Challenger Limited ACN 106 842 371 and its controlled entities.

Interim Financial Report 2016

Challenger Limited provides Australians with financial security for retirement.

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Key Dates

29 March 2016
Interim dividend payment date

17 August 2016
Full year financial results
Final dividend announcement

28 September 2016
Final dividend payment date

27 October 2016
2016 Annual General Meeting

Dates may be subject to change.
A full listing of key dates can be found at:

challenger.com.au/share/keydates

ABOUT THIS REPORT

The Interim Financial Report 2016 can be downloaded from Challenger's online Shareholder Centre at:

challenger.com.au/share

1 Directors

The names and details of the Directors of Challenger Limited (the Company) holding office during the six months to 31 December 2015 and as at the date of this report are listed below. Directors were in office for this entire period unless otherwise stated.

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

2 Review of operations

Challenger has continued to grow income across its operating segments during the first half of the 2016 financial year.

2.1 Key performance indicators (KPIs)

KPIs for the period ended 31 December 2015 (with the 6 months to 31 December 2014 being the prior comparative period (PCP), unless otherwise stated) include:

	31 Dec 2015	31 Dec 2014	change %
Profitability			
Statutory profit attributable to equity holders ($M)	234.3	130.1	80.1
Normalised NPAT ($M)	182.1	154.9	17.6
Statutory EPS (cents)	41.9	24.2	73.1
Normalised EPS (cents)	32.6	28.8	13.2
Interim dividend (cents)	16.0	14.5	10.3
Interim dividend franking	100%	70%	30.0
Normalised cost to income ratio	33.8%	34.4%	(0.6)
Statutory RoE after tax	18.0%	11.1%	6.9
Normalised RoE after tax	14.0%	13.2%	0.8
Growth			
Total Life annuity sales ($M)	1,641.1	1,574.8	4.2
Life annuity net flows ($M)	270.5	560.8	(51.8)
Life annuity net book growth%	3.1%	7.2%	(4.1)
Total FM net flows ($bn)	(4.4)	6.7	Large
Total AUM ($bn)	57.6	57.2	0.7

Challenger's statutory profit attributable to equity holders was significantly higher for the period ended 31 December 2015 primarily as a result of fair value gains during the period relative to fair value losses in the prior period together with significant item gains. The fair value gains for the period were mainly as a result of positive valuation movements associated with policy liabilities and property offset by fair value losses from fixed income credit spreads expanding during the period and fair value losses associated with the equity and alternative portfolio.

Normalised net profit after tax grew compared to the prior period, reflecting AUM growth and disciplined cost managment.

An interim dividend of 16.0 cents was announced, franked at 100%, up from 14.5 cents (70% franked).

Statutory EPS has increased substantially for the period when compared to the prior period, reflecting the increased profit attributable to equity holders as a result of increased earnings and the impact of fair value changes on Challenger Life Company's (CLC's) assets and liabilities and significant item gains.

Challenger's normalised cost to income ratio of 33.8% remains within the targeted range and is in line with the ratio at 30 June 2015. This is notwithstanding the additional costs associated with the Dexion Capital business purchased in July 2015 being reflected for the period ending 31 December 2015. Challenger's medium-term expected normalised cost to income ratio target is a range of 32-36%.

Statutory return on equity (RoE) after tax of 18.0% has increased substantially (31 December 2014: 11.1%) as a result of higher earnings and higher investment experience after tax and significant items.

2 Review of operations (continued)

2.2 Normalised profit and investment experience

Normalised framework

Challenger Life Company (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. Investment experience also includes any impact from changes in economic and 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

	31 Dec 2015 $M	31 Dec 2014 $M	change $M	change %
Net income[1]	360.6	314.6	46.0	14.6
Comprising:				
– Life normalised COE	292.9	257.8	35.1	13.6
– FM net income	67.1	56.1	11.0	19.6
– Corporate and other net income	0.6	0.7	(0.1)	(14.3)
Operating expenses[1]	(121.9)	(108.2)	(13.7)	12.7
Normalised EBIT	**238.7**	**206.4**	**32.3**	**15.6**
Comprising:				
– Life normalised EBIT	248.9	215.8	33.1	15.3
– FM normalised EBIT	21.6	20.8	0.8	3.8
– Corporate and other normalised EBIT	(31.8)	(30.2)	(1.6)	5.3
Interest and borrowing costs	(2.3)	(1.7)	(0.6)	35.3
Tax on normalised profit	(54.3)	(49.8)	(4.5)	9.0
Normalised NPAT	**182.1**	**154.9**	**27.2**	**17.6**
Investment experience after tax	30.1	(24.8)	54.9	Large
Significant items after tax	22.1	-	22.1	Large
Statutory net profit after tax attributable to equity holders	**234.3**	**130.1**	**104.2**	**80.1**

[1] 'Net income' and 'Operating expenses' are internal classifications and are defined in Note 3 Segment information in the interim financial report. These differ from the statutory revenue and expenses classifications, as certain costs (including distribution expenses, property expenses, management fees and special purpose vehicle expenses and finance costs) are netted off against gross revenues. These classifications have been made in the Directors' report and in Note 3 Segment information to reflect how management measures business performance. Whilst the allocation of amounts to the above items, investment experience and significant items differs 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 EBIT increased as a result of higher Life investment assets combined with an increased margin being earned on those assets. Life's average assets under management (AUM) increased by 11.7% as a result of the net book growth in annuities and valuation movements on those assets.

Funds Management net income increased (up $11.0 million) due to higher average funds under management (FUM) in the period when compared to the prior period and revenue from the acquisition of Dexion Capital in the period. Funds Management average FUM increased by 4.3% as a result of inflows throughout the year and mark-to-market gains on investments.

Operating expenses increased for the period ended 31 December 2015 (up $13.7 million) primarily due to operating expenses associated with the Dexion Capital acquisition as well as additional expenses incurred to support the Company's growth ambitions. To 31 December 2015, Challenger's employee numbers increased by 55 (or 9.8%) to 618, of which 44 related to the acquisition of Dexion Capital.

Normalised tax for the period was $54.3 million, up $4.5 million (9.0%) from 31 December 2014 due to higher earnings before interest and tax (up 15.6%). The normalised effective tax rate for the period has reduced slightly to 23.0% (24.3% at 31 December 2014).

2 Review of operations (continued)

2.2 Normalised profit and investment experience (continued)

Management analysis – investment experience

	31 Dec 2015 $M	31 Dec 2014 $M
Actual capital growth[1]		
– Cash and fixed income	(79.6)	(45.7)
– Infrastructure	2.8	16.8
– Property (net of debt)	76.3	75.3
– Equity and other investments	(32.1)	(1.0)
Total actual capital growth	**(32.6)**	**45.4**
Normalised capital growth[2]		
– Cash and fixed income	(14.8)	(14.5)
– Infrastructure	11.2	10.6
– Property (net of debt)	31.4	23.5
– Equity and other investments	20.6	14.9
Total normalised capital growth	**48.4**	**34.5**
Investment experience		
– Cash and fixed income	(64.8)	(31.2)
– Infrastructure	(8.4)	6.2
– Property (net of debt)	44.9	51.8
– Equity and other investments	(52.7)	(15.9)
Annuity valuation experience[3]	124.0	(46.3)
Investment experience before tax	43.0	(35.4)
Tax (expense) /benefit	(12.9)	10.6
Investment experience after tax	**30.1**	**(24.8)**

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

[2] Normalised capital growth is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised capital growth rates represent Challenger's expectations for each asset class over the investment cycle. The normalised growth rate is +4.5% for equity and other investments, +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. For the 2016 financial year, the equity and other normalised growth rate has been reduced to +4.5% (from +6.0%) to reflect the current low growth environment and the mix of CLC's equity portfolio, which includes both listed and unlisted equities.

[3] Annuity valuation experience represents the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions, losses on new business and other factors applied in the valuation of life contract liabilities.

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

31 December 2015 investment experience comprises a $81.0 million loss in relation to fair value movements on Life's assets and a $124.0 million gain in relation to fair value movements on Life's liabilities. Continued property valuation gains (net of related transaction costs) were offset by negative fixed income investment fair value movements due to the expansion in domestic and offshore credit spreads together with adverse equity and alternative fair value movements as a result of falling global equity markets during the period.

Significant items after tax of $22.1 primarily represents the gain on sale of Challenger's equity investment in Kapstream together with boutique impairments and related costs following the closure of Metisq and Areté ($12.1 million) and costs associated with Challenger's head office premises move to 5 Martin Place ($3.2 million).

2.3 Life segment results

The Life segment includes CLC, Australia's leading provider of annuities and guaranteed retirement income products and Accurium Actuarial Pty Limited. CLC has won the Association of Financial Advisers/Planners for Life annuity provider of the year for the past seven years.

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

Life normalised results	31 Dec 2015 $M	31 Dec 2014 $M	change $M	change %
Normalised COE				
– Cash earnings	244.5	223.3	21.2	9.5
– Normalised capital growth	48.4	34.5	13.9	40.3
Operating expenses	(44.0)	(42.0)	(2.0)	4.8
Normalised EBIT	**248.9**	**215.8**	**33.1**	**15.3**

Life normalised EBIT increased by $33.1 million (up 15.3%) due to higher normalised COE (up $35.1 million or 13.6%), which was partially offset with operating expenses increasing by $2 million (or 4.8%). The higher normalised COE was as a result of higher investment assets, with Life average investment assets increasing 11.7% coupled with an increased margin.

Life annuity sales increased slightly over the prior period (up 4.2%), primarily as a result of increased fixed term sales (up 12.5%) offset by a decline in lifetime annuity sales (down 28.4%) following the suspension of the Care Annuity in November 2014. The CarePlus Annuity was launched to the market in August 2015 and sales are expected to grow significantly as the product has now been approved for sale by all the major hubs. Life annuity sales continue to benefit from an ageing population, retiree focus on consistent incomes and retirees taking a more conservative approach to investing in retirement.

2 Review of operations (continued)

2.3 Life segment results (continued)

Life sales	31 Dec 2015 $M	31 Dec 2014 $M	change $M	change %
Fixed-term annuities	1,412.4	1,255.6	156.8	12.5
Lifetime annuities	228.7	319.2	(90.5)	(28.4)
Total Life annuity sales	1,641.1	1,574.8	66.3	4.2
Other Life sales	409.7	548.9	(139.2)	(25.4)
Total Life sales	**2,050.8**	**2,123.7**	**(72.9)**	**(3.4)**
Annuity net flows	270.5	560.8	(290.3)	(51.8)
Other Life net flows	76.6	(122.4)	199.0	Large

Annuity net flows (new annuity sales less capital repayments) decreased by 51.8% to $270.5 million. The reduction reflects higher annuity sales offset by increased capital repayments as a result of historical growth in the business. Based on the opening Life annuity book for the 2016 financial year ($8,692.6 million), annuity net book growth for the period was 3.1%, which was down from 7.2% in the prior period.

Other Life sales represents Challenger's Guaranteed Index Return (GIR) product. While other Life sales were reduced for the period compared to the prior period, maturities were also less resulting in increased net flows for the period.

2.4 Funds Management segment results

Challenger's Funds Management segment is Australia's eighth[1] largest investment manager and one of Australia's fastest growing.

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 Fidante Partners model is delivering superior investment performance, with 92% of all funds and mandates outperforming their benchmark since inception.

FM normalised results	31 Dec 2015 $M	31 Dec 2014 $M	change $M	change %
Net income				
– Fidante Partners	41.3	32.1	9.2	28.7
– CIP	25.8	24.0	1.8	7.5
Operating expenses	(45.5)	(35.3)	(10.2)	28.9
Normalised EBIT	**21.6**	**20.8**	**0.8**	**3.8**

Funds Management normalised EBIT increased for the period by 3.8%, with higher net income offset by higher expenses largely as a result of the acquisition of Dexion Capital. Expenses increased by $10.2 million, of which the majority relates to Dexion Capital's operating costs.

Fidante Partners' net income includes distribution fees, administration fees and a share in the equity accounted profits for the boutique fund managers in which it has an equity interest. Fidante Partners net income increased for the period primarily as a result of increased distribution fees (up $9.2 million to $41.3 million) including income from Dexion.

Challenger Investment Partners' (CIP) net income increased due to higher net management fees (up $2.6 million), partially offset by slightly lower performance and transaction fees.

Funds Management normalised return on equity (RoE) (pre-tax) for the period was 28.4%, down by 4.1 percentage points from the prior period. This reduction comes largely as a result of the capital invested in the acquisition of Dexion Capital. RoE continues to benefit from strong FUM growth and capturing the benefits of scale.

On 2 July 2015, Challenger announced the sale of its 25% equity interest in Australian-based global fixed income fund manager, Kapstream Capital Pty Limited, to Janus Capital Group Inc., a US-based global investment business, for $45.0 million.

Challenger recognised a $40.0 million pre-tax profit from the sale of its 25% equity interest in Kapstream. Fidante Partners no longer receives equity distributions from Kapstream; however, it receives administration and distribution fees. As a result, over the medium term, Fidante Partners' normalised earnings are not expected to be negatively impacted.

During the period, Challenger's equity interest in its associates Metisq and Areté were impaired following the decision to close the businesses. Along with wind up costs, a total of $12.1 million after tax has been recognised as a significant item expense in the period.

FM FUM and flows	31 Dec 2015 $bn	31 Dec 2014 $bn	change $bn	change %
– Fidante Partners	41.6	42.5	(0.9)	(2.1)
– CIP	13.1	12.7	0.4	3.1
Total FUM	**54.7**	**55.2**	**(0.5)**	**(0.9)**
– Fidante Partners	(4.0)	5.4	(9.4)	Large
– CIP	(0.4)	1.3	(1.7)	Large
Total net flows	**(4.4)**	**6.7**	**(11.1)**	**Large**

Fidante Partners FUM (down $0.9 billion) was driven by net flows (down $3.3 billion) and positive impact from investment markets (up $1.2 billion), net of distributions and the loss of FUM resulting from the sale of Kapstream in July 2015 ($5.4 billion).

CIP FUM growth (up $0.4 billion) is primarily a result of additional property, offset by lower fixed income flows (down $0.9 billion) and weaker fixed income markets (down $0.7 billion).

[1] Rainmaker – Consolidated FUM for Australian Fund Managers September 2015.

2 Review of operations (continued)

2.5 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	31 Dec 2015 $M	31 Dec 2014 $M	change $M	change %
Net income	0.6	0.7	(0.1)	(14.3)
Operating expenses	(32.4)	(30.9)	(1.5)	4.9
Normalised EBIT	**(31.8)**	**(30.2)**	**(1.6)**	**5.3**
Interest and borrowing costs	(2.3)	(1.7)	(0.6)	35.3
Normalised loss before tax	**(34.1)**	**(31.9)**	**(2.2)**	**6.9**

Normalised EBIT for the Corporate and other segment was lower (down $1.6 million) as a result of higher other expenses partially offset by lower personnel costs.

2.6 Capital management

Challenger's capital position is managed at both the Group and the prudentially-regulated CLC level, with the objective of maintaining the financial stability of the Group and CLC whilst ensuring that shareholders earn an appropriate risk adjusted return. Refer to Note 9 Contributed equity for further information on the Group's Internal Capital Adequacy Assessment Process.

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

Capital	31 Dec 2015	31 Dec 2014	change
Net assets attributable to equity holders ($M)	2,696.2	2,442.9	253.3
CLC excess capital over PCA ($M)	1,095.6	1,174.7	(79.1)
Group cash ($M)	89.3	126.0	(36.7)
CLC excess capital over PCA + Group cash ($M)	1,184.9	1,300.7	(115.8)
CLC PCA ratio (times)	1.65	1.75	(0.10)
CLC CET1 ratio (times)	1.16	1.21	(0.05)

CLC regulatory capital base

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

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

CLC maintains a level of capital representing APRA's PCA plus a target surplus. The target surplus is a level of excess capital that CLC seeks to carry over and above APRA's minimum requirement 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 1.4 to 1.6 times. This range will change over time and is dependent on a number of factors.

The decrease in excess regulatory capital resulted from a further $107.6m of LAGIC transition balance being amortised on 1 January 2015 together with higher capital requirements as a result of CLC's increased investment in property and equity assets which require a higher PCA than fixed income investments both of which were partially offset by increased retained earnings. CLC's 31 December 2015 excess regulatory capital position includes the remaining LAGIC transition balance of $107.6 million. Following the amortisation of the remaining transition balance on 1 January 2016, CLC's PCA and CET1 ratios were 1.55 times and 1.09 times respectively.

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 an undrawn Group corporate debt facility of $350.0 million in order to provide additional financial flexibility. The facility remained undrawn throughout the period.

Subordinated debt

CLC's total regulatory capital base includes $477.5 million of admissible subordinated debt. Subordinated debt tranches issued prior to 1 January 2013 continue to be fully eligible as Tier 2 regulatory capital under LAGIC until each tranche's first call date after 1 January 2013, and then amortise over four years. For tranches already past their call date, under LAGIC the first coupon date following the effective date of LAGIC is considered the first call date.

CLC's subordinated debt includes $168.9 million which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only $67.6 million (i.e. 40% of the total amount) is eligible as Tier 2 regulatory capital at 31 December 2015.

The largest tranche of CLC's existing subordinated debt comprises $374.7 million with a call date in November 2017. As such, this tranche will continue to be fully eligible as Tier 2 regulatory capital until its call date in November 2017 and will continue to be partially eligible until November 2021.

APRA's Level 3 (conglomerate) proposals

The Group is a Level 3 Head under the APRA conglomerates framework. Level 3 groups are groups of companies that perform material activities across more than one APRA-regulated industry and/or in one or more non-APRA regulated industries. APRA is currently developing a supervisory framework for Level 3 (conglomerate) groups. Draft Level 3 standards were issued by APRA in May 2013. However, APRA is yet to confirm the implementation date.

2 Review of operations (continued)

2.6 Capital management (continued)

In August 2014, APRA deferred a decision on its final Level 3 standards and implementation until the Government response to the recommendations of the Financial System Inquiry were announced. The Government response to the Financial System Inquiry was provided on 20 October 2015. However, to date, APRA has not provided any further comment in relation to the Level 3 proposals.

2.7 Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In December 2015, S&P reaffirmed both Challenger Limited and CLC's credit ratings.

Ratings were confirmed as:

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

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

3 Dividends, share buy-back and dividend reinvestment plan

Dividends	31 Dec 2015	31 Dec 2014	change	change %
Interim dividend (cents)[1]	16.0	14.5	1.5	10.3
Interim dividend franking	100%	70%	30%	N/A

[1] Interim dividend declared on 15 February 2016 and paid on 29 March 2016 in respect of the half year ended 31 December 2015.

An interim dividend of 16.0 cents was announced, franked at 100%, up from 14.5 cents (70% franked).

On 17 August 2015, the Directors of the Company declared a final dividend on ordinary shares in respect of the year ended 30 June 2015 of 15.5 cents per share (franked at 100%). The final dividend totalling $87.5 million was paid on 30 September 2015.

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

With the increase in forecast dividend franking levels, in August 2014 the Board revised the targeted dividend payout ratio to a range of 45% to 50% of normalised net profit after tax. The dividend payout ratio for the period ended 31 December 2015 was 49.1%.

The Company also seeks to frank its dividend to the maximum extent possible and expects future dividends 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.

Challenger implemented a dividend reinvestment plan (DRP) commencing with the final dividend for 2015. The DRP participation rate was 7% of all issued shares and 890,868 ordinary shares were issued to satisfy the DRP requirements on 14 October 2015.

The DRP will continue in operation for the interim dividend. For this interim dividend, the Board has determined that new shares will be issued to fulfil DRP requirements. However, the new shares will not be issued at a discount to the prevailing Challenger share price.

No shares were bought back during the period.

4 Likely developments and expected results

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

1 to be recognised as the leader in retirement income solutions in Australia;
2 to increase the portion of the Australian retirement savings pool allocation to secure and lifetime income products; and
3 within the Funds Management business, to provide clients with relevant strategies exhibiting consistently superior risk/return outcomes.

Life segment outlook

The Australian retirement incomes market is expected to grow strongly over the next 20 years as Australia's Baby Boomers (born 1946 to 1964) move from retirement 'saving' to retirement 'spending'. Over the next 20 years the number of Australians over 65, which is Life's target demographic, is expected to increase by 75%[1].

Challenger is well positioned to benefit from changes in retiree risk preferences, including the focus on longevity risk by retirees and their advisers. Annuities address many of the financial concerns retirees face in retirement.

Challenger is investing in technology to allow its annuities to easily integrate with account-based pensions as there is a growing acceptance that annuities are part of the optimal retirement income solution. Integrating annuities with account-based pensions supports income layering and enables guaranteed incomes to be combined with other products to build more comprehensive retirement income solutions.

During the period, Challenger's annuities were launched on the Colonial First State platform, Australia's leading investment platform, providing access to half of Australia's financial adviser firms. Challenger expects to add annuities to other retail platforms over time.

In the industry fund sector, Challenger backed term and lifetime annuities have been integrated with VicSuper account-based pensions to create Australia's first comprehensive income product for retirement. Challenger has also formed a strategic alliance with the Link Group/AAS, who service the needs of 10 million Australian industry superannuation members. The AAS alliance will see Challenger's annuities available to their industry fund clients. The AAS technology build is currently underway and it is expected the capability will

[1] Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2015-2035.

4 Likely developments and expected results (continued)

Life segment outlook (continued)

be available to AAS clients by mid-calendar year 2016. A number of AAS clients have already indicated that they will be connecting to Challenger annuities once available via AAS, with others expected to follow.

These retail and industry platform innovations are providing Challenger with access to one third of Australia's superannuation industry.

The retirement phase of superannuation is a high growth market driven by ageing demographics and rising superannuation balances due to mandatory superannuation contributions. Over the past 10 years, the annual flow moving from the accumulation phase to the retirement phase has increased by 10% CAGR and is expected to increase by 12%[1] CAGR over the next 10 years.

There is a growing recognition that retirees need to take a different approach to investing in retirement and there is a move toward income layering investing. As retirees transition from Government funded aged pensions to private pensions, they are demanding safe, secure retirement income products that convert savings to income and provide financial security in retirement. Annuities provide this safety and security.

The industry is responding to consumer demand with a range of new retirement income products, including the emergence of Comprehensive Income Products for Retirement as recommended by the Financial System Inquiry (FSI) and retirement income models.

The Australian Federal Government commissioned the FSI to provide a 'blueprint' for Australia's financial system over the next decade. The FSI report (released December 2014) recommended the retirement phase of superannuation would benefit greatly from pre-selected retirement products for members. These products would provide regular and stable income streams with longevity protection. Annuities were recognised as providing this and could be part of pre-selected retirement products offered by all superannuation funds.

The FSI also recommended the impediments to longevity product development be removed. This would clear the way for Challenger to develop and issue deferred lifetime annuities, expanding Life's product offering. Deferred lifetime annuities are expected to be popular as they provide protection against the risk of running out of money late in life.

The Federal Government responded to the FSI recommendations in October 2015 and supported all major retirement income recommendations, including the introduction of Comprehensive Income Products for Retirement and will consult on legislation by the end of 2016. The Federal Government also supports the recommendation that regulatory barriers to longevity products, including deferred lifetime annuities, should be removed.

[1] Rice Warner 2014 Super Projections – forecasted growth over next 10 years based on existing regulatory environment.

As Australia's leading retirement income specialist, Challenger is uniquely positioned to benefit from growth in Australia's retirement incomes market and the move to more guaranteed retirement incomes. Challenger's growth is being amplified through Challenger's market-leading distribution, product innovation and strong retirement incomes brand recognition.

Funds Management segment outlook

The Australian funds management market remains an attractive market underpinned by mandated superannuation contribution flows. Superannuation contributions increased to 9.5% of gross salaries on 1 July 2014 and are scheduled to increase to 12.0% by 2025. The mandated nature of Australia's superannuation system is expected to significantly increase the size of Australia's superannuation assets from $2 trillion[2] at September 2015 to in excess of $10.0 trillion[3] over the next 20 years.

Fidante Partners continues to identify new investment manager talent and is adding capacity to existing managers together with expanding the platform in Europe. The platform has a variety of managers across Australian equities, international equities, fixed income and alternatives.

The acquisition and integration of Dexion Capital has substantially expanded Fidante Partners' successful multi-boutique model into the European market, whilst opening up global distribution opportunities for existing boutique investment managers.

Since the acquisition of Dexion Capital in July 2015, Fidante Partners has:

- integrated the business and combined London offices;
- prepared the business to be rebranded Fidante Partners Europe in late February 2016, with the listed funds component of the business to be branded Fidante Capital. The rebrand reflects the need to unite Fidante Partners' people across the business behind one brand and culture;
- updated the European boutique sourcing strategy to ensure boutiques meet the demand from European alternatives investors; and
- achieved positive boutique net flows in the period with further commitments received.

With the Dexion Capital business being integrated during the period, it has made an immaterial contribution to Funds Management EBIT for the period ended 31 December 2015.

The Dexion Capital acquisition is expected to meet Challenger's 18% pre-tax return on equity target over the medium term.

[2] APRA Superannuation statistics – September 2015.
[3] Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2015–2035.

4 Likely developments and expected results (continued)

Funds Management segment outlook (continued)

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

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

Risks

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

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

Guidance for the 2016 financial year

Life cash operating earnings

Life COE guidance for 2016 is a range of $585 million to $595 million and reflects a lower normalised growth assumption for equities. Commencing in the 2016 financial year, the assumed equities normalised growth assumption has been reduced from 6.0% per annum to 4.5% per annum to reflect lower expected returns on Life's equity portfolio as a result of the lower growth environment and mix of Life's equity portfolio. The lower equities normalised assumption has the impact of reducing Life's 2016 COE guidance by approximately $13 million, based on Life 30 June 2015 equity investment balance.

Challenger Group

Challenger continues to target an overall return on equity of 18% (pre-tax) and expects to achieve a fully franked dividend payout ratio of 45% to 50% of normalised profit, subject to prevailing market conditions and capital allocation priorities.

5 Significant events after the balance date

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

6 Rounding

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

7 Auditor's independence declaration

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

Building a better working world

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

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

Auditor's independence declaration to the Directors of Challenger Limited

As lead auditor for the review of Challenger Limited for the half-year ended 31 December 2015, 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 review; and

b) no contraventions of any applicable code of professional conduct in relation to the review.

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

Ernst & Young

S J Ferguson
Partner

Sydney
15 February 2016

Liability limited by a scheme approved under Professional Standards Legislation.

8 Authorisation

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

G A Cubbin
Director

Sydney
15 February 2016

B R Benari
Managing Director & Chief Executive Officer

Sydney
15 February 2016

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

Statement of comprehensive income

For the six months ended 31 December

	Note	2015 $M	2014 $M
Revenue	1	950.0	846.6
Expenses	2	(566.9)	(520.8)
Finance costs		(99.0)	(149.8)
Share of profits of associates		7.3	6.2
Profit before income tax		**291.4**	**182.2**
Income tax expense	4	(60.8)	(36.2)
Profit for the period		**230.6**	**146.0**
Profit attributable to shareholders of Challenger Limited		234.3	130.1
(Loss)/profit attributable to non-controlling interests		(3.7)	15.9
Profit for the period		**230.6**	**146.0**
Other comprehensive income			
Items that may be reclassified to profit and loss, net of tax			
Translation of foreign entities		18.2	9.2
Hedge of net investment in foreign operations		(18.2)	(9.9)
Cash flow hedges – SPV[1]		(0.8)	2.5
Other comprehensive income for the period		**(0.8)**	**1.8**
Total comprehensive income for the period		**229.8**	**147.8**
Comprehensive income attributable to shareholders of Challenger Limited		233.5	131.9
Comprehensive income attributable to non-controlling interests		(3.7)	15.9
Total comprehensive income for the period		**229.8**	**147.8**
Earnings per share attributable to ordinary shareholders of Challenger Limited		cents	cents
Basic	12	41.9	24.2
Diluted	12	39.0	22.8

[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	Note	31 Dec 2015 $M	30 June 2015 $M	31 Dec 2014 $M
Assets				
Cash and cash equivalents		836.6	409.7	682.9
Cash and cash equivalents – SPV		166.4	183.9	200.0
Receivables		180.8	245.3	216.7
Mortgage assets – SPV		1,916.3	2,231.3	2,561.2
Derivative assets		500.6	584.7	733.8
Financial assets – fair value through profit and loss	5	11,342.1	10,926.4	10,424.5
Investment property held for sale	6	58.1	286.7	177.9
Investment and development property	6	3,324.5	2,826.4	2,735.6
Finance leases		85.8	40.4	44.5
Property, plant and equipment		162.5	138.8	138.1
Current tax asset		-	-	9.9
Investment in associates		30.2	43.4	39.4
Other assets		59.2	65.2	63.7
Goodwill		571.6	531.0	531.0
Other intangible assets		13.9	18.4	16.2
Total assets of shareholders of Challenger Limited, policyholders, external unit holders and non-controlling interests		**19,248.6**	**18,531.6**	**18,575.4**
Liabilities				
Payables		267.2	258.9	191.0
Derivative liabilities		560.2	698.9	721.7
Interest bearing financial liabilities	10	3,648.8	2,925.6	2,835.3
Interest bearing financial liabilities – SPV		1,876.7	2,192.8	2,518.5
External unit holders' liabilities		1,035.1	944.7	954.8
Provisions		21.3	23.8	20.5
Current tax liability		15.4	23.6	-
Deferred tax liabilities		171.3	131.7	150.4
Life contract liabilities	7	8,868.4	8,693.0	8,573.1
Total liabilities of shareholders of Challenger Limited, policyholders, external unit holders and non-controlling interests		**16,464.4**	**15,893.0**	**15,965.3**
Net assets of shareholders of Challenger Limited, policyholders, external unit holders and non-controlling interests		**2,784.2**	**2,638.6**	**2,610.1**
Equity				
Contributed equity	9	1,576.8	1,527.2	1,524.3
Reserves		(19.7)	23.7	13.8
Retained earnings		1,139.1	992.3	904.8
Total equity of shareholders of Challenger Limited		**2,696.2**	**2,543.2**	**2,442.9**
Non-controlling interests		88.0	95.4	167.2
Total equity of shareholders of Challenger Limited, policyholders, external unit holders and non-controlling interests		**2,784.2**	**2,638.6**	**2,610.1**

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

Statement of changes in equity

For the period ended 31 December 2014	Note	Contributed equity $M	Share-based payment reserve $M	Cash flow hedge reserve – SPV $M	Foreign currency translation reserve $M	Adjusted controlling interest reserve $M	Retained earnings $M	Total shareholder equity $M	Non-controlling interests $M	Total equity $M
		Attributable to shareholders of Challenger Limited								
Balance at 1 July 2014		1,237.5	54.9	(0.4)	(4.0)	19.3	846.0	2,153.3	122.8	2,276.1
Profit for the period		-	-	-	-	-	130.1	130.1	15.9	146.0
Other comprehensive income for the period		-	-	2.5	(0.7)	-	-	1.8	-	1.8
Total comprehensive income for the period		**-**	**-**	**2.5**	**(0.7)**	**-**	**130.1**	**131.9**	**15.9**	**147.8**
Other equity movements										
Ordinary shares issued	9	287.2	-	-	-	-	-	287.2	-	287.2
Shares purchased in the CPP Trust	9	(60.9)	-	-	-	-	-	(60.9)	-	(60.9)
Vested shares released from the CPP Trust	9	75.5	-	-	-	-	-	75.5	-	75.5
CPP deferred share purchases	9	(15.0)	-	-	-	-	-	(15.0)	-	(15.0)
Share-based payment expense less releases		-	(56.1)	-	-	-	-	(56.1)	-	(56.1)
Dividends paid	11	-	-	-	-	-	(71.3)	(71.3)	-	(71.3)
Other movements		-	-	-	-	(1.7)	-	(1.7)	28.5	26.8
Balance at 31 December 2014		**1,524.3**	**(1.2)**	**2.1**	**(4.7)**	**17.6**	**904.8**	**2,442.9**	**167.2**	**2,610.1**
For the period ended 31 December 2015										
Balance at 1 July 2015		1,527.2	10.0	1.4	(6.6)	18.9	992.3	2,543.2	95.4	2,638.6
Profit for the period		-	-	-	-	-	234.3	234.3	(3.7)	230.6
Other comprehensive income for the period		-	-	(0.8)	-	-	-	(0.8)	-	(0.8)
Total comprehensive income for the period		**-**	**-**	**(0.8)**	**-**	**-**	**234.3**	**233.5**	**(3.7)**	**229.8**
Other equity movements										
Ordinary shares issued[1]	9	6.3	-	-	-	-	-	6.3	-	6.3
Shares purchased in the CPP Trust	9	(37.5)	-	-	-	-	-	(37.5)	-	(37.5)
Vested shares released from the CPP Trust	9	50.8	-	-	-	-	-	50.8	-	50.8
CPP deferred share purchases	9	30.0	-	-	-	-	-	30.0	-	30.0
Share-based payment expense less releases		-	(44.9)	-	-	-	-	(44.9)	-	(44.9)
Dividends paid	11	-	-	-	-	-	(87.5)	(87.5)	-	(87.5)
Other movements		-	-	-	1.3	1.0	-	2.3	(3.7)	(1.4)
Balance at 31 December 2015		**1,576.8**	**(34.9)**	**0.6**	**(5.3)**	**19.9**	**1,139.1**	**2,696.2**	**88.0**	**2,784.2**

[1] The Company issued 890,868 ordinary shares on 14 October 2015 to shareholders who took part in the Company's Dividend Reinvestment Plan (DRP).

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

Statement of cash flows

For the six months ended 31 December	Note	2015 $M	2014 $M
Operating activities			
Receipts from customers		290.4	299.1
Annuity and premium receipts	7	1,650.0	1,578.6
Annuity and claim payments	7	(1,542.3)	(1,182.2)
Payments to reinsurer	7	(5.2)	(4.6)
Receipts from external unit holders		409.7	548.9
Payments to external unit holders		(339.7)	(718.9)
Payments to vendors and employees		(296.3)	(274.2)
Dividends received		32.2	34.0
Interest received		345.4	270.7
Interest paid		(46.1)	(39.1)
Income tax paid		(30.5)	(43.7)
Net cash inflows from operating activities	**8**	**467.6**	**468.6**
Investing activities			
Payments on net purchases of investments		(640.8)	(813.3)
Payments for purchases of controlled entities		(36.5)	-
Net mortgage loan repayments		317.2	418.8
Proceeds from sale of associate		45.0	-
Payments for net purchases of property, plant and equipment		(10.0)	(3.7)
Net cash outflows from investing activities		**(325.1)**	**(398.2)**
Financing activities			
Proceeds from issue of ordinary shares	9	6.3	290.2
Proceeds from borrowings – interest bearing financial liabilities		723.4	194.6
Repayment of borrowings – interest bearing financial liabilities		(343.9)	(464.6)
Payments for Treasury shares		(31.4)	(74.8)
Dividends paid		(87.5)	(71.3)
Proceeds from issue of Challenger Capital Notes		-	345.0
Costs associated with issue of Challenger Capital Notes and ordinary shares		-	(13.4)
Distributions paid to non-controlling interests		-	(1.2)
Net cash inflows from financing activities		**266.9**	**204.5**
Net increase in cash and cash equivalents		**409.4**	**274.9**
Cash and cash equivalents at the beginning of the period		593.6	608.0
Cash and cash equivalents at the end of the period		**1,003.0**	**882.9**
Cash and cash equivalents		836.6	682.9
Cash and cash equivalents – SPV		166.4	200.0
Cash and cash equivalents at the end of the period		**1,003.0**	**882.9**

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

Basis of preparation and overarching significant accounting policies

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

The interim financial report for Challenger Limited and its controlled entities (the Group or Challenger) for the six months ended 31 December 2015 was authorised for issue in accordance with a resolution of the Directors of the Company on 15 February 2016.

(i) Basis of preparation and statement of compliance

This is a general purpose interim financial report for the six months ended 31 December 2015 that has been prepared in accordance, and complies with the requirements of the *Corporations Act 2001*, AASB 134 *Interim Financial Reporting* and other authoritative pronouncements of the Australian Accounting Standards Board (AASB) and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. Challenger Limited is a for-profit entity for the purposes of preparing financial statements.

The interim financial report does not include all the notes normally included in an annual financial report. It is recommended that this interim financial report be read in conjunction with the financial report for the year ended 30 June 2015 and any public announcements made by the Group in accordance with the continuous disclosure obligations of the ASX listing rules.

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.

(ii) New and revised accounting standards and interpretations

The accounting policies applied in these interim financial statements are the same as those applied in the Group's financial statements as at and for the year ended 30 June 2015.

Except for the matters referred to below there have been no new or revised accounting standards or interpretations which are effective from the period on or after 1 July 2015 that materially impact the interim financial results.

Accounting standards and interpretations issued but not yet effective

IFRS 16 'Leases' amends the accounting for leases. The amendment removes the distinction between operating and finance leases. Lessees will be required to bring all leases on to the statement of financial position. Lessor accounting remains largely unchanged. IFRS 16 will be effective for annual periods beginning on or after 1 January 2019.

The Group is currently assessing the impact of this new standard but does not expect any material impact as a result of complying with the new requirements. Early adoption is currently not anticipated.

Note 1 Revenue

	31 Dec 2015 $M	31 Dec 2014 $M
Investment revenue		
Fixed income securities and cash[1]	324.9	566.2
Investment property and property securities	261.5	224.4
Equity and infrastructure investments	7.5	57.7
Realised and unrealised losses on hedges and foreign exchange translation	18.3	(19.3)
Management fee revenue	89.1	77.7
Other revenue		
Life insurance contract premiums and related revenue[2]	208.7	(60.1)
Gain on sale of associate	40.0	-
Total revenue	**950.0**	**846.6**

[1] Includes fair value movements in subordinated debt (Note 13 Fair values of financial assets and liabilities).
[2] Changes in life insurance and investment contract liabilities arising from discount rates, inflation rates and other assumptions are recognised as revenue, with other movements being included in Note 2 Expenses.

Note 2 Expenses

	31 Dec 2015 $M	31 Dec 2014 $M
Life contract and reinsurance expenses[1]	281.6	296.9
Investment property related expenses[2]	59.3	36.5
Fee expenses	42.1	44.9
Distribution expenses	17.5	22.6
Employee benefits expenses	88.0	78.7
Impairment loss on equity accounted associates	10.6	-
Other expenses[3]	67.8	41.2
Total expenses	**566.9**	**520.8**

[1] Cost of life contract liabilities recognised as an expense consists of the interest expense on the liability and any loss on the initial recognition of new business less the release of liability in respect of expenses incurred in the current period. The interest expense on the liability represents the unwind of the discount on the opening liability over the period, whereas the impacts of changes in the discount rate applied for the current valuation are included in the change in life contract liabilities disclosed in Note 1 Revenue.
[2] Investment property-related expenses relate to rental income generating investment properties.
[3] Other expenses include recurring and one off non-recurring expense items associated with Challenger's head office premises move to 5 Martin Place.

Note 3 Segment information

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

For the six months ended 31 December	Life		Funds Management		Total reporting segments		Corporate and other[2]		Total	
	2015 $M	2014 $M	2015 $M	2014 $M	2015 $M	2014 $M	2015 $M	2014 $M	2015 $M	2014 $M
Net income	292.9	257.8	67.1	56.1	360.0	313.9	0.6	0.7	360.6	314.6
Operating expenses	(44.0)	(42.0)	(45.5)	(35.3)	(89.5)	(77.3)	(32.4)	(30.9)	(121.9)	(108.2)
Normalised EBIT	**248.9**	**215.8**	**21.6**	**20.8**	**270.5**	**236.6**	**(31.8)**	**(30.2)**	**238.7**	**206.4**
Interest and borrowing costs	-	-	-	-	-	-	(2.3)	(1.7)	(2.3)	(1.7)
Normalised net profit/(loss) before tax	**248.9**	**215.8**	**21.6**	**20.8**	**270.5**	**236.6**	**(34.1)**	**(31.9)**	**236.4**	**204.7**
Tax on normalised profit									(54.3)	(49.8)
Normalised net profit after tax									**182.1**	**154.9**
Investment experience after tax									30.1	(24.8)
Significant items after tax									22.1	-
Profit attributable to the shareholders of Challenger Ltd									**234.3**	**130.1**
Other statutory segment information										
Revenue from external customers	467.9	386.0	118.7	64.4	586.6	450.4	0.4	0.4	587.0	450.8
Interest revenue	353.3	370.5	-	-	353.3	370.5	9.7	25.3	363.0	395.8
Interest expense	(88.7)	(143.8)	-	-	(88.7)	(143.8)	(10.3)	(6.0)	(99.0)	(149.8)
Intersegment revenue	(16.7)	(12.4)	16.7	12.4	-	-	-	-	-	-
Depreciation and amortisation	(13.6)	(6.1)	(0.2)	-	(13.8)	(6.1)	(4.4)	(3.8)	(18.2)	(9.9)
As at 31 December										
Segment assets	13,607.2	12,994.3	201.7	149.7	13,808.9	13,144.0	5,293.5	5,255.9	19,102.4	18,399.9
Segment liabilities	(11,040.1)	(10,633.4)	(50.8)	(23.4)	(11,090.9)	(10,656.8)	(5,315.3)	(5,300.2)	(16,406.2)	(15,957.0)
Net assets attributable to shareholders	**2,567.1**	**2,360.9**	**150.9**	**126.3**	**2,718.0**	**2,487.2**	**(21.8)**	**(44.3)**	**2,696.2**	**2,442.9**

[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.

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 Actuarial Pty Limited (provision of self-managed superannuation fund actuarial certificates). CLC offers fixed rate retirement and superannuation products that are designed for investors who are seeking a low-risk, fixed term or lifetime investment and seek capital protection. 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 as well as managing a number of unlisted fund mandates. Funds Management has equity investments in a number of the Fidante Partners boutique fund managers and, through the Challenger Investment Partners business, offers a range of managed investments across fixed income and property.

Corporate and other

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

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

Note 3 Segment information (continued)

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) or significant items (refer below).

Normalised cash operating earnings

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

Normalised EBIT

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

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

Tax on normalised profit

Represents the consolidated statutory tax expense or benefit for the period, less tax attributable to non-controlling interests, less the tax applied to 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 annuity valuation changes. Investment experience after tax is investment experience net of tax at the prevailing income tax rate.

Normalised capital growth

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

The normalised growth rates for the year are +4.5% for equity, +4.0% for infrastructure, +2.0% for property and -0.35% for cash and fixed income. The rates have been set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing market experience. The equity normalised growth rate was reduced from 6.0% in prior periods to 4.5% on 1 July 2015 reflecting lower equity risk premium expectations for future periods.

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

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. None of these items are deemed to have occurred as part of normal operating activities and are considered by management to be non-recurring or abnormal items and have therefore been classified as significant items for the six month period to 31 December 2015 in accordance with the definition.

Major customers

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

Geographical areas

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

Note 3 Segment information (continued)

	31 Dec 2015 $M	31 Dec 2014 $M
Reconciliation of management to statutory view of after-tax profit		
Operating segments normalised net profit before tax	270.5	236.6
Corporate and other normalised net loss before tax	(34.1)	(31.9)
Normalised net profit before tax (management view of pre-tax profit)	**236.4**	**204.7**
Tax on normalised profit	(54.3)	(49.8)
Normalised net profit after tax	**182.1**	**154.9**
Investment experience after tax	30.1	(24.8)
Significant items after tax	22.1	-
Profit attributable to the shareholders of Challenger Limited	**234.3**	**130.1**
Profit attributable to non-controlling interests excluded from management view	(3.7)	15.9
Statutory view of profit after tax	**230.6**	**146.0**
Reconciliation of management view of revenue to statutory revenue		
Operating segments	360.0	313.9
Corporate and other	0.6	0.7
Net income (management view of revenue)	**360.6**	**314.6**
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	28.4	46.6
Distribution expenses offset against related income	17.5	23.3
Change in life contract liabilities and reinsurance contracts recognised in expenses	281.6	296.9
Property related expenses offset against property income	44.9	27.4
Interest and loan amortisation costs	70.5	100.6
Management fees	42.1	43.9
Gain on sale of associate	40.0	-
Adjustment for non-controlling interests and other items	21.4	28.7
Difference between management view of investment experience and statutory recognition		
Actual capital growth	(32.6)	45.4
Normalised capital growth	(48.4)	(34.5)
Annuity valuation experience	124.0	(46.3)
Statutory revenue (refer Note 1 Revenue)	**950.0**	**846.6**

Note 4 Income tax

Analysis of income tax expense	31 Dec 2015 $M	31 Dec 2014 $M
Current income tax (expense)/benefit for the period	(23.6)	16.9
Current income tax benefit prior period adjustment	9.6	0.4
Deferred income tax expense	(46.8)	(53.5)
Income tax expense	**(60.8)**	**(36.2)**
Income tax expense on translation of foreign entities	(7.4)	(3.7)
Income tax benefit on hedge of net investment in foreign entities	8.2	4.3
Income tax benefit from other comprehensive income	**0.8**	**0.6**
Reconciliation of income tax expense		
Profit before income tax	291.4	182.2
Prima facie income tax based on the Australian company tax rate of 30%	(87.4)	(54.7)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
– non-assessable and non-deductible items[1]	21.5	6.8
– rate differential on offshore income	(2.9)	1.1
– tax adjustment in respect of non-controlling interests	(1.1)	4.8
– other items	9.1	5.8
Income tax expense	**(60.8)**	**(36.2)**
Underlying effective tax rate[2]	**20.6%**	**21.8%**

[1] The 31 December 2015 amount includes a reduction in the tax expense for $13.5 million in respect of previously unbooked capital losses brought onto the balance sheet in respect of the capital gain on sale of Kapstream.

[2] The calculation of the underlying effective tax rate excludes the non-controlling interests loss of $3.7 million (profit of $15.9 million at 31 December 2014).

Unused revenue losses

All remaining revenue losses of the Challenger tax consolidated group have been fully utilised in the period to 31 December 2015. A deferred tax asset in relation to $20.2 million (30 June 2015: $20.0 million) of revenue losses (net) has been recognised in respect of a non-tax consolidated group entities. A further deferred tax asset of $27.9 million has not been recognised in respect of non-tax consolidated group entities as it is unlikely sufficient assessable gains will be derived by these entities to utilise the losses.

Unused capital losses

The Group has $434.3 million (30 June 2015: $299.0 million) of gross unused capital losses for which no deferred tax asset has been recognised. The increase in the period is largely attributable to a trust with significant capital losses joining the Challenger tax consolidated group.

Note 5 Financial assets – fair value through profit and loss

	31 Dec 2015 $M	30 June 2015 $M	31 Dec 2014 $M
Domestic sovereign bonds and semi-government bonds	1,900.0	1,347.8	1,740.7
Floating rate notes and corporate bonds	5,802.0	5,779.7	4,721.0
Residential mortgage and asset-backed securities	1,895.0	2,238.5	2,351.3
Non-SPV mortgage assets	276.9	318.3	261.0
Fixed income securities	**9,873.9**	**9,684.3**	**9,074.0**
Shares in listed and unlisted corporations	77.8	43.9	59.1
Unit trusts, managed funds and other	453.1	304.7	245.2
Equity securities	**530.9**	**348.6**	**304.3**
Units in listed and unlisted infrastructure trusts	311.2	290.1	277.1
Other infrastructure investments	309.2	306.0	310.2
Infrastructure investments	**620.4**	**596.1**	**587.3**
Indirect property investments in listed and unlisted trusts	316.9	297.4	458.9
Property securities	**316.9**	**297.4**	**458.9**
Total financial assets – fair value through profit and loss	**11,342.1**	**10,926.4**	**10,424.5**

Note 6 Investment and development property

	31 Dec 2015 $M	30 June 2015 $M	31 Dec 2014 $M
Investment property held for sale[1]	58.1	286.7	177.9
Investment property in use	3,217.2	2,736.6	2,640.0
Investment property under development	53.4	19.2	19.1
Total investment property	**3,328.7**	**3,042.5**	**2,837.0**
Development property held for resale[2]	53.9	70.6	76.5
Total investment and development property	**3,382.6**	**3,113.1**	**2,913.5**

[1] Held for sale properties: Innaloo Cinema and 6 Foray Street (30 June 2015: Forum Cisco, Forum Verizon, Innaloo Cinema and Jam Factory).
[2] Development property held for resale is held at the lower of cost or net realisable value.

Note 7 Life contract liabilities

Fair value of life contract liabilities	31 Dec 2015 $M	30 June 2015 $M	31 Dec 2014 $M
Life investment contract liabilities – at fair value	6,655.3	6,626.9	6,568.3
Life insurance contract liabilities – at margin on services value	2,166.8	2,013.3	1,950.8
Reinsurance contract liabilities – at margin on services value	46.3	52.8	54.0
Total life contract liabilities	**8,868.4**	**8,693.0**	**8,573.1**

	Life investment contract liabilities		Life insurance contract liabilities		Reinsurance contract liabilities		Total life contract liabilities	
Movement in life contract liabilities	31 Dec 2015 $M	31 Dec 2014 $M	31 Dec 2015 $M	31 Dec 2014 $M	31 Dec 2015 $M	31 Dec 2014 $M	31 Dec 2015 $M	31 Dec 2014 $M
Balance at the beginning of the period	6,626.9	6,210.1	2,013.3	1,556.6	52.8	57.6	8,693.0	7,824.3
Deposits and premium receipts	1,412.4	1,255.8	237.6	322.8	-	-	1,650.0	1,578.6
Payments and withdrawals	(1,432.3)	(1,086.3)	(110.0)	(95.9)	(5.2)	(4.6)	(1,547.5)	(1,186.8)
Revenue per Note 1	(64.6)	57.9	(142.0)	2.2	(2.1)	-	(208.7)	60.1
Expenses per Note 2	112.9	130.8	167.9	165.1	0.8	1.0	281.6	296.9
Balance at the end of the period	**6,655.3**	**6,568.3**	**2,166.8**	**1,950.8**	**46.3**	**54.0**	**8,868.4**	**8,573.1**

Life investment contract liabilities

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

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

Life insurance contract liabilities

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

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

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

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

Life insurance premium revenue

Life insurance premiums are recognised as revenue when received.

Life insurance claims expense

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

Reinsurance

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

Valuation

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

Note 7 Life contract liabilities (continued)

Key assumptions applied in the valuation of life contract liabilities

Discount rates

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

Life investment contract liabilities are calculated under the fair value through profit and loss provisions of AASB 139 *Financial Instruments: Recognition and Measurement*. The discount rates are determined based on the current observable, objective rates that relate to the nature, structure and term of the future liability cash flows.

For both insurance and investment contracts the approach is the same as adopted in 2015. Discount rates applied for Australian liabilities were between 2.9-4.1% (30 June 2015: 2.5-4.0%) per annum.

Expenses

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

Inflation

Inflation estimates are based on long-term expectations and reviewed annually for changes in the market environment based on a comparison of real and nominal yields of instruments of equivalent term and credit risk. The current assumption for Australia is 1.7% for short-term inflation and 2.3% for long-term (30 June 2015: 1.4% short-term, 2.6% long-term) per annum.

Surrenders

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

Mortality

Base mortality rates for individual lifetime annuities are determined as a multiple of annuitant experience based on IML00 and IFL00 tables, adjusted for Challenger's own recent experience. IML00 and IFL00 are mortality tables developed by the Institute and Faculty of Actuaries (UK) based on United Kingdom annuitant lives experience from 1999–2002. The tables refer to male and female lives respectively. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. Rates of future mortality improvement for individual lifetime annuities applied are between 1.0-4.0% (30 June 2015: 1.0-4.0%) per annum.

Base mortality rates for wholesale mortality and longevity reinsurance are determined as a multiple of pensioner mortality rates (based on the self-administered pension schemes or SAPS2 tables mortality investigation developed by the Institute and Faculty of Actuaries (UK) using United Kingdom data collected between 2004–2012) or population rates as appropriate. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. Rates of future mortality improvement applied are between 0.0-4.0% (30 June 2015: 0.0-4.0%) per annum.

Impact of changes in assumptions on life insurance contracts

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

Restrictions on assets

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

Statutory fund information

The life contract operations of CLC are conducted within three separate statutory funds as required by the Life Act. Both the shareholders' and policyholders' interests in these statutory funds are reported in aggregate in the financial report of the Group. Fund 1 is a non-investment-linked fund and Fund 3 is investment-linked. Both of these are closed to new business. Fund 2 is the principal operating fund of the Group and contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related reinsurance, plus the wholesale mortality, wholesale morbidity and longevity reinsurance. Life contract liabilities for Funds 1, 2 and 3 are $3.6 million, $8,861.3 million and $3.5 million respectively (30 June 2015: $3.9 million, $8,685.6 million and $3.5 million).

Note 7 Life contract liabilities (continued)

Life insurance risk

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

Actuarial information

Mr A Bofinger FIAA, as the Appointed Actuary of CLC, is satisfied as to the accuracy of the data used in the valuations of life contract liabilities in the financial report and the tables in this note. The life contract liabilities have been determined at the reporting date in accordance with the Life Act.

Note 8 Reconciliation of profit to operating cash flow

	31 Dec 2015 $M	31 Dec 2014 $M
Profit for the period	**230.6**	**146.0**
Adjusted for		
Net realised gain on disposal of investment assets	(60.9)	(142.7)
Net unrealised loss/(gain) on revaluation of investment assets	1.2	(119.8)
Share of associates' net profit	(7.3)	(6.2)
Change in life contract liabilities[1]	72.9	357.0
Depreciation and amortisation expense	18.2	9.9
Share-based payments	11.7	12.9
Dividends from associates	11.5	11.6
Change in operating assets and liabilities		
Decrease/(increase) in receivables	13.5	(34.6)
Decrease/(increase) in other assets	16.5	(2.9)
Decrease in payables	(61.5)	(14.5)
Decrease in provisions	(2.5)	(6.0)
Increase in life contract liabilities	101.9	391.8
Increase/(decrease) in external unit holders' liabilities	90.4	(117.6)
Increase/(decrease) in net tax liabilities	31.4	(16.3)
Net cash flows from operating activities	**467.6**	**468.6**

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

Note 9 Contributed equity

	6 months to 31 Dec 2015 No. of shares M	6 months to 31 Dec 2015 Value of shares $M	Year to 30 June 2015 No. of shares M	Year to 30 June 2015 Value of shares $M	6 months to 31 Dec 2014 No. of shares M	6 months to 31 Dec 2014 Value of shares $M
Analysis of contributed equity						
Ordinary shares issued	570.6	1,629.0	569.7	1,622.7	569.7	1,622.7
CPP Trust shares treated as Treasury shares	(6.1)	(35.4)	(8.7)	(48.7)	(9.2)	(51.6)
CPP deferred share purchases treated as Treasury shares	(2.3)	(16.8)	(7.6)	(46.8)	(7.6)	(46.8)
Total contributed equity	**562.2**	**1,576.8**	**553.4**	**1,527.2**	**552.9**	**1,524.3**
Movements in contributed equity						
Ordinary shares						
Opening balance	569.7	1,622.7	530.9	1,335.5	530.9	1,335.5
Issued under share placement and dividend reinvestment plan	0.9	6.3	38.8	287.2	38.8	287.2
Closing balance	**570.6**	**1,629.0**	**569.7**	**1,622.7**	**569.7**	**1,622.7**
CPP Trust						
Opening balance	8.7	48.7	12.5	66.2	12.5	66.2
Shares purchased (including settled forwards)	6.4	37.5	10.3	60.9	10.3	60.9
Vested shares released to employees	(9.0)	(50.8)	(14.1)	(78.4)	(13.6)	(75.5)
Closing balance	**6.1**	**35.4**	**8.7**	**48.7**	**9.2**	**51.6**
CPP deferred share purchases						
Opening balance	7.6	46.8	7.8	31.8	7.8	31.8
CPP deferred share purchases	-	-	4.6	33.8	4.6	33.8
Settled forward purchases	(5.3)	(30.0)	(4.8)	(18.8)	(4.8)	(18.8)
Closing balance	**2.3**	**16.8**	**7.6**	**46.8**	**7.6**	**46.8**

Capital management

Dividend reinvestment plan

On 18 August 2015, the Company announced the establishment of a Dividend Reinvestment Plan (DRP) that commenced for the final 2015 dividend. On 14 October 2015, the Company issued 890,868 ordinary shares to shareholders under the DRP. The DRP issue price per share for the final 2015 dividend was $7.0059 and represents the volume weighted average share price over the ten trading days from 4 to 17 September 2015. The DRP participation rate was 7 per cent of all issued shares, resulting in proceeds of $6.3m.

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

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

Prescribed capital amount (PCA)

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

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

CLC's excess capital above the PCA at 31 December 2015 was $1,095.6 million, up $86.2 million from 30 June 2015.

Note 9 Contributed equity (continued)

Capital management (continued)

Prescribed capital amount (PCA) (continued)

The introduction of the LAGIC standards increased CLC's regulatory capital requirement by $322.8 million on 1 January 2013. APRA provided a three year transition period to meet these new requirements.

Therefore CLC's 31 December 2015 excess capital position includes a LAGIC transition balance of $107.6 million (30 June 2015 includes $107.6 million). The final $107.6 million of the LAGIC transition balance amortised on 1 January 2016.

While CLC does not target a specific PCA ratio, CLC's internal capital models result in a PCA ratio under current circumstances in the range of 1.4 to 1.6 times. This range can change over time and is dependent on numerous factors. CLC's PCA ratio is currently within this range of 1.4 to 1.6 times.

The PCA ratio at 31 December 2015 was 1.65 times, up from 1.59 times at 30 June 2015, reflecting, changes in asset allocation, net AUM growth and changes in retained earnings. Following the amortisation of the remaining LAGIC transition balance on 1 January 2016 CLC's PCA ratio was 1.55 times.

Subordinated debt

CLC's total regulatory capital base includes $477.5 million (30 June 2015: $474.0 million) of admissible subordinated debt. Subordinated debt tranches issued prior to 1 January 2013 will continue to be fully eligible as Tier 2 regulatory capital under LAGIC until each tranche's first call date after 1 January 2013, and will then amortise over the ensuing four years. For tranches already past their call date at 1 January 2013, under LAGIC the first coupon date after 1 January 2013 is considered the first call date.

CLC's subordinated debt includes $168.9 million which had a call date prior to 1 January 2013 and a first coupon date thereafter of 7 June 2013. As a result, under APRA's transition arrangements, only $67.6 million (i.e. 40% of the total amount) is eligible as Tier 2 regulatory capital on 31 December 2015.

Tier 1 and Tier 2 regulatory capital

Under APRA's transition arrangements, CLC's statutory funds have three years to transition to the minimum requirement of Tier 1 capital representing 80% of the PCA. At a CLC consolidated level, APRA provided a two year transition period from 1 January 2013 to meet the 80% Tier 1 requirement. CLC is currently meeting these requirements at both the statutory and consolidated level. The Tier 1 ratio was 1.16 times the PCA at 31 December 2015 (30 June 2015: 1.11 times). Following the amortisation of the remaining LAGIC transition balance on 1 January 2016 CLC's Tier 1 ratio was 1.09 times.

CLC's target surplus

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

Details of the CLC capital adequacy multiple are below:

CLC Capital	31 Dec 2015 $M	30 June 2015 $M	31 Dec 2014 $M
CLC's excess capital under LAGIC			
Common Equity Tier 1 regulatory capital	1,951.8	1,907.6	1,886.7
Additional Tier 1 regulatory capital	345.0	345.0	345.0
Tier 2 regulatory capital – subordinated debt[1]	477.5	474.0	504.7
CLC total regulatory capital base	**2,774.3**	**2,726.6**	**2,736.4**
Prescribed capital amount			
Asset risk charge[2]	1,731.3	1,773.6	1,718.0
Insurance risk charge	132.7	120.5	143.5
Operational risk charge	22.7	22.6	23.9
Aggregation benefit	(100.4)	(91.9)	(108.5)
Prescribed capital amount – excluding transition relief	**1,786.3**	**1,824.8**	**1,776.9**
LAGIC transition relief[3]	(107.6)	(107.6)	(215.2)
CLC prescribed capital amount	**1,678.7**	**1,717.2**	**1,561.7**
CLC excess over prescribed capital amount	**1,095.6**	**1,009.4**	**1,174.7**
Capital adequacy ratio (times)	**1.65**	**1.59**	**1.75**

[1] Differs from $576.5 million disclosed in Note 10 Interest bearing financial liabilities due to $2.4 million (30 June 2015: $2.5 million) of accrued interest and $101.4 million (30 June 2015: $95.3 million) of inadmissible Tier 2 regulatory capital.
[2] The asset risk charge includes the combined stress test scenarios and default stress adjustments.
[3] LAGIC transition relief reduces by one third ($107.6 million) on each of 1 January 2014, 1 January 2015 and 1 January 2016.

Note 10 Interest bearing financial liabilities

	31 Dec 2015 Facility	31 Dec 2015 Outstanding	30 June 2015 Facility	30 June 2015 Outstanding	31 Dec 2014 Facility	31 Dec 2014 Outstanding
	$M	$M	$M	$M	$M	$M
Bank loans						
Corporate	350.0	-	350.0	-	350.0	-
Controlled property trusts[1]	644.8	623.1	769.8	535.8	771.4	555.9
Controlled infrastructure trusts	206.0	205.2	206.0	206.0	206.1	205.0
Repurchase agreements	1,875.1	1,875.1	1,267.3	1,267.3	1,163.3	1,163.3
Total bank loans	**3,075.9**	**2,703.4**	**2,593.1**	**2,009.1**	**2,490.8**	**1,924.2**
Non-bank loans						
Subordinated debt issuance	576.5	576.5	567.0	567.0	560.7	560.7
Challenger Capital Notes	337.7	337.7	336.8	336.8	336.2	336.2
Other finance	19.5	19.5	1.4	1.4	3.3	3.3
Controlled property trusts	11.7	11.7	11.3	11.3	10.9	10.9
Total non-bank loans	**945.4**	**945.4**	**916.5**	**916.5**	**911.1**	**911.1**
Total interest bearing financial liabilities	**4,021.3**	**3,648.8**	**3,509.6**	**2,925.6**	**3,401.9**	**2,835.3**

[1] Total facility limit consists of redraw loan facility limits totalling $210.0 million and non-redraw loan facility limits totalling $434.8 million.

Note 11 Dividends paid and proposed

	31 Dec 2015 $M	31 Dec 2014 $M
Dividend declared and paid during the period		
Final 30 June 2015 100% franked dividend: 15.5 cents (30 June 2014: 13.5 cents 40% franked)	87.5	71.4
Dividend proposed (not recognised as a liability at 31 December)		
2016 interim 100% franked dividend: 16.0 cents (2015 interim: 14.5 cents 70% franked)	89.2	81.3

A dividend reinvestment plan will be in operation for the interim 2016 dividend.

Group franking credits account	6 months to 31 Dec 2015 $M	Year to 30 June 2015 $M
Franking account balance at the beginning of the period	57.1	25.3
Franking credits from the payment of income tax during the period	29.6	65.3
Franking credits from dividends received during the period	4.9	6.6
Franking debits applied to dividend payments to shareholders	(37.4)	(37.1)
Franking debits applied to Challenger Capital Notes	(2.9)	(3.0)
Franking credits balance	**51.3**	**57.1**

Note 12 Earnings per share

	31 Dec 2015 cents	31 Dec 2014 cents
Basic earnings per share	41.9	24.2
Diluted earnings per share	39.0	22.8
	$M	$M
Profit attributable to ordinary shareholders [1]	234.3	130.1
Add back interest expense on Challenger Capital Notes	6.7	3.7
Total earnings used in the calculation of dilutive earnings per share	**241.0**	**133.8**
Number of shares	Number	Number
Weighted average of ordinary shares issued	570,108,313	556,033,217
Weighted average number of Treasury shares	(10,968,332)	(17,818,025)
Weighted average ordinary shares for basic earnings per share	559,139,981	538,215,192
Adjusted for potential ordinary shares:		
Weighted average effect of Challenger Performance plan	17,691,004	22,979,095
Weighted average effect of Challenger Capital Notes	41,585,304	25,413,883
Weighted average ordinary shares for diluted earnings per share	**618,416,289**	**586,608,170**

In determining the weighted average number of ordinary shares used in the calculation of earnings per share, a reduction is made for the average number of Treasury shares held. The weighted average number of treasury shares for the period was 11.0 million (31 December 2014: 17.8 million).

Diluted earnings per share is calculated by dividing the total profit attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the period adjusted for the effects of dilutive shares that may be converted under the terms of Challenger Capital Notes of 41.6 million shares (31 December 2014: 25.4 million) and shares granted under the Challenger Performance Plan (CPP) of 17.7 million shares (31 December 2014: 23.0 million). Since the CPP Trust commenced operation in December 2006, no shares have been issued to the CPP Trust. Instead, shares are acquired by the CPP Trust to mitigate shareholder dilution.

Note 13 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 139 *Financial Instruments: Recognition and Measurement*.

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

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

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

Valuation techniques

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

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

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

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

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

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

Difference between amortised cost and fair value	31 Dec 2015 Carrying value $M	31 Dec 2015 Fair value $M	30 June 2015 Carrying value $M	30 June 2015 Fair value $M	31 Dec 2014 Carrying value $M	31 Dec 2014 Fair value $M
Mortgage assets – SPV	1,916.3	1,965.3	2,231.3	2,293.1	2,561.2	2,643.0
Interest bearing financial liabilities – SPV	1,876.7	1,802.9	2,192.8	2,118.1	2,518.5	2,445.4
Challenger Capital Notes[1]	345.0	329.0	345.0	327.1	-	-

[1] Challenger Capital Notes are classified as Level 1 in the fair value hierarchy.

Valuation process

The valuation process applied for financial instruments and investment properties categorised within Level 3 of the fair value hierarchy 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 assets are referred to the Valuation Committee who generally meet monthly, or more frequently if required.

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

	Level 1 $M	Level 2 $M	Level 3 $M	Total $M
31 Dec 2015				
Derivative assets	-	500.6	-	500.6
Fixed income securities[1]	-	8,076.8	1,797.1	9,873.9
Equity securities	38.6	173.8	318.5	530.9
Infrastructure investments	150.7	-	469.7	620.4
Property securities	188.4	-	128.5	316.9
Investment property	-	12.5	3,316.2	3,328.7
Total assets	**377.7**	**8,763.7**	**6,030.0**	**15,171.4**
Derivative liabilities	-	560.0	0.2	560.2
Interest bearing financial liabilities	329.0	76.6	596.0	1,001.6
External unit holders' liabilities	-	1,035.1	-	1,035.1
Life investment contract liabilities	-	78.0	6,577.3	6,655.3
Total liabilities	**329.0**	**1,749.7**	**7,173.5**	**9,252.2**
30 June 2015				
Derivative assets	-	584.7	-	584.7
Fixed income securities[1]	-	7,801.9	1,882.4	9,684.3
Equity securities	10.0	106.0	232.6	348.6
Infrastructure investments	128.0	-	468.1	596.1
Property securities	177.4	-	120.0	297.4
Investment property	-	111.7	2,930.8	3,042.5
Total assets	**315.4**	**8,604.3**	**5,633.8**	**14,553.6**
Derivative liabilities	0.1	698.6	0.2	698.9
Interest bearing financial liabilities	327.1	81.3	568.4	976.8
External unit holders' liabilities	-	944.7	-	944.7
Life investment contract liabilities	-	88.4	6,538.6	6,627.0
Total liabilities	**327.2**	**1,813.0**	**7,107.2**	**9,247.4**

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

Valuation process (continued)

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

[1] 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). For structured entities with asset-backed financing 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 31 December 2015 the carrying value of asset-backed financing assets was $24.5 million (30 June 2015: $7.7 million) with no undrawn commitments (30 June 2015: $nil million) and securitisations was $2,946.1 million (30 June 2015: $3,367.2 million) plus $232.1 million undrawn commitments (30 June 2015: $184.4 million).

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 period:

	31 Dec 2015		30 June 2015		31 Dec 2014	
	Assets $M	Liabilities $M	Assets $M	Liabilities $M	Assets $M	Liabilities $M
Balance at the beginning of the period	2,703.1	7,107.2	2,153.4	6,638.6	2,153.4	6,580.9
Fair value gains/(losses)	(25.8)	61.1	153.3	336.7	164.3	285.7
Acquisitions	418.4	1,389.7	1,621.0	2,176.7	892.3	1,196.1
Maturities and disposals	(409.8)	(1,384.6)	(1,172.2)	(2,044.8)	(699.5)	(1,019.0)
Transfers to other categories[1,2]	27.8	-	(52.3)	-	(1.1)	(0.1)
Balance at the end of the period[3]	2,713.8	7,173.5	**2,703.0**	**7,107.2**	**2,509.4**	**7,043.6**
Unrealised gains/(losses) included in the statement of comprehensive income for assets and liabilities held at the statement of financial position date	43.6	(61.8)	(144.5)	(331.1)	71.9	(285.7)

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

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

Level 3 sensitivities

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

	Level 3 value[1] $M	Positive impact $M	Negative impact $M	Valuation technique	Reasonable change in non-observable input[2,3]
31 Dec 2015					
Fixed income securities	1,797.1	54.2	(24.5)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(596.0)	(10.6)	10.3	Discounted cash flow	Primarily credit spreads
Net fixed income	**1,201.1**	**43.6**	**(14.2)**		
Equity, infrastructure, property assets	916.7	61.8	(62.3)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Investment contract liabilities	(6,577.3)	3.8	(3.8)	Discounted cash flow	Primarily expense assumptions
Derivative liabilities	(0.2)	0.2	(0.1)	Discounted cash flow	Primarily credit spreads
Total Level 3	**(4,459.7)**	**109.4**	**(80.4)**		
30 June 2015					
Fixed income securities	1,882.4	63.4	(21.7)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(568.4)	(10.4)	11.5	Discounted cash flow	Primarily credit spreads
Net fixed income	**1,314.0**	**53.0**	**(10.2)**		
Equity, infrastructure, property assets	820.7	46.9	(47.1)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Investment contract liabilities	(6,538.6)	3.8	(3.8)	Discounted cash flow	Primarily expense assumptions
Derivative liabilities	(0.2)	0.3	(0.3)	Discounted cash flow	Primarily credit spreads
Total Level 3	**(4,404.1)**	**104.0**	**(61.4)**		
31 Dec 2014					
Fixed income securities	1,695.0	60.1	(22.8)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(564.0)	(25.4)	26.4	Discounted cash flow	Primarily credit spreads
Net fixed income	**1,131.0**	**34.7**	**3.6**		
Equity, infrastructure, property assets	814.4	46.1	(45.8)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Investment contract liabilities	(6,479.3)	4.3	(4.3)	Discounted cash flow	Primarily expense assumptions
Derivative liabilities	(0.3)	0.3	(0.3)	Discounted cash flow	Primarily credit spreads
Total Level 3	**4,534.2**	**85.4**	**(46.8)**		

[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 reasonable possible alternative assumption was calculated by adjusting the credit spreads by 50bps, discount rates by between 50bps – 100bps, changing the valuation of the unlisted schemes by 5% and adjusting the expense assumption allocation splits by 10%.

Note 14 Acquisitions and disposals of subsidiaries, businesses and associates

On 15 July 2015, the Company's boutique funds management division, Fidante Partners, agreed to acquire 100% of Dexion Capital Holdings Limited (Dexion Capital), a European alternative investment group comprising interests in three specialist fund managers, as well as an investments distribution business, based in London. On 17 July 2015, the acquisition was completed with Fidante Partners acquiring all the capital, with a combination of upfront and deferred cash payments.

Dexion Capital's strategic relationships comprise interests in three boutique fund managers: renewable energy specialist Resonance Asset Management Limited; UK social housing investor Horizon Infrastructure Partnership Limited; and Agricultural Asset Management Limited, which is focused on agricultural investments in the US and UK. In addition, Dexion Capital manages London-listed alternative asset fund Dexion Absolute Limited.

The acquisition substantially expands Fidante Partners' presence in Europe where it already holds interests in UK based alternative asset managers Whitehelm Capital (global infrastructure) and WyeTree Asset Management (asset-backed securities). The acquisition also provided Fidante Partners with established distribution channels to UK and European alternative focused investors.

From the date of acquisition, Dexion Capital's revenue and expenses have been included in the statement of comprehensive income. Acquisition related transaction costs of $2.2 million have been incurred through other expenses with $1.8 million expensed in the prior year.

Details of the fair values of the assets and liabilities acquired and goodwill on acquisition are as follows:

	$M
Total purchase consideration[1]	58.8
Less: fair value of net identifiable assets acquired	18.2
Goodwill on acquisition	40.6

[1] The consideration comprises an upfront payment of £17.3m ($36.5 million), deferred payment of £4m ($8.9 million), and estimated contingent consideration linked to Dexion's profitability. The deferred consideration is to be paid on 30 June 2018 and the contingent consideration payable between 30 June 2018 and 30 June 2021. The fair value of the contingent consideration has been probability assessed and discounted to its present value. The contingent consideration increases in line with Dexion's profitability. Outperformance or underperformance relative to purchase price assumptions will be taken through the statement of comprehensive income. The goodwill on acquisition is subject to annual impairment testing.

The balance sheet of Dexion Capital at acquisition date was as follows:

	Acquiree's carrying amount $M	Fair Value $M
Assets		
Cash	7.6	7.6
Receivables	15.5	15.5
Investment in associates	1.0	1.0
Property, plant and equipment	0.6	0.6
Deferred tax assets	4.4	4.4
Intangible assets	5.7	-
Total assets	34.8	29.1
Liabilities		
Payables	(10.9)	(10.9)
Total liabilities	(10.9)	(10.9)
Net assets	23.9	18.2

Significant entities, businesses and associates acquired, consolidated, disposed of or deconsolidated due to loss of control

On 2 July 2015, the Company announced the sale of its 25% equity interest in Australian based global fixed income fund manager, Kapstream Capital Pty Limited (Kapstream) to Janus Capital Group Inc., a US-based global investment business, for $45 million. The Company recognised a $40 million pre-tax profit from the sale during the period.

Fidante Partners continues to provide distribution and operational support services to Kapstream in Australia through renewed Administration, Distribution and Responsible Entity service agreements.

There were no other significant entities, businesses or associates acquired, consolidated, disposed of or deconsolidated due to loss of control during the period.

Note 15 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 31 December 2015. Other than noted below, at the date of this report no material claims against these warranties have been received by the Group.

Parent entity guarantees and undertakings

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

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

Third party guarantees

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

Contingent future commitments

CLC has made capital commitments to external counterparties for future investment opportunities such as development or investment purchases. As at 31 December 2015 there are potential future commitments totalling $295.7 million (30 June 2015: $303.0 million) in relation to these opportunities. Currently there are no requests from any of these parties to make payments.

Contingent tax assets and liabilities

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

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.

Note 16 Subsequent events

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

Directors' declaration

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

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

   i. giving a true and fair view of the Group's financial position as at 31 December 2015 and of its performance for the six month period ended on that date; and

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

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

On behalf of the Board

G A Cubbin Director	B R Benari Managing Director and Chief Executive Officer
Sydney 15 February 2016	Sydney 15 February 2016

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Independent auditor's report

Independent auditor's report to the members of Challenger Limited

Report on the financial report

We have reviewed the accompanying interim financial report of Challenger Limited, which comprises the Statement of Financial Position as at 31 December 2015, the Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the six months ended on that date, other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the period end or from time to time during the period.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the interim financial report that gives a true and fair view in accordance with Australian Accounting Standards and the Corporations Act 2001 and for such internal controls as the directors determine are necessary to enable the preparation of the interim financial report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the interim financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 Review of a Financial Report Performed by the Independent Auditor of the Entity, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the Corporations Act 2001 including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2015 and its performance for the six months ended on that date; and complying with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001. As the auditor of Challenger Limited and the entities it controlled during the period, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

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

Independence

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

Conclusion

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

i. giving a true and fair view of the consolidated entity's financial position as at 31 December 2015 and of its performance for the six months ended on that date; and

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

Ernst & Young

S J Ferguson
Partner

Sydney
15 February 2016

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Steven Gregg

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