRA's non-capital conglomerate prudential standards relating to the measurement, management, monitoring and reporting of aggregate risk exposures and intragroup transactions and exposures came into effect on 1 July 2017.

In March 2016, APRA announced that it would defer the implementation of conglomerate capital requirements until a number of other domestic and international policy initiatives were further progressed. There has been no further update from APRA in relation to this position.

Under the draft standards, the Group is required to have an ICAAP Summary Statement. The Group ICAAP Summary Statement aims to maintain an investment grade credit rating and robust capital ratios in order to support its business objectives, protect regulated entities within the Group from operational and other risks outside those regulated entities and

maximise shareholder returns. The Group believes that maintaining an investment grade rating is the most appropriate target from a capital structure perspective and is essential in order to secure access to capital at a reasonable cost.

Credit ratings

Standard & Poor's long-term credit ratings for the Company and CLC at the statement of financial position date are 'BBB+' (stable) and 'A' (stable) respectively (30 June 2019: 'BBB+' (positive) and 'A' (positive) respectively). There were no changes to either the Company or CLC's ratings during the period; however the outlooks were revised from positive to stable as a result of the uncertainty caused by the COVID-19 pandemic.

Dividends

The Group has historically targeted a dividend payout ratio of between 45% - 50% of normalised profit after tax over the medium term, subject to prevailing market conditions and alternate uses of capital.

The dividend payout ratio for the year ended 30 June 2020 was 31.0% of normalised profit after tax (30 June 2019: 54.2%). The reduction is in light of the Board's decision not to declare and pay a final dividend for 2020 given the significant investment experience losses incurred in the second half and in order to continue to protect the Group's strong capital position given the uncertainty caused by COVID-19.

Dividend Reinvestment Plan (DRP)

The Company maintained a DRP during the period. On 25 September 2019, the Company issued 364,482 ordinary shares to shareholders under the DRP. The DRP issue price per share for the 2019 final dividend was \$7.0372 and represents the volume weighted average share price over the ten trading days from 4 to 17 September 2019. The DRP participation rate was 2.3% of all issued shares, resulting in proceeds of \$2.6 million.

The Group continued the DRP for the interim 2020 dividend, and on 24 March 2020 issued 338,871 ordinary shares to satisfy the plan. The DRP issue price per share for the interim 2020 dividend was \$8.1983 and represented the volume weighted average share price over the ten trading days from 28 February 2020 to 12 March 2020. The interim DRP participation rate was 2.6% of all issued shares, resulting in proceeds of \$2.8 million.

ICAAP Summary Statement – CLC

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

Note 12 Contributed equity (continued)

Capital management (continued)

Prescribed capital amount (PCA)

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

CLC's regulatory capital base and PCA have been calculated in accordance with prudential capital standards issued by APRA.

While CLC does not target a specific PCA ratio, under current circumstances CLC's internal capital models result in a PCA ratio in the range of 1.3 to 1.6 times. This range can change over time and is dependent on numerous factors.

The PCA ratio at 30 June 2020 was 1.81 times (30 June 2019: 1.53 times), higher than this range of 1.3 to 1.6 times, mainly due to an increase in CET1 capital and changes in asset allocation during the period to target lower capital intensive assets following the impact of COVID-19 on investment markets. The CET1 ratio was 1.20 times at 30 June 2020, up from 1.06 times at 30 June 2019.

CLC's target surplus

CLC maintains a target level of capital representing APRA's PCA plus a target surplus. The target surplus is a management guide to the level of excess capital that CLC seeks to hold over and above APRA's minimum requirements. CLC's target surplus is set to ensure that it provides a buffer against adverse market conditions and having regard to CLC's credit rating.

CLC uses internal capital models to determine its target surplus, which are risk-based and are responsive to changes in CLC's asset allocation and market conditions.

Details of the CLC capital adequacy multiple are below:

	30 June 2020 \$m	30 June 2019 \$m
CLC capital		
CLC's regulatory capital		
Common Equity Tier 1 regulatory capital	2,337.0	2,789.4
Additional Tier 1 regulatory capital	805.0	805.0
Tier 2 regulatory capital – subordinated debt ¹	396.7	405.3
CLC total regulatory capital base	3,538.7	3,999.7
Prescribed capital amount		
Asset risk charge ²	1,842.8	2,539.5
Insurance risk charge	199.5	135.3
Operational risk charge	56.5	51.8
Aggregation benefit	(144.8)	(104.0)
CLC prescribed capital amount	1,954.0	2,622.6
CLC excess over prescribed capital amount	1,584.7	1,377.1
Capital adequacy ratio (times)	1.81	1.53
Common Equity Tier 1 ratio (times)	1.20	1.06

¹ Differs from \$395.7 million (30 June 2019: \$403.8 million) disclosed in Note 13 Interest bearing financial liabilities due to \$1.0 million (30 June 2019: \$1.5 million) of accrued interest.

² Asset risk charge includes the combined stress scenario adjustment and default stress.

Note 13 Interest bearing financial liabilities

	30 June 2019		Cash flows	Non-cash movements			30 June 2020	
	Facility	Opening	Proceeds/	Foreign	Fair value	Other	Closing	Facility
	\$m	balance	(repayments)	exchange	changes		balance	\$m
		\$m	\$m	\$m	\$m	\$m	\$m	
Bank loans								
Corporate ¹	400.0	-	50.0	-	-	-	50.0	400.0
Controlled property trusts ^{2,4}	459.8	459.8	(17.7)	6.8	2.2	2.7	453.8	453.8
Controlled infrastructure trusts ⁴	192.0	192.0	(6.2)	-	-	-	185.8	185.8
Repurchase agreements	4,448.5	4,448.5	944.9	-	-	-	5,393.4	5,393.4
Total bank loans	5,500.3	5,100.3	971.0	6.8	2.2	2.7	6,083.0	6,433.0
Non-bank loans								
Subordinated debt	400.0	403.8	-	-	(8.1)	-	395.7	400.0
Challenger Capital Notes 1 ⁴	345.0	343.6	-	-	-	1.4	345.0	345.0
Challenger Capital Notes 2 ⁴	460.0	452.7	-	-	-	1.8	454.5	460.0
Other finance	12.7	12.7	(12.5)	-	(0.2)	-	-	-
Total non-bank loans	1,217.7	1,212.8	(12.5)	-	(8.3)	3.2	1,195.2	1,205.0
Total interest bearing financial liabilities	6,718.0	6,313.1	958.5³	6.8	(6.1)	5.9	7,278.2	7,638.0
Current		4,473.2					5,468.9	
Non-current		1,839.9					1,809.3	
		6,313.1					7,278.2	

¹ In March 2020, the Group elected to fully draw its \$400.0 million banking facility in order to provide additional financial flexibility during the COVID-19 crisis. \$350.0 million of this drawing was repaid in June 2020.

² Total facility limit consists of non-redraw loan facilities limits totalling \$453.8 million (30 June 2019: \$459.8 million).

³ Differs to Statement of cash flows due to \$134.8 million (30 June 2019: \$189.0 million) repayments relating to SPV. Net cash proceeds comprise \$1,344.9 million (30 June 2019: \$632.8 million) proceeds from borrowings and \$521.2 million (30 June 2019: \$315.4 million) repayments of borrowings.

⁴ Held at amortised cost except for the controlled property trust loan in respect of County Court. The fair value of these are: Challenger Capital Notes 1 and 2 \$340.9 million and \$457.7 million (30 June 2019: \$350.3 million and \$485.7 million) respectively; controlled property trusts \$474.9 million (30 June 2019: \$458.0 million); controlled infrastructure trusts \$189.8 million (30 June 2019: \$192.5 million).

	30 June 2018		Cash flows	Non-cash movements			30 June 2019	
	Facility	Opening	Proceeds/	Foreign	Fair value	Other	Closing	Facility
	\$m	balance	(repayments)	exchange	changes		balance	\$m
		\$m	\$m	\$m	\$m	\$m	\$m	
Bank loans								
Corporate	400.0	-	-	-	-	-	-	400.0
Controlled property trusts ¹	551.2	548.4	(118.6)	32.4	1.4	(3.8)	459.8	459.8
Controlled infrastructure trusts	197.2	197.2	(5.2)	-	-	-	192.0	192.0
Repurchase agreements	3,816.0	3,816.0	632.5	-	-	-	4,448.5	4,448.5
Total bank loans	4,964.4	4,561.6	508.7	32.4	1.4	(3.8)	5,100.3	5,500.3
Non-bank loans								
Subordinated debt	400.0	403.7	-	-	0.1	-	403.8	400.0
Challenger Capital Notes 1	345.0	341.9	-	-	-	1.7	343.6	345.0
Challenger Capital Notes 2	460.0	450.9	-	-	-	1.8	452.7	460.0
Other finance	15.0	15.0	(2.3)	-	-	-	12.7	12.7
Total non-bank loans	1,220.0	1,211.5	(2.3)	-	0.1	3.5	1,212.8	1,217.7
Total interest bearing financial liabilities	6,184.4	5,773.1	506.4²	32.4	1.5	(0.3)	6,313.1	6,718.0
Current		3,839.5					4,473.2	
Non-current		1,933.6					1,839.9	
		5,773.1					6,313.1	

¹ Total facility limit consists of redraw loan facilities limits totalling nil (30 June 2018: \$101.0 million) and non-redraw loan facility limits totalling \$459.8 million (30 June 2018: \$450.2 million).

² Differs to Statement of cash flows due to \$189.0 million (30 June 2018: \$258.2 million) net repayments relating to SPVs. Total net cash proceeds comprise \$632.8 million (30 June 2018: \$988.7 million) proceeds from borrowings and \$315.4 million (30 June 2018: \$708.3 million) repayments of borrowings, inclusive of SPVs.

Note 13 Interest bearing financial liabilities (continued)

Accounting policy

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

Borrowings and subordinated debt, other than those held by CLC's statutory funds or their controlled entities, are subsequently measured at amortised cost. Any difference

between the proceeds (net of transaction costs) and the redemption amount is recognised in the Statement of comprehensive income over the period of the contract using the effective interest rate method.

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

Details of liabilities

Bank loans

Bank loans	Type	Maturity	Rate type	Ranking/security
Corporate	Facility	Tranche 1: \$150m expiring on 30 June 2022 Tranche 2: \$250m expiring on 30 June 2024	Floating	Secured by guarantees between members of the Group
Controlled property trusts ¹	Loan	June 2022 to October 2024	Variable	1) First ranking mortgages over Japanese investment properties: \$424.7 million (30 June 2019: \$420.9 million) 2) First ranking mortgage over County Court, VIC: \$27.0 million (30 June 2019: \$38.6 million)
Controlled infrastructure trusts ²	Facility	June 2022	Variable	First ranking mortgages over infrastructure assets

¹ Controlled properties trusts consists of multiple loans with maturity dates from June 2022 to October 2024. At 30 June 2020 \$424.9 million (30 June 2019: \$419.3 million) of these loans are held at amortised cost. The fair value of these liabilities at 30 June 2020 was \$474.9 million (30 June 2019: \$458.0 million)

² These loans are held at amortised cost. The fair value of these liabilities at 30 June 2020 was \$189.8 million (30 June 2019: \$192.5 million).

Repurchase agreements

CLC has entered into repurchase agreements with certain counterparties whereby fixed income securities are sold for cash whilst simultaneously agreeing to repurchase the fixed income security at a fixed price and fixed date in the future. These agreements finance bonds held for hedging purposes and are interest bearing, with interest factored into the price at which the bonds are repurchased and paid on repurchase. All agreements as at 30 June 2020 are current and all mature by December 2020. They will continue to be rolled into new agreements in the future.

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

Non-bank loans

Subordinated debt

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

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

Notes 1 and Notes 2 have similar structural characteristics, including:

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

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

Note 13 Interest bearing financial liabilities (continued)

With the unprecedented market conditions created by the COVID-19 crisis, Challenger informed the market that the ability to issue a replacement instrument, was not possible at the time and therefore elected not to exercise its right to call Challenger Capital Notes 1 on its Optional Exchange Date of 25 May 2020. Challenger has the ongoing right to repurchase Challenger Capital Notes 1 on any distribution date prior to the Mandatory Conversion Date.

The costs associated with the issue of both Notes 1 and Notes 2 have been capitalised against the relevant liability; Notes 1 costs have been fully amortised to the Statement of comprehensive income, while those related to Notes 2 will continue to be amortised over the life of the Notes.

Neither the Notes 1 issue nor the Notes 2 issue constitute regulatory capital of the Company. The proceeds from the issue of both Notes 1 and Notes 2 were used to fund a subscription for notes issued by CLC.

Both issues of notes by CLC to the Company were approved by APRA and constitute Additional Tier 1 capital of CLC.

Notwithstanding Challenger not exercising its right to call Challenger Capital Notes 1 on its Optional Exchange Date, the notes issued by CLC to the Company in respect of Challenger Capital Notes 1 continue to constitute Additional Tier 1 capital of CLC.

Key estimates and assumptions

Subordinated debt valuation

Subordinated debt is recognised at fair value and is valued by reference to the ask price observable in the market at balance date.

The change recognised in the statement of comprehensive income in respect of valuation changes for the year ended 30 June 2020 was a gain of \$8.1 million (30 June 2019: loss of \$0.1 million).

Note 14 Reserves and retained earnings

	30 June 2020 \$m	30 June 2019 \$m
Share-based payments reserve		
Balance at the beginning of the year	(57.7)	(43.0)
Share-based payments for the period	14.2	21.4
Releases from share-based payments reserve	(14.5)	(42.7)
Tax in equity	1.8	6.6
Balance at the end of the year	(56.2)	(57.7)
Cash flow hedge reserve – SPV¹		
Balance at the beginning of the year	0.1	0.3
Gain/(loss) on cash flow hedges	-	(0.2)
Balance at the end of the year	0.1	0.1
Foreign currency translation reserve¹		
Balance at the beginning of the year	(2.6)	(3.3)
Gain on translation of foreign entities ²	1.6	35.4
Gain/(loss) on hedge of net investment in foreign entities ²	0.5	(34.7)
Balance at the end of the year	(0.5)	(2.6)
Adjusted controlling interests reserve¹		
Balance at the beginning of the year	7.8	12.7
Change in holdings in controlled entities	(2.1)	(4.9)
Balance at the end of the year	5.7	7.8
Total reserves	(50.9)	(52.4)
Retained earnings		
Balance at the beginning of the year	1,559.0	1,467.0
AASB 16 adjustment	(3.7)	-
(Loss)/profit attributable to equity holders	(416.0)	307.8
Dividends paid	(216.4)	(215.8)
Total retained earnings	922.9	1,559.0

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

² Net of tax.

Note 14 Reserves and retained earnings (continued)

Accounting policy

Share-based payments reserve

An expense is recognised over the vesting period of share-based payments granted to employees. This expense is based on the valuation of the equity benefits conferred at the grant date. When an instrument is granted, and an expense incurred, there is a corresponding increase in the share-based payments reserve directly in equity.

The total of this reserve is net of any gain or loss realised on the disposal of forfeited shares held within the schemes. On vesting of the award they are subsequently recognised as an increase in equity and a reduction in share-based payment reserve at an average acquisition price, which may be higher or lower than the initial recognised valuation price.

Foreign currency translation reserve

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

Adjusted controlling interests reserve

This reserve relates to changes arising from movements in the ownership interests in entities already controlled by the Group. The difference between the fair value of the consideration paid/received for the change in holding and the change in the Group's share of the net assets of the entity is recorded in this reserve.

Cash flow hedge reserve – SPV

This comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions.

Note 15 Finance costs

	30 June 2020 \$m	30 June 2019 \$m
Interest expense	155.5	313.7
Interest expense – lease liabilities	2.9	-
Interest expense – SPV	11.1	23.1
Interest expense – property trusts ¹	6.1	6.8
Interest expense – Challenger Capital Notes 1 and 2	31.1	36.5
Other finance costs	7.1	5.5
Total finance costs	213.8	385.6

¹ No interest was capitalised in the period (30 June 2019: \$4.9 million).

Accounting policy

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

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

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

To the extent that the Group allocates general borrowed funds for the purpose of obtaining a qualifying property asset, the borrowing costs eligible for capitalisation are determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate of 3.0% (30 June 2019: 3.9%) is the weighted average of the borrowing costs applicable to the borrowings that are outstanding during the period, other than borrowing made specifically for the purpose of obtaining the qualifying asset.

Note 16 Dividends paid and proposed

	30 June 2020 \$m	30 June 2019 \$m
Dividends declared and paid during the year		
Final 30 June 2019 100% franked dividend: 18.0 cents (30 June 2018: 18.0 cents 100% franked dividend)	109.7	109.4
Interim 30 June 2020 100% franked dividend: 17.5 cents (30 June 2019: 17.5 cents 100% franked dividend)	106.7	106.4
Total dividends paid	216.4	215.8
Dividend proposed (not recognised as a liability at 30 June)		
Final 30 June 2020 dividend: nil (30 June 2019: 100% franked 18.0 cents)	-	109.7

Refer to Note 12 Contributed equity for details of the dividend policy.

Dividend franking credits

Franking credits available to shareholders are \$12.4 million (30 June 2019: \$87.5 million), based on a tax rate of 30%. The amount is calculated from the balance of the franking account

as at the end of the reporting period, adjusted for franking debits that will arise after the end of the reporting period in respect of interest on Challenger Capital Notes 1 and 2.

Note 17 Earnings per share

	30 June 2020 cents	30 June 2019 cents
Basic earnings per share	(68.4)	50.9
Diluted earnings per share	(68.4)	44.8
	\$m	\$m
(Loss)/profit attributable to ordinary shareholders	(416.0)	307.8
Add back interest expense on Challenger Capital Notes 1 and 2	-	32.9
Add back interest expense net of tax on CLC Subordinated Notes	-	11.2
Total earnings used in the calculation of diluted earnings per share	(416.0)	351.9
	Number	Number
Number of shares		
Weighted average of ordinary shares issued	612,872,293	611,216,128
Weighted average of Treasury shares	(4,540,931)	(6,205,078)
Weighted average ordinary shares for basic earnings per share	608,331,362	605,011,050
Adjusted for potential ordinary shares:		
Weighted average effect of Challenger Performance Plan	-	4,481,432
Weighted average effect of Challenger Capital Notes 1 and 2	-	117,792,197
Weighted average effect of CLC Subordinated Notes	-	58,479,532
Weighted average ordinary shares for diluted earnings per share	608,331,362	785,764,211

Accounting policy

Basic earnings per share is calculated by dividing the total profit for the year attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the financial year. The number of ordinary shares outstanding is net of Treasury shares held by the Challenger Performance Plan (CPP) Trust or under CPP deferred share purchase agreements in respect of equity incentive plan awards to employees.

The weighted average number of Treasury shares for the period was 4,540,931 (2019: 6,205,078).

Accounting treatment of Capital Notes and subordinated debt

Challenger Capital Notes 1 and 2 and subordinated debt are an effective source of funding for Challenger.

Each of the Capital Notes 1 and 2 and subordinated debt have convertibility features which would result in these instruments converting to ordinary shares under certain circumstances, including APRA determining CLC to be non-viable.

Note 17 Earnings per share (continued)

Accounting policy (continued)

It is Challenger's current intention to refinance each of these instruments at a future date.

However, under AASB 133 *Earnings per Share*, convertible debt is considered dilutive whenever the interest per potential ordinary share for each of these instruments is less than Challenger's basic EPS for the period. As such, a test is required at each reporting period to determine if they are included in the dilutive share count.

Diluted earnings per share is calculated by dividing the total adjusted profit attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the year adjusted for the effects of dilutive shares that may be converted under the terms of Challenger Capital Notes 1 and 2 (Notes), CLC Subordinated Notes and shares granted under the Challenger Performance Plan (CPP).

The dilutive share count for Challenger's convertible debt (Challenger Capital Notes 1 and 2 and subordinated debt) is based on the following formula:

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

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

An assessment of the dilutive impact of convertible securities is usually done by reference to the determination as to whether the interest received would be more or less than the EPS and whether it would be rational for a holder to receive coupon from the convertible security or dividends from holding the shares. However, when the company is in a loss position the dilutive EPS is capped at the basic EPS. This is because the dilutive impact of issuing more shares means that the loss incurred is spread over a higher number of shares which results in a lower loss per share. In these circumstances, the dilutive EPS cannot be lower than the basic EPS. As a result, the potential shares that might be considered dilutive by virtue of their conversion to equity, are considered non-dilutive in a loss position and are therefore not included in the calculation. In the current year this results in no adjustment for potential dilution from the conversion of securities to ordinary shares.

The profit attributable to ordinary shareholders is adjusted by interest on the Notes and CLC Subordinated Notes for the diluted calculation when the Notes and CLC Subordinated Notes are considered dilutive. No adjustment was required for the year (30 June 2019: \$44.1 million).

In addition, subsequent to balance date the Company conducted a non-underwritten share purchase plan (SPP) raising \$35.0 million with 8.1 million shares issued to retail shareholders at a price of \$4.32 per share. The proceeds from the SPP were received on 30 July 2020 and \$30.0 million of the proceeds from the SPP were injected into CLC as Common Equity Tier 1 capital on 31 July 2020.

Section 5: Risk management

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

Note 18 Financial risk management

Governance and risk management framework

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

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

The Executive Risk Management Committee (ERMC) is an executive committee, chaired by the Chief Risk Officer (CRO), which assists the GRC, GAC and Board in the discharge of their risk management obligations by implementing the Board-approved risk management framework.

The Group's Risk division has day-to-day responsibility for monitoring the implementation of the framework with oversight, analysis, monitoring and reporting of risks. The CRO provides regular reporting to the GRC and the Board.

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

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial instruments, are disclosed in Section 1: Basis of preparation and overarching significant accounting policies and included in the relevant notes to the financial statements.

Market risk

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

Interest rate risk

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

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

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

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

Note 18 Financial risk management (continued)

Interest rate risk (continued)

Interest rate sensitivity

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

duration-hedged for interest rate movements. The impact on profit and equity is post-tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period. As shown below, 100 basis points (1%) movements in interest rates would have minimal impact on the Group's financial position:

Change in variable		Profit/(loss) 30 June 2020 \$m	Change in equity 30 June 2020 \$m	Profit/(loss) 30 June 2019 \$m	Change in equity 30 June 2019 \$m
Non-SPV	+100bps	0.8	0.8	1.2	1.2
	-100bps	(0.8)	(0.8)	(1.2)	(1.2)
SPV	+100bps	(0.3)	(0.3)	(0.7)	(0.7)
	-100bps	0.3	0.3	0.7	0.7
Total	+100bps	0.5	0.5	0.5	0.5
	-100bps	(0.5)	(0.5)	(0.5)	(0.5)

Price risk

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

Equity risks will arise as a natural result of CLC's Asset Allocation Plan. Equity prices can be driven by a range of risk factors specific to an individual exposure including broad macroeconomic and instrument specific factors that may be uncorrelated with broader equity markets. The Group's primary tools for managing investment price risks are CLC's Internal Capital Adequacy Assessment Process (ICAAP) and Asset Allocation plan.

Equity price risk sensitivity

The potential impact of movements in the market value of listed and unlisted equities on the Group's Statement of comprehensive income and Statement of financial position is shown in the below sensitivity analysis. This sensitivity analysis has been performed to assess the direct risk of holding equity instruments; therefore, any potential indirect impact on fees from the Group's funds management business has been excluded.

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

Change in variable		Profit/(loss) 30 June 2020 \$m	Change in equity 30 June 2020 \$m	Profit/(loss) 30 June 2019 \$m	Change in equity 30 June 2019 \$m
Equities and other alternatives					
Property securities	+10%	5.3	5.3	8.9	8.9
	-10%	(5.3)	(5.3)	(8.9)	(8.9)
Infrastructure investments	+10%	3.9	3.9	56.5	56.5
	-10%	(3.9)	(3.9)	(56.5)	(56.5)
Other equities and alternative assets	+10%	101.7	101.7	164.9	164.9
	-10%	(101.7)	(101.7)	(164.9)	(164.9)
Total assets	+10%	110.9	110.9	230.3	230.3
	-10%	(110.9)	(110.9)	(230.3)	(230.3)

Note 18 Financial risk management (continued)

Price risk (continued)

Credit spread risk sensitivity

The Group is exposed to price movements resulting from credit spread fluctuations through its fixed income securities (net of subordinated debt) and policy liabilities. As at 30 June 2020, a 50 basis point increase/decrease in credit spreads would result in a post-tax (at 30%) unrealised loss/gain in the Statement of comprehensive income and equity of \$102.9 million in respect of fixed income securities partially offset by an unrealised gain/loss of \$77.8 million in respect of policy liabilities (30 June 2019: \$133.6 million fixed income securities, \$59.7 million policy liabilities).

Currency risk

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

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

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

	GBP \$m	USD \$m	Euro \$m	JPY \$m	Other \$m
30 June 2020					
Financial assets	560.3	1,940.2	899.7	420.3	514.3
Financial liabilities	(4.7)	(648.8)	(1.7)	(0.8)	-
Foreign currency contracts and cross currency swaps	(550.8)	(1,260.3)	(895.4)	(405.5)	(513.6)
Net exposure in Australian dollars	4.8	31.1	2.6	14.0	0.7
30 June 2019					
Financial assets	503.9	2,506.8	1,031.5	899.3	624.9
Financial liabilities	(5.8)	-	(3.2)	(419.0)	-
Foreign currency contracts and cross currency swaps	(497.0)	(2,506.6)	(1,019.1)	(486.1)	(624.3)
Net exposure in Australian dollars	1.1	0.2	9.2	(5.8)	0.6

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

A sensitivity of 10% has continued to have been applied as it still reflects a reasonable measurement given the current level of exchange rates and the volatility observed during the conditions created by the COVID-19 crisis. The impact on profit and equity is post-tax at a rate of 30%.

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

Note 18 Financial risk management (continued)

Currency risk (continued)

	Movement in variable against \$	Profit/(loss) 30 June 2020 \$m	Change in equity 30 June 2020 \$m	Profit/(loss) 30 June 2019 \$m	Change in equity 30 June 2019 \$m
British Pound (GBP)	+10%	0.4	0.4	0.1	0.1
	-10%	(0.4)	(0.4)	(0.1)	(0.1)
US Dollar (USD)	+10%	2.2	2.2	-	-
	-10%	(2.2)	(2.2)	-	-
Euro (EUR)	+10%	0.2	0.2	0.7	0.7
	-10%	(0.2)	(0.2)	(0.7)	(0.7)
Japanese Yen (JPY)	+10%	-	1.0	-	(0.4)
	-10%	-	(1.0)	-	0.4
Other	+10%	-	-	-	-
	-10%	-	-	-	-
Total	+10%	2.8	3.8	0.8	0.4
	-10%	(2.8)	(3.8)	(0.8)	(0.4)

Credit default risk

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

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

COVID-19 has led to a number of external and internal ratings downgrades and loan restructures and amendments.

Credit exposure by credit rating

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

	Investment grade				Non-inv. grade	Other	Total
	AAA \$m	AA \$m	A \$m	BBB \$m	\$m	\$m	\$m
30 June 2020							
Cash and cash equivalents	603.9	-	-	-	-	-	603.9
Cash and cash equivalents – SPV	58.0	-	-	-	-	-	58.0
Receivables	27.7	41.7	58.2	21.6	5.9	439.0	594.1
Mortgage assets – SPV	348.5	68.3	125.4	166.8	-	(2.4)	706.6
Fixed income securities	11,443.9	1,189.9	2,113.0	2,474.7	2,120.7	132.7	19,474.9
Derivative assets	-	1,033.4	78.4	0.1	0.6	-	1,112.5
Financial leases	-	-	11.4	7.3	13.0	-	31.7
Total assets with credit exposures	12,482.0	2,333.3	2,386.4	2,670.5	2,140.2	569.3	22,581.7
30 June 2019							
Cash and cash equivalents	725.4	-	-	-	-	-	725.4
Cash and cash equivalents – SPV	66.5	-	-	-	-	-	66.5
Receivables	16.5	12.5	212.4	21.5	3.7	313.4	580.0
Mortgage assets – SPV	431.1	144.5	222.2	55.4	7.9	(0.5)	860.6
Fixed income securities	7,530.8	3,022.7	2,191.6	2,629.5	2,112.1	115.8	17,602.5
Derivative assets	-	611.9	60.3	14.6	75.7	-	762.5
Finance leases	-	0.1	8.6	7.9	32.9	-	49.5
Total assets with credit exposures	8,770.3	3,791.7	2,695.1	2,728.9	2,232.3	428.7	20,647.0

Note 18 Financial risk management (continued)

Credit default risk (continued)

Mortgage assets – SPV

Mortgage assets – SPV are funded via securitised residential mortgage-backed securities (RMBS). As a result, the Group is not exposed to significant credit risk on these assets as this is borne by the RMBS holder.

Collateral held over assets

In the event of a default against any of the mortgages in any SPV, the trustee has the legal right to take possession of the secured property and sell it as a recovery action against settlement of the outstanding account mortgage balance. At all times of possession, the risks and rewards associated with ownership of the property are held by the trustee on behalf of the RMBS holder.

Concentration risk

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

Ageing of amortised cost financial assets

The table below gives information regarding the carrying value of the Group's financial assets measured at amortised cost. The analysis splits these assets by those that are not past due and those that are past due (including an ageing analysis at the Statement of financial position date):

		Past due				
	Not past due	0-1	1-3	3-6	6+	Total
	\$m	months	months	months	months	\$m
Amortised cost financial assets						
30 June 2020						
Receivables	587.8	-	4.5	1.8	-	594.1
Mortgage assets – SPV	598.2	26.1	26.7	51.2	4.4	706.6
Finance leases	31.7	-	-	-	-	31.7
Total receivables	1,217.7	26.1	31.2	53.0	4.4	1,332.4
30 June 2019						
Receivables	580.0	-	-	-	-	580.0
Mortgage assets – SPV	742.9	44.8	29.0	14.5	29.4	860.6
Finance leases	49.5	-	-	-	-	49.5
Total receivables	1,372.4	44.8	29.0	14.5	29.4	1,490.1

Liquidity risk

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

The Group aims to ensure that it has sufficient liquidity to meet its obligations on a short and medium-term basis. In setting the level of sufficient liquidity, the Group considers new business activities in addition to current contracted obligations. It considers: minimum cash requirements; collateral and margin call buffers; Australian Financial Services Licence (AFSL) requirements; cash flow forecasts; associated reporting requirements; other liquidity risks; and contingency plans.

The basis of the approach to liquidity management is to target sufficient liquidity to meet all cash requirements of the Group over an ensuing 12 month period which ensures that the regulatory guidelines set out in ASIC Regulatory Guide 166 *Licensing: Financial requirements* for holders of an AFSL are met.

The Group aims to ensure that it has sufficient liquidity to meet its obligations on a short, medium and long-term basis. The Life liquidity management policy is approved by the CLC Board and sets out liquidity targets and mandated actions depending on actual liquidity levels relative to those targets. Detailed forecast cash positions are reported regularly to the Financial Risk Committee (FRC). The FRC and the Investment Committee (IC) replaced the CLC Asset Liability Committee (ALCo) from 1 July 2019. The IC is a committee of investment professionals from within CLC and represents the first line. The FRC is a committee of professionals mainly from the Risk division that is separate from the investment team of CLC. The FRC represents the second line for CLC. At the reporting date, all requirements of the CLC Board approved liquidity management policy were satisfied.

Maturity profile of undiscounted financial liabilities

The table on the following page summarises the maturity profile of the Group's undiscounted financial liabilities. This is based on contractual undiscounted repayment obligations. Totals differ to the amounts on the statement of financial position by the amount of time value of money discounting reflected in the Statement of financial position values.

Note 18 Financial risk management (continued)

	1 year or less \$m	1-3 years \$m	3-5 years \$m	>5 years \$m	Total \$m
Maturing profile of undiscounted financial liabilities					
30 June 2020					
Payables	1,555.5	-	-	27.9	1,583.4
Payables – SPV	2.0	10.2	45.3	-	57.5
Interest bearing financial liabilities	5,458.0	1,336.0	453.2	168.8	7,416.0
Interest bearing financial liabilities – SPV	139.9	260.6	147.1	170.2	717.8
External unit holders' liabilities	1,587.3	828.5	-	-	2,415.8
Life investment contract liabilities	2,966.4	2,325.5	542.5	427.0	6,261.4
Life insurance contract liabilities ¹	775.4	1,272.1	1,014.4	4,574.9	7,636.8
Derivative liabilities	97.1	48.7	80.7	498.9	725.4
Total undiscounted financial liabilities¹	12,581.6	6,081.6	2,283.2	5,867.7	26,814.0
30 June 2019					
Payables	1,077.2	6.1	-	26.2	1,109.5
Payables – SPV	2.3	10.2	46.2	-	58.7
Interest bearing financial liabilities	4,885.8	154.5	1,341.9	185.7	6,567.9
Interest bearing financial liabilities – SPV	236.5	326.3	185.1	222.9	970.8
External unit holders' liabilities	1,356.4	609.8	-	-	1,966.2
Life investment contract liabilities	2,822.7	2,866.7	830.7	510.2	7,030.3
Life insurance contract liabilities ¹	672.7	1,129.0	871.6	4,449.5	7,122.8
Derivative liabilities	135.2	75.2	51.7	307.1	569.2
Total undiscounted financial liabilities¹	11,188.8	5,177.8	3,327.2	5,701.6	25,395.5

¹ Disclosure of life insurance contract liabilities is not required under AASB 7 *Financial Risk Management*, for reference purposes they have been included. Refer to Note 8 Life contract liabilities for further details.

Note 19 Fair values of financial assets and liabilities

Fair value determination and classification

Fair value reflects the price that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The majority of the Group's financial instruments are held in the life insurance statutory funds of CLC and, as a result, are required by AASB 1038 *Life Insurance Contracts* to be designated at fair value through profit and loss where this is permitted under AASB 9 *Financial Instruments*.

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

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

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

Valuation techniques

The majority of the Group's listed and unlisted fixed income securities, over-the-counter derivative financial instruments

and interest bearing liabilities including the subordinated debt issuance are classified as Level 2. This recognises the availability of a quoted price but not from an active market as defined by the standard.

Fixed income securities where market observable inputs are not available are classified Level 3. The Group's derivative financial instruments are traded over-the-counter so, while they are not exchange traded, there is a market observable price. All of the fixed income and government/semi-government securities have prices determined by a market.

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

Valuation techniques (continued)

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

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

External unit holders' liabilities are valued at the face value of the amounts payable and classified as Level 2. The portion of life investment contract liabilities classified as Level 2 represent products or product options for which the liability is determined based on an account balance, rather than a discounted cash flow as applied to the rest of the portfolio.

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

The mortgage SPVs have total equity attributable to residual income unitholders (RIU) holders at amortised cost of \$0.1 million (2019: \$0.2 million). The fair value of this RIU holders' asset is \$41.0 million (2019: \$62.4 million) and would be classified as Level 3 in the fair value hierarchy.

Challenger Capital Notes 1 and 2 have carrying values of \$345.0 million and \$460.0 million. The fair value of these notes is \$340.9 million and \$457.7 million respectively and are classified as Level 1 in the fair value hierarchy.

Valuation process

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

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

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

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

Valuation process (continued)

	Level 1 \$m	Level 2 \$m	Level 3 \$m	Total \$m
30 June 2020				
Derivative assets	-	1,111.9	0.6	1,112.5
Fixed income securities ¹	-	17,566.5	1,908.4	19,474.9
Equity and other alternatives	0.5	627.8	274.4	902.7
Infrastructure investments ¹	-	9.8	370.3	380.1
Property securities	-	-	76.3	76.3
Investment and development property ²	-	-	3,685.9	3,685.9
Total assets	0.5	19,316.0	6,315.9	25,632.4
Derivative liabilities	-	725.4	-	725.4
Interest bearing financial liabilities	798.6	422.7	-	1,221.3
External unit holders' liabilities	-	2,415.8	-	2,415.8
Life investment contract liabilities	-	49.9	5,817.9	5,867.8
Total liabilities	798.6	3,613.8	5,817.9	10,230.3
30 June 2019				
Derivative assets	-	761.9	0.6	762.5
Fixed income securities	-	15,604.8	1,997.7	17,602.5
Equity and other alternatives	6.9	1,025.7	299.6	1,332.2
Infrastructure investments ¹	210.6	234.9	421.6	867.1
Property securities	-	-	127.8	127.8
Investment and development property ²	-	155.8	3,573.4	3,729.2
Total assets	217.5	17,783.1	6,420.7	24,421.3
Derivative liabilities	-	569.1	0.1	569.2
Interest bearing financial liabilities	836.0	443.1	12.5	1,291.6
External unit holders' liabilities	-	1,966.2	-	1,966.2
Life investment contract liabilities	-	58.1	6,699.6	6,757.7
Total liabilities	836.0	3,036.5	6,712.2	10,584.7

¹ The Group has exposures to structured entities (entities designed so that voting or similar rights are not the dominant factor in determining who controls the entity; for example, when any voting rights relate purely to administrative tasks) via investments in asset-backed finance vehicles (where it may act as a lender or purchaser of notes and/or residual income units) and securitisations (such as mortgages, finance leases and other types of collateralised vehicles). The Company assesses, at inception and at each reporting date, whether a structured entity should be consolidated based on the accounting policy. The maximum exposure to loss is limited to the reported fair value of the underlying securities plus any guaranteed undrawn commitments to the counterparties. At 30 June 2020 the carrying value of asset-backed financing assets was \$91.1 million (30 June 2019: \$81.8 million) with \$32.0 million undrawn commitments (30 June 2019: \$39.5 million) and securitisations was \$5,386.5 million (30 June 2019: \$4,313.3 million) plus \$107.2 million undrawn commitments (30 June 2019: \$81.2 million).

² Refer Note 6 Investment and development property for valuation techniques and key unobservable inputs.

Level 3 reconciliation

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

	30 June 2020		30 June 2019	
	Assets \$m	Liabilities \$m	Assets \$m	Liabilities \$m
Balance at the beginning of the year	6,420.7	6,712.2	6,440.9	6,585.3
Fair value gains/(losses)	(187.5)	135.7	72.4	312.0
Acquisitions	2,764.2	1,992.4	2,723.3	2,354.0
Maturities and disposals	(2,666.0)	(3,022.4)	(2,772.3)	(2,539.1)
Transfers to other categories ^{1,2}	(15.5)	-	(43.6)	-
Balance at the end of the year	6,315.9	5,817.9	6,420.7	6,712.2
Unrealised gains/(losses) included in the statement of comprehensive income for assets and liabilities held at the statement of financial position date	(187.5)	135.7	76.3	(312.0)

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

² Transfers to/from other categories are due to changes in the market observability of inputs used in the valuation of financial instruments. There were no transfers between Level 1 and Level 2 during the reporting period. There were \$2.5 million of transfers into Level 3 (30 June 2019: \$216.0 million) and there were \$18.0 million of transfers out of Level 3 and into Level 2 (30 June 2019: \$259.6 million) during the reporting period.

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

Level 3 sensitivities

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

	Level 3 value ¹ \$m	Positive impact \$m	Negative impact \$m	Valuation technique	Reasonably possible change in non-observable input ^{2,3}
30 June 2020					
Derivative assets	0.6	-	-	Discounted cash flow	Primarily credit spreads
Fixed income securities	1,908.4	23.1	(74.9)	Discounted cash flow	Primarily credit spreads
Equity and other alternatives	274.4	18.8	(20.1)	Pricing model	Earnings multiple, Mortality rate
Infrastructure investments	370.3	2.6	(2.6)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Property securities	76.3	3.8	(3.8)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Investment contract liabilities	(5,817.9)	2.3	(2.3)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,685.9	165.3	(116.9)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	498.0	215.9	(220.6)		
30 June 2019					
Derivative assets	0.6	0.1	(0.1)	Discounted cash flow	Primarily credit spreads
Derivative liabilities	(0.1)	0.2	0.1	Discounted cash flow	Primarily credit spreads
Fixed income securities	1,997.7	10.5	(37.2)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(12.5)	0.2	(0.4)	Discounted cash flow	Primarily credit spreads
Equity and other alternatives	299.6	22.7	(24.2)	Pricing model	Earnings multiple, Mortality rate
Infrastructure investments	421.6	4.9	(4.9)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Property securities	127.8	6.4	(6.4)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Investment contract liabilities	(6,699.6)	3.5	(3.5)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,573.4	166.7	(152.7)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	(291.5)	215.2	(229.3)		

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

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

³ The effect of a change to reflect a reasonably possible alternative assumption was calculated by moving the credit band by one tier, adjusting the discount rates by between 50bps – 100bps, adjusting property capitalisation rates by 25bps (Australia) or 10bps (Japan), adjusting credit spreads by 50bps, changing the valuation of the unlisted schemes by 5% and adjusting the expense assumption allocation splits by 10%.

The COVID-19 pandemic has had a significant impact on the economy and continues to drive uncertainty across the commercial property market. Independent valuers have noted these uncertainties in respect of the assumptions applied in the course of performing the independent valuation assessments for the direct property portfolio as at the reporting date. As a result of this uncertainty, a further sensitivity analysis has been undertaken to assess the impact on fair value when the significant non-observable input (capitalisation rates) experience a more material movement. Under this additional sensitivity scenario, the capitalisation rate is moved by 50bps (Australia) / 20 bps (Japan), resulting in a positive impact of \$324.3 million and a negative impact of \$246.4 million across the direct property portfolio.

Fixed income also forms a material part of the level 3 asset class held by the Group. This portfolio primarily consists of internally rated securities where the valuation is derived from applying the market observable comparable spread. The key non-observable input in these valuations is the internally derived credit rating which is based upon credit assessment undertaken by the Risk division. The COVID-19 pandemic has impacted many businesses across various industries and the long term effects are difficult to assess and not all industries and businesses have been impacted equally. An assessment of the current impact of COVID-19 on the performance of the Level 3 component of the fixed income portfolio has been undertaken and that performance has not changed sufficiently to currently warrant any additional sensitivity being included.

Note 20 Collateral arrangements

Accounting policy

CLC receives collateral, where it is considered necessary, when entering into certain financial arrangements. The amount of collateral required is subject to management's credit evaluation of the counterparty which is performed on a case-by-case basis. As at 30 June 2020 \$471.8 million (30 June 2019: \$415.1 million) cash received from third parties as collateral is recorded in payables and \$221.4 million (30 June 2019: nil) of collateral assets received from counterparties were repledged by the Company to third parties. Except in the

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

	30 June 2020 \$m	30 June 2019 \$m
Collateral pledged as security		
Cash	98.4	220.1
Other financial assets ¹	7,730.3	5,991.0
Total collateral pledged	7,828.7	6,211.1

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

Section 6: Group structure

This section provides details and disclosures relating to the parent entity of the Group, controlled entities, investments in associates and any acquisitions and/or disposals of businesses in the year. Disclosure for related parties is also provided in this section.

Note 21 Parent entity

	30 June 2020 \$m	30 June 2019 \$m
Company		
Statement of comprehensive income for the year ended		
Dividends and interest from controlled entities	232.5	322.7
Finance costs	(31.1)	(36.5)
Profit before income tax	201.4	286.2
Income tax benefit	1.7	3.3
Total comprehensive income for the year	203.1	289.5
Statement of financial position as at		
Assets		
Cash and cash equivalents	3.0	2.8
Receivables	1,439.0	1,224.1
Financial asset – fixed income securities ¹	805.0	805.0
Current tax asset	-	6.0
Deferred tax assets	84.1	-
Investment in controlled entities	2,373.8	2,088.9
Total assets	4,704.9	4,126.8
Liabilities		
Payables	661.6	344.7
Interest bearing financial liabilities	799.8	796.5
Total liabilities	1,461.4	1,141.2
Net assets	3,243.5	2,985.6
Equity		
Contributed equity	2,424.7	2,155.3
Share-based payments reserve	(111.0)	(113.6)
Retained earnings	929.8	943.9
Total equity	3,243.5	2,985.6

¹ Financial asset – fixed income securities relates to the subscription by the Company of notes issued by CLC that qualify as Additional Tier 1 capital of CLC.

Refer Note 28 Contingent liabilities, contingent assets and credit commitments for details of any contingent liabilities applicable to the parent entity.

Note 22 Controlled entities

The table below presents the hierarchical structure of Challenger Limited showing its controlled entities that form the main composition of the Group as at 30 June 2020:

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

Challenger's percentage holding of the above entities is 100% and all are incorporated in Australia unless otherwise stated. Entities with non-controlling interests represent net assets of nil (30 June 2019: \$22.5 million).

Accounting policy

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

Principles of consolidation

The financial statements consolidate the financial information of controlled entities. An entity is controlled when the Company is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The statement of financial position date and the accounting policies of controlled entities are consistent with those of the Company. The Company assesses, at inception and at each reporting date, whether an entity should be consolidated based on the accounting policy.

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

Note 23 Investment in associates

Name of company	Principal activity	Country of domicile	30 June 2020 % ¹	30 June 2019 % ¹	30 June 2020 \$m	30 June 2019 \$m
Alphinity Investment Management Pty Ltd	Funds Management	Australia	30	30	2.0	1.3
Ardea Investment Management Pty Ltd	Funds Management	Australia	30	30	3.3	3.1
Ares Australia Management	Funds Management	Australia	35	-	0.2	-
Avenir Capital Pty Ltd	Funds Management	Australia	40	40	3.3	2.7
Bentham Asset Management Pty Ltd	Funds Management	Australia	49	49	0.7	0.7
Eiger Capital Pty Ltd	Funds Management	Australia	40	40	0.8	0.8
FME Asset Management Ltd	Funds Management	UK	-	20	-	2.0
Greencape Capital Pty Ltd	Funds Management	Australia	48	50	39.8	34.2
Lennox Capital Partners Pty Ltd	Funds Management	Australia	40	40	2.0	2.1
Merlon Capital Partners Pty Ltd	Funds Management	Australia	30	30	2.0	1.7
Novaport Capital Pty Ltd	Funds Management	Australia	49	49	0.3	0.2
Resonance Asset Management Limited ²	Funds Management	UK	-	-	0.7	0.7
Structured Credit Research LLP	Funds Management	UK	-	50	-	0.4
Wavestone Capital Pty Ltd	Funds Management	Australia	33	33	2.2	2.3
Whitehelm Capital Pty Ltd	Funds Management	Australia	30	30	5.6	4.9
Wyetree Asset Management Pty Ltd	Funds Management	UK	49	49	0.1	1.0
Total investment in associates³					63.0	58.1

¹ Represents ownership and voting rights percentages.

² Challenger is deemed to have significant influence.

³ Investment in associates is all considered non-current.

Note 23 Investment in associates (continued)

	30 June 2020 \$m	30 June 2019 \$m
Movements in carrying amount of investment in associates		
Opening balance	58.1	62.4
Acquisition of investment in associates	-	2.2
Share of associates' net profit	29.3	22.2
Dividends and net capital redemptions	(21.9)	(28.7)
Reclassification to investment in controlled entities	(0.6)	-
Impairment of investment in associates	(1.9)	-
Carrying amount at the end of the year	63.0	58.1
Share of associates' profit or loss		
Profit after tax for the year	29.3	22.2
Share of the associates' statement of financial position		
Current assets	38.0	36.3
Non-current assets	4.6	1.8
Total assets	42.6	38.1
Current liabilities	21.8	18.5
Non-current liabilities	1.4	1.8
Total liabilities	23.2	20.3
Net assets	19.4	17.8

Investments in associates held by Challenger Life Company (CLC)

As at 30 June 2019, CLC held a 33.3% equity interest in Assetsecure Pty Ltd and was deemed to have significant influence. The investment was \$8.0 million. In November 2019, CLC acquired the residual equity interest. Since 27 November 2019, Assetsecure Pty Ltd is consolidated. Refer to Note 26 Acquisitions and disposals of subsidiaries, businesses and associates.

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

Accounting policy

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

Associates' financial reports are used to apply the equity method and both the financial year end date and accounting policies of associate entities are consistent with those of the Group.

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

Key estimates and assumptions

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

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

Note 24 Related parties

Key management personnel

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

Directors

Peter Polson	Independent Chair
Richard Howes	Managing Director and Chief Executive Officer
John M Green	Independent Non-Executive Director
Steven Gregg	Independent Non-Executive Director
Masahiko Kobayashi¹ (appointed 26 August 2019)	Non-Executive Director
JoAnne Stephenson	Independent Non-Executive Director
Duncan West	Independent Non-Executive Director
Melanie Willis	Independent Non-Executive Director
Leon Zwier (retired 31 October 2019)	Independent Non-Executive Director

¹ Hiroyuki Iioka was appointed as an alternate director to Masahiko Kobayashi on 13 December 2019.

Key executives

Richard Howes	Managing Director and Chief Executive Officer
Nick Hamilton¹	Chief Executive, Funds Management
Angela Murphy	Chief Executive, Distribution, Product and Marketing
Chris Plater	Chief Executive & Chief Investment Officer, Life
Ian Saines²	Chief Executive, Funds Management
Andrew Tobin	Chief Financial Officer

¹ Nick Hamilton commenced being a key executive on 23 September 2019.

² Ian Saines ceased being a key executive on 22 September 2019.

Controlled entities and associates

Unless an exception applies under relevant legislation, transactions between commonly-controlled entities within the Group (except where otherwise disclosed) are conducted on an arm's length basis under normal commercial terms and conditions. The Group's interests in controlled entities are disclosed in Note 22 Controlled entities.

The Group earned fee income during the year of \$47.4 million (2019: \$46.0 million) from transactions entered into with non-controlled funds and associates. Transactions are conducted on an arm's length basis under normal commercial terms and conditions.

Other related parties

During the year, there were transactions between the Group and Challenger-sponsored managed funds for the provision of investment management, transaction advisory and other professional services.

Transactions were also entered into between the Group and associated entities (refer to Note 23 Investment in associates) for the provision of distribution and administration services.

Loans to Directors and key executives

There were no loans made to Directors or key executives as at 30 June 2020 (30 June 2019: nil).

Group products

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

Total remuneration of Key Management Personnel and Non-Executive Directors

	Short-term benefits \$	Post-employment benefits \$	Share-based payments \$	Other benefits \$	Termination benefits \$	Total \$
KMP and Non-Executive Directors						
Non-Executive Directors						
2020	1,660,179	103,398	-	-	-	1,763,577
2019	1,812,945	100,580	-	-	-	1,913,525
KMP						
2020	3,878,943	105,015	5,248,471	143,573	-	9,376,002
2019	6,766,774	103,870	7,722,428	354,813	-	14,947,885
All KMP and Non-Executive Directors						
2020	5,539,122	208,413	5,248,471	143,573	-	11,139,579
2019	8,579,719	204,450	7,722,428	354,813	-	16,861,410

Section 7: Other items

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

Note 25 Goodwill and other intangible assets

	30 June 2020 \$m	30 June 2019 \$m
Goodwill	579.9	557.3
Other intangible assets		
Software at cost	32.6	25.7
Less: accumulated amortisation	(10.7)	(7.7)
Less: asset impairment	(4.1)	-
Less: asset reclassification	(1.3)	-
	16.5	18.0
Revenue sharing agreement	5.9	5.8
Less: accumulated amortisation	(0.7)	(0.5)
Foreign exchange gain	0.7	0.6
Less: impairment	(5.9)	-
	-	5.9
Identifiable Intangible (Assetsecure)	1.7	-
Less: accumulated amortisation	(0.1)	-
	1.6	-
Total other intangible assets	18.1	23.9

	Goodwill		Software		Revenue sharing agreement		Identifiable Intangible	
	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m
Balance at the beginning of the year	557.3	571.6	18.0	15.5	5.9	5.8	-	-
Additions	22.6	-	6.9	6.1	-	-	1.7	-
Disposal of operation ¹	-	(14.3)	-	-	-	-	-	-
Impairment	-	-	(4.1)	-	(5.9)	-	-	-
Amortisation expense	-	-	(3.0)	(3.6)	(0.2)	(0.4)	(0.1)	-
Foreign exchange gain	-	-	-	-	0.2	0.5	-	-
Reclassification	-	-	(1.3)	-	-	-	-	-
Balance at the end of the year	579.9	557.3	16.5	18.0	-	5.9	1.6	-

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

Accounting policy

Goodwill

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

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash generating units (CGU), or groups of CGUs, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Note 25 Goodwill and other intangible assets (continued)

Accounting policy (continued)

Each unit, or group of units, to which the goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Impairment is determined by assessing the recoverable amount of the CGU (or group of CGUs) to which the goodwill relates.

When the recoverable amount of the CGU (or group of CGUs) is less than the carrying amount, an impairment loss is recognised and allocated first to reduce the carrying amount of any goodwill allocated to that CGU, then to reduce the carrying amount of the other assets in the unit on a pro rata basis. Impairment losses recognised for goodwill are not subsequently reversed.

CGUs within the Group are predominantly business operations.

When goodwill forms part of a CGU (or group of CGUs) and an operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this manner is measured based on the relative values of the operation disposed of and the portion of the CGU retained.

Other intangible assets

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

Amortisation is calculated based on the timing of projected cash flows over the estimated useful lives.

Certain internal and external costs directly incurred in acquiring and developing software have been capitalised and are being amortised on a straight line basis over their useful lives.

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

Key estimates and assumptions

Goodwill recoverable amounts

The Group assesses whether goodwill is impaired at least annually in accordance with its accounting policy. The recoverable amount of each CGU is determined based on value in use calculations that utilise cash flow projections based on financial forecasts approved by senior management which cover an appropriate time horizon. In determining these cash flow projections management considers:

- current and expected performance of each CGU;
- Board and management approved budgets and strategic plans; and
- changes in Australian and international economic and market environments.

The impact of COVID-19 has had a profound effect on economies and markets. In addition, the duration and extent of the pandemic together with government responses to it remains uncertain. Notwithstanding, management has made reasonable assumptions of the impact of COVID-19 when determining the cash flow projections to be used for the value in use calculations.

The cash flow projections determined by management are discounted using an appropriate discount rate. The determination of the discount rate is a matter of judgement and is based on a number of factors including a theoretical calculation, observation of third party reports and discount rates used by comparable financial services companies.

The relevant assumptions in deriving the value of the CGU are as follows:

- the budgeted net profit after tax for each CGU for each year within the cash flow projection period;
- the discount rate; and
- growth rates, which are consistent with long-term trends in the industry segments in which the CGUs operate.

The derived values in use for each CGU are in excess of the carrying values of goodwill.

The following CGUs represent the carrying amounts of goodwill:

CGU	30 June 2020		Discount rate		Cash flow horizon (years)
	2020	2019	2020	2019	
	\$m	\$m	%	%	
Life Funds Management	452.3	429.7	10.0	10.0	5
Management	127.6	127.6	10.0	10.0	5
Total	579.9	557.3			

Sensitivity to change in assumptions

Management is of the view that reasonable changes in the key assumptions, such as an increase in the discount rate by 1% or a change in projected cash flows of 5%, would not cause the respective recoverable amounts for each CGU to fall short of the carrying amounts as at 30 June 2020. All goodwill is non-current.

Other intangible assets amortisation

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

Intangible	Useful Life	Depreciation method
Goodwill	Indefinite	Not applicable
Software	3-10 years	Straight line basis over its useful life, usually a period of five years

Note 26 Acquisitions and disposals of subsidiaries, businesses and associates

On 27 November 2019, 255 Finance (a member of the Group's Life business unit), acquired the residual equity of Assetsecure Pty Ltd (Assetsecure), a specialist trade receivables financier with approximately 10 employees. The Group had previously held a 35% equity interest disclosed as an investment in associates measured at fair value through profit or loss. As part of the business combination, the Group has consolidated five Special Purpose Vehicle (SPV) trusts that Assetsecure manages as it is both a significant noteholder and retains the beneficial interest in these SPVs.

A total acquisition of Assetsecure provides 255 Finance a full accounts receivable origination and servicing capability, cost and revenue synergies together with ongoing access to a key origination channel. From the date of acquisition, Assetsecure's revenue and expenses have been included in the statement of comprehensive income. Acquisition related transaction costs have been incurred through other expenses.

Details of the fair values of the assets and liabilities acquired and goodwill on acquisition are as follows:

	30 June 2020 \$m
Total purchase consideration ¹	30.8
Less: fair value of net identifiable assets acquired	(8.2)
Goodwill on acquisition	22.6

¹ Includes existing investment held at fair value; \$20.0 million was paid to acquire the residual 65% interest.

	Acquiree's carrying amount \$m	Fair value \$m
Assets		
Cash and cash equivalents	9.8	9.8
Financial assets – fair value through profit and loss	316.8	316.8
Right-of-use lease asset	0.8	0.8
Receivables	0.7	0.8
Deferred tax asset	0.4	0.2
Other assets	0.1	0.1
Other intangible assets	0.5	1.7
Total assets	329.1	330.2
Liabilities		
Payables	(176.6)	(176.8)
Provisions	(0.3)	(0.3)
Current tax liabilities	(0.4)	(0.4)
Lease liabilities	(0.8)	(0.8)
Interest bearing liabilities	(143.7)	(143.7)
Total liabilities	(321.8)	(322.0)
Net assets	7.3	8.2

Other significant entities and businesses acquired or consolidated due to acquisition of control

There were no other significant entities or businesses acquired or consolidated due to acquisition of control during the period.

Significant entities and businesses disposed of or deconsolidated due to loss of control

There were no significant entities or businesses disposed of or deconsolidated due to loss of control during the period.

Note 27 Lease assets and liabilities

Right-of-use lease asset

	30 June 2020 \$m	30 June 2019 \$m
Cost	37.1	-
Less: accumulated amortisation	(4.7)	-
Right-of-use lease asset	32.4	-

	Office premises ¹		Property, plant and equipment ²	
	30 June 2020 \$m	30 June 2019 \$m	30 June 2020 \$m	30 June 2019 \$m
Balance at the beginning of the year³	36.7	-	-	-
Additions	-	-	0.4	-
Amortisation expense	(4.7)	-	-	-
Balance at the end of the year	32.0	-	0.4	-

¹ The Group has entered into commercial leases for the rental of properties where it is not in the best interests of the Group to purchase these properties. These leases have terms ranging between one and 12 years with renewal terms included in the contracts. Renewals are at the specific option of the entity that holds the lease.

² Property, plant and equipment relates to leases for photocopying equipment.

³ The balance arises due to the adoption of AASB 16.

Lease liabilities

	30 June 2020 \$m	30 June 2019 \$m
Maturity analysis of contractual undiscounted cashflows		
Amounts due in less than one year	6.3	-
Amounts due between one and two years	6.8	-
Amounts due between two and five years	22.4	-
Amounts due in greater than five years	32.1	-
Total lease liabilities	67.6	-

	30 June 2020 \$m	30 June 2019 \$m
Current	6.3	-
Non current	61.3	-
Total lease liabilities¹	67.6	-

¹ Refer to Note 15 for interest expense on lease liabilities and the Statement of cash flows for total cash outflow for leases.

Accounting policy

Right-of-use-lease assets

The Group recognises right-of-use lease assets at the commencement date of the lease (i.e. the date the underlying asset is available for use). Right-of-use lease assets are measured at cost, less any accumulated depreciation and impairment losses, and less any adjustments for any remeasurement of lease liabilities. The cost of right-of-use lease assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received.

Unless the Group is reasonably certain to obtain ownership of the leased assets at the end of the lease term, the recognised right-of-use lease assets are depreciated on a straight line basis

over the shorter of its estimated useful life and the lease term. Right-of-use lease assets are subject to impairment.

Lease liabilities

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments), less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments include the exercise price of a purchase option reasonably certain to be exercised by the Group and payments of penalties for terminating a lease, if the lease term reflects the Group exercising the option to terminate.

Note 27 Lease assets and liabilities (continued)

Accounting policy (continued)

The variable lease payments that do not depend on an index or a rate are recognised as an expense in the period in which the event or condition that triggers the payment occurs. In calculating the present value of lease payments, the Group uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset.

Significant judgement in determining the lease term of contracts with renewal

The Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

The Group has the option, under some of its leases to lease the assets for additional terms. The Group applies judgement in evaluating whether it is reasonably certain to exercise the option to renew. That is, it considers all relevant factors that create an economic incentive for it to exercise the renewal. After the commencement date, the Group reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise (or not exercise) the option to renew.

Note 28 Contingent liabilities, contingent assets and credit commitments

Warranties

Over the course of its corporate activity the Group has given, as a seller of companies and as a vendor of assets, including real estate properties, warranties to purchasers on several agreements that are still outstanding at 30 June 2020. Other than noted below, at the date of this report no material claims against these warranties have been received by the Group.

Parent entity guarantees and undertakings

The Company has extended the following guarantees and undertakings to entities that form part of the Group:

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

Third party guarantees

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

Contingent future commitments

CLC has made capital commitments to external counterparties for future investment opportunities such as development or investment purchases. As at 30 June 2020 there are potential future commitments totalling \$419.7 million (30 June 2019: \$398.0 million) in relation to these opportunities. The Group has made capital commitments to associates to subscribe for up to \$7.2 million (30 June 2019: \$10.0 million) of non-redeemable preference shares to enable them to meet their working capital requirements. Contractual obligations for future property repairs and maintenance are in place but cannot be quantified until required.

Subsidiary guarantees

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

Contingent tax assets and liabilities

From time to time the Group has interactions and matters under review, audit or dispute with the Australian Taxation Office in relation to the taxation treatments of various matters including reportable tax positions. Any potential tax liability resulting from these interactions is only provided for when it is probable that an outflow will occur and a reliable estimate of the amount can be made. No specific contingent liability amounts have been disclosed in relation to these matters as it is considered that it would be prejudicial to their conduct and outcome.

Note 28 Contingent liabilities, contingent assets and credit commitments (continued)

	30 June 2020 \$m	30 June 2019 \$m
Analysis of credit commitments		
Contracted capital expenditure		
Amounts due in less than one year	18.7	32.1
Amounts due between one and two years	0.8	19.8
Amounts due between two and five years	-	0.8
Amounts due in greater than five years	-	-
Total capital expenditure commitments	19.5	52.7
Non-cancellable operating leases – Group as lessor		
Amounts due in less than one year	(221.0)	(223.7)
Amounts due between one and two years	(213.5)	(214.7)
Amounts due between two and five years	(511.3)	(549.1)
Amounts due in greater than five years	(954.3)	(789.0)
Total operating leases – Group as lessor	(1,900.1)	(1,776.5)
Other contracted commitments		
Amounts due in less than one year	6.2	15.9
Total other contracted commitments	6.2	15.9
Net commitments owed to Group	(1,874.4)	(1,707.9)

Other information

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

Operating leases

Group as lessor

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

Contracted capital expenditure commitments

These represent amounts payable in relation to capital expenditure commitments contracted for at the statement of financial position date but not recognised as liabilities. They primarily relate to the investment property portfolio and property, plant and equipment.

Other contracted commitments

This represents amounts payable in relation to fitout commitments and acquisition of investment properties that have exchanged prior to the balance date and will settle subsequent to the balance date.

Note 29 Employee entitlements

	30 June 2020 \$m	30 June 2019 \$m
Annual leave	7.8	5.9
Long service leave	9.4	7.2
Employee¹ entitlements provision	17.2	13.1

¹ The total number of employees of the Group at 30 June 2020 was 735 (30 June 2019: 687) on a full-time equivalent (FTE) basis.

Accounting policy

Superannuation funds

Obligations for contributions to superannuation funds are recognised as an expense in the Statement of comprehensive income as they are incurred. The Group does not hold or pay into any defined benefit superannuation schemes on behalf of employees.

Wages, salaries, annual leave and non-monetary benefits

Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled wholly within 12 months of the Statement of financial position date, are recognised in respect of employees' services up to the Statement of financial position date. They are measured at the amounts expected to be paid when the liabilities are settled. Liabilities for accumulated sick leave are recognised when the leave is taken and are measured at the rates paid or payable.

Long service leave

A liability for long service leave is recognised as the present value of estimated future cash outflows to be made in respect of services provided by employees up to the Statement of financial position date. The estimated future cash outflows are discounted using yields from Australian corporate bonds which have durations to match, as closely as possible, the estimated future cash outflows. Factors which affect the estimated future cash outflows such as expected future salary increases, experience of employee departures and period of service, are included in the measurement.

Share-based payment transactions

Long-term equity-based incentive plan

The Group has an employee share incentive plan for the granting of non-transferable share rights to executives and senior employees. Shares in the Company held by the employee share trust are classified as Treasury shares and presented in the Statement of financial position as a deduction from equity.

Employees of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions).

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined using an option pricing model.

Share-based payment transactions (continued)

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

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

The cumulative expense or investment recognised for equity-settled transactions at each Statement of financial position date reflects the extent to which the vesting period has expired and the best estimate of the number of awards that will ultimately vest.

No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date. This results in the share-based payment expense being recognised in the Statement of comprehensive income and an increase in equity being recognised even if the market performance conditions are not met at the vesting date and the share rights ultimately lapse.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled during the vesting period (other than an award cancelled when the vesting conditions are not satisfied), it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately.

However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award.

Note 29 Employee entitlements (continued)

Accounting policy (continued)

Employee share acquisition plan

Share-based compensation benefits are provided to employees via the Challenger Performance Plan (CPP). The Group has formed a trust to administer the Group's employee share acquisition plan (CPP Trust).

The CPP Trust is consolidated, as the substance of the relationship is that the trust is controlled by the Group.

Through contributions to the CPP Trust, the Group typically purchases shares in the Company on market. Shares acquired are held by the CPP Trust, are disclosed as Treasury shares and are deducted from contributed equity.

In addition to shares held by the CPP Trust, the Group has entered into forward purchase agreements (CPP deferred share purchases) to hedge unvested performance share rights. The CPP deferred share purchase agreements have exercise dates that broadly match the vesting dates of the performance rights issued by the CPP and they require the delivery of Challenger Limited shares to the CPP Trust, by a third party, for the contracted price. The shares to be purchased under these agreements are treated as Treasury shares from the date of the agreement.

In such deferred contracts, changes in the fair value arising from variations in market rates do not affect the amount of cash to be paid or the number of Challenger shares to be received, and these contracts are classified as equity instruments. Changes in the fair value of an equity instrument are not recognised in the financial statements. The liability to the third party is recorded on the balance sheet at present value and the discount is unwound through the Statement of comprehensive income over the duration of the contract.

Deferred performance share rights (DPSRs)

This instrument is a performance right which gives a right to a fully-paid share in the Company at the end of the vesting period. The vesting period is typically between one and four years on existing awards.

The table below sets out the details of the DPSRs granted under the CPP during 2020 and movements on previous issues.

Grant date	Latest date for vesting ¹	Reference price \$	Fair value at grant \$	Outstanding at 1 July 2019	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2020
11 Nov 19	01 Sep 23	6.633	7.87	-	15,377	-	-	15,377
11 Nov 19	01 Sep 22	6.633	7.55	-	15,377	-	-	15,377
11 Nov 19	01 Sep 21	6.633	7.23	-	23,065	-	-	23,065
11 Nov 19	01 Sep 20	6.633	6.94	-	23,065	-	-	23,065
09 Sep 19	01 Sep 23	6.633	5.93	-	206,908	-	(5,212)	201,696
09 Sep 19	01 Sep 22	6.633	6.19	-	206,908	-	(5,212)	201,696
09 Sep 19	01 Sep 21	6.633	6.45	-	310,393	-	(7,821)	302,572
09 Sep 19	01 Sep 20	6.633	6.73	-	310,394	-	(7,821)	302,573
11 Sep 18	01 Sep 21	10.368	9.66	459,987	-	(65,104)	(42,577)	352,306
11 Sep 18	01 Sep 20	10.368	9.94	437,856	-	(68,562)	(13,440)	355,854
11 Sep 18	01 Sep 19	10.368	10.22	437,854	-	(434,089)	(3,765)	-
11 Sep 17	01 Sep 20	12.264	11.39	391,483	-	(65,943)	(36,311)	289,229
11 Sep 17	01 Sep 19	12.264	11.73	384,042	-	(381,291)	(2,751)	-
09 Jun 17	01 Sep 19	12.596	11.79	2,439	-	(2,439)	-	-
12 Sep 16	01 Sep 19	9.210	7.95	376,869	-	(371,441)	(5,428)	-
Total				2,490,530	1,111,487	(1,388,869)	(130,338)	2,082,810

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

Note 29 Employee entitlements (continued)

Accounting policy (continued)

Hurdled performance share rights (HPSRs)

This instrument is a performance share right which gives a right to a fully-paid share in the Company at certain vesting dates, subject to the achievement of performance conditions based on total shareholder returns (TSR). The HPSRs are awarded based on a range of criteria reflecting, in addition to current year performance, the longer-term ability for an employee to add significant value to Challenger and for retention purposes. The award of HPSRs ensures longer-term alignment of interests between Challenger and its employees.

For grants made between 1 July 2014 and 30 June 2019, subject to continued employment and meeting the absolute TSR performance target, two-thirds of an HPSR award will be eligible to commence vesting on the third anniversary and the final third on the fourth anniversary following grant. For grants from 1 July 2019, subject to continued employment and meeting the absolute TSR performance target, an HPSR award is eligible to commence vesting on the fourth anniversary and is subject to a final cumulative test on the fifth anniversary. This change has the effect of increasing the vesting period.

To the extent that the absolute TSR performance targets are not satisfied for a particular tranche of award, unvested HPSRs have the opportunity to vest at the end of the following tranche's vesting period, subject to the higher absolute TSR performance requirements which reflect another year of compound growth. Unvested awards have the opportunity to vest on the fifth anniversary following grant. Any unvested awards lapse at the end of the fifth anniversary following grant. This approach is applied to ensure that Key Management Personnel and employees are motivated to deliver strong long-term performance. HPSRs are converted to ordinary fully paid shares upon vesting.

The table below sets out details of the HPSRs granted under the CPP during 2020 and movements on previous issues:

Grant date	Expected date for vesting ¹	Reference price \$	Fair value at grant \$	Outstanding at 1 July 2019	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2020
09 Dec 19	01 Sep 23	6.729	4.22	-	432,483	-	-	432,483
11 Nov 19	01 Sep 23	6.729	4.42	-	90,618	-	-	90,618
09 Sep 19	01 Sep 23	6.729	3.10	-	3,330,183	-	(142,812)	3,187,371
11 Sep 18	01 Sep 22	11.720	3.94	794,475	-	-	(114,300)	680,175
11 Sep 18	01 Sep 21	11.720	4.56	1,372,843	-	-	(197,509)	1,175,334
11 Sep 17	01 Sep 21	12.732	5.42	653,019	-	-	(100,095)	552,924
11 Sep 17	01 Sep 20	12.732	6.11	1,158,513	-	-	(177,580)	980,933
09 Jun 17	01 Sep 20	9.017	8.55	3,594	-	-	(3,594)	-
09 Jun 17	01 Sep 19	9.017	9.71	6,329	-	-	(6,329)	-
12 Sep 16	01 Sep 20	9.017	3.80	806,883	-	-	(108,549)	698,334
12 Sep 16	01 Sep 19	9.017	4.33	1,416,260	-	-	(190,528)	1,225,732
13 Sep 15	01 Sep 19	7.013	2.84	1,004,997	-	-	(184,420)	820,577
Total				7,216,913	3,853,284	-	(1,225,716)	9,844,481

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

Note 29 Employee entitlements (continued)

Key estimates and assumptions

Share-based payments

The Group measures the cost of equity-settled transactions with employees granted during the year by reference to the fair value of the share rights at the date at which they are granted. The fair values are determined by independent

external valuers using a Black-Scholes model for DPSRs and a Monte Carlo simulation model for HPSRs which utilises the TSR share price hurdles. Key inputs into the valuation models for equity awards granted during the year are as follows:

Input	9 Sep 19 DPSR ¹	11 Nov 19 DPSR ¹	9 Sep 19 HPSR ¹	11 Nov 19 HPSR ¹	9 Dec 19 HPSR ¹
Dividend yield (%)	4.2	4.2	4.2	4.2	4.2
Risk-free rate (%)	0.83-0.85	0.87-0.97	0.83-0.85	0.87-0.97	0.75-0.81
Volatility ² (%)	N/A	N/A	29	29	29
Valuation (\$)	6.73-5.93	7.87-6.94	3.10	4.42	4.22

¹ Staggered deferred vesting applies to these grants.

² Forecast volatility rate implied from historic trend.

Note 30 Remuneration of auditor

	30 June 2020 \$	30 June 2019 \$
Amounts received or due and receivable by Ernst & Young (Australia) relating to:		
Full year audit and half year review of the Group financial report	1,928,488	1,630,924
Other audit services – audit and review of trusts and funds	525,567	469,196
Other assurance services	633,389	495,113
Other services in relation to the Group		
– taxation services	157,500	55,000
– other assurance services	45,000	164,305
	3,289,944	2,814,538
Amounts received or due and receivable by other overseas member firms of Ernst & Young (Australia) for:		
Fees for auditing the financial report of any controlled entities	391,810	413,154
Other services in relation to the Group		
– taxation services	90,238	103,150
	482,048	516,304
Total auditor remuneration¹	3,771,992	3,330,842

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

Note 31 Subsequent events

Subsequent to the balance date the Company completed a non-underwritten share purchase plan (SPP) raising \$35.0 million with 8.1 million shares issued to retail shareholders at a price of \$4.32 per share. Of the proceeds received from the SPP on 30 July 2020, \$30.0 million was injected into CLC as Common Equity Tier 1 capital on 31 July 2020 with the remaining \$5.0 million retained by the Group.

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

Directors' declaration

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

- a) the financial statements and notes of Challenger Limited and its controlled entities (the Group) are in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the Group's financial position as at 30 June 2020 and of its performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001;
- b) the financial statements and notes of the Group also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board, which is disclosed in Section 1(i) Basis of preparation and statement of compliance;
- c) there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable; and
- d) this declaration has been made after receiving the declarations required to be made to the Directors from the Chief Executive Officer and Chief Financial Officer in accordance with section 295A of the *Corporations Act 2001* for the financial year ended 30 June 2020.

On behalf of the Board



P Polson
Independent Chair
Sydney
10 August 2020



R Howes
Managing Director and Chief Executive Officer
Sydney
10 August 2020



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Independent auditor's report to the shareholders of Challenger Limited

Report on the Audit of the Financial Report

Opinion

We have audited the financial report of Challenger Limited (the Company) and its subsidiaries (collectively the Group), which comprises the consolidated statement of financial position as at 30 June 2020, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

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

- a) giving a true and fair view of the consolidated financial position of the Group as at 30 June 2020 and of its consolidated financial performance for the year ended on that date; and
- b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Opinion

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

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

Key Audit Matters

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

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

1 Valuation of Life Contract Liabilities

Financial report reference: **Note 8**

Why significant to the audit

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

Key assumptions used in the Group's model to determine the value of the life contract liabilities include:

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

These assumptions, along with policy information, are used as inputs to the Group's model to calculate the Life Contract Liabilities.

This was a key audit matter due to the value of the balance (30 June 2020: \$12,581.2 million), relative to total liabilities and the degree of judgment and estimation uncertainty associated with the valuation.

How our audit addressed the key audit matter

Our audit procedures involved an assessment of the effectiveness of relevant controls over assumptions and policy information used as inputs into the Group's model. Our IT specialists were involved to assess whether policy information was extracted accurately from the Group's underlying administration system into the valuation process.

Our audit procedures included the following in the evaluation of the assumptions used by the Group:

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

Where appropriate, we involved our life insurance actuarial specialists in the above procedures and overall assessment of the valuation methodology, key assumptions and models deriving the valuation of the life contract liabilities.

We assessed the adequacy of the related financial report disclosures.

2 Valuation of Level 3 Non-Property Investment Assets

Financial report reference: **Note 19**

Why significant to the audit

The Group holds a portfolio of assets carried at fair value, for which an observable market value is not readily available. These assets are classified as Level 3 assets within the fair value hierarchy of the financial report.

Level 3 assets require judgment to be applied in determining their fair value, as the valuation inputs for these assets are not based on observable market transactions or other readily available market data.

The Group exercised judgment to arrive at their best estimates of fair value of these assets. There is complexity in this process, as well as uncertainty associated with the valuation and modelling methodologies and the assumptions adopted.

As at 30 June 2020 there is significant valuation uncertainty arising from the COVID-19 pandemic and the response of Governments to it. This means that the Level 3 asset values may change significantly and unexpectedly over a relatively short period of time. In this situation the disclosures in the financial statements provide particularly important information about the assumptions made in the Level 3 asset valuations and the market conditions at 30 June 2020.

We have, therefore, considered this a key audit matter due to the number of judgments required in determining fair value. For the same reasons we consider it important that attention is drawn to the information in Note 19 in assessing the Level 3 valuations at 30 June 2020.

How our audit addressed the key audit matter

The valuation of Level 3 assets is inherently subjective given that there are alternative assumptions and valuation methods that may result in a range of values. The impact of COVID-19 at 30 June 2020 has resulted in a wider range of possible values than at past valuation points.

Our audit procedures included the following, using sampling techniques:

- Considered the Group's controls over the valuation of Level 3 assets.
- Tested the mathematical accuracy of the valuation models and consistency with the Group's documented methodology and assumptions.
- Our valuation specialists assessed the Group's valuation and modelling methodologies and assessed the key judgmental inputs used in the year-end valuations, including the discount rate and the terminal value.
- Obtained valuation statements provided by external investment managers in respect of unit trusts and hedge funds. We assessed the valuations of investments as provided by external investment managers, including an assessment of the reliability of the information received and the appropriateness of the underlying valuation method.

We assessed the adequacy and appropriateness of the related financial report disclosures, in particular those relating to the valuation uncertainty.

3 Valuation of Level 3 Property Investment Assets

Financial report reference: **Note 6**

Why significant to the audit

The Group owns a diversified portfolio of investment property assets valued at \$3.7 billion as at 30 June 2020, which represents 13.0% of total assets of the Group. The carrying value of investment properties is measured at the fair value of each property, which is assessed by the directors with reference to external independent property valuations and based on market conditions existing at the reporting date.

The fair value of investment property is inherently subjective and impacted by factors such as prevailing market conditions, its geographic location, expected future income and the characteristics and attributes of the subject property.

As at 30 June 2020 there is significant valuation uncertainty arising from the COVID-19 pandemic and the response of Governments to it. This means that the property values may change significantly and unexpectedly over a relatively short period of time.

Given the market conditions at balance date, a number of independent valuers have reported on the basis of the existence of 'material valuation uncertainty', noting that less certainty, and a higher degree of caution, should be attached to the valuations than would normally be the case. In this situation the disclosures in the financial statements provide particularly important information about the assumptions made in the property valuations and the market conditions at 30 June 2020.

We have, therefore, considered this a key audit matter due to the number of judgments required in determining fair value. For the same reasons we consider it important that attention is drawn to the information in Note 6 in assessing the property valuations at 30 June 2020.

How our audit addressed the key audit matter

The valuation of investment properties is inherently subjective given that there are alternative assumptions and valuation methods that may result in a range of values. The impact of COVID-19 at 30 June 2020 has resulted in a wider range of possible values than at past valuation points.

Our audit procedures included the following:

- We assessed the following matters with management:
 - movements in the Group's investment property portfolio;
 - changes in the condition of selected properties;
 - controls in place relevant to the valuation process; and
 - the impact that COVID-19 has had on the Group's investment property portfolio including rent abatements offered to tenants and tenant occupancy risk arising from changes in the estimated lease renewals.
- We performed the following procedures for selected properties, using sampling techniques:
 - Evaluated the key assumptions and agreed key inputs to tenancy schedules. These assumptions and inputs included market and contractual rent, occupancy rates including forecast occupancy levels, forecast rent, lease terms, re-leasing costs, operating expenditure and future capital expenditure. We assessed the effectiveness of relevant controls over the leasing process and associated tenancy reports which are used as source data in the property valuations by testing a sample of the relevant controls.
 - Assessed whether COVID-19 relief provided to tenants had been factored into the valuations and that changes in tenant occupancy risk were also considered.
 - Where relevant we compared the valuation against comparable transactions utilised in the valuation process.
 - Evaluated the suitability of the valuation methodology across the portfolio based on the type of asset. We considered the reports of the independent valuers and held discussions with them where considered appropriate, to gain an understanding of the assumptions and estimates used and the valuation methodology applied. This included the impact that COVID-19 has had on key assumptions such as the capitalisation, discount or growth rate and future forecast rentals. We have also considered and responded to restrictions imposed on the valuation process, if any, and the market conditions at balance date.
- We have considered whether there have been any indicators of material changes in property valuations from 30 June 2020 up to the date of our opinion.

Where appropriate, we involved our real estate valuation specialists in the above procedures.

We assessed the adequacy and appropriateness of the related financial report disclosures, in particular those relating to the valuation uncertainty.

4 Recoverability of Goodwill

Financial report reference: **Note 25**

Why significant to the audit

Goodwill has been recognised as a result of the Group's historical acquisitions, representing the excess of the purchase consideration over the fair value of assets and liabilities acquired. On acquisition date, the goodwill has been allocated to the applicable Cash Generating Units (CGUs).

An impairment assessment is performed at each reporting period, comparing the carrying amount of each CGU containing goodwill with its recoverable amount. The recoverable amount of each CGU is determined on a value in use basis. This calculation incorporates a range of assumptions, including future cash flows, discount rate and terminal growth rate.

This was a key audit matter due to the value of Goodwill relative to total assets (30 June 2020: \$579.9 million), and the degree of judgment and estimation uncertainty associated with the impairment assessment.

How our audit addressed the key audit matter

Our audit procedures included the following:

- Considered the carrying amount of the net assets of the Group against its market capitalisation at 30 June 2020.
- Assessed the valuation methodology used to calculate the recoverable amount of each CGUs.
- Agreed the projected cash flows used in the impairment models to the Board approved five-year plan of the Group.
- Compared the Group's implied growth rate assumption to comparable companies.
- Considered the accuracy of historical cash flow forecasts.
- Assessed the methodology and assumptions used in the calculation of the discount rate, including comparison of the rate to market benchmarks.
- Tested the mathematical accuracy of the impairment model for each CGU.
- Considered the Group's sensitivity analysis and evaluated whether any reasonably foreseeable change in assumptions could lead to a material impairment.

Our valuation specialists were involved in the above procedures where appropriate.

We assessed the Group's determination of the CGUs to which goodwill is allocated and the adequacy of the related financial report disclosures.

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

The directors are responsible for the other information. The other information comprises the information included in the Company's 2020 Annual Report, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon, with the exception of the Remuneration Report and our related assurance opinion.

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

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

Responsibilities of the Directors for the Financial Report

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

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

Auditor's Responsibilities for the Audit of the Financial Report

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

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

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

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

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

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

Report on the Audit of the Remuneration Report

Opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 27 to 47 of the Directors' report for the year ended 30 June 2020.

In our opinion, the Remuneration Report of Challenger Limited for the year ended 30 June 2020, complies with section 300A of the *Corporations Act 2001*.

Responsibilities

The directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.



Ernst & Young



T Johnson
Partner

Sydney
10 August 2020



G McKenzie
Partner

Sydney
10 August 2020

Investor information

Substantial shareholders

The number of shares held by substantial shareholders and their associates, based on the latest substantial shareholder notifications, and the 20 largest individual shareholders are as follows:

Substantial shareholders as at 31 July 2020	Number of shares	% of issued capital
MS&AD Insurance Group Holdings Inc	101,030,303	14.95
Caledonia (Private) Investments Pty Ltd	98,935,890	14.64
20 largest individual shareholders as at 31 July 2020		
1. Citicorp Nominees Pty Limited	199,504,992	29.53
2. HSBC Custody Nominees (Australia) Limited	145,404,473	21.52
3. J P Morgan Nominees Australia Pty Limited	88,219,590	13.06
4. National Nominees Limited	14,539,858	2.15
5. HSBC Custody Nominees (Australia) Limited - GSCO ECA	11,492,590	1.70
6. Merrill Lynch (Australia) Nominees Pty Limited	9,081,709	1.34
7. BNP Paribas Nominees Pty Ltd <Agency Lending DRP A/C>	7,716,627	1.14
8. UBS Nominees Pty Ltd	7,668,360	1.14
9. HSBC Custody Nominees (Australia) Limited - A/C 2	6,759,847	1.00
10. BNP Paribas Nominees Pty Ltd <DRP>	5,448,553	0.81
11. Argo Investments Limited	5,440,311	0.80
12. HSBC Custody Nominees (Australia) Limited - GSI EDA	4,718,651	0.70
13. CPU Share Plans Pty Ltd <CGF Performance Plan A/C>	2,357,766	0.35
14. Australian United Investment Company Limited	2,310,000	0.34
15. Citicorp Nominees Pty Limited <Colonial First State INV A/C>	1,973,379	0.29
16. National Nominees Limited <N A/C>	1,930,224	0.29
17. Warbont Nominees Pty Ltd <Unpaid Entrepot A/C>	1,781,026	0.26
18. Netwealth Investments Limited <Wrap Services A/C>	1,401,673	0.21
19. Merrill Lynch (Australia) Nominees Pty Limited <MLPRO A/C>	1,303,924	0.19
20. AMP Life Limited	1,263,409	0.19
Total 20 largest individual shareholders – issued capital	520,316,962	77.01
Total remaining shareholders balance	155,297,768	22.99

Distribution of shares (as at 31 July 2020)

Range	Number of shareholders	Number of shares	% of issued capital
1 – 1,000	20,923	9,654,429	1.43
1,001 – 5,000	18,843	45,518,938	6.73
5,001 – 10,000	3,944	28,651,655	4.24
10,001 – 100,000	2,496	50,854,721	7.53
100,001 and over	91	540,934,987	80.07
Total	46,297	675,614,730	100.00
Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum \$500.00 parcel at \$4.34 per unit	116	2,723	176,165

ASX listing

Challenger Limited shares are listed on the ASX under code CGF. Share price details and company information can be accessed via either the Company website:

› www.challenger.com.au

or the ASX website:

› www.asx.com.au

Voting rights

On a show of hands, every member present at the meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.

Investor information (continued)

Buy-back

There is currently no market buy-back.

On market acquisitions for employee incentive schemes during the financial year ended 30 June 2020

0.8 million Challenger Limited ordinary shares were purchased on market to satisfy entitlements under Challenger's employee incentive schemes at an average price per share of \$11.00.

Top 20 noteholders of Challenger Capital Notes 1 as at 31 July 2020

20 largest individual noteholders as at 31 July 2019		Number of notes	% of issued notes
1.	HSBC Custody Nominees (Australia) Limited	318,683	9.24
2.	J P Morgan Nominees Australia Pty Limited	150,424	4.36
3.	BNP Paribas Nominees Pty Ltd HUB24 Custodial Serv Ltd <DRP A/C>	94,149	2.73
4.	Australian Executor Trustees Limited <IPS Super A/C>	88,882	2.57
5.	National Nominees Limited	88,326	2.56
6.	Citicorp Nominees Pty Limited	57,735	1.67
7.	BNP Paribas Nominees Pty Ltd <Pitcher Parnters DRP>	50,915	1.48
8.	Netwealth Investments Limited <Wrap Services A/C>	40,463	1.17
9.	Eastcote Pty Ltd <Van Lieshout Family A/C>	40,000	1.16
10.	Navigator Australia Ltd <MLC Investment Sett A/C>	32,084	0.93
11.	Taverners No 11 Pty Ltd <Brencorp No 11 Unit A/C>	30,586	0.89
12.	MF Investments No 1 Pty Ltd	30,000	0.87
13.	Sandhurst Trustees Ltd <Endeavor Asset Mgmt MDA A/C>	28,833	0.84
14.	Madingley Nominees Pty Ltd <Andrew Thyne Reid Charit A/C>	27,512	0.80
15.	Australian Executor Trustees Limited <IPS IDPS A/C>	26,355	0.76
16.	Willimbury Pty Ltd	22,000	0.64
17.	Nulis Nominees (Australia) Limited <Navigator Mast Plan Sett A/C>	20,461	0.59
18.	BNP Paribas Nominees Pty Ltd <IB AU Noms Retailclient DRP>	20,153	0.58
19.	GCF Investments Pty Ltd	20,000	0.58
20.	270 King Street Pty Ltd	17,600	0.51
Total 20 largest individual noteholders – issued notes		1,205,161	34.93
Total remaining noteholders balance		2,244,839	65.07

Distribution of notes (as at 31 July 2020)

Range	Number of holders	Number of notes	% of notes
1 – 1,000	2,861	1,042,550	30.22
1,001 – 5,000	387	775,976	22.49
5,001 – 10,000	38	286,713	8.31
10,001 – 100,000	28	875,654	25.38
100,001 and over	2	469,107	13.60
Total	3,316	3,450,000	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum \$500.00 parcel at \$98.30 per unit	6	3	14

Investor information (continued)

Top 20 noteholders of Challenger Capital Notes 2 as at 31 July 2020

20 largest individual noteholders as at 31 July 2020		Number of notes	% of issued notes
1.	HSBC Custody Nominees (Australia) Limited	405,615	8.82
2.	BNP Paribas Nominees Pty Ltd HUB24 Custodial Serv Ltd <DRP A/C>	150,458	3.27
3.	J P Morgan Nominees Australia Pty Limited	123,064	2.67
4.	Australian Executor Trustees Limited <IPS Super A/C>	112,602	2.45
5.	Citicorp Nominees Pty Limited	91,773	2.00
6.	National Nominees Limited	60,054	1.31
7.	Netwealth Investments Limited <Wrap Services A/C>	57,901	1.26
8.	Taverners No 11 Pty Ltd <Brencorp No 11 Unit A/C>	54,689	1.19
9.	Navigator Australia Ltd <JB Were List Fix Int SMA A/C>	50,692	1.10
10.	Mutual Trust Pty Ltd	47,058	1.02
11.	Navigator Australia Ltd <MLC Investment Sett A/C>	42,610	0.93
12.	Australian Executor Trustees Limited <IPS IDPS A/C>	39,451	0.86
13.	BNP Paribas Nominees Pty Ltd <Pitcher Partners DRP>	33,332	0.72
14.	Taverners J Pty Ltd <Scanlon Foundation RC A/C>	32,538	0.71
15.	LBL Investment Pty Ltd <L&B Family A/C>	30,000	0.65
16.	Trustees Of Church Property, Diocese Of Newcastle <Savings & Development A/C>	29,270	0.64
17.	HSBC Custody Nominees (Australia) Limited - A/C 2	27,287	0.59
18.	Nulis Nominees (Australia) Limited <Navigator Mast Plan Sett A/C>	26,404	0.57
19.	Sargon Ct Pty Ltd <Charitable Foundation>	23,129	0.50
20.	Taverners No 11 Pty Ltd <Stoneyville Invest Unit A/C>	21,604	0.47
Total 20 largest individual noteholders – issued notes		1,459,531	31.73
Total remaining noteholders balance		3,140,469	68.27

Distribution of notes (as at 31 July 2020)

Range	Number of holders	Number of notes	% of notes
1 – 1,000	5,683	1,624,526	35.32
1,001 – 5,000	519	1,094,062	23.78
5,001 – 10,000	29	217,113	4.72
10,001 – 100,000	31	872,560	18.97
100,001 and over	4	791,739	17.21
Total	6,266	4,600,000	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum \$500.00 parcel at \$100.20 per unit	5	5	9

ASX listing

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

➤ www.asx.com.au

Voting rights

Challenger Capital Notes 1 and 2 do not confer any voting rights in the Company but if they are exchanged or converted for ordinary shares in accordance with their terms of issue, then the voting rights of the ordinary shares will be the same as for ordinary shares.

Shareholder queries

For any administrative matters in respect of your Challenger Limited shareholding or noteholding, please contact the Company's share registrar, Computershare:

Computershare Investor Services Pty Limited
Level 3, 60 Carrington Street, Sydney NSW 2000
Telephone: 1800 780 782

Website: ➤ www.computershare.com.au

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

Additional information

Principal place of business and registered office in Australia

Level 2
5 Martin Place
Sydney NSW 2000
Telephone: 02 9994 7000
Facsimile: 02 9994 7777
Investor services: 13 35 66

Directors

Peter Polson (Chair)
Richard Howes (Managing Director and Chief Executive Officer)
John M Green
Steven Gregg
Masahiko Kobayashi
JoAnne Stephenson
Duncan West
Melanie Willis

Company secretaries

Michael Vardanega
Andrew Brown

Website

› challenger.com.au

Manage your shareholding at Computershare Investor Services

Computershare Investor Services Pty Limited
Level 3, 60 Carrington Street
Sydney NSW 2000
Telephone: 02 8234 5000

› computershare.com.au

Telephone: 1800 780 782

Auditor

Ernst & Young
200 George Street
Sydney NSW 2000

Go electronic

Challenger can deliver all of your shareholder communications electronically, by updating your details via Computershare Investor Services.

Online digital version of this report

The 2020 Annual Report is available at:

› challenger.com.au/annualreport2020

