challenger

Challenger Financial Services Group
Annual Report 2010

Contents

2003, 2005, 2006

Award-winning annuities

In 2010 Challenger was again named winner of the AFA/Plan for Life 'Annuity Provider of the Year', further reinforcing our strength in the annuity market.

Challenger today

Challenger Financial Services Group is an ASX-listed investment management firm established in 1985. We are the foremost issuer of annuities and provider of alternate retirement income solutions in Australia. Through our Multi-Boutique and Aligned Investment teams, we are a leading provider of investment products.

Life

Challenger is a leading provider of alternate retirement income solutions and annuities in Australia. Via an APRA-regulated Life company, we offer attractive returns and capital protection, making our products well suited to retirement income planning. Annuity premiums, shareholder funds and other capital are invested in a diversified portfolio of assets to deliver predictable, long-term cash flows to meet annuitant commitments while still providing attractive returns for shareholders.

Funds Management

As one of Australia's largest fund managers, Challenger offers a wide range of fiduciary investment choices across a variety of asset classes and investment styles. Through Aligned Investment teams, we manage assets for Challenger Life and third party investors. Through our Multi-Boutique platform, we participate in a diverse array of independent fund managers in which we own equity stakes and provide distribution and administration support.

Results at a glance

2010 saw a record financial performance, with strong growth in profit and earnings per share, a strengthened capital position and increased returns for shareholders.

Key financial highlights during the year:

- Normalised net profit after tax up 6% to $233m
- Normalised earnings per share up 16% to 45.5 cents per share
- Cost to income reduced over nine percentage points to 40.6%
- Final dividend of 8.5 cents per share (cps) declared, bringing full year dividend to 14.5 cps (unfranked), up 16%

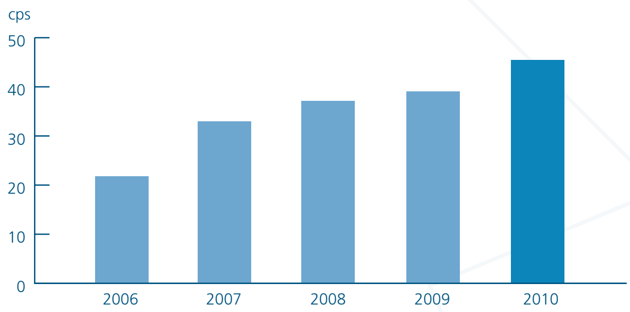
Financial performance	2010	2009
Net income	$448m	$370m
Expenses	$182m	$186m
Normalised NPAT	$233m	$219m
Statutory NPAT	$283m	$(91)m
EPS (normalised basic) – cents per share	45.5	39.2
EPS (statutory basic) – cents per share	55.3	(16.2)

Normalised profit explained

The Group is required to value all assets and liabilities that are supporting the life insurance business at the prevailing balance date fair value prices under applicable life insurance accounting standards. This can give rise to volatile unrealised valuation movements, which were particularly experienced during the global financial crisis as reported in our financial results during 2009 and 2008. Challenger is a long-term holder of assets in order to match the term of the Group's life insurance obligations.

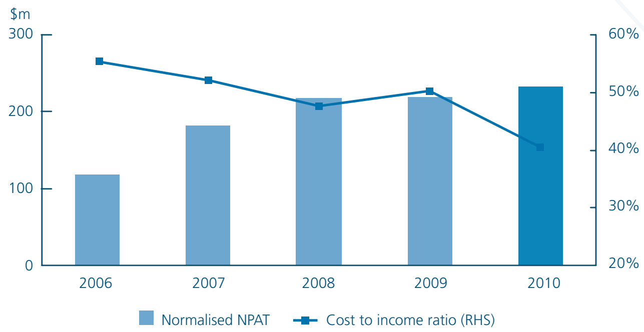
In any given reporting period, the actual investment gains/losses (both realised and unrealised revaluation movements) will vary to the normalised, or the Group's expected, long-term gains for each of the major asset classes held. The difference between the actual net investment gains/losses and the normalised investment gains is referred to as 'investment experience'. The investment experience for each reporting period is reported separately from the normalised profit of the Group in order to provide a better understanding of the Group's normalised financial results for the year and underlying cash generated. It is this income that underpins distributions to shareholders in the form of cash dividends.

Normalised earnings per share – five years



In the last five years, we have maintained a solid track record. Normalised earnings per share have consistently grown at a compound annual growth rate of 20% over that period.

Normalised earnings – five years



Normalised NPAT has steadily increased over the last five years. We have successfully grown our net income and kept a tight control on expenses, resulting in our cost to income ratio falling to 40.6% in 2010.

Sources of income

Life derives its income by achieving a higher rate of return from its diversified portfolio of investments than the obligations it has to pay to annuity policyholders. Total income is a function of the size of the portfolio managed multiplied by the average returns from those invested assets. Income has risen across the year as the size of the portfolio of assets grew in line with increased sales of annuities and increased average returns on investment assets.

Funds Management is a fiduciary manager of third party capital, so its income is calculated as a margin or percentage of total funds under management (FUM). Additional income can also be earned from certain assets in the form of base management, performance and transaction fees. From its co-ownership in boutique funds, it earns distribution and administration fees, as well as a share of profits from the boutique partnership. While FUM rose during the year, net income fell as the asset mix of FUM changed, with a higher proportion of flows into lower margin, fixed income allocations.

Chairman's report

'Through the last year, Challenger has become a simpler and more focused business, positioned to participate in a fast-growing retirement income market'.

Challenger began fiscal year 2010 in a strong position. The Company had weathered the financial market turmoil in 2008 and 2009, and emerged in a strong position with a well-defined strategic focus.

Challenger's business model is now simpler, following the sale of our mortgage operations to National Australia Bank in October last year, and positioned to leverage our investment management capability in the very fast-growing retirement income market via our Life and Funds Management businesses. As baby boomers began retiring this year, a demographic tailwind has already started that will materially increase the demand for retirement income products. At the same time, retirees are seeking simpler investment products that provide a safety net to their superannuation savings. Government and regulatory review committees are also recognising the importance of mitigating risk once the retiree begins to draw on their savings in retirement. Both of these factors present an exciting growth opportunity for your Company as we meet this demand through our annuity and guaranteed income product range.

Your Board and management are confident in our abilities to organically grow our share of the retirement income market and increase returns for shareholders.

Full year result to 30 June 2010

During the year, Challenger saw a continued rise in its normalised net profit after tax to $233m, up 6% on 2009 and backed by underlying operating cash flow of $222m. Normalised earnings of 45.5 cents per share represented a 16% increase on 2009, reflecting stronger earnings, but also the accretion that has been achieved through the on-market share buy-back approved by shareholders at our 2009 annual general meeting.

As volatility in investment and financial markets abated during the year, the investment experience resulting from our fair value accounting moved to a positive position of $51m after tax. This resulted in a statutory net profit after tax of $283m, compared to a statutory net profit after tax of $(91)m in 2009. While it was pleasing to see a return to a statutory profit, we continue to direct our shareholders to our normalised earnings, as this represents a better reflection of the underlying operating performance of the Company.

In our regulated Life company, capital levels remained strong, finishing the year with a surplus over regulatory minimums of approximately $630m.

Peter Polson
Chairman

Dividend

Your Board has declared a final dividend of 8.5 cents per share, bringing the total dividend for shareholders to 14.5 cents per share across the year. This is an increase of 16% from 2009 and in line with our targeted dividend payout ratio of around 30% of normalised earnings.

Board changes

As I noted in last year's annual report, the number of Directors reduced from nine to six following the resignations of Mr Ashok Jacob, Mr James Packer and Mr Tetsuya Wada. Following their resignations, we undertook a review to ensure that we had sufficient Directors to continue to provide a high standard of corporate governance. The review concluded that we had sufficient Directors to discharge the Board's duties and obligations.

Management team

Continued credit must be given to a strong and stable management team that has presided over your Company since 2003. They have successfully navigated testing markets, utilising their strong risk management skills and experience. The result is a company that today is better positioned as markets start to recover. Their strong track record means we can approach consolidation and growth opportunities in our sector with confidence.

Outlook

Challenger now has a simpler investment management business model. It is well placed through a leading and differentiated business model to participate in the growing retirement income market and the fast developing boutique funds management industry. We are directing our focus towards lifting product sales via expanded distribution and the introduction of new guaranteed income products. From this we are confident we can increase value for shareholders over the coming years.

Peter Polson
Chairman

CEO's report

'Challenger has emerged soundly from market turmoil and participated in the global recovery to deliver strong financial results'.

Business performance

Over the year, our business has seen significant growth which has underpinned strong financial results. Total assets under management rose 22% across the year as we saw increased sales of annuities, the introduction of a new institutional guaranteed income product in our Life business and positive inflows to our growing stable of Boutique Partnerships in our Funds Management business.

Normalised net profit after tax rose 6% to $233m, but more importantly our normalised earnings per share rose 16% to 45.5 cents per share, reflecting the accretion achieved by our on-market share buy-back. We have also been vigilant on expenses, which fell a further 2% across the year. The result was a reduction in our cost to income ratio of nine percentage points to 40.6%.

The statutory net profit after tax was materially higher than normalised net profit, as market-driven negative investment experience reversed, producing a profit of $283m. Interest and borrowing costs also fell during the year as we repaid all corporate recourse debt following the sale of our mortgage operations last October.

Operational and financial highlights

- Strong financial performance allowed us to increase our dividend to 14.5 cents per share for the full year, up 16% on 2009.
- During the year, sales of annuities and guaranteed income products by our Life business increased to $2.19bn, a more than threefold increase on 2009.
- Our Multi-Boutique business in Funds Management expanded, with the establishment of three new boutiques, Bentham Asset Management, Merlon Capital Partners and Alphinity Investment Management. Total FUM for Boutique Partnerships at 30 June is almost $7bn post balance date – a threefold increase on 2009.
- Capital levels surplus to our regulatory requirements in our Life company remain strong at approximately $630m. This surplus provides us significant headroom to continue to grow our business organically.
- Our financial flexibility remains strong, with all recourse debt repaid during the year and a net cash position of $76m. Operating cash flow also remained sound at $222m.

Capital management

Since we initiated an on-market share buy-back in mid 2008, we have bought back and cancelled 113m shares at an average price of $3.10. Acquiring these shares at a discount to the current market price has been a prudent and successful use of free cash flow for shareholders, supporting the 16% rise in earnings per share during the year.

Dominic Stevens
Chief Executive Officer

Structural market changes

The investment management market in which we operate has seen significant structural change and development in the last two years. In the retirement income segment our targeted demographic, 65 years and over, is growing almost four times faster than pre-retirement, while in pre-retirement both sides of politics are looking at ways to increase the size of the pool. When these changes are combined with an increased focus on risk and return, both at a consumer level and by regulatory review committees and government, we see an immense growth opportunity for our business to take advantage of these positive tailwinds and believe we are at the beginning of a long-term structural shift in the demand for our products.

Strategy

The last 12 months has only intensified and reinforced our conviction of the importance of a focused strategy that leverages structural and regulatory tailwinds. We have sought to reinvigorate our annuities business through product development, an expanded distribution footprint and increased advertising and marketing to highlight alternate ways to manage retirement incomes. In addition, we made several submissions to regulatory review committees such as the Henry Review into the future tax and retirement income system and the Cooper Review into the superannuation system. This activity has already delivered results, with a large increase in annuity sales during the year, a trend that we expect to continue.

We have also reinvigorated our fiduciary Funds Management business, building out a leading and differentiated Multi-Boutique business to target the growing superannuation pool. Through our Aligned Investment business, we are expanding business through co-investment with other superannuation funds that share similar investment goals to our Life company. The overall Funds Management strategy has delivered results, with an additional three new Boutique Partnerships established, bringing our total to 10 and a threefold increase in FUM, accompanied by new mandates for our Aligned Investment teams.

We see immense opportunity to develop our franchise as the leading provider of alternative retirement income solutions, an opportunity that we look forward to delivering on for all our stakeholders.

Dominic Stevens
Chief Executive Officer

Chief Executives

Life

Our APRA-regulated Life business is the largest provider of annuities in Australia, with over 60,000 customers. At 30 June 2010 we were managing over $7.6bn of assets supporting policy liabilities and institutional guaranteed return products, an increase of 31% over the last 12 months.

In the last quarter of 2009, we were already seeing increased sales in our products and that trend continued throughout 2010. Core sales of annuities, fixed rate allocated pensions and personal superannuation rose 82% over the year to $933m. Sales of our new institutional product, Guaranteed Index Returns, totalled over $1.25bn. Strong sales and product development generated normalised cash operating earnings of $338m, up $87m or 35% on 2009. Expenses rose just over $10m as we invested heavily in expanding our footprint with increased dedicated distribution teams, creating the first unitised annuity (Guaranteed Income Fund or 'GIF') that could be sold via investment wrap platforms and creating technology applications to assist financial planners in selling our product. GIF is now available on all major investment platforms in Australia. We also increased our advertising in mainstream media and expanded our marketing efforts. Resulting EBIT of $304m was up 34% on 2009.

As investment markets began a slow recovery, we saw an increase in asset values across our portfolio, primarily fixed income. This has led to a reversal of investment experience, which was negative in 2009, to a positive position of $51m in 2010.

We entered the year with a strong capital surplus above regulatory minimums of approximately $530m, which gave us confidence to step up our reinvestment process. Key purchases during the year included the acquisition of the residual income units from the term funded residential mortgage book previously held by our Mortgage Management business in October 2009 and the acquisition of a portfolio of Japanese retail property via the privatisation of the Challenger Kenedix Japan Trust in January 2010. These investments have further supported our cash operating earnings. Despite a more active investment process across the year, the capital position of the Life company remains very strong, with approximately $630m of surplus at 30 June 2010.

During the last quarter of the year, two major government regulatory reviews which focused on taxation and the retirement income sector (Henry Review) and the superannuation sector (Cooper Review), both of which we made submissions to, released their findings to the market. The reviews were supportive of the annuities market, with the Henry Review recommending changes to tax and social security rules to stimulate the deferred annuity market and a reduced rate of tax for interest income savings products including annuities. The Cooper Review recommended that superannuation fund trustees be required to have regard for longevity and inflation risks in addition to market risk in the retirement phase, an area that Challenger's products address.

As we move into 2011, we are continuing to develop and market new products to meet the growing demand for alternate solutions that provide capital protection and certainty of income streams. To that end, in August we opened our Liquid Lifetime annuity, which addresses the key liquidity concerns that consumers have historically expressed in relation to lifetime annuities. We will continue to expand our product range.

Richard Howes,
Rob Woods and Rob Adams
Chief Executives Life
and Funds Management

Funds Management

Across our Funds Management operations, we began to see a recovery in markets and market values, albeit with investors' asset allocations remaining more focused on cash and fixed income.

Thus, more broadly, our market will benefit from the push by both sides of politics to increase flows into the pre-retirement superannuation pool over the next 10 years.

Total funds under management increased across the year to $20.2bn, up 26%, as market values rose and net flows reached $3.8bn, compared to net flows of $(2.3)bn in 2009. While net income of $102m was down 11% on 2009, a reduction of 12% on expenses delivered an EBIT contribution of $17.3m, down only 4% on 2009.

Through the year, we have refined our differentiated strategy across Aligned Investment and Multi-Boutique.

Aligned Investment teams develop and manage products under the Challenger brand for third party investors as well as for Challenger's Life business. This includes ASX-listed funds Challenger Diversified Property Group (CDI), Challenger Infrastructure Fund (CIF) and Challenger Wine Trust (CWT), as well as unlisted mandates across property, fixed income and infrastructure. After strengthening it's capital structure in 2009, CDI has performed well and recently announced a lift in its net asset value (NAV) of 2% versus December 2009 as property values rose. CIF sold its remaining stake in Southern Water, at NAV, in late 2009 and successfully refinanced the debt package of Inexus, allowing CIF to repay all fund level borrowings and redeemable preference shares whilst maintaining a strong cash position to fund future growth.

On the unlisted mandate side, the fixed income and real estate teams worked closely to originate investments in the commercial property debt sector, successfully originating mandates for the Life business and third party investors. This included a mandate from an industry super fund to source new investments in those sectors.

Our Multi-Boutique operations comprise of co-owned, separately branded investment managers, to which Challenger provides administration and distribution services. During the year, we acquired the Credit Suisse Investments (Australia) Limited business, which included five credit investment funds and two real estate securities funds. The credit investment business had total funds under management of approximately $1.5bn which created the Boutique Partnership called Bentham Asset Management.

Two new Boutiques were also created from the successful conversion of internally managed funds, Merlon Capital Partners and Alphinity Investment Management. This brings the total number of Boutique Partnerships to 10 with nearly $7bn of FUM, up threefold on 2009. We see the Multi-Boutique space as a segment growing more quickly than the broader funds management market, providing greater capacity and opportunity to leverage our existing fiduciary operations.

ARDEA Investment Management
5ceans FIVE OCEANS ASSET MANAGEMENT
GREENCAPE CAPITAL
KAPSTREAM CAPITAL
kinetic INVESTMENT PARTNERS
WaveStone CAPITAL
Alphinity INVESTMENT MANAGEMENT
BENTHAM ASSET MANAGEMENT
MERLON CAPITAL PARTNERS

Corporate

Paul Rogan

Executive General Manager

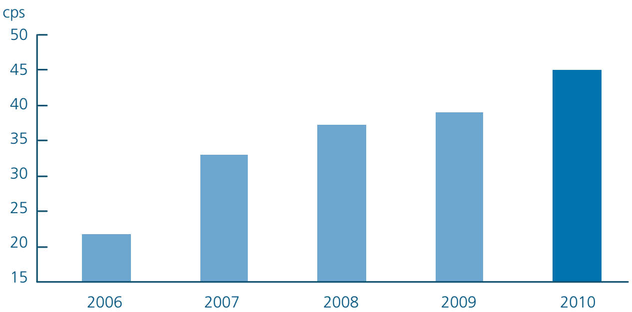
Capital Risk and Strategy

The Capital Risk and Strategy team remained focused on protecting our capital base and accreting value through the on-market share buy-back approved by shareholders at the 2009 Annual General Meeting. While market volatility has abated during the year, the team has continued to monitor and carefully manage our market and credit risk exposures.

The independent credit risk function has expanded during the year, providing greater support and credit analysis to our Life investment teams, particularly in the fixed income sector.

In the first half of the year, the team managed the sale of the Mortgage Management operations to National Australia Bank and repayment of all corporate recourse debt. In the second half of the year, it worked closely with the Funds Management business to develop its Multi-Boutique strategy. This culminated in the successful acquisition of the Credit Suisse investment management business in June and the creation of three new Boutique Partnerships.

Normalised EPS



Jennifer Wheatley

Executive General Manager

Human Resources

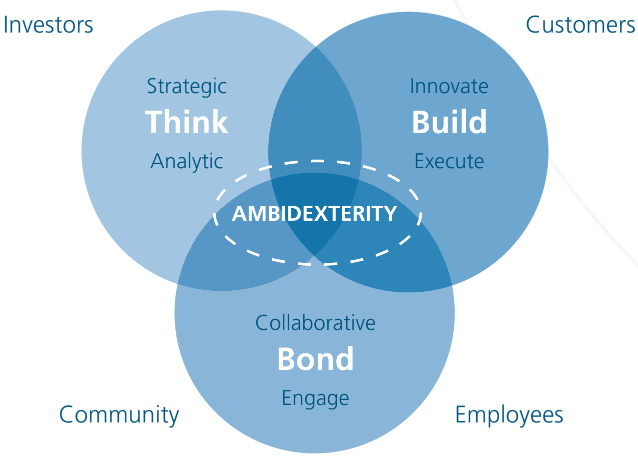
During the year, we have focused on expanding our leadership capabilities as well as establishing a graduate recruitment program to bring young talent into the organisation.

In conjunction with the Australian Graduate School of Management (AGSM) we have developed a senior leadership development program, Leadership Perspectives. The broad theme of 'applying leadership perspectives for better business outcomes' is central to this program, and is explored within three sub-themes: THINK – both strategically and analytically, BUILD – through innovation and execution, and BOND – through personal understanding of engagement and collaboration.

At the same time, a mentoring program was developed to facilitate the professional and personal development of selected individuals by providing them with the opportunity to learn from senior managers within Challenger who have specific knowledge, skills and experience. The program also provides a development opportunity for mentors, thereby building on the capability of senior managers.

This year also saw the establishment of a graduate recruitment program to provide an entry point for high-potential young talent, at a time when Australia faced an ageing workforce and a competitive employment market. We are continuing to build on our strategy of investing in people who have the capability to lead the Challenger business into the future.

Leadership framework



Brian Benari

Group Chief Financial Officer

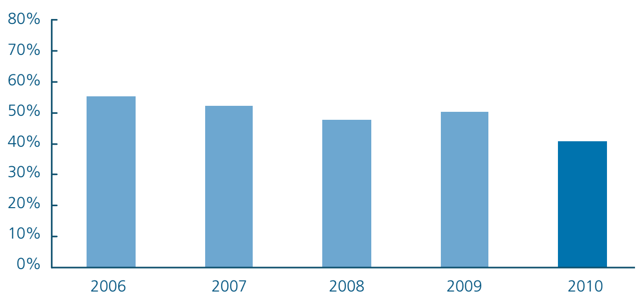
Group Chief Operating Officer

Greater expense synergies have been achieved since the creation of the combined role of Group Chief Financial Officer/Group Chief Operating Officer. These synergies were particularly evident this year as the cost to income ratio across the Group fell over nine percentage points.

We undertook further acquisitions in the Multi-Boutique sector during the year that have seen us increase our funds under management and further leverage our technology and support functions. As markets stabilise and we grow our franchise, we will look to take advantage of the flexibility and scalability of our operational infrastructure to deliver enhanced earnings.

The 2010 financial year has also seen continued industry focus on risk management and compliance practices and processes as market participants and regulators respond to the lessons of the Global Financial Crisis. Challenger has continued to evolve its risk management framework during the year to ensure that risk management and our compliance obligations remain a key focus of all employees within the organisation.

Cost to income ratio



Directors' report

The Directors of Challenger Financial Services Group Limited (the Company) submit their report together with the financial report of the Company and its controlled entities (the Group), for the year ended 30 June 2010.

1. Directors

The names and details of the Company's Directors holding office during the financial year and until the date of this report are as listed below.

The composition of the Board of Directors has changed in the period. Following the sale of shares in the Company by the Consolidated Press Holdings group, the Bank of Tokyo-Mitsubishi UFJ, Ltd. and Mitsubishi UFJ Securities Co. Ltd., Mr James Packer, Mr Ashok Jacob and Mr Tetsuya Wada resigned from the Board in September 2009. With the exception of the Managing Director, Mr Dominic Stevens, all the Directors on the Board are now independent.

The reduction in director numbers from nine to six also prompted a review of Board sufficiency. In order to provide a high standard of corporate governance, the Board must be adequately and appropriately resourced. This review concluded that the six remaining Directors were sufficient to discharge the Board's various duties and obligations. Should the Board's future workload or business conditions demand it, the Board will not hesitate to revisit this decision.

Directors were in office for this entire period unless otherwise stated.

Peter L Polson

Independent Chairman

Experience/qualifications

Mr Polson holds a Bachelor of Commerce degree from the Witwatersrand University in South Africa, a Master of Business Leadership from the University of South Africa and has completed the Harvard Management Development program.

Mr Polson retired from the Commonwealth Bank in October 2002, where he held the position of Group Executive, Investment and Insurance Services. Mr Polson joined the Colonial group in 1994 prior to its acquisition by the Commonwealth Bank. Previously, Mr Polson was Managing Director of National Mutual Funds Management (International) Limited. Mr Polson was a director of the previously listed company Australian Leisure and Hospitality Group Limited. Mr Polson has been a director of the Company since 6 November 2003.

Special responsibilities

Mr Polson is Chairman of the Remuneration Committee, Chairman of the Nomination Committee and is a member of the Group Audit and Compliance Committee.

Directorships of other listed companies

Mr Polson is Chairman of AWB Limited (appointed as a director on 31 March 2003).

Dominic J Stevens

Chief Executive Officer and Managing Director

Experience/qualifications

Mr Stevens commenced in the role of Chief Executive Officer in September 2008 and was previously Deputy Managing Director of the Group. Mr Stevens joined the Group in September 2003 during which time he primarily held responsibility for overseeing Challenger's capital, risk management and strategy group.

Prior to joining Challenger, Mr Stevens led the foundation and was the Senior Managing Director of Zurich Capital Markets in the Asian region. Zurich Capital Markets Asia specialised in the areas of structured finance, derivative solutions and provision of risk management products to investors in alternative assets.

From 1987 to 1999, Mr Stevens held a number of senior roles at Bankers Trust. Mr Stevens was a Partner of Bankers Trust Company, where he headed the Bankers Trust commodity businesses globally (ex energy). In addition Mr Stevens was responsible for the derivatives risk management business at Bankers Trust Australia. Mr Stevens was awarded a Bachelor of Commerce (Hons) Finance in 1986 from the University of New South Wales, Sydney, Australia.

Thomas Barrack Jr.
Non-Executive Director
Independent

Experience/qualifications
Mr Barrack received a Juris Doctor in Law from the University of San Diego and also holds a Bachelor of Arts degree from the University of Southern California.

Mr Barrack is the Founder, Chairman and Chief Executive Officer of Colony Capital, LLC and Colony Advisors, LLC. Prior to forming Colony, Mr Barrack was a principal with the Robert M. Bass Group, Inc. Mr Barrack also served in the Reagan Administration as Deputy Under Secretary of the Department of the Interior. Previously, Mr Barrack was a Senior Vice President at EF Hutton in New York City and President of Oxford Development Ventures, Inc. Mr Barrack was appointed as a director on 22 November 2007.

Special responsibilities
Mr Barrack is a member of the Nomination Committee.

Graham A Cubbin
Non-Executive Director
Independent

Experience/qualifications
Mr Cubbin holds a Bachelor of Economics (Hons) from Monash University and is a Fellow of the Australian Institute of Company Directors.

Mr Cubbin was a Senior Executive with Consolidated Press Holdings Limited (CPH) from 1990 until September 2005, including Chief Financial Officer for 13 years. Prior to joining CPH, Mr Cubbin held senior finance positions with a number of major companies including Capita Financial Group and Ford Motor Company. Mr Cubbin has been a director of the Company since 6 January 2004.

Special responsibilities
Mr Cubbin is a member of the Group Audit and Compliance Committee and the Nomination Committee.

Directorships of other listed companies
Mr Cubbin is a non-executive director of STW Communications Limited (appointed 20 May 2008), a non-executive director of Bell Financial Group Limited (appointed 12 September 2007) and a non-executive director of White Energy Company Limited (appointed 17 February 2010).

Russell R Hooper
Non-Executive Director
Independent

Experience/qualifications
Mr Hooper is a Fellow of the Australian Institute of Company Directors, a Fellow of the Australian Society of Practising Accountants, a Fellow of the Financial Services Institute of Australasia and has completed the Advanced Management Program, Harvard Business School.

He has experience at chief executive level in life insurance, wealth management and listed investment trusts. Mr Hooper has been a director of the Company since 6 November 2003.

Special responsibilities
Mr Hooper is the Chair of the Group Audit and Compliance Committee, a member of the Remuneration Committee and the Nomination Committee.

Directorships of other listed companies
Mr Hooper is a director of Century Australia Investments Limited (appointed 12 September 2006).

Leon Zwier
Non-Executive Director
Independent

Experience/qualifications
Mr Zwier is a partner in the law firm Arnold Bloch Leibler. Mr Zwier holds a Bachelor of Laws from The University of Melbourne. Mr Zwier is a member of the External Advisory Committee of the Department of Business Law and Taxation (Monash University) and is an Honorary Fellow of the same department. Mr Zwier has been a director of the Company since 15 September 2006.

Special responsibilities
Mr Zwier is a member of the Nomination Committee.

Ashok P Jacob
Non-Executive Director

Mr Jacob resigned 8 September 2009

Experience/qualifications
Mr Jacob is Chief Executive Officer of Consolidated Press Holdings Limited (CPH). Prior to joining CPH in 1998, Mr Jacob was the Managing Director of the investment arm of the Pratt group of companies. Mr Jacob was a director of the Company from 6 November 2003 until 8 September 2009.

Mr Jacob holds a Master of Business Administration from the Wharton School and a Bachelor of Science from the University of Pennsylvania.

Special responsibilities
Mr Jacob was a member of the Nomination Committee.

Directorships of other listed companies
Mr Jacob is a director of Consolidated Media Holdings Limited (appointed 9 November 1998) and Crown Limited (appointed 6 July 2007).

James D Packer
Non-Executive Director

Mr Packer resigned 8 September 2009

Experience
Mr Packer is Executive Chairman of Consolidated Press Holdings Limited. Mr Packer was a director of the Company from 6 November 2003 until 8 September 2009.

Special responsibilities
Mr Packer was a member of the Remuneration Committee and the Nomination Committee.

Directorships of other listed companies
Mr Packer is Executive Chairman of Crown Limited (appointed 6 July 2007) and Executive Deputy Chairman of Consolidated Media Holdings Limited (appointed 28 April 1992).

Tetsuya Wada
Non-Executive Director

Mr Wada resigned 17 September 2009

Experience/qualifications
Mr Wada is Managing Executive Officer, Chief Executive Officer for Asia and Oceania of the Bank of Tokyo-Mitsubishi UFJ, Ltd. (BTMU), the largest commercial bank in Japan and a wholly owned subsidiary of Mitsubishi UFJ Financial Group, Inc. (MUFG). Prior to this, Mr Wada held senior executive positions in BTMU and MUFG. Mr Wada was a director of the Company from 21 May 2009 until 17 September 2009.

Mr Wada holds an MBA from Ann Arbor, University of Michigan and a Bachelor of Law from Kyoto University.

Special responsibilities
Mr Wada was a member of the Nomination Committee.

2. Company Secretary

Christopher Robson was appointed to the position of Company Secretary in March 2005. Mr Robson is also the Group General Counsel. He has been qualified as a solicitor for over 20 years, with 16 years experience in the financial services industry.

Suzanne Koeppenkastrop was appointed to the position of Company Secretary in October 2006. Ms Koeppenkastrop is a qualified solicitor and head of the company secretariat team at Challenger. She has over 15 years experience in legal and company secretarial roles in the financial services industry.

3. Principal activities and changes in the state of affairs

The principal activities of the Group during the year were the provision of financial services. At balance date, the following divisional units were responsible for delivering the Group's principal activities:

Life – Manages term guaranteed income streams to annuitants backed by a diverse portfolio of assets, and predictable over-the-cycle returns to shareholders.

Funds Management – Manufactures and distributes quality investment products for both institutional and retail clients, including specialised funds. The Funds Management business model continues to transition from a traditional, in-house portfolio manager structure to a boutique partnership structure. Further details of this are outlined in the 'Operating and financial review' section below.

In addition, the mortgage distribution business, along with a $4.5 billion mortgage portfolio, was sold to National Australia Bank (NAB) during the period, with the sale completing on 30 October 2009. The results of this business up to the date of sale have been disclosed as discontinued operations in the financial report.

There have been no other significant changes in the nature of these principal activities or state of affairs of the Group during the year.

4. Operating and financial review

The year to 30 June 2010 has seen the continued recovery in global debt and equity markets following the events of the global financial crisis, which adversely impacted many participants in the Australian and global financial services sector in the prior financial year. The Group participated in this global market recovery during the year and has emerged in a strong financial position.

The Group's statutory profit after tax was $282.5 million for the year ended 30 June 2010 compared to a statutory loss after tax of $90.7 million in 2009. The Group reported a normalised profit after tax (excluding investment experience and significant items) of $232.5 million, up $13.6 million (6.2%) compared to 2009. This result was supported by normalised earnings before interest and tax (EBIT) of $304.9 million, down $14.9 million (4.7%).

Over the course of the year, Challenger bought back and cancelled 82.2 million shares. As a result, the basic normalised profit after tax per share increased 16.1% and the basic normalised EBIT per share increased 4.4%.

Interest and borrowing costs were $14.1 million, down $22.8 million (61.8%) compared to 2009 due to a combination of lower levels of debt and a lower average cost of debt. The Group has repaid all of its recourse debt during the year, with existing corporate debt facilities remaining undrawn at 30 June 2010.

The major drivers of the changes in normalised profit after tax were improvements in the cash spread earnings generated by the Life division as a result of investments in higher yielding assets and the privatisation of the Challenger Kenedix Japan Trust in January 2010. Asset growth was underpinned by record annuity sales during the year.

While average funds under management for the Funds Management business rose as markets recovered and net fund inflows increased, particularly into the boutique partnerships, the change in asset class composition and margin of funds led to marginally decreased earnings for the period for this division.

Corporate expenses decreased during the period to a more normalised level in 2010 after the one-off restructure expenses incurred during 2009.

Investment experience

The Group is required by accounting standards to value all assets and liabilities supporting the life insurance business at fair value. This can give rise to fluctuating valuation movements being recognised in the income statement, particularly during periods of market volatility such as those experienced during the global financial crisis, and as reported in the Group's results, during 2008 and 2009. As the Group is generally a long-term holder of assets, due to them being held to match the term of the Group's life contract obligations, a large proportion of the gains and losses recognised in the income statement in any one period are unrealised.

Investment experience is a mechanism employed by the Group to remove the volatility arising from asset and liability valuation from the results so as to more accurately reflect the underlying performance of the Group. The difference between the actual investment gains/losses (both realised and unrealised) and the normalised gains/losses (being the Group's expected long-term return) is referred to as 'investment experience'. The investment experience for each period is reported separately from normalised profit in order to provide a better understanding of the Group's normalised financial results for the year.

An investment experience net gain of $51.3 million after tax was recognised during the year compared to a net loss of $309.6 million after tax in 2009. However, global debt and equity markets have remained volatile, particularly during the second half of the year, and asset values still reflect the elevated levels of risk in the markets.

The following table provides an overview of the Group's results for the year.

Group financial summary Management analysis	30 June 2010 $M	30 June 2009 $M	Change %
Income			
Normalised cash operating earnings	338.0	250.8	34.8
Net fee income	102.0	114.4	(10.8)
Other income	7.6	4.7	61.7
Net income[1]	447.6	369.9	21.0
Expenses			
Total operating expenses[1]	(181.8)	(186.2)	(2.4)
Discontinued operations[2]	39.1	136.1	(71.3)
Normalised EBIT	304.9	319.8	(4.7)
Interest and borrowing costs	(14.1)	(36.9)	(61.8)
Normalised profit before tax	290.8	282.9	2.8
Tax	(58.3)	(64.0)	(7.3)
Normalised profit after tax	**232.5**	**218.9**	**6.2**
Investment experience after tax	51.3	(309.6)	Large
Significant items after tax[3]	(1.3)	–	–
Statutory profit/(loss) after tax	282.5	(90.7)	Large
Normalised EBIT by operating division:			
Life	304.1	227.5	33.7
Funds Management	17.3	18.0	(3.9)
Corporate	(55.6)	(61.8)	(10.0)
Discontinued operations[2]	39.1	136.1	(71.3)
Normalised EBIT	304.9	319.8	(4.7)

[1] 'Net income' and 'Total operating expenses' are internal classifications and are defined in Note 2 *Segment information* in the financial report. These differ from the statutory 'revenue' and 'expenses' classifications as certain direct costs (including commissions and management fees) are netted off against gross revenues and Special Purpose Vehicle revenues, expenses and finance costs are netted and included in aggregate in deriving 'Net income'. These classifications have been made in the Directors' report, and the segment information note, as it reflects metrics used by management to measure the business performance of the Group.

[2] Discontinued operations represent the results of the mortgage distribution business for the four months up to the date of sale to NAB on 30 October 2009. The contribution of the mortgage distribution business to the 2009 EBIT has also been reclassified as discontinued operations for ease of comparison.

[3] Represents the loss on sale of the mortgage distribution business to NAB.

Earnings per share

As shown in the table below, on a normalised basis, basic earnings per share (eps) increased 16.1% to 45.5 cents and diluted eps increased 11.0% to 42.7 cents compared to 2009. On a statutory basis, basic eps was 55.3 cents per share compared to a loss of 16.2 cents in 2009 and diluted eps was 51.9 cents compared to a loss of 15.9 cents in 2009. Both basic and diluted eps were positively impacted by the on-market share buy back that continued to be undertaken during the year.

Earnings per share	30 June 2010 Cents	30 June 2009 Cents	% change
Basic – normalised	45.5	39.2	16.1
Diluted – normalised	42.7	38.5	11.0
Basic – statutory	55.3	(16.2)	Large
Diluted – statutory	51.9	(15.9)	Large

Key events during the year

The Group's controlled entity, Challenger Diversified Property Group (CDI), announced a $130 million capital raising in August 2009 with a 4 for 7 pro-rata entitlement offer to eligible unitholders of CDI. The Group subscribed for its entitlement under the offer and its holding has increased from approximately 44.3% of the units prior to the issue to 47.4% as at 30 June 2010.

In October 2009, the Group sold its mortgage distribution business to NAB for a consideration of $383 million. In addition to the mortgage distribution legal entities, NAB acquired $4.5 billion of residential mortgages held in warehouses and a 17% stake in the listed mortgage origination company, Homeloans Limited. The Group continues to own 23% of Homeloans Limited at 30 June 2010.

The entitlement to the residual income units (RIUs) of the remaining residential mortgage loan special purpose vehicles (SPV) not sold to NAB (backed by approximately $11 billion of mortgages) was sold from the Mortgage Management division to Challenger Life Company Limited (CLC) within the Life division. The transfer was completed on arm's length commercial terms for $558 million. The consideration paid reflected a fair value, excluding any obligation for future trail commissions and amortisation of portfolio and origination costs, pertaining to the loan portfolio. The transfer was cash settled but, as it was an intra-Group transfer, did not result in a change in the net assets of the Group.

The proceeds from the sale of the mortgage distribution business have been used to fund a significant repurchase of shares and retire the Group's major debt facilities/borrowings, consisting of the Medium Term Note, Net Interest Margin Bond and Corporate bank facility as outlined in Note 18 of the financial report.

In January 2010, Challenger Kenedix Japan Trust (CKT) unitholders voted in favour of an offer from CLC to buy the remaining units in CKT that it did not already own for $1.05 per unit. This resulted in an additional 95% holding in CKT, taking CLC's holding to 100%. Trading in CKT shares was suspended on the ASX and the entity delisted in February 2010. As a result of the transaction occurring at a discount to the fair value of the net assets of the trust, the Group recognised a pre-tax profit on acquisition of $106 million, net of transaction related expenses.

The Life division has recorded significant annuity sales in its retail product offering of $933 million for the year, up from total sales of $514 million in 2009. In addition, sales totalling $1,253 million of the new Guaranteed Index Return product were achieved during the year. Assets under management of the Life division total $7.6 billion at 30 June 2010, up from $5.8 billion at 30 June 2009, representing growth of $1.8 billion (31.0%) mainly driven by the annuity sales noted above. The Group has continued to invest in product development, marketing and increased distribution capability during the year.

The Funds Management division has experienced positive funds flow during the year, particularly into its Boutique Partnerships, which has $7.0 billion funds under management at 30 June 2010, up from $1.8 billion at 30 June 2009. The Group now has 10 boutique partnerships with the formation of Merlon Capital Partners, Bentham Asset Management (born from the acquisition of Credit Suisse Investment Services (Australia) Limited) and Alphinity Investment Management. Funds under management of the Funds Management division total $20.2 billion at 30 June 2010, up from $16.0 billion at 30 June 2009, representing growth of $4.2 billion (26.3%) over the year.

Capital position

The Group's capital position is managed at both the Group and the, prudentially regulated, Challenger Life Company Limited (CLC) level with the objective of maintaining the financial stability of the Group and CLC whilst ensuring the shareholders earn an appropriate risk adjusted return.

The Group has repaid all of its recourse debt during the year, with existing corporate debt facilities remaining undrawn at 30 June 2010.

Capital reserves above the regulatory minimum in CLC grew from circa $530 million at 30 June 2009 to circa $630 million at 30 June 2010, supported by CLC's increased underlying earnings during the period. The Company continued its on-market share buy back activity during the period and also received shareholder approval at the Annual General Meeting (AGM) on 12 November 2009 to buy back a further 56.9 million shares, effectively refreshing the ability of the Company to buy back up to 10% of its shares.

In total, the Company has bought back 82.2 million shares during the year at an average price of $3.77 per share. From the commencement of the program in July 2008 to the date of this report, a total of 113.4 million shares have been repurchased at an average price of $3.10 per share. The share buy back has had an accretive impact on reported earnings per share of the Group over this period.

5. Likely developments and expected results

The investment management market in which the Group operates has seen significant structural change and development in the last two years. In the retirement income segment, our targeted demographic is growing almost four times faster than pre-retirement, and in the pre-retirement sector, Government has announced its intention to lift superannuation contributions from 9% to 12% over the next 10 years via the superannuation guarantee charge.

When these changes are combined with an increased focus on risk and return, both at a consumer level and by regulatory review committees and government, we see material growth opportunities for our business to take advantage of these positive tailwinds.

Subsequent to the key events above, the Group has a more focused business model and is well placed to participate in the growing Australian retirement income market and the fast developing boutique funds management business. We are directing our focus towards lifting product sales, via expanded distribution and the introduction of new guaranteed income products. Subject to continued stability in global markets, we are confident we can increase value for shareholders over the coming years.

6. Environmental regulation and performance

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

7. Dividends

On 21 August 2009, the Directors of the Company declared a final dividend on ordinary shares in respect of the year ended 30 June 2009 of 7.5 cents per share. The total final dividend paid by the Group on 16 October 2009 was $42.0 million.

On 19 February 2010, the Directors of the Company declared a 2010 interim dividend on ordinary shares of 6.0 cents per share. The total interim dividend paid by the Group on 16 April 2010 was $31.2 million.

On 20 August 2010, the Directors of the Company declared a final dividend on ordinary shares in respect of the year ended 30 June 2010 of 8.5 cents per share. The final dividend, estimated to be $41.0 million, will be unfranked, is payable on 15 October 2010 and has not been provided for in the 30 June 2010 financial report.

The final unfranked dividend of 8.5 cents per share brings the total dividends declared for the 2010 year to 14.5 cents per share compared to 12.5 cents per share for 2009, representing an increase of 2.0 cents (16%). The full year dividend represents a dividend payout ratio of 32% of normalised after tax earnings per share and is consistent with the Group's stated dividend policy of paying approximately 30% of normalised earnings after tax.

8. Indemnification and insurance of officers and Directors

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

In accordance with the provisions of the *Corporations Act 2001*, the Company has insured the Directors and officers against liabilities incurred in their role as Directors and officers of the Company and its subsidiaries. The terms of the insurance policy, including the premium, are subject to confidentiality clauses and as such the Company is prohibited from disclosing the nature of the liabilities covered and the premium. The Company has not given or agreed to give any indemnity to an auditor of the Group and has not paid any premium for insurance against that auditor's liabilities for legal costs.

9. Significant events after the balance date

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

10. Corporate Reporting Reform Act – removal of parent entity reporting

The *Corporations Amendment (Corporate Reporting Reform) Act 2010* was enacted in June 2010 and has amended the *Corporations Act 2001* such that an entity required to present consolidated financial statements must disclose only the consolidated amounts in the primary statements and notes thereto. The Group has therefore removed the parent entity financial statements and notes in the attached financial report, with summarised parent entity information included in Note 38.

11. Rounding

The amounts contained in the financial report have been rounded off to the nearest $100,000 under the option available to the Group under Australian Securities and Investments Commission (ASIC) Class Order 98/0100. The Group is an entity to which the class order applies.

12. Audited Remuneration Report

Dear Shareholder,

The last year has seen increasing scrutiny of financial sector executive remuneration around the world stemming from the Global Financial Crisis which has impacted government regulation and companies' approaches to remuneration matters. I wish to outline for you some of the key initiatives that have been undertaken during fiscal year 2010 which continues to ensure that Challenger's remuneration arrangements drive the right sustainable results for shareholders.

After a period of consultation, the Australian Prudential Regulation Authority (APRA) released new remuneration governance requirements to apply within regulated financial institutions to be effective from 1 April 2010. Many of APRA's requirements were also identified by the Productivity Commission as being of relevance to improve the governance of executive remuneration in listed companies generally.

This year, the Remuneration Committee consolidated Challenger's existing remuneration practices and approaches into a single remuneration policy. This policy now forms the core reference for the Board, Remuneration Committee and senior management when considering remuneration matters.

Specifically the Remuneration Policy covers:

- the roles and responsibilities of those involved in supporting, making, monitoring, evaluating or approving remuneration decisions; and
- the structure of remuneration arrangements which are encompassed by the Reward Strategy.

Consistent with APRA's requirements and the Government's response to the Productivity Commission, Challenger's governance and remuneration structure continues to provide for:

- independence of the Remuneration Committee from management and access to external remuneration advice from its own appointed adviser;
- non-formulaic remuneration performance based incentives which allow for significant discretion to be applied by the Remuneration Committee when determining remuneration outcomes with the benefit of hindsight;
- significant deferral of short-term bonuses into performance rights linked directly to the Challenger share price to encourage long-term sustainable results over short-term excessive risk taking (no cash bonuses were paid to the CEO or his direct reports in 2009 and 50% of short-term bonuses for 2010 have been deferred);
- alignment of senior executives with shareholders by weighting a significant proportion of long-term reward to equity based programs; and
- an executive shareholding guideline that further aligns executives' and shareholders' interests, while reducing the potential for excessive risk taking.

These are key elements which global regulators identified as requiring improvement from remuneration schemes at many global financial services firms. Each of these elements is described in more detail in the Remuneration Report.

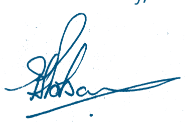
The Board is committed to providing clear and transparent information around executive remuneration. It is for this reason that this report (as with the 2009 Remuneration Report) includes information in addition to the statutory requirements. This includes, importantly in the Board's view, details of the value of equity awards that vested during the year plus the portion of that value delivered as a direct result of any increase in the Challenger share price since the awards were made.

As you will see from the remuneration tables, the most significant contributor to overall compensation levels has been the significant appreciation of the Challenger share price – an appreciation which has also directly benefited shareholders.

The Board believes that the 2010 Remuneration Report will assist stakeholders in understanding the Company's remuneration arrangements and, in particular, how individual reward outcomes are aligned to business performance and shareholder outcomes.

We trust that you find this additional information of value.

Yours sincerely,



Peter Polson
Chairman
Remuneration Committee

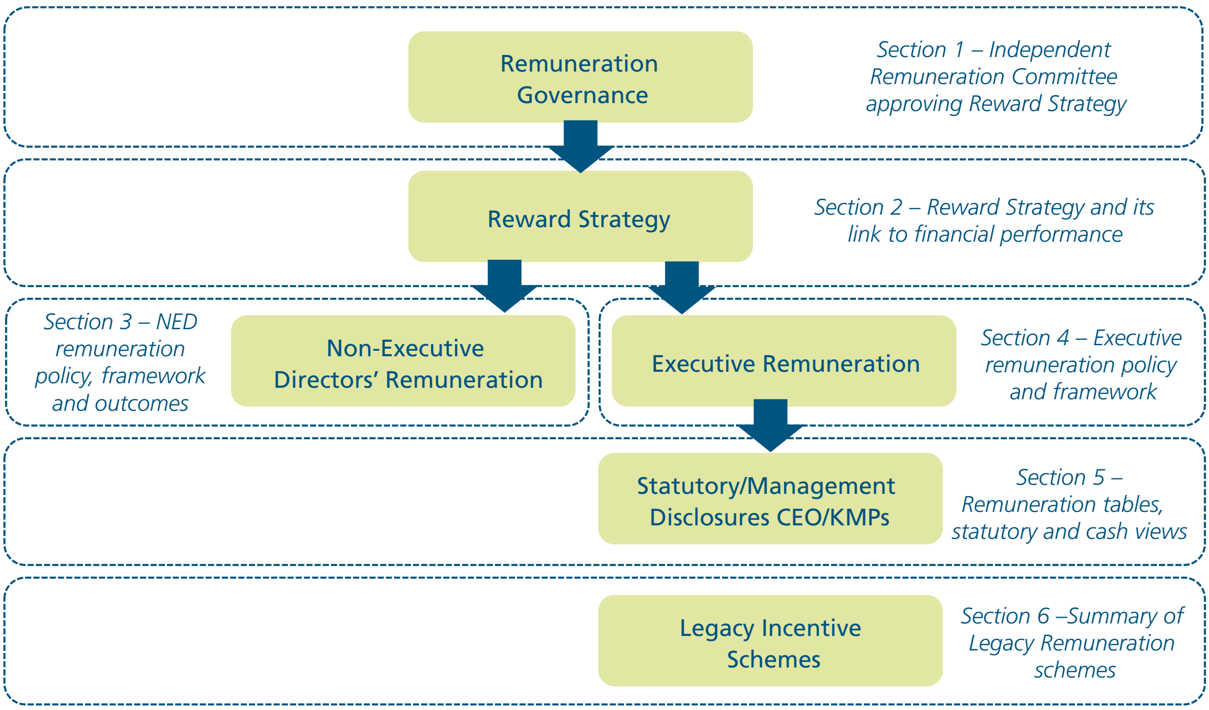
Remuneration Report

This audited Remuneration Report describes Challenger's director and executive remuneration arrangements as required by the *Corporations Act 2001*. The report covers Key Management Personnel 'KMP' (Directors and Key Executives) of the Group. These personnel include the five highest remunerated executives of the Company and the Group and those who have authority and responsibility for planning, directing and controlling the major activities of the Company and the Group.

Summary of key items during the year:

- **Remuneration Committee:** following the appointment of Graham Cubbin to the Remuneration Committee during the year, the Committee is now solely comprised of independent members. During the year, the Committee also appointed Guerdon Associates as its independent remuneration advisers.
- **Introduction of minimum shareholding for KMPs:** all KMPs will be required to meet minimum shareholding levels of 100,000 shares.
- **Increased level of deferred remuneration/compensation:** deferral of 50% of short term incentive payments to KMPs in 2010 and longer vesting periods for long term incentives.
- No increase in overall pool for **Non-Executive Directors' fees**.
- Separation of legacy long term incentive (LTI) schemes from contemporary schemes to enhance disclosure for stakeholders.
- Enhancements to remuneration policies supporting changes introduced by the Australian Prudential Regulation Authority (APRA) and recommended by the Productivity Commission.

Challenger Remuneration Framework



1. Remuneration Governance

The Remuneration Committee comprises three independent directors. The current members are:

- Peter Polson (Chairman)
- Russell Hooper
- Graham Cubbin

All three are also members of the Group Audit and Compliance Committee, providing a relevant link in ensuring that remuneration arrangements are established and managed in a way which is consistent with Challenger's overall Risk Management Framework. The Group Audit and Compliance Committee provides an annual report to the Remuneration Committee prior to the quantum and underlying allocation of short and long term incentives for each financial year being finalised. The report summarises any high risk breaches of the Risk Management Framework or other Compliance policies. The Remuneration Committee will consider the report when finalising the quantum of the short term and long term incentive pools and reviewing or recommending individual allocations thereof.

The Remuneration Committee's key responsibilities involve approving and recommending to the Board adoption of employee and executive remuneration and incentive policies and practices, including the Remuneration Policy.

On an annual basis, the Remuneration Committee also reviews and either approves or submits to the Board for approval recommendations in relation to total remuneration outcomes (including base pay, incentive awards and equity awards) for the following individuals and groups of employees:

Role	Role of Committee
1. Chief Executive Officer	Committee makes recommendations for review and approval by the full Board
2. Direct reports to the Chief Executive Officer	Committee makes recommendations for review and approval by the full Board
3. Individuals whose activities may affect the financial soundness of the Company or its divisions (or any other person specified by APRA)	Committee makes recommendations for review and approval by the full Board
4. Remuneration for the top 50 highest paid Challenger employees	Committee approves
5. Key risk and financial control employees	Committee approves

Full details of the role and responsibilities of the Committee are set out in the Remuneration Committee Charter which is available on the Group's website. The Remuneration Committee met five times during the financial year.

Remuneration Advisers to the Remuneration Committee

Following an extensive selection process, the Board appointed Guerdon Associates in March 2010 as its independent remuneration advisers.

Employee Share Trading Policy

All employees must comply with Challenger's Employee Share Trading Policy. All employees are required to obtain pre-approval from the Company Secretary if they wish to trade in Challenger shares. Employees are also prohibited from trading during specified black-out periods including prior to the release of the Group's financial results.

Under this policy, employees are prohibited from hedging their unvested share awards including performance rights and share options. In the Board's view, hedging unvested awards goes against the intention in which long term incentives are granted to employees. Where a person is found to have breached this requirement it will be regarded as serious misconduct and may be grounds for dismissal.

Challenger generally prohibits employees from taking out margin loans on Challenger shares with any exceptions to this requiring formal Board approval. There have been no exceptions to this prohibition in 2010.

Challenger has introduced equity holding guidelines which apply to Key Executives and Non-Executive Directors from 1 July 2010.

Minimum Shareholding for Non-Executive Directors and Key Executives

Under the guidelines, Key Executives are expected to maintain a minimum holding of Challenger shares equal to 100,000 shares. Non-Executive Directors are expected to maintain a minimum holding of 20,000 shares. All will be expected to have achieved the minimum shareholding level by 1 July 2012.

The Board will retain the discretion to allow Key Executives and Non-Executive Directors to vary from this guideline policy.

In the Board's view, maintaining these significant levels of shareholdings in tandem with other alignment qualities of the remuneration mix reduces the potential for excessive risk taking and further strengthens alignment with shareholders.

2. Reward Strategy and Link to Financial Performance

Challenger's reward strategy is critical to the ongoing creation of value for shareholders. It has been designed by the Remuneration Committee with support from independent advisers to provide alignment between our employees and our shareholders.

The Board, in representing shareholders, approves strategic directions, budgets and risk management and compliance procedures supporting long-term sustainable growth for the business. Our Reward Strategy for employees is designed to drive superior levels of performance based around these strategies and align remuneration with the resultant value creation for shareholders.

Challenger has a leading and differentiated business strategy. The APRA regulated Challenger Life Company is the number one provider of guaranteed income streams to over 60,000 customers and the Funds Management business also manages more than $20 billion of assets in a fiduciary capacity for investors. Both businesses share complementary common technology and support services. This strategy is differentiated from other similar investment management companies as Challenger's key focus is on the provision of annuities and has a unique multi-boutique funds management model.

This differentiation has served Challenger well over the medium term, with normalised earnings per share growing at a compound rate of 16% over the past five years. However, this model is particularly reliant on the skills and experience of our senior executives, many of whom have significant experience in the investment banking and wealth management sectors. As such we believe the retention of our Key Executives is critical to the sound management of our business and the continuation and implementation of the next phase of our growth path.

The objective of Challenger's Reward Strategy is to attract, retain and motivate the talent pool capable of delivering our business strategy. The key elements and the ways in which Challenger seeks to achieve this are as follows:

Objective	Delivered by
Pay people fairly for the type of work they do.	Regularly benchmarking remuneration to the external market by participating in industry and role specific salary surveys, and ensuring the quantum and balance between fixed, short-term and long-term remuneration is appropriate for individual roles.
Reward above expected contribution to Challenger performance.	Maintaining a robust performance management framework which ensures all employees have appropriately structured performance objectives which are aligned to team, business unit and Challenger objectives. Offering participation in the discretionary annual Employee Incentive Plan to all employees who achieve the requisite requirements.
Ensure that all remuneration arrangements are designed in a way that encourages and supports the long-term sustainability of Challenger's business.	Determining remuneration outcomes on the basis of performance as well as demonstrated behaviours in line with the Challenger Principles. Ensuring that remuneration of support function employees including risk and financial control employees, is determined independently of the businesses they support.
Ensure alignment of shareholder and executive outcomes.	Deferring and linking significant portions of annual Employee Incentive Plan awards to Challenger's future performance through the Challenger Performance Plan, and ensuring deferred remuneration remains at risk and subject to forfeiture including in the event of material breaches of the Risk Management Framework or material individual operational errors. Timing the delivery of long-term remuneration to reflect both the time necessary for results from business activities to be reliably measured as well as broader retention outcomes. All KMP will be required to meet minimum shareholding levels of 100,000 shares.
Provide transparency to external stakeholders.	Significant additional (non-statutory) disclosure to better help external stakeholders understand Challenger's remuneration arrangements including details of amounts actually received by individuals (as opposed to accounting valuations).
Ensure equity and consistency across the Group.	Ensuring remuneration outcomes are subject to rigorous peer review through the annual calibration process involving the CEO and direct reports.
Ensure sufficient flexibility to deliver value for shareholders in maintaining a strong management team despite the volatility that arises from the financial markets in which our business operates.	Maintaining discretionary, non-formulaic schemes, which permit outcomes to be considered with the benefit of hindsight. Examples include the ability to significantly reduce and/or defer a greater portion of remuneration levels. For example, during the uncertainty of the Global Financial Crisis, 100% of 2009 short term incentives for KMPs were deferred into future periods.

Relationship of Remuneration to Group's Financial Performance

Executive remuneration is directly linked with the following measures of Group performance:

- *Normalised net profit after tax (Normalised NPAT) and net profit after tax (NPAT)*

  The Group is required to value all assets and liabilities that support the life insurance business at the prevailing balance date fair value prices under applicable life insurance accounting standards. This can give rise to volatile unrealised valuation movements, particularly as experienced during the Global Financial Crisis and as reported in our financial results during 2008 and 2009.

  Challenger is generally a long-term holder of assets in order to match the term of the Group's life insurance obligations and so over the medium to long term should not be affected by short-term fluctuations in the market price of assets. In any given reporting period, the actual investment gains/losses (both realised and unrealised revaluation movements) will vary to the normalised or the Group's expected long-term gains for each of the major asset classes held. The difference between the actual net investment gains/losses and the normalised investment gains is referred to as 'investment experience'. The investment experience for each reporting period is reported separately from the normalised profit of the Group in order to provide a better understanding of the Group's normalised financial results for the year.

- *Normalised earnings per share (Normalised EPS)*

  Normalised EPS is calculated using normalised earnings, as outlined above, and the basic share count.

- *Total Shareholder Return (TSR)*

  TSR represents the total return for a shareholder being capital appreciation and dividends over a specified timeframe. As a hurdle for remuneration it provides a strong link between employee outcomes and shareholder outcomes.

- *Overall corporate result against plan (financial measures including Cash Operating Earnings and Investment Experience, and strategic non-financial measures)*

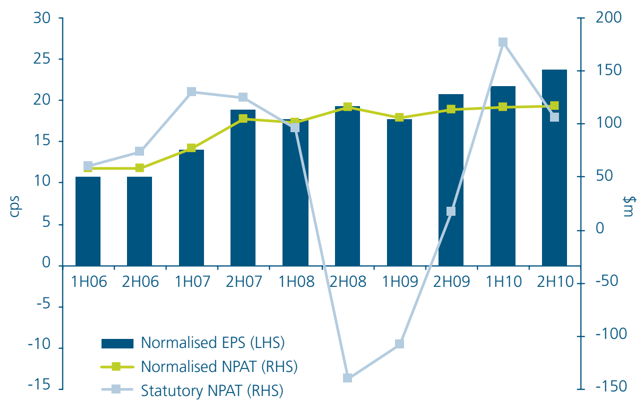
  Prior to the beginning of each financial year there are detailed Board approved budgets established for each of the businesses. These budgets detail expected revenues and expenses for each of the businesses and the Group as a whole, capital usage, cash generation, headcount, growth in funds under management, etc. Throughout the year, the Board is kept up to date with any deviation from that budget and will use the actual performance versus budget as a key determinant of incentive compensation.

The Board also takes other significant factors into account when determining remuneration outcomes:

- Movements in the external remuneration market
- Organisational capacity to pay
- Cost and amount of capital employed in arriving at financial results
- External factors beyond management control
- Unplanned one-off transactions and/or events (e.g. acquisitions and disposals of businesses)
- Degree of difficulty of achievement of objectives with the benefit of hindsight
- Management of risk (operational, credit, market, strategic)
- Assessment against key behaviours (Challenger Principles)
- Performance against key non-financial objectives

Key financial performance outcomes are provided in the following chart and table:

Chart 1 – Five Year History of Profit and Earnings per Share



- Normalised earning per share has grown at a compound rate of 20% over the past five years
- Stable and accretive normalised net profit after tax over the past five years
- Statutory net profit after tax impacted by volatile global markets through financial years 2008 and 2009 now returning to a more normal level
- One year TSR of 63% for year ended 30 June 2010

Table 1 – Five Year History of Key Financial Metrics

	30 June 2006	30 June 2007	30 June 2008	30 June 2009	30 June 2010
Normalised net profit after tax ($m)[1,2]	117.6	182.0	217.9	218.9	232.5
Normalised basic earnings per share (cents)[1,2]	21.8	33.0	37.1	39.2	45.5
Statutory net profit/(loss) after tax ($m)	134.3	255.0	(44.2)	(90.7)	282.5
Closing share price ($)	3.16	5.83	1.89	2.24	3.52
Dividends per share (cents)	7.5	12.5	12.5	12.5	14.5
One Year TSR (%)	4%	91%	(66)%	27%	63%

[1] Normalised net profit is defined in section 5 of the Directors' report.

[2] Normalised numbers for 30 June 2006 are on a historic cost basis.

3. Non-Executive Director Remuneration

The Non-Executive Directors holding office in the year ended 30 June 2010 were:

Peter L Polson (Chairman)
Thomas J Barrack Jr.
Graham A Cubbin
Russell R Hooper
Leon Zwier

Ashok P Jacob (Resigned 8 September 2009)
James D Packer (Resigned 8 September 2009)
Tetsuya Wada (Resigned 17 September 2009)

Policy

The remuneration policy for Non-Executive Directors aims to ensure that the Company can attract and retain suitably skilled and experienced people to serve on the Board and to reward them appropriately for their time and expertise. The Board's focus is on strategic direction and the delivery of sustained long-term corporate performance.

The maximum aggregate of annual Non-Executive Director fees is approved by shareholders in accordance with the requirements of the Corporations Act.

Fee Pool

The current fee pool of $2 million was approved by shareholders in 2007. No increase to the Non-Executive Director fee pool will be sought for 2011.

Fee Framework

The Board periodically reviews the fee framework. The most recent review was conducted in March 2010. Under the current fee framework, Non-Executive Directors are remunerated by way of fees paid in recognition of membership of, and work in regard of, Boards and Committees (excluding the Nomination Committee) to reflect the position's accountabilities. The fees detailed below also cover service provided on subsidiary company boards.

Fees applicable to membership and chair of main Board and Committees that applied in the year ended 30 June 2010 were as follows:

Board/Committee	Role	Annual Fee
Board[1]	Chairman[1,2]	$180,000
	Member	$120,000
Group Audit and Compliance	Chairman[2]	$15,000
	Member	$20,000
Remuneration	Chairman[2]	$10,000
	Member	$15,000

[1] Board fees include Nomination Committee fees.

[2] Chairman fees are in addition to Member fees.

Superannuation

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

Equity Participation

The Non-Executive Directors do not receive shares, share options or share rights as part of their remuneration and do not participate in any equity based incentive plans.

Details of Non-Executive Director Remuneration for 2010 Financial Year

The remuneration of each Non-Executive Director of the Company and of the Group for the year ended 30 June 2010 is set out in the table below:

		Short-term Salary Benefits	Post-employment	Total
		Director Fees	Superannuation	
	Year	$	$	$
P Polson	2010	317,084[5]	13,256	330,340
	2009	316,039	13,745	329,784
T Barrack Jr.[1]	2010	–	–	–
	2009	–	–	–
G Cubbin[6]	2010	155,000	–	155,000
	2009	155,000	–	155,000
R Hooper[6]	2010	189,996	–	189,996
	2009	219,996[2]	–	219,996
L Zwier[6]	2010	120,000	–	120,000
	2009	120,000	–	120,000
A Jacob[3]	2010	–	–	–
	2009	–	–	–
J Packer[3]	2010	–	–	–
	2009	–	–	–
T Wada[4]	2010	–	–	–
	2009	10,000	–	10,000

[1] Acts as a Director in discharging his duties as an executive of Colony Capital, LLC and consequently does not accept fees for his services.

[2] Includes Challenger Listed Investments Limited Director fees.

[3] Mr Jacob and Mr Packer resigned on 8 September 2009. No Director fees were previously paid as Mr Jacob and Mr Packer acted as a Director in connection with discharging their duties as executives of Consolidated Press Holdings (CPH) and consequently did not accept fees for their services.

[4] Mr Wada resigned on 17 September 2009. No fees were paid for this interim period.

[5] Includes in the case of Mr Polson the cost of Death, TPD and Salary Continuance insurances.

[6] These Directors provide their services to Challenger through service companies. Fees are shown exclusive of GST.

4. Executive Remuneration

Key Executives

The Key Executives whose remuneration is detailed in this report are:

Name	Current Role
Dominic Stevens	CEO and Managing Director
Rob Adams	Joint Chief Executive, Funds Management
Brian Benari	Group Chief Financial Officer/Chief Operating Officer
Richard Howes	Chief Executive, Life
Paul Rogan	Executive General Manager, Capital Risk & Strategy
Robert Woods	Joint Chief Executive, Funds Management
Drew Hall	Former Chief Executive, Mortgage Management

All of the above have been Key Executives for the whole of the reporting period with the exception of Mr Hall who ceased to be a Key Executive of the Group on 31 October 2009 following the sale of the Mortgage Management business to National Australia Bank Limited.

Challenger's remuneration components – at a glance

The following provides an overview and the rationale of Challenger's remuneration and changes applicable to 2011.

Remuneration Components	Challenger's Relevant Component(s)	Challenger's Approach	Rationale for Approach
Salary Package	Base Salary + Compulsory Superannuation	Positioned on average around the median for comparable market incumbents.	Individuals should receive sufficient fixed salary such that there is significant variable 'at risk' components of reward particularly those in senior positions.
Short Term Incentive	Employee Incentive Plan (EIP)	Discretionary short term incentive based on individual contribution to team, division and Challenger performance as well as behaviours supportive of Challenger Principles. A significant portion of short term incentives for Key Executives are deferred in the form of Performance Rights which are 100% linked to future movements in Challenger's share price, which vest over two year's subject to continued employment. It is expected that EIP will comprise a significant proportion of executive remuneration, and should be sufficient to take Challenger's highest achievers to the upper quartile of the market for their respective performance and roles.	Having a fully discretionary scheme as opposed to formulaic target bonus pools recognises that at the most senior levels judgement needs to be exercised across multiple, complex and interacting variables, requiring constant fine tuning for sustainable performance. It provides for significant increases or decreases in reward outcomes from year to year that bypasses the unintended consequences, risk and gaming that formulaic approaches may engender. Providing deferred bonuses in the form of Performance Rights directly aligns executives' interests with shareholders and vesting deferred bonuses over time subject to continued employment provides a significant retention mechanism that reduces operational risk associated with executive loss. Lastly, deferring bonuses allows for clawback in the event that a bonus outcome was achieved in ways that exposed the Company to excessive risk.
Long Term Incentives	Challenger Performance Plan – Hurdled equity awards of Share Options or Performance Rights	Hurdled awards granted to executives who are able to influence long term shareholder wealth creation. Vesting occurs progressively (over one, two and three years) subject to the achievement of a normalised Earnings Per Share or absolute Total Shareholder Return performance hurdle. For 2011, new awards will vest progressively over two, three and four years, subject to ongoing employment and the achievement of a performance hurdle.	A large proportion of performance pay is linked to performance over the longer term. Providing limited participation in hurdled Long Term Incentive awards ensures only those with true line of sight and the ability to impact the performance measure receive awards. Moving to a longer vesting period will provide for a greater retention benefit and further focus executives on longer term performance. Having a long term incentive (LTI) that is only majority vested after three years has passed is in line with market best practice.

The remuneration mix will vary for different roles, reflecting relativities to the external market and internal comparators, as well as the skills and experience individuals bring to their role. Generally, the proportion of remuneration at risk in the form of short and long term incentives will be higher for more senior employees and those in revenue generating areas.

Salary Package

Challenger aims to position the salary package on average around the median of the external market for comparable roles.

Salary package is determined by the scope of the employee's role, their level of knowledge, skills and experience, having regard to performance and market benchmarking against a peer group of companies comprising banking and financial services companies. Salary packages are reviewed annually, although are not necessarily increased each year.

Challenger is a member of the Financial Institutions Remuneration Group (FIRG) and participates in the semi-annual FIRG remuneration survey. The FIRG remuneration survey is the principal source of remuneration data for roles at Challenger. Challenger participates in additional relevant surveys with organisations including Hewitt, McLagan, Towers Watson, HayGroup and Avdiev to ensure it can draw on contemporary market data for the full range of roles across its business.

Employees have the opportunity to salary sacrifice amounts from their salary package towards the cost of certain benefits inclusive of any associated fringe benefits tax.

Short Term Incentives

The aim of the Employee Incentive Plan (EIP) is to reward employees who have made a significant contribution to Challenger's results over the course of the financial year. All permanent full time and permanent part time employees who commenced employment prior to 1 April in the financial year are eligible to participate in the EIP.

Payment of EIP is provided on a discretionary basis only to those employees who meet the objectives of their role and consistently display the Challenger Principles. Employees have no contractual right to receive any EIP payment. The Challenger Board reserves the right to amend or withdraw the EIP scheme at any time at their sole discretion.

Determining the EIP Pool

As illustrated and outlined above, the overall bonus pool is determined by the Board with reference to Challenger's overall financial performance.

Determining Individual Allocations from the EIP Pool

Individual EIP bonus awards are related directly to an employee's performance against individual objectives (linked to Business/Division objectives) as well as the extent that the employee's behaviours are in accord with the Challenger Principles.

Managers make recommendations on the proposed amount of any EIP bonus award and these recommendations are then considered relative to the employee's peers in 'calibration' sessions. The aim of calibration sessions is to ensure that remuneration outcomes are consistent for individuals performing similar roles to a similar level of overall performance and are reasonable with respect to external market benchmarks. The Remuneration Committee conducts a 'calibration' session for the CEO and senior executive remuneration.

Consistent with the APRA guidelines, the assessment of remuneration for key risk and financial control employees is determined separately from the businesses they support and ensures that remuneration does not compromise the independence of these individuals in carrying out their roles.

Deferral of EIP Bonus Awards into Performance Rights

At the Board's discretion, Challenger may defer the payment of an EIP bonus award (or part thereof) to an employee or group of employees with payment contingent upon their continuity of employment. In such cases the employee will be advised of the deferral arrangements at the time they are notified of any EIP bonus award.

Deferred EIP bonuses will generally be provided in the form of Performance Rights under the Challenger Performance Plan (CPP) with one Performance Right giving employees the right to one ordinary Challenger share once the employment condition has been met. Performance Rights will typically vest over a two year period.

The purpose of deferring bonuses is twofold. Firstly, deferring some or all of bonuses and vesting them over time subject to continued employment provides a significant retention mechanism. Secondly, providing deferred bonuses in the form of Performance Rights directly links the deferred amounts with the Challenger share price over time and further aligns employees' interests with those of shareholders.

The CEO and all Key Executives received 50% of short term incentives in performance rights in 2010. Receipt of 50% of these performance rights was deferred for one year, and 50% for two years.

Performance Rights: Forfeiture Conditions

The terms of the Challenger Performance Plan that applied in the 2010 financial year provide that Performance Rights are forfeited or lapse where an employee resigns prior to the satisfaction of any time based vesting conditions. Performance Rights are also forfeited where an individual commits an act of gross misconduct or dismissed with fair cause.

For 2011 awards, the rules will also provide for forfeiture to:

- protect the financial soundness of the Company (e.g. Challenger experiencing losses affecting its financial soundness, causing it to not meet prudential capital requirements and to seek significant additional capital injections); or

- respond to unsatisfactory risk management (e.g. material risk management breaches, unexpected financial losses to the Company, reputational damage or regulatory non-compliance).

Performance Rights do not automatically vest on change of control, rather the Board has sole and absolute discretion to determine the manner in which Performance Rights will be dealt with. Consistent with common market practice and governance expectations, flexibility and discretion are necessary to deal with varied circumstances.

Long Term Incentives

Hurdled Share Options or Performance Rights are granted to employees whose responsibilities provide them with the opportunity to significantly influence long-term shareholder value. Whilst Share Options are issued at no initial charge to the employee, the employee must pay the exercise price of the Share Option to convert vested options into underlying shares.

The Challenger Performance Plan provides the Board with flexibility around the form of the performance hurdle it attaches to particular grants of Share Options or Performance Rights to ensure that there is appropriate alignment between shareholders and executives.

To minimise the dilution of existing shareholders, exercised Share Options during the 2010 financial year have been satisfied by the transfer of shares acquired on market and held by the Challenger Performance Plan Trust rather than through new share issues. As Share Options are issued under the Challenger Performance Plan, the forfeiture provisions described above for Performance Rights, apply.

Challenger will issue hurdled Performance Rights rather than Share Options in 2011. Hurdled Performance Rights will vest progressively over four years.

5. Statutory and Management Disclosures – CEO and KMPs

The following table (Table 2A) provides a breakdown of the CEO and other Key Executives' remuneration.

The value of the share based payments included in Table 2A reflects the amortised expense of the share based payment awards that have been granted during the year and also prior years as outlined in Note 1(xxix) of the financial report.

The fair value of the benefit is derived at the date at which the awards were granted rather than the actual realised value during the year. As the majority of the Group's share based payment awards are subject to share price based performance hurdles (e.g. TSR of the Company) no adjustment to the fair value after grant date is allowed under the accounting standards for the likelihood of the market performance conditions not being met. Therefore the value of the reward included in Table 2A may vary materially to the actual value that is realised by the Key Executives.

The value of the 2010 share based payment and cash settled share awards have also been impacted by a confluence of historical factors which have materially increased the statutory remuneration disclosures in Table 2A. Key factors include:

- The Remuneration Committee determines the grant of Options and Performance Rights and the award allocation price annually as part of the financial close process. In 2009, due to the significant uncertainty arising from the proposed changes in tax legislation regarding Employee Share Ownership Plans, the grant of Options and Performance Rights only occurred upon tax clarification. Whilst the terms and conditions of the grants, as established by the Board, did not change, the increase in the Company's share price during the intervening period led to a material increase in the accounting fair value at the date of formal award grant. The total impact for KMPs was $4.2 million for 2010.
- The 2010 share based remuneration values include the final full year amortisation costs relating to legacy incentive loan schemes as outlined in Section 6 of the Remuneration Report. The total impact for KMPs was $3.8 million for 2010.
- Finalisation of legacy cash settled LTIP schemes which were granted in 2003. The performance hurdles were not expected to be achieved in the prior year and so the previously recognised expenses since 2003 were reversed in 2009. With the significant rally in the Company's share price in 2010 the full expense of the award has been reinstated solely in the current period. This is not reflective of the six years to which the award benefit pertains. The total impact for KMPs was $1.7 million for 2010.

The impact of these factors will not be repeated in 2011 and, as such, the reported total KMP statutory remuneration levels are expected to decrease by circa 30%.

The Board is aware that the statutory remuneration disclosures are quite complex, particularly in terms of the accounting requirements of long term incentive schemes. An additional table (Table 2B) has therefore been provided that depicts the actual remuneration that has become available to Key Executives over the reporting period from any current, or historical, scheme. This includes:

- salary package and short term incentive received for the year to 30 June;
- other cash received during the year; and
- realisable value of share based payments vested during the period (valued by reference to the market price of the underlying shares less any exercise price on the earlier of the exercise date or 30 June), whether or not the underlying shares have been sold.

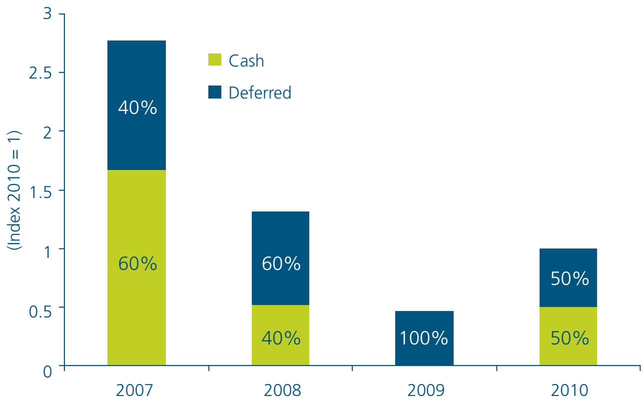
Each individual's awarded remuneration varies with the extent that the individual achieved his or her agreed performance requirements. Given these Key Executives are directly responsible for company performance, which is often reflected in share price movement, there is a link between share price movement and each individual's realised remuneration. As expected, and in line with the clear link between equity based incentives and shareholder outcomes, as the Company's share price increased, actual remuneration of the CEO and Key Executives also increased in 2010. This is in contrast to the prior year, where realised remuneration declined in line with the Company's share price.

In addition to the share price movement, the realised value of remuneration may include a prior year deferred short term bonus or the final payment from the vesting of a long term equity scheme. As such, these values have been uneven over time depending on both share price movements and vesting dates. Importantly a significant amount of the value relating to the 2010 year for the Key Executives reflects the final vesting event from the 2003/04 Long Term Incentive Plan scheme, which reflects remuneration relating to six years of employment.

To assist in understanding these issues, the following charts have been provided to show:

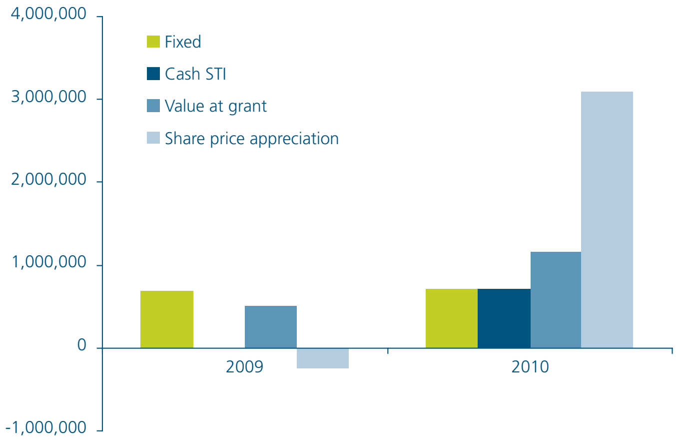
- the percentage of cash and deferred short term incentive (STI) (Chart 2);
- that part of the remuneration that has accrued purely from the change in share price since the grant date (this may be a positive or a negative number) (Chart 3); and
- the remuneration by year of issuance (Chart 4).

Chart 2 – Short Term Incentives awarded to Key Executives allocated between cash and deferred



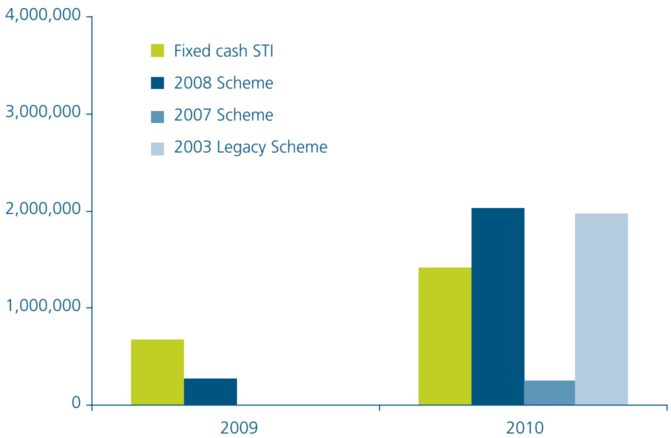
- A significant portion of the short term incentives have been deferred into Performance Rights
- In 2010, 50% of short term incentives were deferred with 100% deferred in 2009
- The short term incentive pool has reduced since 2007 following impacts of investment experience on statutory NPAT and changes in external market conditions

Chart 3 – Average Key Executives source of cash remuneration – 2009 and 2010



- During 2010, a significant portion of the realised remuneration of Key Executives related to the substantial appreciation in the Challenger share price

Chart 4 – Average Key Executives cash remuneration by year of original grant



- A significant proportion of realised remuneration in 2010 resulted from legacy schemes where initial grants were made in 2003

Table 2A – Statutory Reporting Table: Remuneration of the CEO and other Key Executives for the years ended 30 June 2010 and 30 June 2009

		Short Term Employee Benefits				Share Based Payments[3]				
Name	Year	Salary[1] $	STI[2] $	Post Employment Super $	Subtotal $	Equity settled shares and units[3] $	Equity settled options and rights[3] $	Cash settled shares and units[4] $	Other[5] $	Total $
Dominic Stevens	2010	990,795	1,100,000	14,461	2,105,256	220,635	2,686,246	330,000	1,285,143	6,627,280
	2009	921,068	–	13,745	934,813	499,209	2,027,704	(330,000)	944,202	4,075,928
Rob Adams	2010	637,034	425,000	14,461	1,076,495	157,553	1,320,221	650,000	131,861	3,336,130
	2009	637,567	–	13,745	651,312	327,731	673,717	(650,000)	56,503	1,059,263
Brian Benari	2010	639,750	925,000	14,461	1,579,211	65,458	3,690,820	650,000	1,182,979	7,168,468
	2009	639,954	–	13,745	653,699	138,664	2,012,255	(650,000)	1,013,235	3,167,853
Richard Howes	2010	636,414	750,000	14,461	1,400,875	138,610	2,886,824	120,000	1,128,880	5,675,189
	2009	553,711	–	13,745	567,456	270,603	1,796,362	(120,000)	988,275	3,502,696
Paul Rogan	2010	635,539	425,000	14,461	1,075,000	778,759	1,421,670	–	503,578	3,779,007
	2009	636,255	–	13,745	650,000	1,219,916	771,906	–	396,567	3,038,389
Robert Woods	2010	638,847	650,000	14,461	1,303,308	53,306	2,914,393	–	1,130,497	5,401,504
	2009	639,194	–	13,745	652,939	120,872	1,863,458	–	991,270	3,628,539
Drew Hall[6]	2010	211,846	–	4,820	216,666	(35,798)	1,730,759	–	–	1,911,627
	2009	371,149	–	8,018	379,167	15,153	329,387	–	–	723,707

1 Salary includes the cost of Death, TPD and Salary Continuance insurances.

2 No STI in the form of cash was awarded to the CEO and Key Executives in 2009.

3 The value of the equity settled shares and units and equity settled options and rights is calculated on the basis outlined in Note 1(xxix) to the financial statements and reflects the fair value of the benefit derived at the date at which they were granted. The fair value is determined using an option pricing model. As the majority of the Company's equity settled share based payment rewards are subject to share price based performance hurdles (e.g. TSR of the Company), no adjustment to the fair value after grant date is allowed to be made under the Accounting Standards for the likelihood of the market performance conditions not being met. Therefore, the value of the reward included in the table may not necessarily have been vested to the Key Executives during the year.

4 Performance hurdles for the cash settled shares and rights were not expected to be achieved in 2009 and therefore the shares and units were not expected to vest and previously recognised expenses were written back. With the significant rally in the Company's share price, this situation was reversed in 2010 and the expenses were again recognised and amounts vested.

5 Relates to the interest amounts accrued in the year on the loan taken out by individuals to acquire Challenger shares and dividend payments received from the Challenger Performance Plan Trust.

6 Mr Hall became a Key Executive on 11 November 2008 when he became Chief Executive, Mortgage Management and ceased to be a Key Executive on 31 October 2009 when the Mortgage Management business was sold. Disclosures cover the period Mr Hall was a Key Executive.

Table 2B – Remuneration of the CEO and other Continuing Key Executives for the years ended 30 June 2010 and 30 June 2009: Realised Remuneration

		Short Term Employee Benefits				Share based payments[3]			
Executive	Year	Salary $	STI $	Post Employment Superannuation $	Subtotal[1] $	Award Value[2] $	Value due to share price appreciation[3] $	Total Share Based Payment $	Total Compensation[2] $
Dominic Stevens	2010	990,795	1,100,000	14,461	2,105,256	1,697,037	4,002,925	5,699,962	7,805,218
	2009	921,068	–	13,745	934,813	556,100	(274,853)	281,247	1,216,060
Rob Adams	2010	637,034	425,000	14,461	1,076,495	448,524	3,212,623	3,661,147	4,737,642
	2009	637,567	–	13,745	651,312	223,167	(99,583)	123,584	774,896
Brian Benari	2010	639,750	925,000	14,461	1,579,211	1,541,535	4,133,307	5,674,842	7,254,053
	2009	639,954	–	13,745	653,699	571,795	(242,983)	328,812	982,511
Richard Howes	2010	636,414	750,000	14,461	1,400,875	1,284,939	2,933,888	4,218,827	5,619,702
	2009	553,711	–	13,745	567,456	706,837	(338,585)	368,252	935,708
Paul Rogan	2010	635,539	425,000	14,461	1,075,000	628,248	853,886	1,482,134	2,557,134
	2009	636,255	–	13,745	650,000	258,492	(111,534)	146,958	796,958
Robert Woods	2010	638,847	650,000	14,461	1,303,308	1,353,222	3,405,108	4,758,330	6,061,638
	2009	639,194	–	13,745	652,939	776,499	(378,419)	398,080	1,051,019

1 Refers to actual cash and superannuation received by, and cash short term incentives awarded to, a Key Executive in relation to a financial year.

2 Represents the value of performance rights vesting during the period, at original grant price, and dividend payments received from the Challenger Performance Plan Trust.

3 Represents the share appreciation on performance rights, options, cash LTIP and other LTI that vested during the year based on the value at exercise date, or 30 June if not sold. The value is net of exercise cost.

Table 3 – Split of the Table 2A remuneration components for the CEO and Key Executives

				Long Term Incentive		
Executive	Year	Fixed	STI	Share Options	Other	Total
Dominic Stevens	2010	15%	36%	13%	36%	100%
	2009	23%	23%	16%	38%	100%
Rob Adams	2010	20%	17%	24%	39%	100%
	2009	61%	5%	29%	5%	100%
Brian Benari	2010	9%	29%	26%	36%	100%
	2009	21%	32%	20%	27%	100%
Richard Howes	2010	11%	33%	33%	23%	100%
	2009	16%	28%	18%	38%	100%
Paul Rogan	2010	17%	25%	18%	40%	100%
	2009	21%	13%	7%	59%	100%
Robert Woods	2010	12%	33%	35%	20%	100%
	2009	18%	27%	17%	38%	100%

Terms and conditions of Performance Rights and Share Options granted for the year

The Company granted a mix of Performance Rights and Share Options to Key Executives during 2010. The mix of Performance Rights and Share Options ensures Key Executives make sound decisions driving shareholder value and company performance. As Share Options have an in-built share price hurdle and long-term service hurdles, they are designed to motivate long-term sustainable share price growth.

Performance Rights were granted in recognition of past performance and were in lieu of cash for retention and shareholder alignment purposes, and are subject to service conditions only. Participants realise the same growth as shareholders, therefore sustainability of share price growth remains a key driver.

Table 4 – Performance Rights granted to the CEO and Key Executives

Executive	Compulsory deferral from 2009 EIP $	EIP deferred %	Allocation price	Number of rights granted	Date of grant	Vesting 15 September 2010 Number	Fair value at grant	Vesting 15 September 2011 Number	Fair value at grant
D Stevens	1,200,000	100%	$2.33	515,818	23 Oct 09	257,909	$3.68	257,909	$3.56
R Adams	300,000	100%	$2.33	128,954	23 Oct 09	64,477	$3.68	64,477	$3.56
B Benari	1,000,000	100%	$2.33	429,848	23 Oct 09	214,924	$3.68	214,924	$3.56
R Howes	300,000	100%	$2.33	128,954	23 Oct 09	64,477	$3.68	64,477	$3.56
P Rogan	400,000	100%	$2.33	171,939	23 Oct 09	85,970	$3.68	85,969	$3.56
R Woods	300,000	100%	$2.33	128,954	23 Oct 09	64,477	$3.68	64,477	$3.56
D Hall	1,000,000	100%	$2.33	429,848	23 Oct 09	214,924	$3.68	214,924	$3.56

No cash bonuses were paid to Key Executives in respect of the 2009 year. Short term incentives were instead fully deferred into Performance rights noted in the table above and will only vest after the satisfaction of future employment conditions.

Table 5 – Share Options Granted to Key Executives during the year ended 30 June 2010.

Executive	Grant date	Number	Vesting Exercise Price	Vesting Tranche 1 15 September 2010 Number vesting	Fair value at grant	Vesting Tranche 2 15 September 2011 Number vesting	Fair value at grant	Vesting Tranche 3 15 September 2011 Number vesting	Fair value at grant	Aggregate fair value
R Adams	23 Oct 09	700,000	$2.33	233,334	$1.56	233,333	$1.62	233,333	$1.58	1,100,667
B Benari	23 Oct 09	1,750,000	$2.33	583,334	$1.56	583,333	$1.62	583,333	$1.58	2,776,667
R Howes	23 Oct 09	1,750,000	$2.33	583,334	$1.56	583,333	$1.62	583,333	$1.58	2,776,667
P Rogan	23 Oct 09	700,000	$2.33	233,334	$1.56	233,333	$1.62	233,333	$1.58	1,100,667
R Woods	23 Oct 09	1,750,000	$2.33	583,334	$1.56	583,333	$1.62	583,333	$1.58	2,776,667
D Hall	23 Oct 09	1,000,000	$2.33	333,334	$1.56	333,333	$1.62	333,333	$1.58	1,586,667

The options in each tranche will vest to the Key Executives if the following performance conditions are met:

- EPS: If compound EPS growth is 10% or more annually over the respective performance period then 100% of Share Options will vest, if compound EPS growth is less than 10% per annum no share options will vest; or
- TSR: If compound annual TSR growth is greater than 10% over the respective performance period, 100% of the Share Options will vest. If compound TSR growth is less than 10% per annum over the respective performance period, no Share Options will vest. There is no pro-rata vesting. The share price used to calculate TSR is the 90 day volume weighted average price.

The performance periods applicable to each tranche are as follows:

	EPS performance period	TSR performance period
Tranche 1:	1 July 2009 to 30 June 2010	20 August 2009 to 19 August 2010
Tranche 2:	1 July 2010 to 30 June 2011	20 August 2009 to 19 August 2011
Tranche 3:	1 July 2011 to 30 June 2012	20 August 2009 to 19 August 2012

There is no retesting of tranches that fail to meet the performance conditions. Executives can exercise their Share Options for a period of 15 days after the date of vesting. Any Share Options not exercised by the end of the 15 day vesting period will lapse.

The Company's auditor, Ernst & Young, will independently test whether the performance conditions attached to each tranche have been satisfied.

Mr Stevens was not granted Share Options in this financial year. Mr Stevens' last grant of Share Options was upon his appointment as CEO and was approved by shareholders at the Annual General Meeting on 20 November 2008.

For full details of all new issues and awards vested during the year from the Challenger Performance Plan during the period see Note 31 *Employee entitlements* in the financial report.

CEO employment agreement: notice periods

Mr Stevens is not on a fixed term contract.

Under the terms of his appointment as CEO, which commenced 1 September 2008, if The Group terminates Mr Stevens' Service Agreement (other than for cause), Mr Stevens will be entitled to a payment equivalent to $1,500,000 (Termination Payment). The Termination Payment is in addition to accrued statutory entitlements.

If Mr Stevens' employment is terminated for cause all unvested Performance Rights and all unvested Share Options will lapse at the termination date.

If his employment terminates for any other reason (including resignation with Board approval):

- unvested Performance Rights will vest in full at the termination date ('Accelerated Vesting Entitlement'); and
- unvested Share Options will continue to be held by Mr Stevens in accordance with, and subject to, the terms relating to the original issue ('Retained Option Arrangement').

Mr Stevens may terminate his service agreement by giving 26 weeks notice, in which event he will receive accrued statutory and contractual entitlements, but he will not be entitled to any termination payment (unless The Group makes a payment in lieu of notice).

Mr Stevens will not be entitled to any short term incentive payment in these circumstances (unless his resignation is with Board approval).

Key Executives (excluding CEO) employment agreements: notice periods

Key Executives do not have fixed terms of employment.

Notice period by the Company and the Key Executive is 26 weeks (unless terminated for cause).

Upon termination, if the Key Executive is considered a Good Leaver (such as cessation of employment due to redundancy) the Key Executive will be entitled to a pro rata short term incentive payment. Board discretion will also apply in relation to awards under the CPP.

6. Legacy Incentive Schemes

Legacy schemes are those which were offered to employees in prior years but which are no longer in operation. Corporations law regulations require these schemes to continue to be disclosed until such time as each tranche relating to such schemes has been fully vested or lapsed.

Long Term Incentive Plan (LTIP)

The LTIP was a share scheme provided by way of a limited recourse loan with shares vesting and being released over a five year period, subject to the achievement of a 15% compound TSR performance hurdle. Participants paid an amount of interest on their loan equal to any dividends payable on their LTIP shares.

The LTIP was approved by Shareholders at the Annual General Meeting on 22 December 2003 and a more detailed description can be found in the 2006 and 2007 Annual Reports. The last commitments were made under the LTIP in September 2006 and, subject to participants continued employment and the performance hurdle being satisfied, the scheme will cease in September 2012.

The LTIP was suspended in December 2006.

Cash LTIP

Prior to corporatisation, certain employees were entitled to incentive payments under a cash based shadow LTIP scheme. The vesting schedule mirrors that of the LTIP share scheme with unpaid entitlements forfeited upon resignation.

The scheme ceased in November 2009.

Deferred Loan Plan

A small number of employees had outstanding future commitments under the Long Term Incentive Plan (LTIP) at the time it was suspended in December 2006.

To replace those commitments, an arrangement was entered into with a third party investment bank to provide the individuals with a loan over a similar number of Challenger shares as their prior LTIP commitment. This arrangement is known as the Deferred Loan Plan.

The Group is responsible for meeting the interest payable on the loan over its term, net of any dividends paid on the shares. Shares vest progressively over four years, commencing at the end of year two, subject to continued employment with the Group. Shares are forfeited and the arrangement unwound in the event that the employment condition is not satisfied. In certain special circumstances (such as death, total and permanent disablement and redundancy) individuals may be entitled to retain their unvested shares if they fully discharge the outstanding loan amount.

The loans are limited in their recourse to the Group and the Challenger Performance Plan Trust has the option of taking ownership of the shares and using them to satisfy other share awards in the event of forfeiture by the employee.

The last commitments were made under the Deferred Loan Plan in September 2007 and subject to participants' continued employment, the scheme will cease in September 2011.

Other Short Term Employee Benefits: Third Party Loan Facilities

The Group has agreed to pay interest on loans taken out by certain Key Executives to acquire Challenger shares on market. The loans are fully secured against the underlying shares and are not margin loans. The Group has no exposure in relation to the loan principal advanced to the Key Executives by the third party. In the Board's view, this arrangement, when considered with the Key Executive's other long term incentive arrangements, provided significant alignment with shareholders' interests.

The last commitments were made under the Third Party Loan Facilities in June 2008 and, subject to participants' continued employment, the scheme will cease in December 2010.

Capped Performance Rights

The grant of capped performance rights was a transitional arrangement introduced as a retention mechanism, with a cap put into place to moderate the risk-taking behaviour that might otherwise be encouraged by incentive plans that offer 'all or nothing' outcomes. This is reflective of the approaches advocated within emerging governance and regulatory initiatives. In addition the design of the scheme minimised dilution of shareholders by not having unlimited upside for participants.

The Capped Performance Rights vest subject to the achievement of certain service and performance conditions. The conditions are employment with the Group at the time of vesting and a share price performance condition.

If the five day VWAP of the Company at the testing date of 15 September 2010 is less than $1.50, the Capped Performance Rights will not vest and there is no benefit to the employees. If the five day VWAP is $3.50 or greater the employee receives 100% of the capped benefit of $3.50 for each Performance Right. There is pro-rata award of the benefit between $1.50 and $3.50.

Commitments were made under the Capped Performance Rights plan only once in December 2008 and the scheme will cease in September 2010.

13. Auditor's independence and non-audit services

The Directors received the following declaration from the auditor of Challenger Financial Services Group Limited.

ERNST & YOUNG

Ernst & Young Centre
680 George Street
Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001
Tel: +61 2 9248 5555
Fax: +61 2 9248 5959
www.ey.com/au

Auditor's Independence Declaration to the Directors of Challenger Financial Services Group Limited

In relation to our audit of the financial report of Challenger Financial Services Group Limited for the financial year ended 30 June 2010, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

Ernst & Young

S J Ferguson
Partner
20 August 2010

Liability limited by a scheme approved under Professional Standards Legislation.

Non-audit services

The following non-audit services were provided by the Group's auditor, Ernst & Young. The Directors are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

Ernst & Young received, or is due to receive, the following amounts for the provision of non-audit services to the Group over the year:

	$'000
Tax compliance services	421.0
Due diligence services	246.0
Other assurance services	475.0

14. Authorisation

Signed in accordance with a resolution of the Directors of Challenger Financial Services Group Limited.

G A Cubbin
Director
Sydney
20 August 2010

D J Stevens
Director
Sydney
20 August 2010

The Company's approach to corporate governance

The Board and management of Challenger Financial Services Group Limited ('the Company') recognise their duties and obligations to stakeholders to implement and maintain a robust system of corporate governance. The Company believes that the adoption of good corporate governance adds real value to stakeholders and enhances investor confidence.

The Board determines the most appropriate corporate governance arrangements for the Challenger Group, taking into consideration Australian and international standards and the prudential requirements of regulators such as APRA and ASIC. This statement reflects the Company's corporate governance system as at the date of signing this report.

This statement reports against the ASX Corporate Governance Council's 'Corporate Governance Principles and Recommendations'. As required by the ASX Listing Rules, this statement sets out the extent to which Challenger has followed the Principles or, where appropriate, indicates a departure from them with an explanation.

This report applies to the Company and its subsidiaries; however, some subsidiaries have adopted their own policies and procedures to deal with specific issues relevant to their business, for instance Australian Financial Services Licence compliance. Where such policies and procedures have been adopted, they have been developed in line with the standards referred to throughout this report.

Principle 1 – Lay solid foundations for management and oversight

The role of the Board and delegations

The Board is accountable to shareholders for the activities and performance of the Company by overseeing the development of sustainable shareholder value within an appropriate framework of risk and regard for all stakeholder interests.

The Board has identified the key functions which it has reserved for itself. These duties are outlined below and set out in the Board Charter, a copy of which is available on the Company's website:

- establishment, promotion and maintenance of the strategic direction of the Company;
- approval of business plans, budgets and financial policies;
- consideration of management recommendations on strategic business matters;
- establishment, promotion and maintenance of proper processes and controls to maintain the integrity of accounting and financial records and reporting;
- fairly and responsibly rewarding executives, having regard to the interests of shareholders, the performance of executives, market conditions and the Company's performance;
- adoption and oversight of implementation of appropriate corporate governance practices;
- oversight of the establishment, promotion and maintenance of effective risk management policies and processes;
- determination and adoption of the Company's dividend policy;
- review of the Board's composition and performance;
- appointment, duration, evaluation and remuneration of the Chief Executive Officer (CEO) and approval of the appointment of the Chief Financial Officer (CFO), the General Counsel and the Company Secretary; and
- determination of the extent of the CEO's delegated authority.

The Board has established Committees to assist in carrying out its responsibilities and to consider certain issues and functions in detail. The Board Committees are discussed in Principle 2 below.

Non-Executive Directors are issued with formal letters of appointment governing their role and responsibilities. The responsibilities of the Chairman and the Directors are also set out in the Board Charter.

Management responsibility

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

Executive performance assessment

The performance of senior executives is reviewed at least annually against appropriately agreed and documented performance objectives and measures, consistent with the Performance Management framework that applies to all Challenger employees. All employees at Challenger are also assessed against the Challenger Principles (refer to Principle 3 below).

The Remuneration Committee is responsible for reviewing the performance of the Group CEO at least annually, including setting the Group CEO goals for the coming year and reviewing progress in achieving those goals and making recommendations to the Board. The Group CEO is responsible for setting performance objectives and reviewing the performance of his direct reports.

Performance evaluations for the Group CEO and senior executives have taken place in respect of the 2010 reporting period in accordance with the above process.

Principle 2 – Structure the Board to add value

Membership of the Board

The Board comprises Directors who possess an appropriate range of skills, experience and expertise to:

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

The Company's constitution provides for a minimum of three Directors and a maximum of 12 Directors. The table below summarises the current composition of the Board. Background details of each Director are set out in the Directors' report.

Name	Position	Independent	First appointed
Peter Polson	Non-Executive Chairman	Yes	2003
Dominic Stevens	Executive Director	No	2008
Thomas Barrack Jr.	Non-Executive Director	Yes	2007
Graham Cubbin	Non-Executive Director	Yes	2004
Russell Hooper	Non-Executive Director	Yes	2003
Leon Zwier	Non-Executive Director	Yes	2006

The Chairman is selected by Non-Executive Directors of the Board. The roles of Chairman and CEO are not exercised by the same person.

As noted in the Directors' report, the composition of the Board of Directors has changed during the year. Following the sale of shares in the Company by the Consolidated Press Holdings Group and the Mitsubishi UFJ Financial Group Inc., Mr James Packer, Mr Ashok Jacob and Mr Tetsuya Wada resigned from the Board in September 2009. Following these Board changes, and with the exception of the Chief Executive Director, Dominic Stevens, all the Directors on the Board are independent.

The reduction in Director numbers from nine to six prompted a review of Board sufficiency. In order to provide a high standard of corporate governance, the Board must be adequately and appropriately resourced.

This review concluded that the six remaining Directors were sufficient to discharge the Board's various duties and obligations. Should the Board's future workload or business conditions demand it, the Board will not hesitate to revisit this decision.

Nominations and appointment of new Directors

Recommendations for nominations of new Directors are made by the Nomination Committee and considered by the Board as a whole. If a new Director is appointed during the year, that person will stand for election by shareholders at the next annual general meeting. Shareholders are provided with appropriate information to judge the adequacy of candidates. All new Directors are provided with an appropriate induction into Challenger's business. A copy of the Nomination Committee Charter can be found on the Company's website.

Retirement and re-election of Directors

The Company's constitution requires that, excluding the CEO, one third of the remaining Directors must retire each year. In addition, any Director who is appointed during the year must retire at the next annual general meeting.

Succession planning

In conjunction with the Nomination Committee, the Board considers the succession of its members, the CEO, the CFO, and the Chief Executives of each of the business divisions, as required.

Review of Board performance

The Board Charter sets out the requirement for a formal review of the Board's performance at least every two years. A review of the Board's performance was conducted in June 2010.

The review of the Board's performance is conducted by the Chairman with all Board members. The review involves consideration of the effectiveness of the Board and its Committees, having regard to the knowledge, skills and experience of the Directors. The review involves considering the weighting of attributes, culture and capabilities of the Board.

Director independence

The Board has adopted an Independence Policy that states that an Independent Director should be independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the independent exercise of their judgement.

The Board regularly considers and assesses the independence of each Director in light of the interests and information which Directors disclose. In accordance with the Corporations Act, Directors are required to advise the Company of any material personal interests they have in a matter.

In assessing independence, the Board will have regard to whether the Director has any of the following relationships with Challenger or any Challenger Group company:

1. is a substantial shareholder (as defined by section 9 of the Corporations Act) of Challenger, or is a Director or officer of, or otherwise associated directly with, a substantial shareholder of Challenger;
2. is employed, or has previously been employed in an executive capacity by Challenger or another Group company, and there has not been a period of at least three years between ceasing such employment and serving on the Board;
3. has within the last three years been a principal of a material professional adviser or a material consultant to Challenger or another Group company, or an employee materially associated with the service provided;
4. is a material supplier or customer of Challenger or another Group company, or an officer of or otherwise associated directly or indirectly with a material supplier or customer; and
5. has a material contractual relationship with Challenger or another Group company other than as a Director.

The Board will state its reasons if it considers a Director to be independent notwithstanding the existence of a relationship of the kind referred to in paragraphs 1 – 5 above.

Determination of materiality in assessing independence

The materiality of a relationship is assessed on a case-by-case basis after having regard to each Director's individual circumstances. In line with the Company's Independence Policy, Messrs Jacob, Packer, and Wada were not considered independent due to their association with a substantial shareholder. As outlined above, these Directors resigned from the Board during the year.

Conflicts of interest

In accordance with the Board Charter and the Corporations Act 2001, any Director with a material personal interest in a matter being considered by the Board must declare such an interest and may only be present when the matter is being considered at the Board's discretion. Directors with a material interest may not vote on any matter in which they have declared a personal interest.

Meetings of the Board

During the year, the Board generally meets formally approximately every six weeks. In addition, the Board may meet whenever necessary to deal with specific matters needing attention between scheduled meetings.

The CEO, in consultation with the Chairman, establishes the meeting agendas to ensure adequate coverage of strategic, financial and material risk areas throughout the year. Senior executives are invited to attend Board meetings and are available for contact by Non-Executive Directors between meetings. The Non-Executive Directors often hold a private session without any executive involvement as part of Board meetings.

Board access to information and advice

All Directors have unrestricted access to the Company records and information. The Company Secretary provides Directors with guidance on corporate governance issues and developments and on all other matters reasonably requested by the Directors, and monitors compliance with the Board Charter.

The Board or each individual Director has the right to seek independent professional advice at the Company's expense to assist them to discharge their duties. Whilst the Chairman's prior approval is required, it may not be unreasonably withheld or delayed.

Board committees

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

- the Audit and Compliance Committee;
- the Nomination Committee; and
- the Remuneration Committee.

Each Committee has its own Charter, copies of which are available on the Company's website.

The Charters specify the composition, responsibilities, duties, reporting obligations, meeting arrangements, authority and resources available to the Committees and the provisions for review of the Charter. Details of Directors' membership of each Committee and their attendance at meetings throughout the period are set out below.

Directors' meetings

Director	Board		Audit and Compliance Committee		Remuneration Committee		Nomination Committee	
	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
P Polson	9	9	4	4	5	5	2	2
D Stevens	9	9	–	–	–	–	–	–
T Barrack Jr.*	9	8	–	–	–	–	2	1
G Cubbin	9	9	4	4	4	4	2	2
R Hooper	9	8	4	4	5	5	2	2
L Zwier	9	8	–	–	–	–	2	2
A Jacob	2	2	–	–	–	–	–	–
J Packer	2	2	–	–	1	1	–	–
T Wada*	2	2	–	–	–	–	–	–

* Directors attended by personal attendance and through the attendance of their appointed alternate Directors.

Principle 3 – Promote ethical and responsible decision-making

The Board and the Company's commitment to ethical and responsible decision-making is reflected in the internal policies and procedures, underpinned by the Challenger Principles of:

- Commercial ownership;
- Compliance;
- Creative customer solutions;
- Working together; and
- Integrity.

Code of Conduct

The Board has adopted a Code of Conduct which applies to all Directors, executives, management and employees of the Company and its subsidiaries. The Code articulates the standards of honest, ethical and law-abiding behaviour expected by the Company. Employees are actively encouraged to bring any problems to the attention of management or the Board, including activities or behaviour which may not comply with the Code of Conduct, other policies and procedures in place, or other regulatory requirements or laws. A copy of the Code can be found on the Company's website.

Political donations policy

The Board has adopted a policy of not making political donations in any country or jurisdiction in which it operates. Representatives of the Company may on occasion attend political functions. This attendance is strictly for commercial reasons and is predicated on the price charged not being in excess of commercial value (in terms of access) of the function.

Directors' and staff trading policy

Directors and staff are subject to restrictions under the law relating to dealing in securities, including the securities issued by the Company, if they are in possession of insider information. The Board has approved the Group's Staff Trading Policy, which prescribes the manner in which staff can trade in the Company's shares. A summary of the policy is available on the Company's website.

The policy applies to all Directors and staff, and places restrictions and reporting requirements on staff, including the imposition of blackout periods for trading in the securities of the Company (or other listed entities within the Group) and requiring pre-trade approval.

Challenger prohibits any Director or staff member from trading in derivatives in respect of remuneration related unvested Challenger shares or options. Challenger prohibits Directors and staff members from margin lending over Challenger shares.

Those staff designated as potentially having access to insider information are required to seek prior approval to trade in other securities. The policy applies to listed funds offered by Challenger Group companies.

Principle 4 – Safeguard integrity in financial reporting

Integrity of Challenger financial reporting

The Board has the responsibility to ensure truthful and factual presentation of the Company's financial position. The Board has established an Audit and Compliance Committee to assist the Board to focus on issues relevant to the integrity of the Group's financial reporting. In accordance with its Charter, the Audit and Compliance Committee must have at least three members and is comprised of all Non-Executive Directors and a majority of independent members. The Committee is chaired by an Independent Director, who is not Chair of the Board.

The background details of the Audit and Compliance Committee members are set out in the Directors' report. The Committee typically meets four times a year and additional meetings are scheduled as required. The members' names and attendance at meetings are set out on page 40 of this report.

The Committee makes recommendations to the Board in relation to the appointment, review and removal of an external auditor, assessment of the external auditor's independence and the appropriateness of non-audit services that the external auditor may provide. A copy of the Audit and Compliance Committee Charter is available on the Company's website.

Declaration by the Chief Executive Officer and the Chief Financial Officer

The CEO and CFO periodically provide formal assurance statements to the Board that:

- the Company's financial statements present a true and fair view of the Company's financial condition and operational results; and
- the risk management and internal compliance and control systems are sound, appropriate and operating efficiently and effectively.

Independent external audit

The Company requires its independent external auditor to:

- provide stakeholders with assurance over the true and fair view of the financial reports; and
- ensure accounting practices comply with applicable accounting rules and policies.

The Company's independent external auditor is Ernst & Young (E&Y). E&Y was appointed upon constitution of the Company in November 2003, and this appointment was ratified by members at the annual general meeting held in November 2004.

External auditors are required to rotate the engagement partner assigned to the Company on a five-year basis. Under this policy, the lead audit engagement partner assigned to the Company rotated at the conclusion of the 2007 financial reporting period.

The Board has requested that E&Y attend the Company's annual general meeting, and that E&Y be available to answer questions arising in relation to the conduct of its audit.

Principle 5 – Make timely and balanced disclosure

Continuous Disclosure Policy

The Company is committed to ensuring that all investors have equal and timely access to material information concerning the Company and that Company announcements are factual and presented in a clear and objective manner.

The Board has approved and implemented a Continuous Disclosure Policy. The policy is designed to ensure compliance with the Corporations Act and ASX Listing Rules continuous disclosure requirements. The Company has a Continuous Disclosure Committee which is responsible for:

- making decisions on what should be disclosed publicly under the Continuous Disclosure Policy;
- maintaining a watching brief on information; and
- ensuring that disclosure is made in a timely and efficient manner.

Principle 6 – Respect the rights of shareholders

The Company recognises the importance of enhancing its relationship with investors by:

- communicating effectively;
- providing ready access to clear and balanced information about the Company; and
- encouraging participation at general meetings.

As set out in Principle 5, it is Company policy that material information concerning the Company will be announced to the market in a timely and objective manner. Following release to the market, the Company publishes annual and half-yearly reports, announcements, market releases and other relevant information on its website.

Internet web-casting and teleconferencing facilities are provided for market briefings to encourage participation from all stakeholders, regardless of their location. The Company also encourages greater use of electronic media by providing shareholders with greater access to the electronic receipt of reports and meeting notices.

All major and price sensitive announcements by Challenger are lodged with the ASX and made publicly available via its website before being discussed or disseminated with members of the investment community.

Principle 7 – Recognise and manage risk

Risk management and compliance

The management of risks is fundamental to the Company's business and to building shareholder value. The Board recognises the broad range of risks which apply to Challenger as a participant in the financial services industry, including, but not limited to, market risk, funding and liquidity risk, credit risk, investment, strategic and business risk, reputation, licence (compliance) and operational risk. The Board is responsible for determining the Group's risk management strategy. Management is responsible for implementing the Board's strategy and for developing policies and procedures to identify, manage and mitigate risks across the whole of the Group's operations.

The key design component of Challenger's approach to risk management is that the heads of the business units have accountability for the risks within their divisions with oversight, analysis, monitoring and reporting of these risks by executives who are independent of the business units and are responsible to the CEO and the Board or its Committees.

The Board has delegated certain authorities to management to manage risk. The Group Risk Management Framework is underpinned by a robust set of policies, procedures and delivery plans that are regularly reviewed.

The framework and policies are developed and approved by management, reviewed and approved by the Group Audit and Compliance Committee, and then made available to all staff of the Company and its subsidiaries. The Group's Risk Management functions have day-to-day responsibility for monitoring the implementation of the framework and policy, with regular reporting provided to the Group Audit and Compliance Committee on the adequacy and effectiveness of management controls for material business risk.

The Committee provides reporting to the Board on compliance with the framework and policies. A summary of the Group Risk Management Framework can be found on the Company's website.

The Board Audit and Compliance Committee reviews the effectiveness of the risk management and internal control system on an annual basis.

Internal audit

Internal audit services for the Challenger Group were provided by KPMG during the period.

The Group Audit and Compliance Committee oversees the scope of internal audit and monitors the progress of the internal audit work program. The Committee receives reports from internal audit at each meeting and monitors management's responsiveness to internal audit findings and recommendations. The internal audit function is independent of the external auditor and reports directly to the Group Audit and Compliance Committee.

Assurance

During the period, the Board has received formal assurance from the CEO and the CFO that:

- the Company's financial statements present a true and fair view of the Company's financial condition and operational results; and
- the risk management and internal compliance and control systems are sound, appropriate and operating efficiently and effectively.

This assurance forms part of the process by which the Board determines the effectiveness of its risk management and internal control systems in relation to financial reporting risks.

Principle 8 – Remunerate fairly and responsibly

The Board Remuneration Committee

The Board has established a Remuneration Committee comprised of a majority of Independent Directors, having at least three members and chaired by an Independent Director.

The background details of the Remuneration Committee members are set out in the Directors' report. The Committee usually meets at least four times during the year, and additional meetings are scheduled as required. The members' names and attendance at meetings are set out in Principle 2 of the corporate governance statement.

The Remuneration Committee is responsible for reviewing and making recommendations to the Board in relation to:

- the Company's remuneration, recruitment, retention and termination policies and procedures for senior executives;
- senior executives' remuneration and incentives;
- superannuation arrangements; and
- the remuneration framework for Directors.

Remuneration

The remuneration details for Key Executives and Non-Executive Directors are reported in the Remuneration Report. Non-Executive Directors are not entitled to participate in incentive schemes.

There are no termination payments to Non-Executive Directors on their retirement from office other than payments accruing from superannuation contributions comprising part of their remuneration.

Challenger policy, contained in the staff trading policy, prohibits any executive or staff member from entering into a transaction that is designed or intended to hedge that component of their unvested remuneration which is constituted by Challenger shares or options.

It is also Company policy to prohibit margin lending over Challenger shares by Directors, senior executives and staff members.

Five-year history

	30 June 2006 $M	30 June 2007 $M	30 June 2008 $M	30 June 2009 $M	30 June 2010 $M
Profit and loss					
Income					
Normalised cash operating earnings	132.7	163.8	207.9	250.8	338.0
Net fee income	125.7	183.7	187.3	114.4	102.0
Other income	3.2	6.8	6.5	4.7	7.6
Total income	261.6	354.3	401.7	369.9	447.6
Total operating expenses	(150.6)	(188.4)	(191.3)	(186.2)	(181.8)
Discontinued operations	85.0	98.2	110.2	136.1	39.1
Normalised EBIT	196.0	264.1	320.6	319.8	304.9
Interest and borrowing costs	(34.9)	(33.7)	(41.3)	(36.9)	(14.1)
Normalised profit before tax	161.1	230.4	279.3	282.9	290.8
Tax	(43.5)	(48.4)	(61.4)	(64.0)	(58.3)
Normalised profit after tax	117.6	182.0	217.9	218.9	232.5
Investment experience after tax	35.7	49.6	(192.3)	(309.6)	51.3
Significant items after tax	(19.0)	23.4	(69.8)	–	(1.3)
Statutory profit after tax	134.3	255.0	(44.2)	(90.7)	282.5
Balance sheet					
Total assets	24,305.3	27,015.2	27,157.3	25,237.8	18,375.9
Total liabilities	23,045.0	25,566.6	25,527.3	23,548.4	16,656.2
Net assets	1,260.3	1,448.6	1,630.0	1,689.4	1,719.7
Total equity attributable to shareholders	1,234.8	1,444.9	1,612.9	1,381.9	1,339.6
Assets under management and administration					
Life	3,076	3,476	5,245	5,767	7,578
Funds Management	13,457	22,996	21,921	16,041	20,221
Cross Holdings (continuing operations)	(248)	(886)	(1,478)	(2,168)	(3,851)
	16,285	25,586	25,688	19,644	23,948
Mortgage Management	20,901	23,013	48,068	93,295	–
Financial Planning	1,914	8,796	–	–	–
Cross Holdings (discontinued operations)	(2,643)	(3,185)	(3,044)	(2,604)	–
Total assets under management and administration	36,457	54,210	70,712	110,335	23,948

	30 June 2006	30 June 2007	30 June 2008	30 June 2009	30 June 2010
Share information					
Earnings per share (cents)					
Basic – statutory profit/(loss)	24.9	46.3	(7.5)	(16.2)	55.3
Diluted – statutory profit/(loss)	23.9	43.2	(8.1)	(15.9)	51.9
Basic – normalised profit	21.8	33.0	37.1	39.2	45.5
Diluted – normalised profit	20.8	30.7	35.4	38.4	42.7
Dividends per share (cents)					
Interim	2.5	5.0	5.0	5.0	6.0
Final	5.0	7.5	7.5	7.5	8.5
Total	7.5	12.5	12.5	12.5	14.5
Dividends payout ratio[1]					
Statutory	30.1%	27.0%	n/a	n/a	26.2%
Normalised	34.4%	37.9%	33.7%	31.9%	31.9%
Ratios					
Net gearing[2]	5.2%	5.6%	0.6%	11.5%	0%
Gearing[3]	8.7%	16.9%	13.4%	19.6%	0%
Return on shareholders' funds – statutory[4]	10.9%	17.7%	(2.7%)	(6.6%)	21.1%
Return on shareholders' funds – normalised[5]	9.5%	12.6%	13.5%	15.8%	17.4%
Staff numbers[6]	958	1,063	911	837	460
Share price at 30 June ($)	3.16	5.83	1.89	2.24	3.52
Ordinary share capital (million shares)[7]	544.8	554.6	600.4	569.0	499.6
Market capitalisation at 30 June ($ million)[8]	1,721.5	3,233.3	1,134.8	1,275.3	1,785.0

1 Dividends per share/EPS (basic).

2 Calculated as net debt/(net debt + equity).

3 Calculated as debt/(debt + equity).

4 Calculated as statutory profit after tax/total equity attributable to equityholders of the parent.

5 Calculated as normalised profit after tax/total equity attributable to equityholders of the parent.

6 2008 staff numbers exclude employees associated with the Financial Planning sale completed on 30 June 2008. 2009 staff numbers exclude employees associated with the Mortgage Management business sold on 30 October 2009.

7 Represents issued shares on the ASX.

8 Calculated as share price x number of ordinary shares excluding LTIP vested but not settled.

Financial report

Income statement

For the year ended 30 June	Notes	2010 $M	2009 $M
Continuing operations			
Revenue	3	1,634.7	1,673.8
Expenses	4	(651.5)	(681.1)
Finance costs	5	(640.9)	(1,176.7)
		342.3	(184.0)
Share of profits of associates	37	3.7	2.6
Profit/(loss) from continuing operations before income tax		346.0	(181.4)
Income tax (expense)/benefit from continuing operations	6	(60.2)	77.1
Profit/(loss) after income tax from continuing operations		285.8	(104.3)
Profit after income tax from discontinued operations	35	8.0	16.7
Profit/(loss) after income tax for the year		293.8	(87.6)
Less: profit attributable to non-controlling interests	26	(11.3)	(3.1)
Profit/(loss) attributable to equity holders		282.5	(90.7)

		Cents	Cents
Earnings per share from continuing operations:			
Basic earnings per share	8	53.8	(19.2)
Diluted earnings per share	8	50.4	(18.9)
Earnings per share from all operations:			
Basic earnings per share	8	55.3	(16.2)
Diluted earnings per share	8	51.9	(15.9)

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

Statement of comprehensive income

For the year ended 30 June	Notes	2010 $M	2009 $M
Profit/(loss) after income tax for the year		293.8	(87.6)
Gain on translation of foreign entity	24	21.8	(0.6)
Loss on hedge of net investment in foreign entity	24	(16.8)	–
Cash flow hedge gain/(loss) taken to equity	24	8.1	(28.3)
Net (loss)/gain on available-for-sale assets	24	(5.6)	1.7
Other comprehensive income/(expense) after income tax for the year		7.5	(27.2)
Total comprehensive income/(expense) after income tax for the year		301.3	(114.8)
Less: comprehensive income attributable to non-controlling interests		(11.3)	(3.1)
Comprehensive income attributable to equity holders		290.0	(117.9)

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

Balance sheet

As at 30 June	Notes	2010 $M	2009 $M
Assets			
Cash and cash equivalents	9	674.4	1,071.7
Cash and cash equivalents – SPV[1]	9	458.1	737.0
Receivables	10	113.0	582.4
Receivables – SPV	10	8,466.8	15,644.1
Current tax assets		4.8	2.7
Derivative assets	28	287.1	191.7
Other financial assets – fair value through profit and loss	11	5,050.2	4,009.0
Other financial assets – available-for-sale	11	11.8	24.3
Investment property	12	2,610.1	2,020.5
Plant and equipment	13	63.1	56.8
Deferred tax assets	6	–	52.2
Investments in associates	37	33.0	43.2
Other assets	14	77.0	92.4
Goodwill	15	509.7	688.7
Other intangible assets	15	16.8	21.1
Total assets		18,375.9	25,237.8
Liabilities			
Payables	17	317.2	662.8
Derivative liabilities	28	223.2	164.5
Interest bearing financial liabilities	18	1,387.6	1,818.2
Interest bearing financial liabilities – SPV	18	8,637.0	16,261.9
External unit holders' liabilities	19	1,259.0	–
Provisions	20	42.5	52.9
Deferred tax liabilities	6	43.9	14.3
Life contract liabilities	21	4,745.8	4,573.8
Total liabilities		16,656.2	23,548.4
Net assets		1,719.7	1,689.4
Equity			
Contributed equity	23	1,106.6	1,401.4
Reserves	24	211.1	167.9
Retained earnings/(accumulated losses)	25	21.9	(187.4)
Total equity attributable to equity holders		1,339.6	1,381.9
Non-controlling interests	26	380.1	307.5
Total equity		1,719.7	1,689.4

[1] SPV = Special Purpose Vehicles.

The balance sheet should be read in conjunction with the accompanying notes.

Statement of changes in equity

For the year ended 30 June	Notes	2010 $M	2009 $M
Contributed equity			
Issued share capital			
At the beginning of the year		1,563.0	1,622.1
Shares purchased and cancelled under share buy back		(310.1)	(41.8)
Net shares cancelled under share based payment plans		(17.3)	(17.3)
At the end of the year	23	1,235.6	1,563.0
Treasury shares			
At the beginning of the year		(161.6)	(159.7)
LTIP shares forfeited and cancelled		17.3	17.3
Shares purchased and held in trust, net of forfeitures		(38.6)	(26.2)
Vested shares released from the CPP Trust		44.9	6.6
Vested shares released from the Long Term Incentive Plan		9.0	0.4
At the end of the year		(129.0)	(161.6)
Total contributed equity	23	1,106.6	1,401.4
Reserves			
At the beginning of the year		167.9	170.2
Increase in equity option premium reserve		0.1	0.1
Gain on foreign currency translation		21.8	(0.6)
Loss on hedge of net investment in foreign entities		(16.8)	–
Changes in cash flow hedges		8.1	(28.3)
Changes in available-for-sale assets		(0.7)	2.9
Cost of share based payments		22.4	23.6
Discount on increase in holding in controlled entity		8.3	–
At the end of the year	24	211.1	167.9
Retained earnings			
At the beginning of the year		(187.4)	(19.7)
Profit/(loss) for the year		282.5	(90.7)
Dividends paid		(73.2)	(77.0)
At the end of the year	25	21.9	(187.4)
Total equity attributable to equity holders		1,339.6	1,381.9
Non-controlling interests			
At the beginning of the year		307.5	17.1
Other non-controlling interest movements/distributions		69.3	12.3
Profit for the year		11.3	3.1
Consolidation of controlled entities		(8.0)	275.0
At the end of the year	26	380.1	307.5
Total equity		1,719.7	1,689.4

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

Statement of cash flows

For the year ended 30 June	Notes	2010 $M	2009 $M
Operating activities			
Receipts from customers		1,278.5	2,054.6
Annuities received		933.1	514.0
Annuities paid		(1,152.9)	(1,171.8)
Payments to vendors and employees		(1,121.4)	(1,905.6)
Dividends received		36.1	104.2
Interest received		338.1	318.6
Interest paid		(88.7)	(126.7)
Income tax refund/(paid)		6.3	(6.3)
Net cash inflow/(outflow) from operating activities	32	229.1	(219.0)
Investing activities			
Net proceeds/(payments) on sale/purchase of investments		78.4	(176.4)
Mortgage loans – advanced and purchased		(645.6)	(7,011.6)
Mortgage loans – repaid and sold		7,554.6	10,116.8
Net proceeds from sale of controlled entities/significant transactions		495.2	610.4
Payments for purchase of plant and equipment		(19.4)	(3.2)
Net cash inflow from investing activities		7,463.2	3,536.0
Financing activities			
Proceeds from interest bearing liabilities		1,285.9	8,324.7
Repayment of interest bearing liabilities		(9,291.8)	(11,435.9)
Payments on buy back of shares/treasury shares		(322.9)	(67.0)
Proceeds from CDI rights issue		50.9	–
Dividend paid		(72.7)	(76.8)
Distributions paid to non-controlling interests		(17.9)	(13.4)
Net cash outflow from financing activities		(8,368.5)	(3,268.4)
Net (decrease)/increase in cash and cash equivalents		(676.2)	48.6
Cash and cash equivalents at the start of the year		1,808.7	1,760.1
Cash and cash equivalents at the end of the year	9	1,132.5	1,808.7
Cash		674.4	1,071.7
Cash – SPV		458.1	737.0
Cash and cash equivalents at the end of the year		1,132.5	1,808.7

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

1. Summary of significant accounting policies

Challenger Financial Services Group Limited (the Company) is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Securities Exchange.

The financial report of Challenger Financial Services Group Limited and its controlled entities (the Group) for the year ended 30 June 2010 was authorised for issue in accordance with a resolution of the Directors on 20 August 2010.

(i) Basis of preparation

This is a general purpose financial report that has been prepared in accordance with the requirements of the *Corporations Act 2001* and Australian Accounting Standards.

The *Corporations Amendment (Corporate Reporting Reform) Act 2010* was enacted in June 2010 and has amended the *Corporations Act 2001* such that an entity required to present consolidated financial statements must disclose only the consolidated amounts in the primary statements and notes thereto. The Group has therefore removed the parent entity financial statements and notes, with summarised parent entity information included in Note 38.

Unless stated otherwise, the financial report is presented in Australian dollars, has been prepared on the historical cost basis and amounts are rounded to the nearest one hundred thousand dollars.

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

(ii) Statement of compliance

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

(iii) New accounting standards and interpretations

Changes in accounting policy or disclosure

The revised AASB 101 *Presentation of Financial Statements* and AASB 2007-8 *Amendments to Australian Accounting Standards arising from AASB 101* were adopted for the first time during the period, with the major impact being the inclusion of a 'statement of comprehensive income' as an additional primary statement in the financial report.

The adoption of AASB 2009-2 *Amendments to Australian Accounting Standards – Improving Disclosures about Financial Instruments* introduced into this financial report some additional disclosures in respect of the source of inputs to the fair value measurement of financial instruments.

Of the changes introduced upon adoption of AASB 2008-5 *Amendments to Australian Accounting Standards arising from the Annual Improvement Project* the most relevant to this financial report was the requirement to recognise development property at fair value rather than at cost. However, there was no financial impact as the Group held no properties in this category until after the change was adopted.

The Group has early adopted the changes relating to the presentation of the statement of changes in equity arising from AASB 2010-4 *Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project* which allows detailed movements in constituent elements of equity to be shown in notes to the financial statements.

Accounting standards and interpretations issued but not yet effective

There are numerous amendments to Australian Accounting Standards that were available for early adoption but have not been applied in this financial report. Other than those arising from future changes to the accounting for financial instruments (described in more detail below), the application of amendments relevant to the Group would have only resulted in minor disclosure impacts if they had been adopted early.

AASB 9 Financial Instruments

AASB 9 *Financial Instruments* (AASB 9) was issued in December 2009 and is mandatory for annual reporting periods beginning on or after 1 January 2013 and provides revised guidance on the classification and measurement of financial instruments.

The new standard permits more limited criteria for a financial instrument to be measured at amortised cost and requires all other financial instruments to be measured at fair value. The new standard also limits the ability to recognise fair value movements on financial assets directly in equity.

The Group is required to apply this standard for the first time in the 30 June 2014 financial report and is currently assessing the impact. The classification of a financial instrument will be assessed on the facts at the date of initial application and it is possible that the classification of some financial assets may change upon adoption of the new standard.

(iv) Basis of consolidation

The financial statements comprise the financial statements of the Company and its controlled entities. Interests in associates are equity accounted and are not part of the Group (see *Investments in associates* below.)

Controlled entities are all those entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities, regardless of the legal ownership structure. The financial reporting period end of controlled entities, and the accounting policies applied in the preparation of their financial reports, are consistent with that of the Company.

All intercompany balances and transactions, including unrealised profits arising from intra-group transactions, are eliminated in full. Unrealised losses are eliminated unless costs cannot be recovered.

For controlled entities where the Group owns less than 100% of the issued capital or units, the share of the results and equity attributable to non-controlling interests are shown separately in the consolidated financial statements.

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

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

Goodwill is subject to impairment testing as described in Note 1(xx).

Investments in associates

Investments in associates are entities for which the Group has significant influence over the financial and operating policies, but not control. These are accounted for under the equity method whereby investments are carried at cost plus post-acquisition changes in the Group's share of the net assets of the entity.

The financial statements of associates are used to apply the equity method and both the financial year end and accounting policies of associated entities are consistent with those of the Group. After application of the equity method, the Group determines whether it is necessary to recognise any additional impairment loss in the carrying value of the net investment in associates.

The investments in associates are carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associate, less any impairment in value. The consolidated income statement reflects the share of the results of operations of the associate. Where there has been a change recognised directly in the associate's equity, the Group recognises its share of any changes and discloses this in the consolidated statement of changes in equity.

Special purpose vehicles

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

(v) Segment reporting

Operating segments are identified on the basis of internal reports to senior management and comprise component parts of the Group that are regularly reviewed by senior management in order to allocate resources and assess performance.

(vi) Revenue

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

- Management fee revenue is derived from the provision of investment management services to the Group's managed investment products and residential mortgage assets. Revenue is recognised when the services are deemed to have been earned using an effective interest rate method over the life of the contract.
- Interest revenue is recognised as it accrues using an effective interest rate, taking into account the effective yield of the financial asset.
- Dividends on listed equity shares are recognised as income on the date the share is quoted ex-dividend. Dividends from unlisted companies are recognised when the dividend is declared.
- Gains or losses arising from changes in the fair value of financial instruments classified as fair value through profit and loss are recognised as revenue in the income statement when the change in value is recognised on the balance sheet.
- Rental revenue from investment properties is accounted for on a straight-line basis over the lease term. Contingent rental income is recognised as income in the periods which it is earned. Lease incentives granted are recognised as an integral part of the total rental income.

1. Summary of significant accounting policies (continued)

(vi) Revenue (continued)

- Operating lease rental income is earned on a straight-line basis over the life of the contract.
- The portion of the change in life contract liabilities recognised in the income statement that relates to changes in interest rates is classified as revenue. The remaining change is classified as an expense. See Note 1(xxvi) for more detail on the recognition and measurement of life contract liabilities.

(vii) Expenses

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

- See Note 1(xviii) for details of how the costs incurred in the establishment of special purpose vehicles and the origination of interest bearing liabilities are recognised in the income statement.
- Expenses incurred under an investment property operating lease are recognised on a straight-line basis over the term of the lease.
- Investment property expenditure, including rates, taxes, insurance and other costs associated with the upkeep of a building, are brought to account on an accrual basis. Repair costs are expensed when incurred. Other amounts that improve the condition of the investment are capitalised into the carrying value of the asset.
- The portion of the change in life contract liabilities recognised in the income statement that relates to changes in interest rates is classified as revenue. The remaining change is classified as an expense. See Note 1(xxvi) for more detail on the recognition and measurement of life contract liabilities.

(viii) Finance costs

Finance costs represent interest on financial liabilities, primarily the securitised residential mortgage backed securities issued by the special purpose vehicles, overdrafts and other borrowings, and are recognised as an expense in the period in which they are incurred.

(ix) Foreign currency

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

Transactions

Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into the functional currency at the rate of exchange ruling at the balance sheet date.

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

Derivatives are used to hedge the foreign exchange risk relating to certain transactions. Refer to Note 1(xiii).

Foreign controlled entities

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

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

(x) Income tax

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

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

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

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

- when the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss in the income statement; or

- when the taxable temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, and the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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

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

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

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

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

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

Tax consolidation

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

Tax effect accounting by members of the tax group

Members of the tax consolidated group have applied tax funding principles under which Challenger Financial Services Group Limited and each of the members of the tax consolidated group agree to pay tax equivalent payments to or from the head entity, based on the current tax liability or current tax asset of the member. Such amounts are reflected in the amounts receivable from or payable to each member and the head entity.

The group allocation approach is applied in determining the appropriate amount of current tax liability or current tax asset to allocate to members of the tax consolidated group. Deferred taxes are allocated to members of the tax consolidated group in accordance with the principles of AASB 112.

Income tax – Challenger Diversified Property Group (CDI)

CDI was formed by stapling the units of Challenger Diversified Property Trust 1 (CDPT1) and Challenger Diversified Property Trust 2 (CDPT2).

Under current income tax legislation, CDPT1 will not be subject to income tax as unit holders are presently entitled to the income of CDPT1 each year. Any taxable income of CDPT1, including any taxable capital gains derived from the sale of an asset, is fully distributed to unit holders.

CDPT2 is a public trading trust under Division 6C of Part III of the *1936 Tax Act*. CDPT2 owns all the shares in Challenger Diversified Property Development Pty Ltd (CDPD), which carries on development and other business activities. Both CDPT2 and CDPD are subject to tax at the corporate tax rate on their taxable income.

(xi) Cash and cash equivalents

Cash and cash equivalents are financial assets and comprise cash at bank and in hand plus short-term deposits with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash and cash equivalents are recognised at the fair value of the outstanding balance. Interest is recognised in the income statement when earned via the effective income method. For the purposes of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

1. Summary of significant accounting policies (continued)

(xii) Receivables

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

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

(xiii) Derivative financial instruments and hedging

The Group uses derivative financial instruments such as foreign currency contracts and interest rate swaps to hedge its risks associated with interest rate and foreign currency fluctuations. The Group does not hold derivative financial instruments for trading purposes. However, for derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement.

All derivative financial instruments are stated at fair value. The fair value of forward foreign exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swap contracts is determined by reference to market values for similar instruments.

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

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

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

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

Fair value hedges

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

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

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

The Group discontinues fair value hedge accounting if the hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting or the Group revokes the designation. Any adjustment to the carrying amount of a hedged financial instrument for which the effective interest method is used is amortised to the income statement. Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

Cash flow hedges

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

Amounts taken to equity are transferred to the income statement when the hedged transaction affects profit or loss, such as when hedged income or expenses are recognised or when a forecast sale or purchase occurs.

When the hedged item is the cost of a non-financial asset or liability, the amounts taken to equity are transferred to the initial carrying amount of the non-financial asset or liability.

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

Hedges of net investments in foreign operations

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

(xiv) Other financial assets

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

Purchases and sales of other financial assets are recognised on the date on which the Group commits to purchase or sell the asset. Other financial assets are initially recognised at fair value (plus transaction costs for available-for-sale assets).

Other financial assets are derecognised when the right to receive cash flows from the asset have expired or when the risks and rewards of ownership have been substantially transferred.

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

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

Financial assets at fair value through profit and loss

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

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are either designated into this category or are not classified as either receivables or financial assets through profit and loss.

After initial recognition, available-for-sale investments are measured at fair value with gains or losses being recognised as a separate component of equity. When the asset is derecognised, or is determined to be impaired, the cumulative gain or loss previously reported in equity is recognised in the income statement.

(xv) Investment property

Investment property is initially recognised at cost, including transaction costs. Subsequent to initial recognition, investment property is recognised at fair value. Independent valuations for all investment properties are conducted at least annually, from suitably qualified valuers, and the Directors make reference to these independent valuations when determining fair value.

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

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

Investment property under development

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

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

Development property held for resale

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

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

1. Summary of significant accounting policies (continued)

(xvi) Plant and equipment

Items of plant and equipment are stated at cost, or deemed cost, less accumulated depreciation and impairment losses.

Depreciation is calculated on a straight-line basis to write off the net cost of each class of fixed assets over its expected useful life. Estimates of remaining useful lives are made on a regular basis for all assets, with annual reassessments for major items. The expected useful life of plant and equipment is three to five years.

Infrastructure fixed assets

Infrastructure fixed assets are stated at cost and amortised on a straight-line basis over their estimated useful life of 40 years. This is done on an asset by asset basis with amortisation commencing when the Group starts receiving income from the asset.

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

(xvii) Operating leases

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

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

Where the Group acquires, as part of a business combination, an operating lease over land, the fair value of the operating lease over land is recognised separately from goodwill. See Note 1(xix) below.

Other operating lease payments are charged to the income statement in the periods in which they are incurred.

Surplus lease space

The present value of future payments for surplus lease space under non-cancellable operating leases, net of sub-leasing revenue, is recognised as a provision in the period in which it is determined that the lease space will be of no future benefit to the Group. See Note 1(xxv) below.

(xviii) Prepayments

Deferred portfolio costs

Portfolio costs represent the expenses incurred in establishing mortgage trusts. They are recognised as an asset when incurred and subsequently amortised in the income statement as the future economic benefits from the mortgage assets are expected to be received.

Deferred origination costs

Origination costs are expenses incurred as a direct result of the origination of mortgage loans to customers. These costs are recognised as an asset and subsequently amortised through the income statement in line with the pattern of expected future economic benefits arising from the related mortgage asset.

(xix) Goodwill and other intangible assets

Goodwill

Goodwill acquired in a business combination is initially measured at cost, being the excess of the fair value of the consideration for the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Each unit, or group of units, to which the goodwill is so allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. When the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount, an impairment loss is recognised.

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

Other intangible assets

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

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

Certain internal and external software costs directly incurred in acquiring and developing software have been capitalised and are being amortised on a straight-line basis over their useful life, usually a period of five years. Useful lives are examined on an annual basis and where applicable, adjustments are made on a prospective basis. Costs incurred on software maintenance are expensed as incurred.

(xx) Impairment of assets

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

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

When the carrying amount of an asset or cash-generating unit exceeds its recoverable amount, the asset or cash-generating unit is considered impaired and is written down to its recoverable amount.

Impairment losses are recognised in the income statement, unless an asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through the income statement.

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

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

(xxi) Payables

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

(xxii) Interest bearing financial liabilities

All interest bearing financial liabilities, with the exception of those held by Challenger Life Company Limited (CLC), are initially recognised at the fair value of the consideration received, less directly attributable transaction costs. After initial recognition, interest bearing financial liabilities are subsequently measured at amortised cost using the effective interest method.

Interest bearing financial liabilities of CLC are carried at fair value and unrealised gains and losses are recognised through the income statement.

(xxiii) Employee benefits

Superannuation funds

Obligations for contributions to superannuation funds are recognised as an expense in the income statement as incurred. The Group does not hold or pay into any defined benefit superannuation schemes on behalf of employees.

Wages, salaries, annual leave and non-monetary benefits

Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled within 12 months of the reporting date, are recognised in respect of employees' services up to the reporting date. They are measured at the amounts expected to be paid when the liabilities are settled. Liabilities for accumulated sick leave are recognised when the leave is taken and are measured at the rates paid or payable.

1. Summary of significant accounting policies (continued)

(xxiii) Employee benefits (continued)

Long service leave

A liability for long service leave is recognised as the present value of estimated future cash outflows to be made in respect of services provided by employees up to the reporting date. The estimated future cash outflows are discounted using bond yields from Australian Commonwealth government bonds which have durations to match, as closely as possible, the estimated future cash outflows.

Factors which affect the estimated future cash outflows such as expected future salary increases, experience of employee departures and period of service, are included in the measurement.

(xxiv) External unit holders' liabilities

Unit trusts will record unit holders' contributed funds as either debt or equity, depending on the nature of the trust. Previously, all non-controlling interests in such entities were recorded in equity. The Group gained control over entities during the period whose unit holders' funds are classed as liabilities.

Upon consolidation, the liability related to non-Group entities remain in the balance sheet as *external unit holders' liabilities*.

(xxv) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

When the Group expects some or all of a provision to be reimbursed; for example, under an insurance contract, the reimbursement is recognised as a separate asset only when the reimbursement is virtually certain.

The expense relating to any provision is presented in the income statement net of any reimbursement.

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

(xxvi) Life contract liabilities

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

Life investment contract liabilities

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

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

Life insurance contract liabilities

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

The financial reporting methodology used to determine the value of life insurance contract liabilities is referred to as Margin on Services (MoS). Under MoS, the excess of premium 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 movement in life insurance contract liabilities recognised in the income statement reflects the planned release of this margin.

Life insurance contract liabilities are usually determined using a projection method, whereby estimates of policy cash flows (annuity payments, expenses etc) 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.

Reinsurance

The Group entered into a reinsurance arrangement during the period that meets the definition of a life insurance contract. The Margin on Services (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. As a result, the life insurance contract liability recognised at 30 June 2010 is stated net of the impacts of this reinsurance contract.

(xxvii) Contributed equity

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

Treasury shares are ordinary shares in the Company held by the employee share trust and those issued in respect of long term incentive plan awards to employees. Refer Note 1(xxix) for further details.

(xxviii) Earnings per share

Basic earnings per share is calculated by dividing the (total and continuing) profit for the year attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the financial period. The number of ordinary shares outstanding includes any shares granted under the employee share incentive plan which have vested and settled.

Diluted earnings per share is calculated by dividing the (total and continuing) profit attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the year (adjusted for the effects of dilutive options and shares granted under the Challenger Performance Plan).

(xxix) Share based payment transactions

Long-term equity based incentive plan

The Group has an employee share incentive plan and an employee share trust for the granting of non-transferable options to executives and senior employees. Shares in the Company held by the employee share trust are classified as treasury shares and presented in the balance sheet as a deduction from equity.

Employees of the Group receive remuneration in the form of share based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions).

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined using an option pricing model. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company (market conditions).

In accordance with Australian Accounting Standards, the cost of equity-settled transactions is recognised in the income statement, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (vesting date). At the Company level, the cost of the equity shares are recognised as an equity distribution, whereby the investment in subsidiary is increased with a corresponding increase in the share based equity reserve.

The cumulative expense or investment recognised for equity-settled transactions at each reporting date reflects the extent to which the vesting period has expired and the number of awards that, in the opinion of the Directors of the Group at that date, will ultimately vest.

No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled during the vesting period (other than a grant cancelled forfeiture when the vesting conditions are not satisfied), it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately.

However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

(xxx) Employee share acquisition plan

Share based compensation benefits are provided to employees via the Challenger Performance Plan (CPP). The Group has formed a trust to administer the Group's employee share acquisition plan. This trust is consolidated, as the substance of the relationship is that the trust is controlled by the Group.

1. Summary of significant accounting policies (continued)

(xxx) Employee share acquisition plan (continued)

Through contributions to the trust the Group purchases shares in the Company on market. Shares acquired are held by the Challenger Performance Plan Trust, are disclosed as Treasury Shares and deducted from contributed equity. The cost of the shares acquired by the CPP is recognised as an employee benefit expense with a corresponding increase in equity, being a share based payments reserve.

The fair value is measured at grant date and recognised over the period during which the employees become unconditionally entitled to the shares.

(xxxi) Goods and Services Tax (GST)

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

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

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

(xxxii) Restrictions on assets

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

(xxxiii) Significant accounting judgements, estimates and assumptions

The carrying amount of certain assets and liabilities are often determined based on estimates and assumptions of future events.

The key estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of certain assets and liabilities within the next annual reporting period are:

Share based payments

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the ordinary shares at the date at which they are granted.

The fair value is determined using the Black-Scholes formula, taking into account the terms and conditions upon which the equity instruments were granted, as discussed in Note 31. The fair value calculation is performed by an external valuer.

Life insurance contract liabilities

Life insurance contract liabilities are recognised under the MoS methodology described in Note 1(xxvi) above. Significant judgement is applied in the determination of the life insurance contract liability, which involves actuarial assumptions.

The key areas of judgement in the determination of the actuarial assumptions are:

- the duration of claims/policy payments;
- acquisition and maintenance expense levels; and
- economic assumptions for discount and inflation rates.

Additional information on the life insurance contract liabilities is set out in Note 21 *Life contract liabilities*.

Property valuations

Investment properties in Note 12 are primarily stated at fair value, which has been determined based on valuations performed by independent valuers during the year ended 30 June 2010.

The Valuer or Valuation Practice is authorised to practise as a Valuer under the law of the relevant jurisdiction where the valuation takes place. The Valuer performing the valuation has at least five years of continuous experience in the valuation of property of a similar type to the property being valued. Neither the Valuer, nor Valuation Practice, has a pecuniary interest that could conflict with the valuation of the property. The Valuer and Valuation Practice comply with the Australian Property Institute (API) Code of Ethics and Rules of Conduct.

Valuations are prepared on the basis of Market Value as defined by The International Assets Valuation Standards Committee (TIAVSC) and endorsed by the API.

Market value is the estimated amount for which an asset could exchange on the date of valuation between a willing buyer and willing seller in an arm's length transaction wherein the parties had each acted knowledgeably, prudently and without compulsion. In determining Market Value, Valuers have examined available market evidence and applied this analysis to both the traditional capitalisation approach and discounted cash flow approach.

Interest bearing financial liabilities

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

Deferred tax assets

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

Unlisted investment valuations

Investments for which there is no active market or an external valuation available are valued either by reference to the current market value of another instrument that is substantially the same; a discounted cash flow analysis or other methods consistent with market best practice. Refer Note 27 for further disclosure.

Impairment of goodwill

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

(xxxiv) Comparatives

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

As a result of the sale of part of the Mortgage Management division to National Australia Bank Limited (NAB) on 30 October 2009, revenue and expenses in the comparatives relating to the legal entities sold have been removed from revenue and expense comparatives and included in Note 35 *Discontinued operations*.

(xxxv) Rounding of amounts

Amounts in this financial report are rounded to the nearest hundred thousand dollars ($0.0M), unless otherwise stated, under the option available to the Company under ASIC Class Order 98/100.

2. Segment information

Business segments

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

	Reporting segments			
	Life		Funds Management	
	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M
Management view				
Total segment revenue	338.0	250.8	102.0	114.4
Operating expenses	(33.9)	(23.4)	(84.7)	(96.3)
Normalised EBIT[1]	304.1	227.4	17.3	18.1
Interest and borrowing costs	–	–	–	–
Discontinued operations[2]	–	–	–	–
Normalised net profit/(loss) before tax, investment experience and significant items[1]	304.1	227.4	17.3	18.1
Investment experience[1,5]	55.5	(442.3)	–	–
Net profit/(loss) before tax	359.6	(214.9)	17.3	18.1
Income tax (expense)/benefit				
Significant items after tax	–	–	–	–
Profit/(loss) attributable to equity holders				
Segment assets	8,275.1	6,119.7	161.0	108.2
Segment liabilities	(6,822.6)	(5,213.4)	(28.2)	(14.9)
Net assets	1,452.5	906.3	132.8	93.3
Other segment information – statutory view				
Revenue from external customers	587.2	(76.0)	99.2	128.3
Interest revenue	771.1	276.4	0.4	0.6
Interest expense	(490.6)	(85.8)	–	(0.2)
Intersegment revenue[4]	(11.6)	(2.5)	11.6	(3.1)
Impairment	(4.9)	(1.2)	–	–
Depreciation and amortisation	(38.7)	(2.8)	(0.3)	(0.4)

[1] Normalised EBIT, normalised net profit and investment experience are defined below.

[2] The Mortgage Management division was disposed of on 30 October 2009.

[3] 'Corporate and other' includes corporate companies, corporate SPV, non-controlling interests and Group eliminations.

[4] Intersegment transactions are at arm's length.

[5] On 31 January 2010, the Group acquired a controlling interest in Challenger Kenedix Japan Trust (CKT); refer to Notes 3 and 34 for further information. On 31 December 2008, the Group acquired a controlling interest in the Challenger Diversified Property Group (CDI). The difference between the purchase consideration and the Group's share of the properties acquired is included in Life investment experience.

Mortgage Management[2]		Total reporting segments		Corporate and other[3]		Total management view	
30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M
–	–	440.0	365.2	7.6	4.7	447.6	369.9
–	–	(118.6)	(192.5)	(63.2)	(66.6)	(181.8)	(186.3)
–	–	321.4	381.6	(55.6)	(61.9)	265.8	183.6
–	–	–	–	(14.1)	(36.9)	(14.1)	(36.9)
39.1	136.1	39.1	136.1	–	–	39.1	136.1
39.1	136.1	360.5	381.6	(69.7)	(98.8)	290.8	282.8
–	–	55.5	(442.3)	–	–	55.5	(442.3)
39.1	136.1	416.0	(60.7)	(69.7)	(98.8)	346.3	(159.5)
						(62.5)	68.8
(1.3)	–	(1.3)	–	–	–	(1.3)	–
						282.5	(90.7)
–	1,121.9	8,436.1	7,349.8	9,939.8	17,888.0	18,375.9	25,237.8
–	(608.9)	(6,850.8)	(5,837.2)	(9,805.4)	(17,711.2)	(16,656.2)	(23,548.4)
–	513.0	1,585.3	1,512.6	134.4	176.8	1,719.7	1,689.4
–	47.3	686.4	99.6	(116.4)	(42.9)	570.0	56.7
–	1,325.6	771.5	1,602.6	298.1	14.5	1,069.6	1,617.1
–	(1,060.1)	(490.6)	(1,146.1)	(150.3)	(30.6)	(640.9)	(1,176.7)
–	5.6	–	–	–	–	–	–
–	–	(4.9)	(1.2)	–	–	(4.9)	(1.2)
–	(77.4)	(39.0)	(80.6)	(6.9)	(14.0)	(45.8)	(94.6)

2. Segment information (continued)

Definitions

Segment revenue and operating expenses differs from *revenue* and *expenses* as disclosed in the income statement as certain direct costs (including commissions and management fees) included in *expenses* are netted off against gross revenues in deriving the management view of segment revenue above. In addition, the revenues, expenses and finance costs from special purpose vehicles are separately disclosed in the statutory view but are netted off in the management view of segment revenue.

The normalised view of profit given above differs from the statutory view as it excludes *investment experience*, which is the effect of realised and unrealised fair value gains and losses on the Group's investments, net of management's estimate of their expected capital growth, using stable, long-term growth assumptions.

Operating segments

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

Life – includes annuity and life insurance business carried out by Challenger Life Company Limited (CLC). CLC invests in assets providing long-term income streams for customers.

Funds Management – earns fees from its operations in the funds management and specialised funds fields, providing an end to end funds management business as well as managing three listed funds and a number of unlisted fund mandates.

Mortgage Management – was a white label funding provider for the commercial and residential mortgage lending market. The segment also distributed mortgages through ownership of broker aggregation platforms. This segment ceased to operate after the sale of the mortgage distribution business and $4.5 billion of mortgages on 30 October 2009 (see Note 35 for further details).

Corporate and other

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

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

Products and services

The Group's divisional segment split represents the products that the Group supplies.

Life – offers fixed rate superannuation products and fixed rate retirement products that are both designed for investors who are seeking a low-risk investment for a known period of time and want to protect their capital.

Funds Management – offers a range of management investments across the major asset classes with funds in:

- Fixed interest and mortgages;
- Australian shares;
- Property funds; and
- International shares.

Funds Management also has equity investments in a number of boutique fund managers.

Mortgage Management – was sold on 30 October 2009 so the segment only includes the results up to that date and are disclosed as discontinued operations for both the management and statutory view.

Geographical areas

The Group operates predominantly in Australia and so no geographical split is provided to the chief operating decision maker.

Major customers

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

	30 June 2010 $M	30 June 2009 $M
Reconciliation of segment revenue to statutory revenue		
Reportable segment revenue	440.0	365.2
Corporate and other revenue	7.6	4.7
Management view of revenue	447.6	369.9
SPV interest costs and fees offset against SPV revenue	525.2	1,060.0
Commission expenses offset against commission revenue	70.0	89.5
Portfolio and origination costs offset against mortgage fee revenue	36.5	78.2
Property related expenses offset against property income	55.9	35.1
Change in life contract liabilities recognised as an expense	240.3	190.7
Realised and unrealised gains/(losses) recognised as investment experience	164.5	(314.1)
Expected capital growth assumptions applied to investment experience	(54.5)	(64.1)
Interest expense in controlled property trusts offset against management revenue	31.2	38.9
Expenses of other controlled trusts offset against trust revenue	21.2	–
Interest expense on non-corporate liabilities offset against management revenue	42.8	45.0
Difference between management and statutory view of discontinued revenue	65.6	208.9
Other expenses and change in non-controlling interests offset against management revenue	(11.4)	(64.2)
Statutory revenue	1,634.7	1,673.8
Reconciliation of segment profit to statutory profit/(loss)		
Reportable segment normalised net profit before tax, investment experience and significant items	360.5	381.6
Corporate and other normalised loss before tax, investment experience and significant items	(69.7)	(98.8)
Management view of profit	290.8	282.8
Investment experience	55.5	(442.3)
Difference between management and statutory view of discontinued operations	(11.4)	(25.2)
Change in non-controlling interest shown net in management view	11.3	3.1
Other	(0.2)	0.2
Statutory profit/(loss) before tax	346.0	(181.4)

	30 June 2010 $M	30 June 2009[3] $M
3. Revenue		
Fee revenue		
Management fee revenue	89.5	127.2
Fee revenue – SPV	25.9	45.6
Other fee revenue	11.0	11.8
Investment revenue		
Equity and infrastructure securities		
Dividend revenue	32.6	72.8
Net realised losses on equity securities	(6.3)	(21.0)
Net unrealised gains/(losses) on equity securities	20.2	(69.2)
Net realised gains on infrastructure securities	5.9	17.5
Net unrealised losses on infrastructure securities	(6.4)	(229.6)
Debt securities, cash and cash equivalents		
Interest revenue	323.9	294.5
Net realised gains/(losses) on debt securities	105.4	(89.9)
Net unrealised gains/(losses) on debt assets and liabilities	126.0	(17.9)
Investment property and property securities		
Dividend revenue	2.3	12.1
Property rental income	207.5	150.2
Net realised losses on property securities	(7.6)	(1.0)
Net unrealised losses on property securities	(56.7)	(148.9)
Discount on acquisition of controlled entities[1]	112.4	66.4
Other		
Interest revenue – SPV	745.7	1,322.6
Impairment loss on financial assets available-for-sale	(4.9)	(1.2)
Net realised gains/(losses) on foreign exchange translation and foreign currency hedges	189.2	(147.9)
Net unrealised (losses)/gains on foreign exchange translation and foreign currency hedges	(113.9)	57.5
Net realised (losses)/gains on interest rate derivative assets and liabilities	(8.4)	95.0
Net unrealised (losses)/gains on interest rate derivative assets and liabilities	(7.1)	106.0
Other revenue		
Change in life contract liabilities[2]	(138.8)	(9.6)
Change in reinsurance contract liabilities	(12.7)	–
Gain on annuity book transfer	–	30.8
	1,634.7	1,673.8

[1] On 31 January 2010, the Group acquired a controlling interest in Challenger Kenedix Japan Trust (CKT); refer to Note 34 for further information. On 31 December 2008, the Group acquired a controlling interest in the Challenger Diversified Property Group (CDI). The purchase of property assets is considered core to the operations of the Group.

[2] Life contract liability movements arising from changes in interest rates are recognised as revenue.

[3] 2009 comparatives have been restated to remove amounts related to discontinued operations. For details see Note 35.

	30 June 2010 $M	30 June 2009[2] $M
4. Expenses		
Commission expenses	70.0	89.5
Amortisation of deferred portfolio and origination costs	36.5	78.2
Change in life contract liabilities[1]	240.3	190.7
Property related expenses	55.9	35.1
Management fees	31.9	12.9
Fee expenses – SPV	4.3	6.7
Intangibles amortisation expense	2.4	8.8
Employee expenses	116.4	153.0
Employee share based payments	31.5	26.9
Superannuation	5.0	6.9
Occupancy expense – operating lease	4.5	12.8
Depreciation expense	6.9	7.6
Communications	7.6	8.9
IT maintenance	3.8	3.8
Professional fees	11.9	5.7
Other expenses	22.6	33.6
	651.5	681.1

[1] Life contract liability movements other than those arising from changes in interest rates are recognised as an expense.

[2] 2009 comparatives have been restated to remove amounts related to discontinued operations. For details see Note 35.

	30 June 2010 $M	30 June 2009[1] $M
5. Finance costs		
Derived from operating activities:		
Interest and loan amortisation expenses incurred by:		
SPV	520.9	1,053.3
Other entities	76.2	80.2
Property trusts	31.2	38.9
Other finance costs	12.6	4.3
	640.9	1,176.7

[1] 2009 comparatives have been restated to remove amounts related to discontinued operations. For details see Note 35.

6. Income tax

	30 June 2010 $M	30 June 2009[1] $M
Analysis of income tax (expense)/benefit		
Current income tax (expense)/benefit for the year	(89.1)	67.0
Current income tax (expense)/benefit – prior year adjustment	(8.5)	0.6
Deferred income tax benefit	37.4	9.5
Income tax (expense)/benefit from continuing operations	(60.2)	77.1
Income tax benefit on loss on hedge of net investment in foreign entity	7.2	–
Income tax (expense)/benefit on cash flow hedge movements taken to equity	(3.5)	12.1
Income tax benefit/(expense) on available-for-sale asset revaluations taken to equity	2.4	(1.2)
Income tax benefit from other comprehensive income	6.1	10.9
Analysis of deferred income tax benefit:		
Increase/(decrease) in deferred tax assets	19.4	(81.8)
Decrease in deferred tax liabilities	18.0	91.3
Deferred income tax benefit	37.4	9.5
Reconciliation of income tax benefit/(expense) from continuing operations:		
Profit/(loss) from continuing operations before income tax	346.0	(181.4)
Less: profit relating to non-controlling interests	(11.3)	(3.1)
Profit/(loss) before income tax from continuing operations attributable to equity holders	334.7	(184.5)
Prima facie income tax based on the Australian company tax rate of 30%	(100.4)	55.4
Tax effect of amounts not deductible/assessable in calculating taxable income:		
Rate differential on offshore income	(0.8)	0.7
Non-assessable and non-deductible items	38.7	(3.0)
Other items	2.3	24.0
	40.2	21.7
Income tax (expense)/benefit from continuing operations	(60.2)	77.1
Tax losses		
Gross unused losses for which no deferred tax asset has been recognised	(134.4)	(83.4)

All available revenue losses have been recognised in the balance sheet at 30 June 2010 and 30 June 2009.

[1] 2009 comparatives have been restated to remove amounts related to discontinued operations. For details see Note 35.

	Balance sheet		Income statement	
	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M
Deferred tax				
Deferred tax at 30 June relates to the following:				
Deferred tax liabilities				
Deferred acquisition and origination costs	(7.9)	(25.4)	(17.5)	(15.9)
Fixed asset temporary differences	(1.6)	(16.0)	(14.4)	(2.4)
Future assessable trail commission	–	(51.7)	–	102.9
Tax balances recognised on acquisitions	(35.9)	(35.9)	–	–
Unrealised foreign exchange movements	6.4	(9.3)	(14.1)	(2.9)
Unrealised gains on investment property	(156.0)	(99.2)	68.0	(12.2)
Other	(19.7)	(34.9)	(4.0)	21.1
	(214.7)	(272.4)		
Deferred tax assets				
Accruals and provisions	34.3	54.6	24.8	(43.8)
Employee entitlements	2.4	3.2	0.8	(0.5)
Future deductible trail commission	–	99.6	18.2	(62.0)
Losses	124.2	138.3	(29.1)	(17.7)
Surplus lease space	5.4	6.2	0.8	(1.6)
Other	4.5	8.4	3.9	44.5
	170.8	310.3		
Net deferred tax (liability)/asset	(43.9)	37.9		
Deferred tax benefit/(expense)			37.4	9.5
Netted by tax jurisdiction				
Deferred tax asset	–	52.2		
Deferred tax liability	(43.9)	(14.3)		
Net deferred tax (liability)/asset	(43.9)	37.9		

	30 June 2010 $M	30 June 2009 $M

7. Dividends and distributions paid and proposed

	30 June 2010 $M	30 June 2009 $M
Dividends declared and paid during the year		
Final unfranked dividend for the financial year 30 June 2009: 7.5 cents (2008: 7.5 cents 60% franked)	42.0	47.4
Interim unfranked dividend for the financial year 30 June 2010: 6.0 cents (2009: 5.0 cents unfranked)	31.2	29.6
	73.2	77.0
Dividend proposed (not recognised as a liability as at 30 June)		
Final unfranked dividend for the financial year 30 June 2010: 8.5 cents (2009: 7.5 cents unfranked)	41.0	42.0
Distributions paid or provided		
Distributions paid or provided represents amounts paid or payable to non-controlling interests of entities controlled by the Group.		
Distributions paid during the period to non-controlling interests	17.9	13.4
Distributions provided during the period to non-controlling interests	10.7	11.9
	28.6	25.3

	30 June 2010 Cents	30 June 2009 Cents

8. Earnings per share

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	30 June 2010 Cents	30 June 2009 Cents
Total from continuing operations:		
Basic earnings per share	53.8	(19.2)
Diluted earnings per share	50.4	(18.9)
Total from all operations:		
Basic earnings per share	55.3	(16.2)
Diluted earnings per share	51.9	(15.9)

	$M	$M
Earnings used in calculating earnings per share		
For basic earnings per share:		
Profit/(loss) after income tax from continuing operations	274.5	(107.4)
Profit/(loss) after income tax from discontinued operations	8.0	16.7
Net profit/(loss) after income tax attributable to ordinary shareholders for basic earnings per share	282.5	(90.7)
For diluted earnings per share:		
Net profit/(loss) after income tax from continuing operations	274.5	(107.4)
Interest received on LTIP loans	(0.1)	–
Net profit/(loss) after income tax from continuing operations attributable to ordinary shareholders for diluted earnings per share adjusted for the impact of interest received on LTIP loans	274.4	(107.4)
Profit after income tax from discontinued operations	8.0	16.7
Net profit/(loss) after income tax attributable to ordinary shareholders for diluted earnings per share	282.4	(90.7)

Number of shares	Number	Number
Weighted average number of ordinary shares for basic earnings per share	510,402,038	558,725,530
Effect of dilution	33,901,624	10,269,251
Adjusted weighted average number of ordinary shares for diluted earnings per share	544,303,662	568,994,781

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 in the employee share trust. The weighted average number of treasury shares for the period was 41,838,441 (2009: 53,778,215).

There have been no other material transactions involving ordinary shares or potential ordinary shares since the reporting date and before the completion of the financial report.

9. Cash and cash equivalents

	30 June 2010 $M	30 June 2009 $M
Cash at bank and on hand	317.0	296.0
Cash equivalents	337.1	652.7
Deposits at call	20.3	123.0
	674.4	1,071.7
SPV cash	458.1	737.0
	1,132.5	1,808.7

	30 June 2010 $M	30 June 2009 $M
10. Receivables		
Trade debtors	33.4	434.6
Amounts recoverable from managed trusts	8.1	6.4
Dividends and distributions receivable	10.1	17.0
Interest receivable	48.2	40.3
Secured loans	1.5	37.7
Other debtors	11.7	46.4
	113.0	582.4
Current	113.0	202.0
Non-current	–	380.4
	113.0	582.4
Receivables – SPV	8,466.8	15,644.1
	8,466.8	15,644.1
Current	–	–
Non-current	8,466.8	15,644.1
	8,466.8	15,644.1
Provision for impairment of SPV receivables		
Opening balance	83.1	40.1
(Release of)/increase in provision	(3.9)	62.6
Utilisation of provision against incurred losses	(20.6)	(19.6)
Closing balance	58.6	83.1

For further detail on the Special Purpose Vehicles (SPV) refer to Note 22. *Receivables – SPV* is stated net of provision for impairment. This provision for impairment is measured as the difference between the carrying amount of the loan and the present value of expected future cash flows, discounted at the loan's original effective interest rate and adjusted for lenders mortgage insurance coverage.

Importantly, whilst the SPV are required by accounting standards to be consolidated into the Group, the effective credit risk exposure in relation to the mortgage loans within the SPV is held by either the holders of the securitised interest bearing liabilities issued by these trusts or the wholesale warehouse facility providers.

	30 June 2010 $M	30 June 2009 $M
11. Other financial assets		
Financial assets at fair value through profit and loss		
Debt securities		
Bonds	1,376.6	1,039.3
Fixed interest notes	154.7	153.5
Floating rate notes	2,535.7	1,690.0
	4,067.0	2,882.8
Equity securities		
Unlisted unit trusts and managed funds	148.2	86.8
Shares in listed and unlisted corporations	152.5	154.5
Shares in listed corporations held in relation to endowment warrants	38.4	45.2
	339.1	286.5
Infrastructure investments		
Shares in listed and unlisted infrastructure trusts	489.6	653.8
	489.6	653.8
Property securities		
Indirect property investments in listed and unlisted trusts	154.5	185.9
	154.5	185.9
Total financial assets at fair value through profit and loss[1]	5,050.2	4,009.0
Current	1,366.5	570.7
Non-current	3,683.7	3,438.3
	5,050.2	4,009.0
Available-for-sale assets		
Other financial assets	11.8	24.3
	11.8	24.3
Current	–	–
Non-current	11.8	24.3
	11.8	24.3

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

	30 June 2010 $M	30 June 2009 $M
12. Investment property		
Investment property in use	2,487.0	1,892.4
Investment property under development	25.0	26.4
Development property held for resale	98.1	101.7
Total investment property[2]	2,610.1	2,020.5
Reconciliation of carrying amounts		
Investment property in use		
Carrying amount at the beginning of the period	1,892.4	1,163.9
Acquisitions[1]	706.8	824.2
Sale of properties at cost	(97.7)	–
Transfer from investment property under development	–	0.2
Capital expenditure	9.1	8.4
Foreign currency exchange gain/(loss)	30.8	(5.3)
Net revaluation loss	(54.4)	(99.0)
Carrying amount at the end of the period	2,487.0	1,892.4
Investment property under development		
Carrying amount at the beginning of the period	26.4	–
Acquisitions[1]	–	25.2
Transfer to investment property	–	(0.2)
Capital expenditure	7.7	1.4
Net revaluation loss	(9.1)	–
Carrying amount at the end of the period	25.0	26.4
Development property held for resale		
Carrying amount at the beginning of the period	101.7	75.8
Acquisitions[1]	–	14.3
Sale of properties at cost	(18.1)	–
Development expenditure	14.5	17.4
Net revaluation loss	–	(5.8)
Carrying amount at the end of the period	98.1	101.7

[1] On 31 January 2010, the Group acquired a controlling interest in Challenger Kenedix Japan Trust (CKT); refer to Note 34 for further information. On 31 December 2008, the Group acquired a controlling interest in the Challenger Diversified Property Group (CDI).

[2] All investment property is considered to be non-current.

12. Investment property (continued)

Analysis of investment property

Investment property in use	Notes	Acquisition date	Total cost $M	Carrying value 2010 $M	Cap rate 2010 %	Last external valuation	Carrying value 2009 $M	Cap rate 2009 %
Australia								
Century City Walk, VIC	[a][d]	16-Oct-06 30-Jun-08	27.4	30.0	8.50%	30-Jun-10	27.4	8.50%
Innaloo Cinema, WA	[b][e]	17-Dec-01	28.4	35.5	8.00%	31-Dec-09	35.8	7.75%
Jam Factory, VIC	[b][e]	4-Jul-00	102.6	104.5	8.50%	31-Dec-09	110.1	8.00%
George Street Cinemas, NSW	[n]	4-Jul-00	–	–	–	–	84.0	8.25%
Kings Langley, NSW	[b][e]	29-Jul-01	16.5	16.0	8.25%	30-Jun-10	16.0	8.25%
County Court, VIC	[e]	30-Jun-00	201.3	273.0	7.00%	31-Dec-09	273.0	6.75%
CSIRO, NSW	[h]	27-Jun-01	150.7	159.0	8.00%	30-Jun-10	159.0	8.20%
Pacific Brands, Port Melbourne, VIC (formerly Globe)	[b][e]	13-Nov-02	20.1	19.4	8.75%	30-Jun-10	19.7	9.00%
Goodman Fielder, North Ryde, NSW	[b][e]	23-Feb-01	43.4	37.6	8.50%	31-Dec-09	43.5	7.75%
Heidelberg, Waterloo, NSW	[n]	7-Jan-00	–	–	–	–	13.7	8.00%
Kraft, Port Melbourne, VIC	[b][e]	28-Jun-02	27.1	23.3	9.50%	30-Jun-10	26.0	9.25%
Rexel, North Ryde, NSW	[a][e]	30-Nov-06 30-Jun-08	17.7	13.8	8.75%	31-Dec-09	17.5	8.25%
ABS Building, ACT	[b][e]	1-Jan-00	115.6	148.0	7.50%	30-Jun-10	140.0	8.00%
DIAC (formerly DIMIA) Building, ACT	[b][e]	1-Dec-01	99.8	112.0	7.75%	30-Jun-10	104.0	7.75%
Discovery House, ACT	[b][e]	28-Apr-98	84.7	100.6	7.50%	31-Dec-09	97.5	7.50%
Elders House, SA	[b][h]	21-Jun-02	48.1	47.3	8.75%	30-Jun-10	47.0	8.75%
Executive Building, Hobart, TAS	[b][e]	30-Mar-01	26.2	34.0	8.75%	30-Jun-10	31.4	9.00%
Makerston, QLD	[b][f]	14-Dec-00	55.2	67.4	8.75%	31-Dec-09	75.0	7.50%
417 St Kilda Road, Melbourne, VIC	[h]	27-Jun-02	85.7	77.0	8.50%	30-Jun-10	79.6	8.50%
Taylors Institute, Waterloo, NSW	[b][e]	16-May-01	42.7	43.5	8.50%	31-Dec-09	43.4	8.25%
The Forum, Cisco, NSW	[b][e]	5-Jan-01	115.1	102.9	8.35%	31-Dec-09	110.5	7.75%
The Forum (formerly UUNet), NSW	[a][d]	5-Jan-01	72.6	59.8	8.75%	31-Dec-09	68.0	8.10%
6 Foray Street (formerly Tetra Pak), Fairfield, NSW	[a][f]	23-Oct-06	21.2	16.7	10.25%	30-Jun-10	16.9	10.00%
Cosgrove Industrial Park, Enfield, NSW	[a][e]	31-Mar-07	21.7	20.5	8.25%	31-Dec-09	21.9	7.50%
Spotlight, Laverton North, VIC	[a][f][m]	16-Oct-06	15.8	14.8	9.50%	30-Jun-10	16.4	8.25%
API Richlands, Richlands, QLD	[a][e]	24-Oct-06	13.8	12.1	9.50%	31-Dec-09	11.2	9.00%
12-30 Toll Drive, Altona North, VIC	[a][e]	16-Oct-06	13.5	13.0	9.25%	30-Jun-10	13.9	8.25%
2-10 Toll Drive, Altona North, VIC	[a][e]	16-Oct-06	6.3	6.2	9.15%	30-Jun-10	6.4	8.25%
1-9 Toll Drive, Altona North, VIC	[a][d]	16-Oct-06	3.3	3.6	9.00%	30-Jun-10	3.3	9.50%
Rendezvous Hotels	[f]	8-Dec-05	56.3	59.0	8.50%	30-Jun-10	56.5	8.50%
Total Australia			1,532.8	1,650.5			1,768.6	

Investment property in use	Notes	Acquisition date	Total cost $M	Carrying value 2010 $M	Cap rate 2010 %	Last external valuation	Carrying value 2009 $M	Cap rate 2009 %
Hungary								
Mangro Kft	[d]	12-Apr-07	31.3	14.4	9.52%	30-Jun-10	24.6	9.15%
Namoc Kft	[d]	12-Apr-07	12.0	5.5	9.52%	30-Jun-10	7.6	9.15%
Rozalia Kft	[d]	12-Apr-07	12.8	6.4	9.52%	30-Jun-10	9.0	9.15%
Rozal Kft	[d]	12-Apr-07	7.5	3.5	9.52%	30-Jun-10	4.4	9.15%
Lazor Kft	[d]	12-Apr-07	7.6	3.3	9.52%	30-Jun-10	5.2	9.15%
Surplus Land	[d]	12-Apr-07	1.0	0.6	9.52%	30-Jun-10	–	9.15%
France								
Rue Charles Nicolle, Villeneuve les Beziers	[a][j]	06-Jun-07	15.3	12.4	8.25%	30-Jun-10	14.0	8.35%
Avenue de Savigny, Aulnay sous Bois	[a][j]	06-Jun-07	18.0	12.8	6.50%	30-Jun-10	16.7	6.10%
105 Route d'Orleans, Sully sur Loire	[a][j]	06-Jun-07	22.9	15.7	8.75%	30-Jun-10	21.0	7.65%
140 Rue Marcel Paul, Gennevilliers	[a][j]	06-Jun-07	11.5	9.3	7.50%	30-Jun-10	11.0	8.20%
ZAC Papillon, Parcay-Meslay	[a][j]	06-Jun-07	9.2	6.6	8.25%	30-Jun-10	8.0	8.40%
6 Rue Doulaclouew, Toulouse	[a][j]	06-Jun-07	2.8	2.6	8.50%	30-Jun-10	2.3	8.60%
Japan								
Carino Chitosedai	[c][k]	30-Jun-07	117.9	124.7	5.00%	31-Dec-09	–	–
Carino Tokiwadai	[c][k]	30-Apr-07	76.9	76.1	5.20%	30-Jun-10	–	–
Izumiya Hakubaicho	[c][l]	30-Apr-07	68.0	70.8	5.40%	31-Dec-09	–	–
Unicus Ina	[c][l]	30-Apr-07	56.3	59.4	5.30%	30-Jun-10	–	–
Valor Toda	[c][k]	30-Apr-07	42.2	44.7	5.70%	30-Jun-10	–	–
Life Higashinakano	[c][l]	30-Apr-07	32.6	33.6	5.20%	31-Dec-09	–	–
Life Asakusa	[c][l]	30-Apr-07	27.4	29.6	5.30%	30-Jun-10	–	–
Osada Nagasaki	[c][l]	30-Apr-07	21.1	22.6	6.30%	31-Dec-09	–	–
Yaoko Sakato Chiyoda	[c][l]	30-Apr-07	18.1	19.4	5.30%	31-Dec-09	–	–
Sunny Noma	[c][l]	30-Apr-07	16.4	17.7	6.20%	30-Jun-10	–	–
Kansai Super Saigo	[c][l]	30-Apr-07	13.0	14.0	6.10%	30-Jun-10	–	–
Kojima Nishiarai	[c][k]	30-Apr-07	10.8	11.2	5.50%	31-Dec-09	–	–
DeoDeo Kure	[c][l]	31-Aug-07	31.4	33.8	6.10%	30-Jun-10	–	–
Seiyu Miyagino	[c][l]	30-Sep-07	9.6	10.4	6.20%	30-Jun-10	–	–
Aeon Kushiro	[c][k]	31-Dec-07	27.8	30.0	6.10%	30-Jun-10	–	–
Valor Ichinomiya	[c][k]	31-Dec-07	27.9	29.3	5.70%	30-Jun-10	–	–
Life Nagata	[c][l]	29-Feb-08	25.2	26.9	5.30%	31-Dec-09	–	–
Renaissance Fujimidai	[c][k]	29-Feb-08	28.3	30.2	5.30%	31-Dec-09	–	–
Valor Takinomizu	[c][k]	31-Mar-08	26.8	28.4	5.70%	31-Dec-09	–	–
Life Kema	[c][l]	31-Mar-08	28.8	30.5	5.30%	31-Dec-09	–	–
Total overseas			858.4	836.4			123.8	
Investment property in use			2,391.2	2,487.0			1,892.4	
TRE Data Centre	[g]	14-Apr-10	6.0	6.0	n/a	30-Jun-10	–	n/a
Enfield	[a][g]	31-Mar-07	28.1	19.0	n/a	30-Jun-10	26.4	n/a
Investment property under development			34.1	25.0			26.4	
Maitland	[i]	6-Dec-06	91.8	91.8	n/a	30-Jun-10	78.4	n/a
Mavis Court	[n]	30-Apr-07	–	–	n/a	–	10.1	n/a
Smithfield	[a][i]	3-Aug-07	13.3	6.3	n/a	30-Jun-10	13.2	n/a
Development property held for resale			105.1	98.1			101.7	

12. Investment property (continued)

Analysis of investment property (continued)

Except where indicated below, the carrying values have been determined with reference to independent valuations using market capitalisation and discounted cash flow methods. As at 30 June 2010 the investment property portfolio occupancy rate was 93.5% (CLC), 93.2% (CDI) and 100.0% (CKT) with a weighted average lease expiry of 7.5 years (CLC), 4.9 years (CDI) and 14.3 years (CKT).

The properties listed above (other than the properties separately identified below) are partially debt financed with funding that contains a number of negative undertakings (including an undertaking not to create or allow encumbrances, and an undertaking not to incur financial indebtedness which ranks in priority to existing debt). This debt funding is in place via a note issuance under a security trust structure.

CSIRO and County Court are each financed via separate capital markets bond issuances. Security has been granted over these properties under the bond issuances, which includes a mortgage over the properties.

Maitland is partially funded by external debt. Security has been granted over each development in relation to that funding, which includes a mortgage over each property.

The Hungarian investments were not funded by debt as at 30 June 2010, and so were not subject to any security or charge at that time.

Notes to the investment property table

[a] Property is 100% owned by CDI.

[b] Property is 60% owned by CDI and 40% owned by CLC.

[c] Property is 100% owned by CKT. In 2010, the value shown is 100% as a result of the consolidation of CKT.

[d] Valued by JLL.

[e] Valued by Savills.

[f] Valued by Colliers.

[g] Valued at cost less impairment.

[h] Valued by M3 Property.

[i] Valued at lower of cost or net realisable value.

[j] Valued by Cushman & Wakefield.

[k] Valued by HIRO.

[l] Valued by TOEL.

[m] On 29 June 2010, conditional contracts were exchanged for the sale of API Richlands. The carrying value at 30 June 2010 is based on the sale price.

[n] Property has been sold in 2010.

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

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

	30 June 2010 $M	30 June 2009 $M

13. Plant and equipment

	30 June 2010 $M	30 June 2009 $M
Plant and equipment at cost	44.7	49.2
Less accumulated depreciation	(20.5)	(21.4)
	24.2	27.8
Infrastructure fixed assets at cost	43.9	33.2
Less accumulated depreciation	(5.0)	(4.2)
	38.9	29.0
Total plant and equipment	63.1	56.8

Reconciliations:	Plant and equipment $M	Infrastructure fixed assets $M	Total $M
30 June 2010			
Opening balance	27.8	29.0	56.8
Additions	4.3	14.6	18.9
Disposals	(2.4)	–	(2.4)
Depreciation expense	(5.5)	(1.4)	(6.9)
Foreign exchange losses	–	(3.3)	(3.3)
	24.2	38.9	63.1
30 June 2009			
Opening balance	30.7	31.0	61.7
Acquisition of subsidiaries	0.6	–	0.6
Additions	3.0	0.2	3.2
Disposals	–	(0.6)	(0.6)
Depreciation expense	(6.5)	(1.1)	(7.6)
Foreign exchange losses	–	(0.5)	(0.5)
	27.8	29.0	56.8

All plant and equipment and infrastructure fixed assets are considered to be non-current.

14. Other assets

	30 June 2010 $M	30 June 2009 $M
Prepayments – deferred portfolio and origination costs	27.9	85.7
Rental bond deposits[1]	32.7	–
Other	12.6	6.3
Other SPV	3.8	0.4
	77.0	92.4
Current	36.5	30.1
Non-current	40.5	62.3
	77.0	92.4

[1] Rental bond deposits acquired as part of Challenger Kenedix Japan Trust acquisition on 31 January 2010. Refer to Note 34 for more information.

	30 June 2010 $M	30 June 2009 $M

15. Goodwill and other intangible assets

	30 June 2010 $M	30 June 2009 $M
Goodwill		
Cost	789.7	968.7
Less accumulated impairment	(280.0)	(280.0)
Total goodwill	509.7	688.7
Other intangible assets		
Software at cost	23.7	26.7
Less accumulated amortisation	(21.9)	(23.7)
	1.8	3.0
Operating lease intangible at cost[1]	22.8	22.8
Less accumulated amortisation	(2.7)	(2.0)
Foreign exchange losses	(5.1)	(2.7)
	15.0	18.1
Total other intangible assets	16.8	21.1

[1] Clashfern Investments (UK) Limited, a subsidiary of the Group, holds a 99 year lease for the rental of a site. The lease expires in 2032.

	Goodwill		Software		Operating lease	
	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M
Opening balance	688.7	624.0	3.0	9.5	18.1	19.4
Acquisitions through business combinations	11.1	57.6	–	–	–	–
Additions	–	–	0.5	1.4	–	–
Disposals	(190.2)	–	–	–	–	–
Reappraisal of fair value of net assets acquired	2.5	(0.5)	–	–	–	–
Foreign exchange losses	(2.4)	(0.5)	–	–	(2.4)	(0.5)
Amortisation expense	–	–	(1.7)	(7.9)	(0.7)	(0.8)
Deferred acquisition costs	–	8.1	–	–	–	–
Closing balance	509.7	688.7	1.8	3.0	15.0	18.1

16. Impairment testing of goodwill

Goodwill acquired through business combinations is allocated to the Life and Funds Management cash-generating units for impairment testing. The Mortgage Management cash-generating unit was disposed of during the year and goodwill not disposed of with this business has been reallocated to Life. The recoverable amount of goodwill for each cash-generating unit has been determined based on a value in use calculation which utilises cash flow projections based on financial budgets approved by senior management covering an appropriate horizon. The discount rates applied to cash flow projections are set out below and are based on the Group's weighted average cost of capital.

Cash-generating unit	30 June 2010 Discount rate %	30 June 2009 Discount rate %	Cash flow horizon years
Life	11.8	12.0	5
Funds Management	11.8	12.0	5
Mortgage Management	–	12.0	10

	Life		Funds Management		Mortgage Management		Total	
	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M
Goodwill	420.6	150.7	89.1	78.0	–	460.0	509.7	688.7

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

Budgeted gross margins – is the average gross margins achieved in the year ended immediately before the budgeted year, adjusted for expected impact of competitive pressure on margins and expected efficiency improvements.

Bond rates – the yield on a government bond rate at the beginning of the budgeted year is utilised.

Growth rates – are consistent with long-term trends in the industry segments in which the businesses operate.

The derived values for the cash-generating units were in excess of the carrying value of goodwill. Management is of the view that reasonably possible changes in the key assumptions, such as a change in the discount rate of 1% or a change in cash flow of 5%, would not cause the respective recoverable amounts for each cash generating unit to fall short of the carrying amounts as at 30 June 2010.

All goodwill is considered to be non-current.

	30 June 2010 $M	30 June 2009 $M
17. Payables		
Trade creditors and accruals	131.1	126.2
Present value of trail liabilities	–	376.2
Warrant liability[1]	39.9	46.3
Other creditors	61.5	45.2
Unsettled trades payable	18.1	13.9
Payables – SPV[2]	66.6	55.0
	317.2	662.8
Current	201.0	337.3
Non-current	116.2	325.5
	317.2	662.8

[1] Does not represent an in substance liability of the Group as the Group has a Deed of Assignment; refer to Note 36 for additional information.

[2] See Note 22 for details of SPV.

	30 June 2010		30 June 2009	
	Outstanding $M	Facility $M	Outstanding $M	Facility $M
18. Interest bearing liabilities				
Bank loans				
Recourse				
Corporate	–	100.0	130.0	300.0
Non-recourse				
Controlled property trusts[1]	839.3	1,039.9	804.1	990.8
Repurchase arrangements	–	–	59.8	59.8
Total bank loans	839.3	1,139.9	993.9	1,350.6
Non-bank loans				
Recourse				
Medium term note	–	–	206.0	206.0
Non-recourse				
Controlled property trusts	7.4	7.4	7.0	7.0
Corporate	–	–	130.0	130.0
Loan note finance	65.8	65.8	62.5	62.5
Subordinated debt issuance	475.1	475.1	418.8	418.8
Total non-bank loans	548.3	548.3	824.3	824.3
Total interest bearing liabilities	1,387.6	1,688.2	1,818.2	2,174.9
Current	127.3		890.7	
Non-current	1,260.3		927.5	
	1,387.6		1,818.2	
Interest bearing liabilities – SPV	8,637.0	8,739.2	16,261.9	17,485.1
Total interest bearing liabilities – SPV	8,637.0	8,739.2	16,261.9	17,485.1
Current	110.5		5,043.0	
Non-current	8,526.5		11,218.2	
	8,637.0		16,261.9	

[1] At 31 January the Group acquired 100% of the units in the Challenger Kenedix Japan Trust; refer to Note 34 for further information.

Bank loans

Corporate

The corporate bank facility was fully repaid during the year and was subsequently reduced from $300 million to $100 million. The new facility of $100 million is secured by guarantees in place between members of the Group. A floating interest rate was applied to this facility during the year. There was no amount drawn on the facility at 30 June 2010.

Controlled property trusts – CKT

Total bank loans at balance date were $463.2 million. All loans are denominated in Yen (2010: ¥34.8 billion).

These loans are part of the CKT Japanese property trust, have a mix of fixed and variable terms, are secured by way of first ranking mortgages over the investment properties and they expire in 2010.

Controlled property trusts – CDI

CDI has a multi-option syndicated finance facility with Westpac Banking Corporation Limited (WBC) and Commonwealth Bank of Australia Limited (CBA). The loan facility comprises a non-recourse secured and unsecured component. A portion of the outstanding loan was repaid in the period. The total outstanding facility at 30 June 2010 is $165.5 million (2009: $333.8 million).

In relation to the unsecured component, CDI has not granted security over its properties but provided a number of negative undertakings, including undertaking not to create or allow encumbrance over its properties. The secured component relates to the funding of property acquisitions in France. Security was granted by way of mortgages of shares in, and of debts between, entities established to acquire the French properties.

Other controlled property trusts

Bank loans in the wholly owned unlisted property trusts of $210.6 million (2009: $470.3 million) are secured solely by fixed and floating first mortgages over investment properties.

Repurchase arrangements

The Group entered into repurchase agreements with the Reserve Bank of Australia (RBA) whereby a portfolio of debt securities were sold to the RBA for cash whilst simultaneously agreeing to repurchase the debt securities at a fixed price and fixed date in the future. These arrangements were interest bearing with interest paid on maturity. The maturity date of the repurchased amount outstanding was 15 December 2009 and they were repaid in full on that date.

Non-bank loans

Medium term notes

Challenger Treasury Limited issued $250 million of Australian dollar fixed rate medium term notes on 23 April 2007. The notes are secured by cross guarantees in place between certain Group companies. The notes are fixed at 7% and matured on 23 April 2010. During the period, $175.7 million of the medium term notes were bought back prior to maturity. All notes are now fully repaid.

Controlled property trusts

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

Corporate

The $130 million Net Interest Margin Bond securitised through SPV was repaid in October 2009.

Loan note finance

CLC has entered into a restricted recourse £25 million loan that is secured by investment properties. The fixed rate interest applied will be capitalised and is expected to be repaid together with the principal in 2012 (but no later than 2015).

Subordinated debt issuance – CLC

CLC issued A$400 million of subordinated notes into the US private placement market in November 2007. The notes were issued under an APRA approved Instrument of Issue and count as Approved Subordinated Debt for regulatory capital purposes. The notes are unsecured and will mature in 30 years with a non-call period of 10 years.

CLC issued US$150 million of subordinated notes into the US private placement market in December 2006. These notes were also issued under an APRA approved Instrument of Issue and count as Approved Subordinated Debt for regulatory capital purposes. The notes are unsecured and were issued in two maturities (US$125 million at 10 years with a non-call period of five years; and US$25 million at 20 years with a non-call period of 10 years). A portion of this subordinated debt has a fixed interest rate with the remaining portion being floating.

The proceeds from the issuance of both the November 2007 and the December 2006 notes were made available to Statutory Fund No. 2 of CLC. The repayment obligations and other liabilities of CLC in respect of the principal, interest and other amounts owing with respect to the notes are liabilities of, and referable to, Statutory Fund No. 2.

The notes rank in right of payment either pari passu with, or senior to, all other unsecured and subordinated indebtedness of CLC allocated to Statutory Fund No. 2, except for such indebtedness preferred by operation of bankruptcy laws or similar laws of general application.

Subordinated debt is measured at fair value through profit and loss and adjusted for movements in interest rates, credit spreads and foreign exchange.

	30 June 2010 $M	30 June 2009 $M
19. External unit holders' liabilities		
Total liabilities to external unit holders[1]	1,259.0	–
	1,259.0	–
Current	131.5	–
Non-current	1,127.5	–
	1,259.0	–

[1] The Group established three guaranteed income return trusts during the period. The external unit holder funds for these Trusts are classified as liabilities.

	30 June 2010 $M	30 June 2009 $M
20. Provisions		
Surplus lease provision	16.8	21.0
Employee entitlements (Note 31)	8.2	13.5
Relocation provision	3.6	2.8
Other provisions	13.9	15.6
	42.5	52.9

	Surplus lease provision $M	Employee entitlements $M	Relocation provision $M	Other $M
30 June 2010				
Opening balance	21.0	13.5	2.8	15.6
Arising during the year	2.5	9.8	1.3	3.8
Amounts utilised	(6.7)	(15.1)	(0.5)	(5.5)
Closing balance	16.8	8.2	3.6	13.9
30 June 2009				
Opening balance	15.4	19.1	2.4	14.2
Arising during the year	13.0	6.6	0.4	14.5
Amounts utilised	(7.4)	(12.2)	–	(13.1)
Closing balance	21.0	13.5	2.8	15.6

Surplus lease provision represents the Group's net rental expense obligation on surplus space in leased buildings in Sydney. The Group's obligation on these leases expires in 2015 and 2016 respectively.

Relocation provision represents the Group's net make-good obligations on building leases.

Other provisions include distribution provision for CDI of $10.7 million (2009: $11.9 million) representing the final distribution payable to the non-controlling interest for the period ended 30 June 2010.

	30 June 2010 $M	30 June 2009 $M
21. Life contract liabilities		
Life investment contract liabilities – at fair value	4,096.1	3,964.4
Life insurance contract liabilities – at Margin on Services value	637.0	609.4
Life reinsurance contract liabilities	12.7	–
Life contract liabilities	4,745.8	4,573.8
Reconciliation of movements in life contract liabilities		
Life investment contract liabilities		
Opening balance	3,964.4	3,663.4
New business deposits recognised as an increase in life contract liabilities	933.1	514.0
Withdrawals and payments recognised as a decrease in life contract liabilities	(1,100.3)	(1,138.6)
Transfer under court approved Part 9 scheme of arrangement[1]	–	636.5
Policyholder liability adjustments[2]	91.9	117.6
Cost of policyholder liabilities[3]	207.0	171.5
Other movements	–	(1.0)
Life investment contract liabilities	4,096.1	3,964.4
Life insurance contract liabilities		
Opening balance	609.4	79.7
Withdrawals and payments recognised as a decrease in life contract liabilities	(52.6)	(33.2)
Transfer under court approved Part 9 scheme of arrangement[1]	–	651.7
Policyholder liability adjustments[2]	46.9	(108.0)
Cost of policyholder liabilities[3]	33.3	19.2
Life insurance contract liabilities	637.0	609.4
Life reinsurance contract liabilities		
Opening balance	–	–
Reinsurance contract liability adjustment losses	12.7	–
Life reinsurance contract liabilities	12.7	–
Life contract liabilities	4,745.8	4,573.8

[1] In the prior year, the Group acquired a portfolio of life contracts from the National Mutual Life Insurance Association of Australia Limited (AXA).

[2] See Note 3 *Revenue*.

[3] See Note 4 *Expenses*.

	30 June 2010 $M	30 June 2009 $M
21. Life contract liabilities (continued)		
Life insurance contract disclosures		
Life insurance and reinsurance contract claims and related expenses		
Total life insurance contract claims paid and payable	52.4	33.2
Inwards reinsurance claims	0.2	0.1
Life insurance contract claims expense	52.6	33.3
Less: component recognised as a change in life insurance contract liabilities	(52.6)	(33.3)
Total life insurance contract claims and related expenses	–	–
Life insurance contract operating expenses		
Maintenance expenses – commission	0.4	0.5
Maintenance expenses – other	2.3	2.2
	2.7	2.7
Analysis of life insurance contract liability		
Best estimate liability		
Value of future life insurance contract benefits	605.1	579.8
Value of future expenses	31.9	28.1
Total best estimate liability	637.0	607.9
Value of future profit margins	–	1.5
Life insurance contract liability	637.0	609.4

Assumptions and methodology applied in the valuation of life insurance contract liabilities

Life insurance contract liabilities, and the income statement impact of change in the liability, have been calculated using the Margin on Services (MoS) method in accordance with the requirements of Life Prudential Standard 1.04 *Valuation of Policy Liabilities* (LPS 1.04) under section 114 of the *Life Insurance Act 1995*. LPS 1.04 requires the value of life insurance contracts to be calculated in a manner that allows for the systematic release of planned margins on services as these services are provided to life insurance contract holders.

The Group maintains only one product group of life insurance contracts, individual annuities, and utilises annuity payments as the profit carrier when calculating the value of life insurance contracts under the projection method. Key assumptions used in the calculation of life insurance liabilities are:

Assumption	Basis applied
Discount rate	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.
Maintenance expenses	The assumption is based on budgeted maintenance expenses for the year ending 30 June 2011. These expenses are converted to a per-contract unit cost or percentage of account balance, depending on their nature, based on an expense analysis.
Inflation	The assumption is based on long-term expectations of inflation and is reviewed annually for changes in the market environment. The current assumption is 2.43% for short-term inflation, and 2.53% for long-term (2009: 1.03% short-term inflation and 2.47% for long-term).
Shareholder tax	The corporate tax rate of 30% has been used.
Voluntary discontinuances	No voluntary discontinuances are assumed.
Surrender values	Not applicable as no voluntary discontinuances are assumed.
Mortality	The assumption is based on a review of recent mortality experience for the portfolio. This is adjusted for expected mortality improvements both before the valuation date and after. Expected mortality improvements have been estimated based on observed historic levels of improvement in Australian mortality.

Impact of changes in assumptions

Under MoS, for life insurance contracts valued using the projection method, changes in actuarial assumptions are generally 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 of contracts is in a net loss position (loss recognition), in which case changes in future profit are recognised in the income statement in the period in which they are applied.

Changes in actuarial assumptions do not include market related changes in discount rates such as changes in benchmark market yields caused by changes in investment markets and economic conditions. These are reflected in both life insurance contract liabilities and asset values at the balance date.

Life insurance risk

The Group is exposed to longevity risk on its life insurance liabilities, being the risk that annuitants may live longer than expectations. The Group manages this risk in part by using reinsurance in addition to the regular review of the portfolio to confirm continued survivorship of annuitants receiving income; and regular review of mortality experience to ensure that mortality assumptions remain appropriate.

During the period, CLC took out a life reinsurance contract to cover the longevity risk acquired in the 2009 acquisition of the National Mutual Life Insurance Association of Australia Limited (AXA) annuity book.

Insurance risk sensitivity analysis

The table below discloses the sensitivity of life insurance contract liabilities, shareholder profit after income tax and equity to changes in the key assumptions relating to insurance risk.

	Increase/(decrease) in life insurance contract liabilities				Profit/(loss) impact in the income statement and on equity			
	Gross of reinsurance		Net of reinsurance		Gross of reinsurance		Net of reinsurance	
	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M	30 June 2010 $M	30 June 2009 $M
50% increase in the rate of mortality improvement	53.1	43.4	1.0	42.5	(37.2)	(30.4)	(0.7)	(29.7)
10% increase in maintenance expenses	2.7	0.9	2.7	0.9	(1.9)	(0.6)	(1.9)	(0.6)

Liquidity risk

The following table summarises the undiscounted maturity profile of the Group's life insurance contracts. The analysis is based on undiscounted estimated cash outflows, including interest and principal payments. The undiscounted maturity profile of life investment contracts is disclosed in Note 27.

	1 year or less $M	1-3 years $M	3-5 years $M	>5 years $M	Total undiscounted amount $M
Life insurance contract liabilities					
2010	54.4	108.2	106.1	901.6	1,170.4
2009	54.6	108.7	106.5	928.9	1,198.7

Other life insurance and life investment contract disclosures

	30 June 2010 $M	30 June 2009 $M
Analysis of life contract profit		
Profit attributable to life insurance contracts	45.1	5.9
Profit/(loss) attributable to life investment contracts	257.2	(175.9)
Profit/(loss) arising from difference between actual and assumed experience	302.3	(170.0)
Investment earnings on assets in excess of life contract liabilities	11.1	7.8
Life contract profit/(loss)	313.4	(162.2)

21. Life contract liabilities (continued)

Other life insurance and life investment contract disclosures (continued)

Restrictions on assets

Investments held in the statutory funds of Challenger Life Company Limited can only be used within the restrictions imposed under the Life Insurance Act 1995. The main restrictions are that the assets in a 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 as distributions when solvency and capital adequacy requirements are met.

Investment assets of the life statutory funds comprising cash, equity securities, debt securities, property securities, other financial assets and investment property are held to match investment contract liabilities amounting to $4,096.1 million (2009: $3,964.4 million) and life insurance contract liabilities amounting to $637.0 million (2009: $609.4 million). Investment assets are traded on a regular basis taking into account the movements in liabilities as well as incoming cash flows.

Current/non-current split

There is a fixed settlement date for the majority of life contract liabilities. Approximately $580.0 million (2009: $636.4 million) of life contract liabilities have a contractual maturity within 12 months of the reporting date.

Based on assumptions applied for the 30 June 2010 valuation of life contract liabilities, $789 million of principal payments on fixed term and lifetime business are anticipated for the 12 months ended 30 June 2011.

Actuarial information

Mr A Bofinger FIAA, as the Appointed Actuary of Challenger Life Company Limited, is satisfied as to the accuracy of the data used in the valuations of life contract liabilities in the financial report and in the tables in this note and the solvency ratio in Note 23. The life contract liabilities and solvency ratios have been determined at the reporting date in accordance with the *Life Insurance Act 1995*.

22. Special Purpose Vehicles

Special purpose vehicles (SPV) are entities that fund pools of residential mortgage loans via the issuance of residential mortgage backed securities. All borrowings of these SPV are limited in recourse to the assets of the SPV. The sale of part of the mortgage management division on 30 October 2009 included approximately $4.5 billion of residential mortgages held in the SPV trusts, but a large portion of the existing mortgages were retained by the Group. The Group is not originating any significant new mortgage assets or securitised liabilities but is managing the run-off of the retained portfolio.

Whilst the Group has neither the ownership rights to the underlying mortgages nor any obligation or duty to repay the residential mortgage backed securities, it is deemed to control these entities as a consequence of holding the beneficial interest to the residual income streams. This results in a gross up of assets and liabilities but these have been separately disclosed in the financial report as this presentation is considered to provide a more transparent view of the Group's financial position and results.

Transactions between the SPV and other entities within the Group are eliminated on consolidation. The only net asset impact on consolidation is the recognition of a cash flow hedge reserve. The SPV exposures to interest rate and exchange rate risk are hedged using derivative financial instruments. All derivatives in the SPV are designated as cash flow hedges, thereby protecting the Group's income statement from significant volatility.

The sub-consolidated amounts in respect of SPV, prior to subsequent eliminations of transactions with other entities within the Group, are as follows.

	30 June 2010 $M	30 June 2009 $M
Balance sheet		
Assets		
Cash and cash equivalents	458.1	737.0
Receivables	8,549.6	15,772.0
Total assets	9,007.7	16,509.0
Liabilities		
Payables	183.3	113.4
Derivative liability	6.9	13.7
Interest bearing liabilities	8,824.4	16,395.6
Total liabilities	9,014.6	16,522.7
Net assets	(6.9)	(13.7)
Equity attributable to residual income unit holders		
Cash flow hedge reserve	(6.9)	(13.7)
Total equity attributable to residual income unit holders	(6.9)	(13.7)
Statement of cash flows		
Cash flows from operating activities		
Receipts from customers (inclusive of GST)	776.8	1,441.9
Payments to suppliers and employees (inclusive of GST)	(545.3)	(1,207.9)
Net cash inflow from operating activities	231.5	234.0
Cash flows from investing activities		
Mortgage loans – advanced and purchased	(589.7)	(7,011.6)
Mortgage loans repaid and sold	6,436.9	10,116.7
Net cash inflows from investing activities	5,847.2	3,105.1
Cash flows from financing activities		
Proceeds from borrowings	1,250.2	8,177.8
Repayment of borrowings	(7,537.6)	(11,735.9)
Net cash outflows from financing activities	(6,287.4)	(3,558.1)
Net decrease in cash and cash equivalents	(208.7)	(219.0)
Cash and cash equivalents at the beginning of the year	737.0	956.0
Reclassification to non-cash and cash equivalents – SPV	(70.2)	–
Cash and cash equivalents at the end of the year	458.1	737.0
Reconciliation of reserves		
Cash flow hedge reserve		
Opening balance	(13.7)	13.3
Net gains/(losses) from changes in fair value	6.8	(27.0)
Closing balance	(6.9)	(13.7)

23. Contributed equity

	30 June 2010 No. of shares M	30 June 2010 $M	30 June 2009 No. of shares M	30 June 2009 $M
Shares on issue				
Ordinary shares issued (see table below)	507.1	1,235.6	596.0	1,563.0
LTIP shares treated as treasury shares	(10.0)	(35.1)	(40.7)	(117.5)
CPP Trust shares held in trust and treated as treasury shares	(25.4)	(93.9)	(12.7)	(44.1)
Contributed equity consolidated	471.7	1,106.6	542.6	1,401.4
Movement in shares on issue				
Ordinary shares				
Opening balance	596.0	1,563.0	632.4	1,622.1
Net shares cancelled under share based payment plan	(6.7)	(17.3)	(5.3)	(17.3)
Shares purchased and cancelled under share buy-back	(82.2)	(310.1)	(31.1)	(41.8)
Closing balance	507.1	1,235.6	596.0	1,563.0
LTIP				
Opening balance	40.7	117.5	46.2	135.2
Shares forfeited and cancelled	(6.7)	(17.3)	(5.3)	(17.3)
Shares vested or forfeited and sold to the CPP Trust	(20.5)	(56.1)	–	–
Vested shares released from LTIP plan	(3.5)	(9.0)	(0.2)	(0.4)
Closing balance	10.0	35.1	40.7	117.5
CPP Trust				
Opening balance	12.7	44.1	4.5	24.5
Shares purchased	5.4	20.0	9.9	26.2
Shares transferred from LTIP	20.5	74.7	–	–
Shares released to employees	(13.2)	(44.9)	(1.7)	(6.6)
Closing balance	25.4	93.9	12.7	44.1

	30 June 2010 No. of shares M	30 June 2009 No. of shares M
Ordinary shares issued		
Listed on the ASX	499.6	569.3
Unvested LTIP shares not listed on the ASX	7.5	26.7
Total ordinary shares issued	507.1	596.0

Terms and conditions of shares

Ordinary shares

A holder of an ordinary share is entitled to certain rights, including:

- to receive dividends as declared;
- to be provided with copies of annual reports and other information in respect of the Company;
- to receive notice of, and vote at, meetings of holders of shares, either in person or by proxy;
- after liquidation of the Company, to receive the distribution of the net proceeds of Company assets according to the number of shares registered at termination; and
- to transfer shares and on death, to pass the shares to a surviving joint holder, or by will or otherwise to the holder's estate.

A holder of a share is entitled to one vote on a show of hands and on a poll; each shareholder will have one vote for each fully paid share, determined from the sale of such shares on the ASX on the trading day immediately before the day on which the poll is taken.

Shares issued under Long Term Incentive Plan (LTIP)

The terms and conditions of shares issued under the LTIP are disclosed in Note 31 of the financial report. The shares held under the LTIP are treated as treasury shares and deducted from equity.

Challenger Performance Plan Trust

The Challenger Performance Plan Trust (CPP Trust) holds shares in the Company for allocations made under the Challenger Performance Plan. The CPP Trust is treated as a controlled entity and consolidated. The CPP Trust's shareholding in the Company is disclosed as treasury shares and deducted from equity. Dividends paid from the Company to the CPP Trust are eliminated on consolidation.

Capital risk management

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

Capital risk management involves the management of this risk. The Group manages capital risk management via Capital Management Plans at both the Group level and at the prudentially regulated Challenger Life Company Limited (CLC) level. These Capital Management Plans have an objective of maintaining the financial stability of the Group and CLC whilst ensuring the shareholders earn an appropriate risk adjusted return through the optimisation of the capital structures. The Capital Management Plans are approved by the respective boards and are reviewed at least annually.

Capital Management Plan – Group

At the Group level, the Capital Management Plan aims to maintain an investment grade credit rating and robust capital ratios, in order to support its business objectives and maximise shareholder wealth. The Group believes that maintaining an investment grade rating is the most appropriate target from a capital structure perspective and is essential in order to secure access to capital at a reasonable cost.

Standard & Poor's long-term credit ratings for the Group and CLC as at the balance date are shown below.

There were no changes to either the Group or CLC rating during the financial year. The outlook for both the Group and CLC ratings have been revised upwards to stable (from negative). These revisions in outlook reflect Challenger Group's improved earnings outlook and reduced debt load in addition to the improved financial flexibility and generally more robust economic outlook.

Entity	Ratings agency	Long-term credit rating	Outlook
Group	Standard & Poor's	BBB+	Stable
CLC	Standard & Poor's	A	Stable

23. Contributed equity (continued)

Capital risk management (continued)

Capital Management Plan – Group (continued)

The capital structure of the Group primarily consists of common equity and net recourse debt.

The Group monitors its capital structure on the basis of the gearing ratio which is calculated as:

Net recourse debt

divided by

Net recourse debt plus common equity.

Net recourse debt is calculated as recourse debt less cash and cash equivalents that are available to the Group.

Common equity equates to equity attributable to equity holders per the balance sheet, i.e. the aggregate of contributed equity, reserves, and retained profits less equity attributable to non-controlling interests.

To maintain the preferred investment grade rating, the Capital Management Plan targets a gearing ratio within a range of 20%–30%. The gearing ratio at balance date is shown in the table below and throughout the financial year the gearing ratio did not exceed the Capital Management Plan targets.

	2010 $M	2009 $M
Recourse debt		
Corporate banking facility	–	130.0
Medium term notes	–	206.0
	–	336.0
Less: cash and cash equivalents (available to Group)	(76.1)	(157.1)
Net recourse debt	(76.1)	178.9
Total common equity	1,339.6	1,381.9
Total capital	1,263.5	1,560.8
Net gearing ratio (%)	0%	11.5%

The details of the recourse debt are provided at Note 18. The Group's current dividend target is a payout ratio of approximately 30% of normalised profit after tax (as defined in Note 2). There were no material changes to the Group's Capital Management Plan during the financial year.

Capital Management Plan – CLC

CLC is a life insurance company regulated under the *Life Insurance Act 1995* (the *Life Act*). The *Life Act* imposes minimum statutory capital requirements, as set out in Prudential Standards issued by APRA, on all life insurance companies. At all times during the financial year, CLC complied with these requirements.

Separate and distinct from the Group's Capital Management Plan, CLC's Capital Management Plan integrates the statutory capital and solvency requirements, insurer financial strength rating as assessed by Standard & Poor's, and economic capital requirements. There were no material changes to CLC's Capital Management Plan during the financial year.

CLC's resources available to meet statutory capital requirements at balance date are set out in the table below:

	2010 $M	2009 $M
CLC capital resources		
Shareholder equity	1,123.8	793.4
Subordinated debt	475.1	418.9
Total regulatory capital	1,598.9	1,212.3
Solvency reserve		
Solvency reserve %	40.1	34.9
Coverage of solvency reserve (times)	1.5	1.5

	2010 $M	2009 $M
24. Reserves		
Equity option premium reserve		
Opening balance	125.2	125.1
Amortisation of issue costs	0.1	0.1
Closing balance	125.3	125.2
Share based payments premium reserve		
Opening balance	57.8	34.2
Share based payments for the year	49.7	28.5
Releases from share based payment premium reserve	(27.3)	(4.9)
Closing balance	80.2	57.8
Available-for-sale investment revaluation reserve		
Opening balance	0.5	(2.4)
Revaluation (gain)/loss net of tax taken to reserve	(5.6)	1.7
Impairment loss taken to income statement	4.9	1.2
Closing balance	(0.2)	0.5
Cash flow hedge reserve		
Opening balance	(1.3)	–
Transfer of gain to income statement	–	–
Charged to equity	1.3	(1.3)
Closing balance	–	(1.3)
Cash flow hedge reserve – SPV		
Opening balance	(13.7)	13.3
Charged to equity	6.8	(27.0)
Closing balance	(6.9)	(13.7)
Foreign currency translation reserve		
Opening balance	(0.6)	–
Gain on foreign currency translation	21.8	(0.6)
Loss on hedge of net investment in foreign entities	(16.8)	
Closing balance	4.4	(0.6)
Adjusted controlling interest reserve		
Opening balance	–	–
Discount on increase in holding in controlled entity	8.3	–
Closing balance	8.3	–
Total reserves	211.1	167.9

24. Reserves (continued)

Nature and purpose of reserves

Equity option premium reserve

This reserve represents the valuation assigned to options issued to Consolidated Press Holdings Limited and to Colony Marlin-Holdings LLC.

Shares under option	Grant date	Expiry date	Exercise price	Number
Consolidated Press Holdings Limited[1]	22 Dec 2003	22 Dec 2013	$3.25	60,000,000
Colony Marlin-Holdings LLC[2]	07 Nov 2007	07 Nov 2012	$7.00	57,142,857

[1] Options issued to Consolidated Press Holdings Limited are non-transferable call options and may be exercised at any time within 10 years from their grant date.

[2] Options issued to Colony Marlin-Holdings LLC are non-transferable call options and may be exercised at any time within five years from their grant date.

Share based payments premium reserve

An expense is recognised over the vesting period of share options, performance rights and capped performance rights granted to employees as part of the Challenger Performance Plan and the Long Term Incentive Plan. This expense is based on the valuation of the equity benefits granted at the grant date. When an instrument is granted, and an expense incurred, there is a corresponding increase in the share based payments reserve directly in equity. The total of this reserve is net of any gain or loss realised on the disposal of forfeited shares held within the schemes.

Available-for-sale investment revaluation reserve

This reserve includes the cumulative net change in the fair value of financial assets classified as available-for-sale until the investment is derecognised or sold.

Cash flow hedge reserve

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

Cash flow hedge reserve from SPV

Refer to Note 22.

Foreign currency translation reserve

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

Adjusted controlling interest reserve

This reserve relates to changes arising from movements in the ownership interests in entities already controlled by the Group. This current year figure is driven by changes in the ownership percentages as a result of new capital issued by CDI.

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

	30 June 2010 $M	30 June 2009 $M
25. Retained earnings/(accumulated losses)		
Opening balance	(187.4)	(19.7)
Profit/(loss) attributable to equity holders	282.5	(90.7)
Dividends paid	(73.2)	(77.0)
Retained earnings/(accumulated losses)	21.9	(187.4)
26. Non-controlling interests		
Share of		
Contributed equity	437.9	349.3
Reserves	(6.5)	4.2
Opening retained losses	(62.6)	(49.1)
Profit after tax for the period attributable to non-controlling interests	11.3	3.1
	380.1	307.5

27. Financial risk management

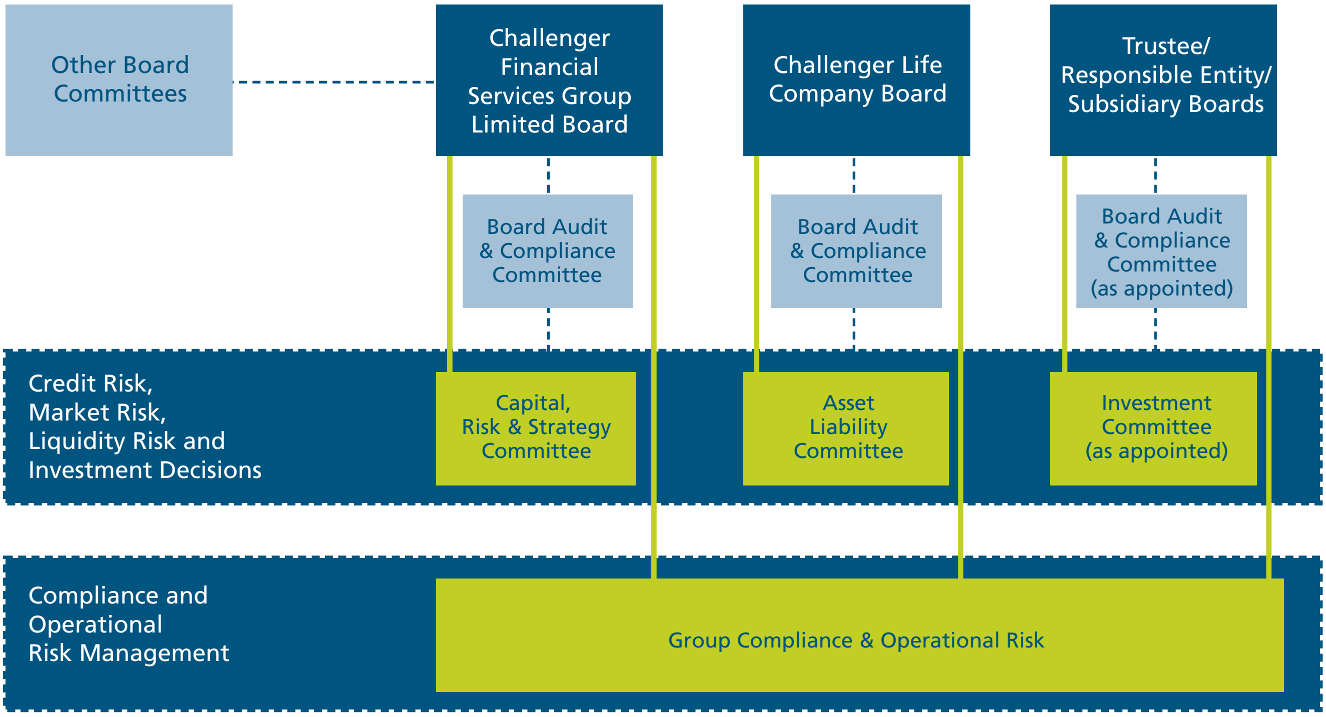
Governance and risk management framework

The Group's activities expose it to a variety of financial risks, these are:

- market risk (including currency risk, interest rate risk, equity price risk and credit spread risk);
- credit default risk; and
- liquidity risk.

The Board of Directors of the Company has the ultimate responsibility for the approval of the Group's financial risk management policies. The Group Capital Risk and Strategy Committee is responsible for monitoring and reporting to the Board on the financial risks that impact the Group. The management of these risks is supported by a comprehensive range of policies. See below for a diagrammatic overview of the risk management framework of the Group.

Governance and risk management framework



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

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial instruments, are disclosed in Note 1.

Risks and mitigation

Derivative financial instruments are used to hedge exposures to fluctuations in foreign exchange rates and interest rates. Instruments used include interest rate futures contracts, forward foreign exchange contracts and cross currency, inflation linked and interest rate swap contracts. Via the utilisation of these and other instruments, the Group aims to reduce these risks to a minimal level.

All derivative financial instruments held within Challenger Life Company Limited legal entity (CLC) are stated at fair value with any gains or losses arising from changes in fair value being taken directly to the income statement for the year.

Other derivatives held by the Group are designated as hedges, being either cash flow, fair value or net investment in foreign operations, in line with the accounting policy in Note 1(xiii).

27. Financial risk management (continued)

Market risk

Market risk is the risk that the fair value or future cash flows from a financial instrument will fluctuate because of changes in market factors. Market risk comprises (amongst others): interest rate risk (due to fluctuations in interest rates); equity price risk (due to fluctuations in market prices); currency risk (due to fluctuations in foreign exchange rates) and credit spread risk (due to changes in credit spreads).

Each of the entities or divisions within the Group is responsible for managing market risks that arise in their own businesses, with oversight from a centralised treasury team. In line with the risk management framework described above, it is the policy of the Group to monitor the policies adopted by all divisions to ensure that the overall risk to the Group is monitored and hedged (if required).

Interest rate risk

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

It is the Group's policy to minimise the impact of interest rate movements on debt servicing capacity, Group profitability, business requirements and company valuation.

The Group targets hedging of between 30% and 70% of drawn net recourse interest bearing liabilities of the corporate segment. The amount of drawn net recourse corporate interest bearing liabilities, and their duration, is determined with reference to the annual budget and the most current forecasts. The Group's strategy is to have no interest rate hedges with duration greater than five years and targets average hedge duration of three years.

CLC's Market Risk Policy is approved by the CLC Board and sets out the relevant risk limits for interest rate exposure. It is CLC's policy to minimise the impact of interest rate movements on its ability to service life contract holders. The management of the risks associated with life investment and life insurance contracts, including interest rate risk, are subject to the prudential requirements of the *Life Insurance Act 1995*. This includes satisfying solvency requirements, which in turn include consideration of how the interest rate sensitivity of assets and liabilities are matched.

Geared property trusts include Challenger Diversified Property Group (CDI) and Challenger Kenedix Japan Trust (CKT). CDI's exposure to interest rate risk arises predominantly from liabilities bearing variable interest rates and interest rate derivatives are taken out to effectively hedge interest rates on a minimum of 60% of expected borrowings over the next two to 10 years. Hedging activity is performed using interest rate swaps.

The Group's policy for managing interest rate exposure in CKT is to hedge interest rate exposure, through fixed interest facilities or interest rate derivatives, to protect greater than 90% of its floating rate borrowings denominated in Japanese Yen from exposure to movements in Japanese interest rates. The contracts require settlement of net interest receivable or payable on a quarterly basis. Currently, 95% of debt is hedged either through fixed interest facilities or interest rate derivatives.

For the Special Purpose Vehicles (SPV) the impact of a rising/falling BBSW benchmark over the Reserve Bank of Australia's target cash rate can have a significant increase/decrease in the cost of funding and therefore on the profit of the trusts. This interest rate risk is mitigated by actively adjusting the interest rate charged to borrowers if a sustained adverse differential to the benchmark is evidenced.

SPV are also exposed to the risks arising from borrowers fixing the rates on their mortgage. This interest rate risk is managed by using a cash flow hedge whereby the fixed rate is swapped for a floating rate for an amount of notes equal to the notional value of the mortgages being fixed.

No other entities within the Group have any significant exposure to interest rate risk.

Interest rate sensitivity

The Group's sensitivity to movements in interest rates in relation to the value of financial assets and liabilities is shown in the table below. It is assumed that the change happens at the balance date and that there are concurrent movements in interest rates and parallel moves in the yield curve. All material underlying exposures and related hedges are included in the analysis.

	Change in variable	Profit/(loss) 30 June 2010 $M	Increase/(decrease) in equity 30 June 2010 $M	Profit/(loss) 30 June 2009 $M	Increase/(decrease) in equity 30 June 2009 $M
CLC	+100bps	11.0	11.0	9.0	9.0
	–100bps	(11.2)	(11.2)	(9.3)	(9.3)
SPV	+100bps	(7.4)	(7.4)	(9.7)	(9.7)
	–100bps	7.4	7.4	9.7	9.7
Total	+100bps	3.6	3.6	(0.7)	(0.7)
	–100bps	(3.8)	(3.8)	0.5	0.5

The impact on profit and equity is post tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis did not change from the previous period. As shown above, 100 basis points (1%) movements in interest rates would have only a small net impact on the Group's financial position as upside risks in CLC and the property trusts largely offset downside risk in the SPV, and vice versa.

Equity price risk

Equity price risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded on the market.

The Group is exposed to equity price risk on its holdings in equity securities and uses derivative financial instruments to manage this risk. It is the Group's policy to hedge the exposure resulting from movements in the value of listed equity portfolio investments. Equity investments regarded as 'operational' or 'strategic' will not be hedged. CLC is required to fair value all equities held to back life contract liabilities. No other entities within the Group have any significant exposure to equity price risk.

Equity price risk sensitivity

The potential impact of movements in the market value of listed and unlisted equities on the Group's income statement and balance sheet is shown in the below sensitivity analysis. This sensitivity analysis has been performed to assess the direct risk of holding equity instruments; therefore any potential indirect impact on fees from the Group's funds management business has been excluded. It is assumed that the relevant change occurs as at the reporting date.

Asset class	Change in variable	Profit/(loss) 30 June 2010 $M	Increase/(decrease) in equity 30 June 2010 $M	Profit/(loss) 30 June 2009 $M	Increase/(decrease) in equity 30 June 2009 $M
Property securities	+10%	10.8	10.8	12.2	12.2
	–10%	(10.8)	(10.8)	(12.2)	(12.2)
Infrastructure investment	+10%	34.4	34.4	41.0	41.0
	–10%	(34.4)	(34.4)	(41.0)	(41.0)
Available-for-sale assets	+10%	–	0.8	–	1.0
	–10%	(0.8)	(0.8)	(1.0)	(1.0)
Other assets	+10%	24.2	24.2	19.6	19.6
	–10%	(24.2)	(24.2)	(19.6)	(19.6)

The impact on profit and equity is post tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis did not change from the previous period. As shown above, a 10% movement in equity prices would have a material impact on the consolidated Group's financial position.

27. Financial risk management (continued)

Market risk (continued)

Currency risk

It is the Group's policy to hedge the exposure of all balance sheet items to movements in foreign exchange rates. Corporate has entered into forward currency derivatives to hedge international investment exposure in US Dollars and British Pounds.

CLC's currency risks arise primarily as a result of investments in the Eurozone, Japan, the United Kingdom and the United States. The currencies giving rise to currency risk are therefore the Euro, British Pound, US Dollar and Japanese Yen. In order to protect against exchange rate movements, CLC has entered into foreign currency derivatives.

CLC manages its exposure to its controlled property trusts with overseas portfolios by designating foreign currency derivatives as hedges of net investments in foreign entities in equity to match its foreign currency translation reserve exposure. The policy is to monitor the hedges closely and rebalance for maturities and underlying changes to the net assets. Effectiveness is monitored on a regular basis to ensure that the hedge remains within 80% to 125% effective and any ineffective portion of the hedge is recognised directly in the income statement.

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

The following table details the Group's net exposure to foreign currency as at the reporting date in Australian dollar equivalent amounts:

	GBP $M	USD $M	Euro $M	JPY $M	Other $M
30 June 2010					
Financial assets	418.7	949.8	662.0	297.1	44.2
Financial liabilities	(0.4)	(164.8)	–	(10.9)	–
Foreign currency contracts and cross currency swaps	(410.8)	(771.6)	(664.0)	(290.4)	(39.4)
Net exposure in Australian dollars	7.5	13.4	(2.0)	(4.2)	4.8
30 June 2009					
Financial assets	343.3	721.1	573.8	5.2	44.2
Financial liabilities	–	(162.9)	(0.1)	–	–
Foreign currency contracts and cross currency swaps	(334.3)	(552.5)	(564.1)	(6.1)	(42.6)
Net exposure in Australian dollars	9.0	5.7	9.6	(0.9)	1.6

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

	Movement in variable against A$	Profit/(loss) 30 June 2010 $M	Increase/(decrease) in equity 30 June 2010 $M	Profit/(loss) 30 June 2009 $M	Increase/(decrease) in equity 30 June 2009 $M
British Pounds (GBP)	+10%	(0.5)	(0.5)	(0.6)	(0.6)
	–10%	0.5	0.5	0.6	0.6
US Dollar (USD)	+10%	(0.9)	(0.9)	(0.4)	(0.4)
	–10%	0.9	0.9	0.4	0.4
Euro (EUR)	+10%	0.1	0.1	(0.6)	(0.6)
	–10%	(0.1)	(0.1)	0.6	0.6
Japanese Yen (JPY)	+10%	0.3	0.3	0.1	0.1
	–10%	(0.3)	(0.3)	(0.1)	(0.1)
Other	+10%	(0.2)	(0.2)	(0.1)	(0.1)
	–10%	0.2	0.2	0.1	0.1

The impact on profit and equity is post tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis did not change from the previous period. As shown above, a 10% movement in exchange rates would have minimal impact on the consolidated Group's financial position.

Credit spread risk

The Group is exposed to movements in credit spreads above the interbank swap curve through its debt securities. As at 30 June 2010, a fifty basis point increase/decrease in credit spreads would result in an unrealised loss/gain in the income statement and equity of $71.5 million (2009: $65.0 million).

Credit default risk

Credit default risk is the risk of loss in value of an asset due to a counterparty failing to discharge an obligation.

The Group's approach to credit management utilises a credit risk framework to ensure that the following principles are adhered to:

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

Each of the divisions is responsible for managing credit risks that arise in their own businesses with oversight from a centralised credit risk management team. It is the policy of the Group to monitor the policies of all divisions to ensure that the risk to the Group is monitored and if necessary hedged.

Credit exposure by credit rating

The Group makes use of external ratings (Standard & Poor's, Fitch, Moody's or another reputable credit rating agency) and will ordinarily adopt a rating no greater than the lowest external rating assigned. Where an external rating is not available, an internal or implied rating will be used. Internal ratings are expressed on the basis of Standard & Poor's rating definitions. All credit exposures are additionally rated internally and this rating is cross referenced to the external ratings in place. Internal credit ratings are assigned by appropriately qualified and experienced credit personnel who are independent from risk originators.

CLC's Credit Policy is approved by the CLC Board and sets out the relevant limits for interest rate exposure to individual counterparties and credit rating band. Exposures are reported regularly to the CLC Asset and Liability Committee.

Within the Funds Management division, a number of controlled entities act as a Responsible Entity (RE) for various managed schemes. These REs aim to ensure that at all times they have an appropriate credit risk management framework in place and that the relevant Boards and senior management are appropriately informed of the entity's credit risks.

The following table provides information regarding the maximum credit risk exposure of the Group in respect of the major classes of financial assets. The maximum credit exposure is deemed to be the carrying value of the asset. The analysis classifies the assets according to internal or external credit ratings. Assets rated investment grade are assets rated BBB- or above (based on Standard & Poor's methodology). Assets rated non-Investment grade are assets rated below BBB-.

27. Financial risk management (continued)

Credit default risk (continued)

Credit exposure by credit rating (continued)

	Equivalent credit rating						
	Investment grade			Non investment grade			
	AAA $M	AA $M	A $M	BBB $M	Non-investment grade $M	Other $M	Total $M
30 June 2010							
Cash and cash equivalents	674.1	–	–	–	–	–	674.1
Cash and cash equivalents – SPV	458.1	–	–	–	–	–	458.1
Receivables	0.2	0.2	0.1	48.4	–	64.1	113.0
Receivables – SPV[1]	7,914.3	496.6	32.5	20.7	2.7	–	8,466.8
Debt securities	1,305.7	762.4	902.5	279.9	816.5	–	4,067.0
Derivative assets	–	178.2	78.4	–	30.5	–	287.1
Total	10,352.4	1,437.4	1,013.5	349.0	849.7	64.1	14,066.1
30 June 2009							
Cash and cash equivalents	1,071.7	–	–	–	–	–	1,071.7
Cash and cash equivalents – SPV	737.0	–	–	–	–	–	737.0
Receivables	0.3	0.3	0.1	39.2	31.3	511.2	582.4
Receivables – SPV	9,338.8	5,839.0	344.2	63.1	59.0	–	15,644.1
Debt securities	1,281.9	274.6	232.8	436.1	657.4	–	2,882.8
Derivative assets	–	88.7	101.7	–	–	1.3	191.7
Total	12,429.7	6,202.6	678.8	538.4	747.7	512.5	21,109.7

[1] SPV receivables are rated by reference to the latest external credit rating assigned to the applicable mortgage backed security issued by that SPV, on the basis that this rating represents a look through assessment of the credit quality of the underlying mortgage assets.

Management of credit default risk concentration

The Group has no significant concentrations of credit risk. The credit quality of all financial instruments is consistently monitored in order to identify any adverse changes in the credit quality.

The below tables give information regarding the carrying value of the Group's financial assets that are neither past due nor impaired, an ageing analysis of those assets that are past due but not impaired and financial assets that are past due and impaired at the balance sheet date.

		Past due but not impaired					
	Neither past due nor impaired $M	0-1 months $M	1-3 months $M	3-6 months $M	Greater than 6 months $M	Past due and impaired $M	Total $M
As at 30 June 2010							
Receivables	97.5	0.7	5.8	5.6	3.4	–	113.0
Receivables – SPV	7,587.2	484.1	200.7	155.1	–	39.7	8,466.8
Total receivables	7,684.7	484.8	206.5	160.7	3.4	39.7	8,579.8
As at 30 June 2009							
Receivables	558.4	–	7.2	6.4	7.7	–	579.7
Receivables – SPV	14,706.6	547.3	291.4	40.0	2.0	59.5	15,646.8
Total receivables	15,265.0	547.3	298.6	46.4	9.7	59.5	16,226.5

The SPV receivables/mortgage loans are funded via a combination of securitised residential mortgage backed securities and warehouse facilities provided via a panel of international and domestic banks. The credit risk of the mortgage loans within the SPV is therefore that of the residential mortgage backed security or the bank warehouse facility providers. As a result, the Group does not bear the credit risks on these loans.

CDI minimises concentration of credit risk in relation to trade receivables by providing leases to a number of different tenants who are considered creditworthy third parties. CKT minimises concentration of credit risk in relation to trade receivables by ensuring no more than 30% of the property portfolio is let by one tenant and providing leases only to tenants who are considered creditworthy third parties. It is CDI and CKT's policy that all customers who wish to trade on credit terms are subject to credit verification procedures.

No other controlled entities have any material credit risk exposure.

Subordinated debt

CLC has subordinated debt liabilities with nominal value of A$400 million and US$150 million. These notes are required to be classified as financial liabilities through profit and loss. The change in fair value recognised in the income statement is $56.2 million (2009: $135.9 million), of which $62.1 million (2009: $176.0 million) was due to credit risk.

CLC has estimated the change in fair value due to credit risk by comparing the carrying value of the instruments to the estimated value using benchmark interest rates at balance date, but assuming credit risk had not been changed.

Collateral held over assets

In the event of a default against any of the mortgages in the SPV, in compliance with the trust deed, the Trustee may exercise the power vested under the applicable law and take possession of the secured property.

It may exercise any power of sale conferred by applicable law as a recovery action against settlement of the outstanding mortgage balance. At all times of possession, the risks and rewards associated with ownership of the property are held by the Trustee on behalf of the residential mortgage backed security holder or warehouse facility provider.

Liquidity risk

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

The Group aims to ensure that it has sufficient liquidity to meet its obligations on a short-term and medium-term basis. In setting the level of sufficient liquidity, the Group considers new business activities in addition to current contracted obligations. It considers: minimum cash requirements; collateral and margin call buffers; Australian Financial Services (AFS) Licence requirements; cash flow forecasts; associated reporting requirements; other liquidity risks; and contingency plans.

The basis of the approach to liquidity management is on targeting sufficient liquidity to meet the regulatory guidelines set out in ASIC Policy Statement 166 for holders of an AFS Licence. AFS Licence holders make a reasonable estimate of cash flows over at least the next three months to demonstrate whether surplus capital will exceed either:

- 20% of the greater of cash outflows for the forecast three month average (equivalent to 18 days' outgoings); or
- cash outflow for the most recent financial year, adjusted to produce a three month average.

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

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

27. Financial risk management (continued)

Liquidity risk (continued)

Undiscounted maturity profile	1 year or less $M	1-3 years $M	3-5 years $M	> 5 years $M	Total contractual amount $M
30 June 2010					
Payables	134.3	116.3	–	–	250.6
Payables – SPV	66.6	–	–	–	66.6
Interest bearing liabilities	200.4	679.5	126.8	1,529.6	2,536.3
Interest bearing liabilities – SPV	117.6	–	–	11,338.0	11,455.6
External unit holders' liabilities	131.5	1,127.5			1,259.0
Life investment contract liabilities	967.4	1,492.3	896.5	1,579.1	4,935.3
Derivative financial liabilities	59.9	7.7	1.0	18.5	87.1
Total financial liabilities	1,677.7	3,423.3	1,024.3	14,465.2	20,590.5
30 June 2009					
Payables	327.1	213.3	125.8	75.5	741.7
Payables – SPV	6.7	–	–	–	6.7
Interest bearing liabilities	844.2	324.4	141.6	1,774.8	3,085.0
Interest bearing liabilities – SPV	5,331.9	–	–	13,454.3	18,786.2
Life investment contract liabilities	1,065.3	1,274.3	858.6	1,793.5	4,991.7
Derivative financial liabilities	24.8	14.3	8.3	80.0	127.4
Total financial liabilities	7,600.0	1,826.3	1,134.3	17,178.1	27,738.7

Fair value determination and classification

Fair value reflects the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The majority of the Group's financial instruments are held in the life insurance statutory funds of CLC and, as a result, are required by Australian accounting standards to be designated at fair value through profit and loss wherever possible.

All other financial instruments in the Group, with the exception of the SPV balances carried at amortised cost listed below, are either designated at fair value through profit and loss at initial recognition, or the carrying value materially approximates fair value.

	Carrying value 30 June 2010 $M	Fair value 30 June 2009 $M	Carrying value 30 June 2010 $M	Fair value 30 June 2009 $M
Difference between amortised cost and fair value				
Receivables – SPV	8,466.8	8,696.2	15,644.1	16,145.9
Interest bearing liabilities – SPV	8,637.0	8,838.7	16,310.2	16,310.2

The fair value of investments that are actively traded in organised financial markets are determined by reference to quoted market bid prices at the close of business on each reporting date. Where no such market exists, valuation models that utilise both internal and external inputs are used to determine fair value. Financial instruments are split into the following categories depending on the level of observable inputs into the models used to determine fair value:

Level 1 unadjusted quoted prices in active markets.

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

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

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

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

The table below summarises those financial instruments for which a fair value has been determined and the level of observable inputs into the valuation methodology.

30 June 2010	Level 1 $M	Level 2 $M	Level 3 $M	Total $M
Derivative assets	–	287.1	–	287.1
Debt securities	–	2,930.8	1,136.2	4,067.0
Equity securities	169.6	8.9	160.6	339.1
Infrastructure investments	177.7	0.3	311.6	489.6
Property securities	9.4	–	145.1	154.5
Available-for-sale assets	11.8	–	–	11.8
Assets	368.5	3,227.1	1,753.5	5,349.1
Derivative liabilities	–	223.2	–	223.2
Interest bearing liabilities	–	–	475.1	475.1
External unit holders' liabilities	–	1,259.0	–	1,259.0
Investment contract liabilities	–	117.0	3,979.0	4,096.0
Liabilities	–	1,599.2	4,454.1	6,053.3

The Group derivative financial instruments are 'over the counter' so, whilst they are not exchange traded, there is a market observable price. All of the listed debt and government/semi-government securities have prices determined by a market but are not actively traded. Externally rated unlisted debt is valued by applying market observable credit spreads on similar assets with an equivalent credit rating. Both are therefore level 2. Internally rated debt is level 3 as the determination of an equivalent credit rating is a significant non-observable input.

Unlisted equity, infrastructure and property securities are valued using either cash flow forecasts discounted using the applicable yield curve, earning-multiple valuations or, for managed funds, the net assets of the trust per the most recent financial report.

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

Level 3 reconciliation

The following table shows a reconciliation of the movement in the fair value of financial instruments categorised within level 3 over the year to 30 June 2010.

Level 3	Assets $M	Liabilities $M
Opening balance	1,571.5	4,278.6
Total gains and losses	30.1	321.2
Purchases	500.9	872.2
Sales	(349.0)	(1,017.9)
Closing balance	1,753.5	4,454.1
Total gains for the period included in the income statement for assets and liabilities held at 30 June 2010	14.4	283.3

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	30 June 2010 $M	Positive impact $M	Negative impact $M	Reasonable change in non-observable input
Debt securities	1,136.2	32.2	(27.9)	Primarily credit spreads
Interest bearing liabilities	(475.1)	(23.8)	23.8	Primarily credit spreads
Net debt	661.1	8.4	(4.1)	
Equity, infrastructure, property assets	617.3	28.8	(28.6)	Primarily discount rate on cash flow models
Investment contract liabilities	(3,979.0)	6.2	(13.7)	Primarily expense assumptions
Total level 3	(2,700.6)	43.4	(46.4)	

28. Derivative financial instruments

The Group holds the following derivatives valued at fair value through profit and loss:

	Notional/ principal contract value $M	Net fair value assets $M	Net fair value liabilities $M
Interest rate swaps			
30 June 2010			
Less than 1 year	440.6	1.8	(2.1)
1-3 years	1,326.2	19.8	(11.6)
3-5 years	715.6	35.8	(5.8)
Greater than 5 years	1,988.2	108.5	(37.7)
	4,470.6	165.9	(57.2)
30 June 2009			
Less than 1 year	403.0	4.3	(0.7)
1-3 years	895.3	23.3	(6.6)
3-5 years	732.4	29.2	(2.9)
Greater than 5 years	2,155.7	85.8	(31.3)
	4,186.4	142.6	(41.5)
Inflation linked swaps			
30 June 2010			
1-3 years	590.0	5.3	(2.8)
	590.0	5.3	(2.8)
30 June 2009			
	–	–	–
Futures contracts			
30 June 2010			
Less than 1 year	511.3	–	(4.6)
	511.3	–	(4.6)
30 June 2009			
Less than 1 year	1,006.3	–	(1.0)
	1,006.3	–	(1.0)
Forward currency contracts			
30 June 2010			
Less than 1 year	1,642.2	45.5	(99.2)
1-3 years	109.7	3.4	(3.2)
3-5 years	132.5	6.6	(10.0)
	1,884.4	55.5	(112.4)
30 June 2009			
Less than 1 year	2,698.6	19.4	(17.9)
3-5 years	14.7	0.1	–
	2,713.3	19.5	(17.9)

	Notional/ principal contract value $M	Net fair value assets $M	Net fair value liabilities $M
Cross currency swaps			
30 June 2010			
Less than 1 year	201.0	11.1	(9.9)
1-3 years	491.9	23.8	(14.6)
3-5 years	333.3	23.0	(13.2)
Greater than 5 years	9.3	0.9	–
	1,035.5	58.8	(37.7)
30 June 2009			
Less than 1 year	33.7	–	(18.4)
1-3 years	55.6	–	(8.2)
3-5 years	40.4	–	(18.2)
Greater than 5 years	44.0	–	(14.6)
	173.7	–	(59.4)

Derivatives designated as hedges of net investment in foreign currency operations

As described in Note 1(xiii), the Group hedges its exposure to accounting gains and losses arising from translation of foreign controlled entities from their functional currency into the Group's presentation currency on consolidation. At 30 June 2010, a loss of $16.8 million (2009: $nil) was recognised in equity for the hedging of exposure to the net investment in foreign operations arising from the above derivatives.

Hedging instruments designated as cash flow hedges

As described in Note 1(xiii), the Group applies hedge accounting when it can demonstrate that the value movements, or part thereof, of a derivative financial instrument hedge the known outcome of a future transaction. Once hedge effectiveness is demonstrated, the effective portion of the value change is taken to equity.

As described in Note 27, SPV are exposed to the risks arising from borrowers fixing the rates on their mortgage. Future contracts are used to hedge the interest rate risk between variable rate loans, which generally reprice with changes in official interest rates, and issued mortgage backed securities which reprice with changes in 30 day and 90 day BBSW. Cross currency swaps are used to hedge foreign denominated securities and any potential impact of adverse changes in the foreign exchange rate on these securities.

At each financial reporting date an examination is carried out to ensure the hedge is still effective, i.e. the critical terms still match. All hedges in place are with high grade credit counterparties.

At 30 June 2010 a loss of $6.9 million (2009: $27.0 million) was recognised in equity for the derivative financial instruments designated as cash flow hedges detailed below. There was no income statement impact of any ineffective portions during either the current or prior period.

28. Derivative financial instruments (continued)

Hedging instruments designated as cash flow hedges (continued)

	Notional/ Principal contract value $M	Net fair value assets $M	Net fair value liabilities $M
Interest rate swaps			
30 June 2010			
Less than 1 year	263.9	–	(1.8)
1-3 years	279.4	–	(6.6)
3-5 years	47.6	0.4	–
Greater than 5 years	1.1	–	(0.1)
	592.0	0.4	(8.5)
30 June 2009			
Less than 1 year	450.8	1.1	(6.5)
1-3 years	848.1	–	(21.4)
3-5 years	355.0	–	(15.5)
	1,653.9	1.1	(43.4)
Futures contracts			
30 June 2010	–	–	–
30 June 2009			
Less than 1 year	12,246.0	–	(1.3)
	12,246.0	–	(1.3)
Cross currency swaps			
30 June 2010			
Greater than 5 years	5,014.8	1.2	–
	5,014.8	1.2	–
30 June 2009			
Greater than 5 years	5,354.7	28.5	–
	5,354.7	28.5	–

29. Commitments

Operating leases

Group as lessee

The Group has entered into commercial operating leases for the rental of properties where it is not in the best interests of the Group to purchase these properties. These leases have an average life of between one and 10 years with renewal terms included in the contracts. Renewals are at the specific option of the entity that holds the lease.

Surplus lease space under non-cancellable operating leases has been subleased, and the revenue from these leases calculated on a straight-line basis. The leases have a remaining life of up to six years with renewal terms included in the contract. Renewals are at the specific option of the entity that holds the lease.

A surplus lease provision has been created representing the Group's net rental expense obligation. Refer to Note 20 for details.

Group as lessor

All investment properties owned by the Group are leased to third parties under operating leases at 30 June 2010 and measured at fair value as the properties are held to earn rentals. Lease terms vary between tenants and some leases include percentage rental payments based on sales volume.

Capital expenditure commitments

Amounts payable in relation to capital expenditure commitments contracted for at the reporting date but not recognised as liabilities. This includes amounts in relation to the investment property portfolio.

Remuneration commitments

Amounts disclosed as remuneration commitments include commitments arising from contracts (retention bonus, termination payment, interest) of key management personnel referred to in the Remuneration Report that are not recognised as liabilities at balance date.

	30 June 2010 $M	30 June 2009 $M
Commitments		
Non-cancellable operating leases – Group as lessee	87.3	118.6
Capital expenditure	46.4	50.7
Remuneration	4.5	8.2
Non-cancellable operating leases – Group as lessor	(1,899.3)	(879.9)
Operating leases – Group as lessee		
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Not later than 1 year	17.9	20.5
Later than 1 year but not later than 2 years	17.6	20.9
Later than 2 years but not later than 5 years	40.4	51.1
Later than 5 years	11.4	26.1
	87.3	118.6
Capital expenditure commitments		
Commitments payable in relation to capital expenditure commitments contracted for at the reporting date but not recognised as liabilities:		
Not later than 1 year	18.0	16.4
Later than 1 year but not later than 5 years	18.7	17.0
Later than 5 years	9.7	17.3
	46.4	50.7
Remuneration commitments		
Commitments payable for salaries and other remuneration under long-term employment contracts in existence at the reporting date but not recognised as liabilities:		
Not later than 1 year	4.0	4.7
Later than 1 year but not later than 5 years	0.5	3.5
	4.5	8.2
Operating leases – Group as lessor		
Commitments for minimum lease rentals in relation to non-cancellable operating leases are receivable as follows:		
Not later than 1 year	(193.9)	(138.5)
Later than 1 year but not later than 2 years	(190.9)	(122.3)
Later than 2 years but not later than 5 years	(511.0)	(304.3)
Later than 5 years	(1,003.5)	(314.8)
Total minimum lease receivables	(1,899.3)	(879.9)

30. Related parties

Subsidiaries

Transactions with related parties in the wholly owned group

Transactions with related parties (except otherwise disclosed) are conducted on an arm's length basis under normal commercial terms and conditions.

Ultimate parent entity

Challenger Financial Services Group Limited is the ultimate parent entity.

Other related parties

During the year, there were transactions between the Group and Challenger specialised funds (Challenger Infrastructure Fund, Challenger Kenedix Japan Trust Fund, Challenger Wine Trust and Challenger Diversified Property Group) for the provision of investment management, transaction advisory and other professional services. From 31 December 2008, the Group has held a controlling interest in the Challenger Diversified Property Group (CDI). Any transactions between the Group and CDI that occurred after the date of control are eliminated on consolidation. Transactions were also entered into between the Group and associate entities (refer to Note 37) for the provision of distribution and administration services.

The Group earned fee income during the year of $23.7 million (2009: $47.5 million) from transactions entered into with specialised funds and associates. Transactions are conducted on an arm's length basis under normal commercial terms and conditions.

Directors and Key Executives

The Directors and Key Executives of Challenger Financial Services Group Limited at any time during the financial year were as follows:

Directors

Current

Peter Polson	Chairman
Thomas Barrack Jr.	Non-Executive Director
Graham Cubbin	Non-Executive Director
Russell Hooper	Non-Executive Director
Leon Zwier	Non-Executive Director

Past

Ashok Jacob	Non-Executive Director (resigned 8 September 2009)
James Packer	Non-Executive Director (resigned 8 September 2009)
Tetsuya Wada	Non-Executive Director (resigned 17 September 2009)

Executive Director

Current

Dominic Stevens	Chief Executive Officer and Managing Director.

Key Executives

Current

Rob Adams	Joint Chief Executive, Funds Management
Brian Benari	Group Chief Financial Officer/Group Chief Operating Officer
Richard Howes	Chief Executive, Life
Paul Rogan	Executive General Manager, Capital Risk & Strategy
Robert Woods	Joint Chief Executive, Funds Management

Past

Drew Hall	Chief Executive, Mortgage Management (Mr Hall left the Group when the Mortgage Management business was sold on 30 October 2009).

Loans to Directors and Key Executives

There were no loans made to Directors and specified Key Executives as at 30 June 2010 (2009: nil).

Director and Key Executive compensation for the year ended 30 June 2010

	Year	Short-term employee benefits $	Post employment $	Share based payments $	Other long-term benefits $	Total $
Directors	2010	782,080	13,256	–	–	795,336
	2009	812,035	13,745	–	–	825,780
Executive Director	2010	2,090,795	14,461	2,906,881	1,615,143	6,627,280
	2009	921,068	13,745	2,526,913	614,202	4,075,928
Key Executives	2010	6,574,430	77,125	15,122,575	5,497,795	27,271,925
	2009	3,477,830	76,743	9,540,024	2,025,850	15,120,447
Total	2010	9,447,305	104,842	18,029,456	7,112,938	34,694,541
	2009	5,210,933	104,233	12,066,937	2,640,052	20,022,155

Director and Key Executive shareholdings in Challenger Financial Services Group Limited

Details of the Directors' and Key Executives' and their affiliates' shareholdings in Challenger Financial Services Group Limited as at 30 June 2010 are set out below. All shareholdings were acquired at arm's length prices.

2010 Number of shares	Held at 1 July 2009	Acquired on vesting of long-term incentive awards	Other changes	Held at 30 June 2010
Directors				
P Polson	99,500	–	12,500	112,000
T Barrack Jr.	–	–	–	–
G Cubbin	177,702	–	–	177,702
R Hooper	160,000	–	–	160,000
L Zwier	–	–	2,360	2,360
A Jacob[1]	20,000	–	(20,000)	–
J Packer[2]	122,788,278	–	(122,788,278)	–
T Wada[1]	–	–	–	–
Executive Director				
D Stevens	7,782,655	666,432	(5,800,000)	2,649,087
Key Executives				
R Adams	2,029,947	483,155	(1,983,155)	529,947
B Benari	5,231,562	1,156,848	(3,388,410)	3,000,000
R Howes	4,101,821	1,057,011	(1,658,832)	3,500,000
P Rogan	3,553,541	639,957	(473,498)	3,720,000
R Woods	5,013,800	1,068,990	(2,982,790)	3,100,000
D Hall[3]	565,989	1,412,771	(1,978,760)	–
Total	151,524,795	6,485,164	(141,058,863)	16,951,096

[1] A Jacob and T Wada resigned as Directors during the year so holding disclosure is removed in the 'Other changes' column.

[2] J Packer sold his shares in the Challenger Group prior to resigning as a Director.

[3] D Hall ceased to be a Key Executive during the period due to the sale of the Mortgage Management division on 30 October 2009. Previously held shares are reported in the 'Other changes' column.

30. Related parties (continued)

Director and Key Executive shareholdings in Challenger Financial Services Group Limited (continued)

2009 Number of shares	Held at 1 July 2008	Acquired on vesting of long-term incentive awards	Other changes	Held at 30 June 2009
Directors				
P Polson	99,500	–	–	99,500
T Barrack Jr.	–	–	–	–
G Cubbin	177,702	–	–	177,702
R Hooper	160,000	–	–	160,000
A Jacob	20,000	–	–	20,000
J Packer	122,788,278	–	–	122,788,278
T Tanaka[1]	–	–	–	–
T Wada[2]	–	–	–	–
L Zwier	–	–	–	–
Executive Directors				
D Stevens[3]	7,500,000	82,655	200,000	7,782,655
M Tilley[4]	11,072,999	–	(11,072,999)	–
Key Executives				
R Adams	2,000,000	29,947	–	2,029,947
B Benari	5,118,491	73,071	40,000	5,231,562
D Hall[5]	–	5,989	560,000	565,989
R Howes	4,000,000	101,821	–	4,101,821
P Rogan	3,520,000	33,541	–	3,553,541
R Woods	4,900,000	113,800	–	5,013,800
Total	161,356,970	440,824	(10,272,999)	151,524,795

[1] T Tanaka resigned as a Director during 2009.
[2] T Wada was appointed as a Director during 2009.
[3] D Stevens was formerly a Key Executive and became Executive Director during 2009.
[4] M Tilley retired as Executive Director during 2009 so his holding is removed in the 'Other changes' column.
[5] D Hall became a Key Executive during 2009. Previously held shares are reported in the 'Other changes' column.

Director and Key Executive options

Details of Directors' and Key Executives' and their affiliates' options over shares in the Company as at 30 June 2010 are set out below.

2010 Number of options	Held at 1 July 2009	Granted as remuneration	Exercised	Forfeited	Other changes	Held at 30 June 2010
Executive Director						
D Stevens	7,400,000	–	(300,000)	–	–	7,100,000
Key Executives						
R Adams	1,700,000	700,000	(400,000)	–	–	2,000,000
B Benari	3,400,000	1,750,000	(800,000)	–	–	4,350,000
R Howes	3,400,000	1,750,000	(800,000)	–	–	4,350,000
P Rogan	1,500,000	700,000	(500,000)	–	–	1,700,000
R Woods	3,400,000	1,750,000	(800,000)	–	–	4,350,000
D Hall[1]	1,350,000	1,000,000	(900,000)	(450,000)	(1,000,000)	–
Total	22,150,000	7,650,000	(4,500,000)	(450,000)	(1,000,000)	23,850,000

[1] D Hall ceased to be a Key Executive during the period. Previously held options are reported in the 'Other changes' column.

Terms and conditions of option allocations for the year ended 30 June 2010

2010 Options	Granted number	Grant date	Exercise price $	Fair value at grant $	Start vesting date	Last vesting date
Executive Director						
D Stevens	–	–	–	–	–	–
Key Executives						
R Adams	233,334	23-Oct-09	2.33	1.56	15-Sep-10	30-Sep-10
	233,333	23-Oct-09	2.33	1.62	15-Sep-11	30-Sep-11
	233,333	23-Oct-09	2.33	1.58	15-Sep-12	30-Sep-12
B Benari	583,334	23-Oct-09	2.33	1.56	15-Sep-10	30-Sep-10
	583,333	23-Oct-09	2.33	1.62	15-Sep-11	30-Sep-11
	583,333	23-Oct-09	2.33	1.58	15-Sep-12	30-Sep-12
R Howes	583,334	23-Oct-09	2.33	1.56	15-Sep-10	30-Sep-10
	583,333	23-Oct-09	2.33	1.62	15-Sep-11	30-Sep-11
	583,333	23-Oct-09	2.33	1.58	15-Sep-12	30-Sep-12
P Rogan	233,334	23-Oct-09	2.33	1.56	15-Sep-10	30-Sep-10
	233,333	23-Oct-09	2.33	1.62	15-Sep-11	30-Sep-11
	233,333	23-Oct-09	2.33	1.58	15-Sep-12	30-Sep-12
R Woods	583,334	23-Oct-09	2.33	1.56	15-Sep-10	30-Sep-10
	583,333	23-Oct-09	2.33	1.62	15-Sep-11	30-Sep-11
	583,333	23-Oct-09	2.33	1.58	15-Sep-12	30-Sep-12
D Hall	333,334	23-Oct-09	2.33	1.56	15-Sep-10	30-Sep-10
	333,333	23-Oct-09	2.33	1.62	15-Sep-11	30-Sep-11
	333,333	23-Oct-09	2.33	1.58	15-Sep-12	30-Sep-12

Director and Key Executive performance rights

Details of Directors' and Key Executives' and their affiliates' performance rights for shares in the Company as at 30 June 2010 are set out below.

2010 Number of performance rights	Held at 1 July 2009	Granted as remuneration	Exercised	Held at 30 June 2010
Executive Director				
D Stevens	768,801	515,818	(366,432)	918,187
Key Executives				
R Adams	166,311	128,954	(83,155)	212,110
B Benari	749,635	429,848	(356,848)	822,635
R Howes	549,961	128,954	(257,011)	421,904
P Rogan	288,898	171,939	(139,957)	320,880
R Woods	573,919	128,954	(268,990)	433,883
D Hall[1]	82,923	429,848	(512,771)	–
Total	3,180,448	1,934,315	(1,985,164)	3,129,599

[1] D Hall ceased to be a Key Executive during the period.

Performance rights are exercised on vesting and shares are transferred out of the plan to the individual. Vested shares are transferred into the name of the Key Executive but remain subject to trading restrictions.

30. Related parties (continued)

Terms and conditions of performance rights allocations for the year ended 30 June 2010

2010 Performance rights	Granted number	Grant date	Exercise price $	Fair value at grant $	Start vesting date	Last vesting date
Executive Director						
D Stevens	257,909	23-Oct-09	2.33	3.68	15-Sep-10	15-Sep-10
	257,909	23-Oct-09	2.33	3.56	15-Sep-11	15-Sep-11
Key Executives						
R Adams	64,477	23-Oct-09	2.33	3.68	15-Sep-10	15-Sep-10
	64,477	23-Oct-09	2.33	3.56	15-Sep-11	15-Sep-11
B Benari	214,924	23-Oct-09	2.33	3.68	15-Sep-10	15-Sep-10
	214,924	23-Oct-09	2.33	3.56	15-Sep-11	15-Sep-11
R Howes	64,477	23-Oct-09	2.33	3.68	15-Sep-10	15-Sep-10
	64,477	23-Oct-09	2.33	3.56	15-Sep-11	15-Sep-11
P Rogan	85,970	23-Oct-09	2.33	3.68	15-Sep-10	15-Sep-10
	85,969	23-Oct-09	2.33	3.56	15-Sep-11	15-Sep-11
R Woods	64,477	23-Oct-09	2.33	3.68	15-Sep-10	15-Sep-10
	64,477	23-Oct-09	2.33	3.56	15-Sep-11	15-Sep-11
D Hall	214,924	23-Oct-09	2.33	3.68	15-Sep-10	15-Sep-10
	214,924	23-Oct-09	2.33	3.56	15-Sep-11	15-Sep-11

Director and Key Executive capped performance rights

Details of Directors' and Key Executives' and their affiliates' capped performance rights for shares in the Company as at 30 June 2010 are set out below.

2010 Number of capped performance rights	Held at 1 July 2009	Other changes	Held at 30 June 2010
Key Executives			
R Adams	285,714	–	285,714
B Benari	571,428	–	571,428
R Howes	571,428	–	571,428
P Rogan	285,714	–	285,714
R Woods	571,428	–	571,428
D Hall[1]	285,714	(285,714)	–
Total	2,571,426	(285,714)	2,285,712

[1] D Hall ceased to be a Key Executive during the period. Previously held capped performance rights are included in the 'Other changes' column.

Terms and conditions of capped performance rights allocations for the year ended 30 June 2010

There were no allocations in this plan during the year.

Director and Key Executive participation in deferred loan scheme

Details of Directors' and Key Executives' and their affiliates' participation in the deferred loan scheme for shares in the Company as at 30 June 2010 are set out below.

2010 Shares held under deferred loan scheme	Held at 1 July 2009	Other changes	Held at 30 June 2010
Key Executive			
P Rogan	2,000,000	–	2,000,000
Total	2,000,000	–	2,000,000

31. Employee entitlements

	30 June 2010 $M	30 June 2009 $M
Employee entitlements provision	8.2	13.5

Employees of the Group at balance date totalled 460. The number fell from 837 at 30 June 2009 as a result of the sale of the Mortgage Management business.

Challenger Performance Plan

The Challenger Performance Plan (CPP) is a flexible plan that provides for the award of either options or performance rights with awards being satisfied from either the issue of new shares or on-market acquisition. A two-tiered approach provides optimal flexibility and ensures that the equity based reward instrument being applied addresses the particular needs of the individual. Non-Executive Directors are not eligible to participate in the plan. The key features of the plan are as follows:

Performance share rights (PSR)

This instrument is a performance right which converts into a fully paid share in the Company at the end of the vesting period. The core purpose of PSR is the retention of key employees and its features encourage long-term sustainable results, aligning the interests of key employees with those of the Company's shareholders.

The vesting period is typically two years. Performance rights are converted to ordinary fully paid shares upon vesting.

Options

Under the CPP, Key Executives receive options to purchase shares in the Company at an exercise price set at the prevailing market price at the time of the grant. The options become exercisable at the end of a vesting period, subject to the achievement of performance conditions based on shareholder returns. The core purpose of these options is to directly align the interests of Key Executives with shareholders.

The vesting period is flexible but typically over three years from date of grant. Options must generally be exercised within 90 days of them vesting.

PSR and options (whether vested or unvested) will lapse if the participant acts fraudulently, dishonestly or if they materially breach their obligations (either under the CPP or their contract of employment), unless the Board determines otherwise.

PSR and options will lapse if a participant's employment terminates before the vesting date due to resignation or dismissal, unless the Board determines otherwise. If a participant's role becomes redundant, Board discretion will apply.

Capped performance rights

The CPP issued restricted capped performance rights on 22 December 2008. These capped rights, which convert into fully paid shares in the Company, vest on 15 September 2010 subject to the achievement of certain performance conditions. The performance conditions are continued employment with the Group at the time of vesting and a share price performance condition.

If the five day volume-weighted average price (VWAP) of the Company's share price is less than $1.50 at the vesting date there is no benefit to the participant. If the five day VWAP is $3.50 or greater at the vesting date the participant receives 100% of the benefit. There is a pro-rata grant of the benefit if the five day VWAP is between $1.50 and $3.50. There is no exercise price payable by the participants.

31. Employee entitlements (continued)

Performance rights

The following table sets out the details of the share performance rights granted under the Challenger Performance Plan during 2010 and movements on previous issues:

Grant date	Latest date for exercise[1]	Reference price	Fair value at grant	Outstanding at 1 July 2009	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2010[1]
06 Mar 07	01 Oct 09	4.67	4.40	75,000	–	(75,000)	–	–
14 Sep 07	15 Sep 09	5.57	5.38	971,754	–	(969,958)	(1,796)	–
14 Sep 07	15 Sep 10	5.57	5.24	972,567	–	(218,697)	(9,963)	743,907
14 Sep 07	15 Sep 10	5.57	5.24	821,233	–	(105,519)	(30,545)	685,169
15 Sep 08	15 Sep 09	2.82	2.52	2,642,214	–	(2,639,332)	(2,882)	–
15 Sep 08	15 Sep 10	2.82	2.39	2,642,269	–	(631,153)	(25,996)	1,985,120
01 Oct 08	15 Sep 09	2.39	2.25	14,185	–	(14,185)	–	–
01 Oct 08	15 Sep 10	2.39	2.12	14,190	–	(14,190)	–	–
23 Oct 09	15 Sep 10	2.33	3.68	–	1,588,887	(400,812)	(300)	1,187,775
23 Oct 09	15 Sep 11	2.33	3.56	–	1,588,860	(393,388)	–	1,195,472
Total				8,153,412	3,177,747	(5,462,234)	(71,482)	5,797,443

[1] At the date of vesting performance rights are transferred to the individual and released from the Challenger Performance Plan Trust.

Options

The following table sets out the details of the share options granted under the Challenger Performance Plan during 2010 and movements on previous issues.

Grant date	Latest date for vesting	Exercise price $	Fair value at grant $	Outstanding at 1 July 2009	Granted during the year	Exercised during the year	Expired during the year	Outstanding at 30 June 2010
27 Feb 07	01 Feb 11	4.00	1.06[1]	6,550,000	–	(250,000)	(250,000)	6,050,000
14 Sep 07	14 Sep 11	5.57	1.28[1]	3,700,000	–	–	(1,125,000)	2,575,000
28 Sep 07	28 Sep 09	5.57	1.04[1]	666,666	–	–	(666,666)	–
28 Sep 07	28 Sep 10	5.57	1.30[1]	666,666	–	–	–	666,666
28 Sep 07	28 Sep 11	5.57	1.56[1]	666,668	–	–	–	666,668
31 Mar 08	31 Mar 12	2.14	0.33[1]	250,000	–	–	(250,000)	–
30 Jun 08	30 Aug 09	2.20	0.19	2,300,000	–	(2,300,000)	–	–
30 Jun 08	30 Aug 10	2.20	0.27	2,300,000	–	(200,000)	–	2,100,000
30 Jun 08	30 Aug 11	2.20	0.32	2,300,000	–	(200,000)	–	2,100,000
22 Dec 08	22 Dec 09	1.34	0.46	4,200,000	–	(4,200,000)	–	–
22 Dec 08	22 Dec 10	1.34	0.52	4,200,000	–	(450,000)	(233,000)	3,517,000
22 Dec 08	22 Dec 11	1.34	0.57	4,200,000	–	(450,000)	(245,009)	3,504,991
09 Mar 09	22 Dec 09	1.13	0.18	66,667	–	(66,667)	–	–
09 Mar 09	22 Dec 10	1.13	0.22	66,667	–	–	–	66,667
09 Mar 09	22 Dec 11	1.13	0.22	66,666	–	–	–	66,666
30 Jun 09	30 Aug 10	2.29	0.56	116,667	–	–	–	116,667
30 Jun 09	30 Aug 11	2.29	0.65	116,667	–	–	–	116,667
30 Jun 09	30 Aug 12	2.29	0.68	116,666	–	–	–	116,666
23 Oct 09	30 Sep 10	2.33	1.56	–	4,855,019	–	–	4,855,019
23 Oct 09	30 Sep 11	2.33	1.62	–	4,854,995	–	–	4,854,995
23 Oct 09	30 Sep 12	2.33	1.58	–	4,854,995	–	–	4,854,995
CEO options								
27 Nov 08	24 Aug 11	2.36	0.24	5,500,000	–	–	–	5,500,000
Total				38,050,000	14,565,009	(8,116,667)	(2,769,675)	41,728,667

[1] The valuation method has changed from EPS to TSR.

Capped rights

The following table sets out the details of the capped performance rights issued under the Challenger Performance Plan during 2010.

Grant date	Latest date for vesting	Vesting price $	Fair value at grant $	Outstanding at 1 July 2009	Granted during the year	Exercised during the year	Expired during the year	Outstanding at 30 June 2010
22 Dec 08	15 Sep 10	1.50-3.50	0.532	3,857,137	–	–	–	3,857,137

All options and performance rights have been externally valued. The options are valued by a Monte Carlo simulation model using the TSR share price hurdles, or a binomial option pricing model for the options with the EPS hurdle. A Black-Scholes model is used to value the performance rights. Key inputs into the valuation models are as follows:

Plan	Grant date 23-Oct-09 Rights[1]	23-Oct-09 Options[1]
Dividend yield (%)	3.6	3.6
Risk-free rate (%)	4.22 – 4.60	4.22 – 4.98
Volatility (%)[2]	n/a	40 – 60
Valuation ($)	3.56 – 3.68	n/a
TSR valuation ($)	n/a	1.56 – 1.62
EPS valuation ($)	n/a	1.56 – 1.62

[1] Staggered vesting applies to this grant, valuation given is average value.

[2] Forecast volatility rate implied from historic trend.

Long Term Incentive Plan

The Long Term Incentive Plan (LTIP) was a share scheme provided by way of a limited recourse loan. The LTIP was suspended in 2006 with the final award being made on 15 September 2006.

Under this plan, shares vest over a five year period, subject to the achievement of a 15% compound Total Shareholder Return (TSR) performance hurdle. If the hurdle is not satisfied at a relevant anniversary test date no awards vest.

Loans over vested shares must be repaid before shares are released, with the maximum term of the loan being six years. For the majority of participants (including those participants who received grants in FY07), subject to the hurdle being met, 20% of the shares vest at the end of years two, three and four, with the remaining 40% of shares vesting at the end of year five. Unreleased participating shares are forfeited upon the resignation of participants.

Dividends received on shares that have been issued under the LTIP must be paid to the Company as interest on the associated non-recourse loans. All grants of shares during the period were issued and placed on trust on behalf of the employee. Details of the movement and fair value of employee shares remaining under the LTIP are detailed in the following table:

Grant date	On issue at 1 July 2009	Issue price	Fair value at grant date	Vested	Forfeited	Balance at 30 June 2010
23-Feb-04	8,120,000	2.65	0.41	(7,640,000)	(480,000)	–
01-Apr-04	40,000	2.65	0.38	(40,000)	–	–
23-Dec-04	600,000	2.65	0.19	–	(600,000)	–
15-Sep-04	2,190,000	2.24	0.28	–	(2,190,000)	–
15-Mar-05	580,000	3.19	0.42	–	(580,000)	–
26-Apr-05	1,440,000	3.20	0.41	–	(1,440,000)	–
15-Sep-05	3,320,000	3.77	0.51	–	(240,000)	3,080,000
19-Dec-05	1,800,000	2.65	1.32	–	(1,800,000)	–
15-Mar-06	3,150,000	3.67	0.50	–	(200,000)	2,950,000
15-Sep-06	1,500,000	3.55	0.54	–	–	1,500,000
Total	22,740,000			(7,680,000)	(7,530,000)	7,530,000

31. Employee entitlements (continued)

Deferred Loan Plan

A small number of employees had outstanding future commitments under the LTIP at the time it was suspended. In lieu of a number of those commitments, an arrangement was entered into with Deutsche Bank AG to provide the individual with a loan over a similar number of shares as their prior LTIP commitment.

The Group is responsible for meeting the interest payable on the loan over its term, net of any dividends paid on the shares. Shares vest progressively over four years, commencing at the end of year 2, subject to continued employment with Challenger. Shares are forfeited in the event that the employment condition is not satisfied. In certain special circumstances (such as death, total and permanent disablement and redundancy) individuals may be entitled to retain their unvested shares if they fully discharge the outstanding loan amount.

The loans are limited in their recourse to the Group and the Challenger Performance Plan Trust has the option of taking ownership of the shares and using them to satisfy other share awards in the event of forfeiture by the executive.

Cash LTIP

Prior to corporatisation, certain executives were entitled to incentive payments under a cash based shadow scheme. All cash LTIP was forfeit in 2009 as the target share price was not believed likely to be achieved by the testing date. This amount was reinstated and paid in 2010 when the share price had recovered at the testing date.

Other short-term employee benefits

Challenger pays interest on loans taken out by certain Key Executives to acquire Challenger shares on market. The loans are fully secured against the underlying shares and are not margin loans. Challenger has no exposure in relation to the loan principal advanced to the Key Executives by the third party for the purposes of acquiring the shares. In the Board's view, this arrangement when considered with the Key Executive's other long-term incentive arrangements provides significant alignment with shareholders' interests.

32. Reconciliation of profit to operating cash flow

Reconciliation of profit after income tax to net cash flows from operating activities:

	30 June 2010 $M	30 June 2009 $M
Profit /(loss) after tax	282.5	(90.7)
Adjustments for:		
(Profit)/loss on sale of investments	(278.2)	147.2
Net unrealised (losses)/profits on investments	(74.5)	235.9
Profit from non-controlling interests	11.3	3.1
Share of associates' net profit	(3.7)	(3.1)
Amortisation and depreciation	45.9	95.4
Employee share based payments	31.5	26.9
Impairment loss on financial assets available-for-sale	4.9	1.2
Change in life contract liabilities – revenue	138.8	9.6
Change in life contract liabilities – acquisitions and maintenance expenses	240.3	190.6
Change in life reinsurance contract liability	12.7	–
Gain on annuity book transfer	–	(30.8)
Change in assets and liabilities, net of effects from purchase of controlled entity:		
Decrease/(increase) in receivables	47.7	(238.6)
Decrease in other assets	72.4	17.2
Increase/(decrease) in payables	(80.9)	165.0
Decrease in provisions and employee benefits	(9.7)	(15.2)
Decrease in policy liabilities	(222.6)	(657.8)
Increase/(decrease) in tax assets/liabilities	10.7	(74.9)
Net cash inflow from operating income	229.1	(219.0)

33. Remuneration of auditor

	30 June 2010 $'000	30 June 2009 $'000
Amounts received or due and receivable by Ernst & Young for:		
Audit of full year and half year review of the financial report of the Group	1,388.0	1,687.0
Other audit services – audit and review of trusts and funds	502.0	932.0
Other services in relation to the Group		
Taxation services	421.0	236.0
Due diligence services	246.0	34.0
Other assurance services	475.0	504.0
	3,032.0	3,393.0

Auditor's remuneration for the Group is paid by Challenger Group Services Limited, an entity within the Group.

34. Significant transactions and business combinations

New guaranteed index return annuity trusts

The Harris Global Sovereign Bond Trust was established in December 2009. The Group has a wholesale mandate governing the operation of this entity that locks in 100% of its funding for a three year period. This lock-in period effectively places the balance of the risks related to the performance of the Trust with the Group, resulting in deemed control and, as a result, it is consolidated.

The Balloon Inflation Linked Bond Trust is an existing Trust that became a controlled entity from December 2009 due to a change in the wholesale mandate that materially increased the locked-in funding in the Trust.

The Mercury Term Trust is a new Trust established on 30 June 2010. It has 100% of its funding locked-in for periods of two and three years. This lock-in period places the balance of the risks related to the performance of the Trust with the Group, requiring the Company to consolidate the Trust from June 2010.

The balance sheets of these newly consolidated Trusts at 30 June 2010 is as follows:

	Carrying amount $M	Fair value $M
Cash and cash equivalents	100.7	100.7
Receivables	8.1	8.1
Debt securities	1,170.2	1,170.2
Derivative assets	4.4	4.4
External unit holder liabilities	(1,259.0)	(1,259.0)
Derivative liabilities	(24.4)	(24.4)
Net assets	–	–

A profit of $7.8 million was recorded for the Trusts in the period from consolidation to 30 June 2010.

34. Significant transactions and business combinations (continued)

CKT

On 31 January, the Group acquired 100% of the Challenger Kenedix Property Trust (CKT). The acquired operation contributed revenues of $16.6 million and a net loss after tax of $22.6 million from 1 February to 30 June 2010. If the transfer had occurred on 1 July 2009, consolidated revenue and consolidated profit after tax for the year ended 30 June 2010 would have increased by $40.1 million and $45.4 million respectively.

A discount on acquisition has arisen from the Group's assessment of the fair value of the acquired entity's identifiable assets and liabilities and the cost of acquisition, and has been recognised in the Group's profit in the period.

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

	$M
Cash and other assets	160.3
Total purchase consideration	160.3
Less: fair value of net identifiable assets acquired	(272.7)
Discount on acquisition	(112.4)

The balance sheet of CKT at acquisition date is as follows:

	Acquiree's carrying amount $M	Fair value $M
Assets		
Cash	39.4	39.4
Properties	684.2	684.2
Deferred tax assets	4.1	4.1
Other assets	33.4	33.4
Total assets	761.1	761.1
Liabilities		
Payables	(46.0)	(46.0)
Provisions	(6.1)	(6.1)
Interest bearing liabilities	(415.7)	(415.7)
Derivative liabilities	(19.1)	(19.1)
Property debt	(1.5)	(1.5)
Total liabilities	(488.4)	(488.4)
Net assets	272.7	272.7

Credit Suisse Investments Australia Limited

The acquisition of the Credit Suisse (CS) entities was completed on 31 May 2010. The transaction resulted in the purchase of $1.7 billion of funds under management within 11 managed trusts and two mandates.

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

	$M
Cash and other assets	16.6
Total purchase consideration	16.6
Less: fair value of net identifiable assets acquired	5.5
Goodwill on acquisition	11.1

35. Discontinued operations

Discontinued operations

On 30 October 2009, the Group sold its mortgage distribution business to National Australia Bank Limited (NAB) for a consideration of $383 million. In addition to the mortgage distribution legal entities, NAB acquired $4.5 billion of residential mortgages held in warehouses and 17% of the listed mortgage origination company, Homeloans Limited.

The Group continues to own 23% of Homeloans Limited at 30 June 2010.

Details of operations disposed

The results and earnings per share impact of the disposal of the mortgage distribution business are presented below:

	Period ended 30 October 2009 $M	Year ended 30 June 2009 $M
Revenue	119.4	299.2
Expenses	(108.7)	(273.0)
Finance costs	–	(1.6)
Share of net profits of associates	0.8	0.5
Profit before income tax	11.5	25.2
Tax expense	(2.2)	(8.4)
Profit after income tax on discontinued operations	9.3	16.7
Loss on disposal after income tax	(1.3)	–
Profit from discontinued operations after income tax	8.0	16.7

Earnings per share – cents per share	30 Oct 2009 cents	30 June 2009 cents
– Basic from discontinued operations	1.5	3.0
– Diluted from discontinued operations	1.5	3.0

Assets and liabilities and cash flow information of disposed entities

The major classes of assets and liabilities of the disposed entities are:

	As at 30 October 2009 $M	As at 30 June 2009 $M
Assets		
Cash	20.0	0.2
Receivables	645.9	452.7
Deferred tax assets	94.9	112.0
Goodwill	190.2	188.7
Other assets	2.5	0.2
Investment in associate	10.8	10.8
Total assets	964.3	764.6
Liabilities		
Payables	571.7	387.9
Provisions	7.7	1.8
Current tax liabilities	1.2	–
Total liabilities	580.6	389.7
Net assets	383.7	374.9

35. Discontinued operations (continued)

Assets and liabilities and cash flow information of disposed entities (continued)

The net cash flows of the mortgage distribution business for the period prior to disposal are as follows:

	Period ended 30 October 2009 $M	Year ended 30 June 2009 $M
Operating cash flows	11.4	18.2
Investing cash flows	(38.0)	(72.0)
Net cash inflow	(26.6)	(53.8)

	$M
Loss on sale	
Cash	382.8
Associated costs	(9.9)
Total disposal consideration	372.9
Less: net assets disposed	(383.7)
Loss on disposal before income tax	(10.8)
Income tax benefit	9.5
Loss on disposal after income tax	(1.3)
Net cash inflow on disposal	
Consideration	382.8
Less: cash and cash equivalents disposed of	(20.0)
Net cash inflow on disposal	362.8

36. Investments in controlled entities

Controlled entities

Name of entity	Country of incorporation	Class of shares	Equity holding 2010 %	Equity holding 2009 %
417 St Kilda Road Melbourne Trust B	Australia	Ordinary	100	100
417 St. Kilda Road Holding Trust A	Australia	Ordinary	100	100
417 St. Kilda Road Trust	Australia	Ordinary	50	50
Allfine Holdings Pty Limited	Australia	Ordinary	100	100
Allfine Property Trust No.1	Australia	Ordinary	100	100
Balloon Inflation Linked Bond Trust[2]	Australia	Ordinary	–	–
Belconnen Property Trust	Australia	Ordinary	100	100
Bluezen Property Trust No.1	Australia	Ordinary	100	100
Bluezen Pty Limited	Australia	Ordinary	100	100
CDPG Australia Pty Limited	Australia	Ordinary	100	100
Cescade Pty Limited	Australia	Ordinary	100	100
CFSG Holdings No.2 Victoria Pty Limited	Australia	Ordinary	100	100
Challenger Australian Listed Property Holding Trust	Australia	Ordinary	100	100
Challenger Boutique (GFI) Holdings Pty Limited	Australia	Ordinary	100	100
Challenger Boutique Ardea Holdings Pty Limited	Australia	Ordinary	100	100
Challenger Boutique Bentham Holdings Pty Ltd	Australia	Ordinary	100	–
Challenger Boutique Holdings Pty Ltd	Australia	Ordinary	100	100
Challenger Boutique Merlon Holdings Pty Ltd	Australia	Ordinary	100	–
Challenger Boutique Wavestone Holdings Pty Limited	Australia	Ordinary	100	100
Challenger Broker Support Services Pty Ltd	Australia	Ordinary	–	100
Challenger Capital Markets Ltd	Australia	Ordinary	100	100
Challenger CKT Holding Trust	Australia	Ordinary	100	100
Challenger Commercial Lending Limited	Australia	Ordinary	100	100
Challenger Credit Alpha Fund	Australia	Ordinary	–	100
Challenger Credit Relative Value Trust	Australia	Ordinary	–	100
Challenger Diversified Properties Group	Australia	Ordinary	47	43
Challenger European Property Holding Trust	Australia	Ordinary	100	100
Challenger European Property Trust	Australia	Ordinary	100	100
Challenger Ferndale Trust	Australia	Ordinary	100	100
Challenger Financial Services Group	Australia	Ordinary	100	100
Challenger FM Nominees Pty Limited (formerly Custom Choice Managed Investments Limited)	Australia	Ordinary	100	100
Challenger Funds Management Holdings Pty Limited (formerly Challenger Wealth Management Pty Limited)	Australia	Ordinary	100	100
Challenger German Property Trust	Australia	Ordinary	100	100
Challenger GIF Trust	Australia	Ordinary	100	100
Challenger Global Infrastructure Fund	Australia	Ordinary	100	100
Challenger Group Holdings Limited	Australia	Ordinary	100	100
Challenger Group Pty Limited	Australia	Ordinary	100	100
Challenger Group Services (UK) Limited	Australia	Ordinary	100	100
Challenger Group Services Pty Limited	Australia	Ordinary	100	100
Challenger Guernsey Trust	Australia	Ordinary	100	100
Challenger Holding Kft	Hungary	Ordinary	100	100
Challenger Home Loan Corporation Pty Limited (formerly Interstar Home Loan Corporation Pty Limited)	Australia	Ordinary	100	100
Challenger Howard Property Trust for 417 St. Kilda Road	Australia	Ordinary	100	100
Challenger Hungary International Capital Investment & Management Limited	Hungary	Ordinary	100	100
Challenger Infrastructure Unit Holding Trust	Australia	Ordinary	100	100
Challenger Infrastructure Unit Trust	Australia	Ordinary	100	100
Challenger Inventory Finance Servicing Pty Limited	Australia	Ordinary	100	100
Challenger Jersey i3 Limited	Jersey	Ordinary	100	100
Challenger Kenedix Japan Trust	Australia	Ordinary	100	5
Challenger LBC Terminals Australia Pty Limited	Australia	Ordinary	100	100
Challenger Life Company Holdings Pty Limited (formerly Challenger Life Pty Limited)	Australia	Ordinary	100	100

36. Investments in controlled entities (continued)

Controlled entities (continued)

Name of entity	Country of incorporation	Class of shares	Equity holding 2010 %	Equity holding 2009 %
Challenger Life Company Limited (formerly Challenger Life No.2 Limited)	Australia	Ordinary	100	100
Challenger Life Holdings Pty Limited	Australia	Ordinary	100	100
Challenger Life Nominees No. 2 Limited (formerly Challenger Property Funds Management Limited)	Australia	Ordinary	100	100
Challenger Life Nominees Pty Limited (formerly Challenger Property Nominees Pty Ltd)	Australia	Ordinary	100	100
Challenger Life Offshore Investment Limited	Australia	Ordinary	100	–
Challenger Limited (formerly Challenger Hedging Limited)	Australia	Ordinary	100	100
Challenger Listed Investments Limited	Australia	Ordinary	100	100
Challenger Luxembourg Holding No.1A S.a.r.l.	Luxembourg	Ordinary	100	100
Challenger Luxembourg Holding No.1B S.a.r.l.	Luxembourg	Ordinary	100	100
Challenger Luxembourg Holding No.2 S.a.r.l.	Luxembourg	Ordinary	100	100
Challenger Managed Investments (International) Pty Limited	Australia	Ordinary	100	100
Challenger Managed Investments Limited	Australia	Ordinary	100	–
Challenger Management Services (UK) Limited	UK	Ordinary	100	100
Challenger Management Services Limited	Australia	Ordinary	100	100
Challenger Margin Lending Pty Limited	Australia	Ordinary	100	100
Challenger MEIF Holding Trust	Australia	Ordinary	100	100
Challenger MEIF Trust	Australia	Ordinary	100	100
Challenger Millennium NPL Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-1C Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-1E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-3 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2002-1G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2002-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-1G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-3G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-4 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-5G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-1E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-2G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-3P Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-4E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-5 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2005-1G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2005-2L Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2005-3E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2006-1 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2006-2G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2006-3L Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2006-4H Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2007-1E Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2007-2L Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2008-1 Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2008-2 Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2009-1 Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse A Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse B Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse B1 Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse B2R Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse C Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse F Trust	Australia	Ordinary	100	100

Name of entity	Country of incorporation	Class of shares	Equity holding 2010 %	Equity holding 2009 %
Challenger Millennium Warehouse G Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse H Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse J Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse JP Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse N Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse R Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse S Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse U Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse V Trust	Australia	Ordinary	100	100
Challenger Mortgage Management NZ Limited	New Zealand	Ordinary	100	100
Challenger Mortgage Management Pty Limited	Australia	Ordinary	100	100
Challenger Mortgage Pty Ltd (formerly Interstar Mortgage Management Pty Ltd)[1]	Australia	Ordinary	–	100
Challenger Non-Conforming Finance Management Pty Limited (formerly Interstar Non-Conforming Finance Management Pty Limited)[1]	Australia	Ordinary	–	100
Challenger Non-Conforming Finance Pty Limited	Australia	Ordinary	100	100
Challenger Non-conforming Mortgage Trust	Australia	Ordinary	100	–
Challenger Non-performing Mortgage Trust	Australia	Ordinary	100	–
Challenger North of England Gas Holding Trust	Australia	Ordinary	100	100
Challenger North of England Gas Trust	Australia	Ordinary	100	100
Challenger NZ Millennium Series 2004-A Trust	New Zealand	Ordinary	100	100
Challenger NZ Millennium Series 2007-AP Trust	New Zealand	Ordinary	100	100
Challenger NZ Millennium Warehouse W Trust	New Zealand	Ordinary	100	100
Challenger Originator Finance Pty Limited	Australia	Ordinary	100	100
Challenger Property Asset Management Pty Limited	Australia	Ordinary	100	100
Challenger Property Income Trust	Australia	Ordinary	100	100
Challenger Property Trust No. 18	Australia	Ordinary	100	100
Challenger Property Trust No. 19	Australia	Ordinary	100	100
Challenger Property Trust No. 25	Australia	Ordinary	100	100
Challenger Property Trust No. 27	Australia	Ordinary	100	100
Challenger Property Trust No. 28	Australia	Ordinary	100	100
Challenger Property Trust No. 29	Australia	Ordinary	100	100
Challenger Property Trust No. 30	Australia	Ordinary	100	100
Challenger Property Trust No. 31	Australia	Ordinary	100	100
Challenger Property Trust No. 32	Australia	Ordinary	100	100
Challenger Property Trust No. 33	Australia	Ordinary	100	100
Challenger Property Trust No. 34	Australia	Ordinary	100	100
Challenger Property Trust No. 35	Australia	Ordinary	100	100
Challenger Property Trust No. 36	Australia	Ordinary	100	100
Challenger Retirement Services Pty Limited	Australia	Ordinary	100	100
Challenger Seattle Trust	Australia	Ordinary	100	100
Challenger Securities (International) Pty Limited (formerly Interstar Securities (International) Pty Limited)[1]	Australia	Ordinary	100	100
Challenger Securities (NZ) Pty Limited	Australia	Ordinary	100	100
Challenger Securitisation Management Pty Limited	Australia	Ordinary	100	100
Challenger SkyBridge (Capital II) Investment LLP	Jersey	Ordinary	100	100
Challenger SkyBridge (Fund LP) Limited	Jersey	Ordinary	100	100
Challenger Skybridge (Fund) Holding Company Pty Limited	Australia	Ordinary	100	100
Challenger Skybridge (Group) Holding Company Pty Limited	Australia	Ordinary	100	100
Challenger Skybridge (Hastings) Holdings Company Pty Limited	Australia	Ordinary	100	100
Challenger South Monaco LLC (US)	United States	Ordinary	–	100
Challenger Special Servicing Pty Limited	Australia	Ordinary	100	100
Challenger Specialised Finance Unit Trust	Australia	Ordinary	–	100
Challenger Strategic Capital Pty Limited	Australia	Ordinary	100	100
Challenger Strategic Property Partners 1 Fund	Australia	Ordinary	100	100
Challenger Structured Credit UK Trust	Australia	Ordinary	100	100
Challenger Superannuation Pty Limited	Australia	Ordinary	100	100

36. Investments in controlled entities (continued)

Controlled entities (continued)

Name of entity	Country of incorporation	Class of shares	Equity holding 2010 %	Equity holding 2009 %
Interstar Titanium Series 2004-1 Trust	Australia	Ordinary	100	100
Interstar Titanium Series 2005-1 Trust	Australia	Ordinary	100	100
Interstar Titanium Series 2006-1 Trust	Australia	Ordinary	100	100
Challenger Towers Holding Trust	Australia	Ordinary	100	100
Challenger Towers Trust	Australia	Ordinary	100	100
Challenger Treasury Limited	Australia	Ordinary	100	100
Challenger UK Tank Storage Holding Trust	Australia	Ordinary	100	100
Challenger UK Tank Storage Limited	UK	Ordinary	100	100
Challenger UK Terminals Limited	Jersey	Ordinary	100	100
Challenger US Infrastructure Holdings Pty Limited	Australia	Ordinary	100	100
Challenger USPF II Trust	Australia	Ordinary	100	100
Challenger Wales and the West Gas Holding Trust	Australia	Ordinary	100	100
Challenger Wales and the West Gas Trust	Australia	Ordinary	100	100
Challenger Welcome Break Limited	Jersey	Ordinary	100	100
Challenger Welcome Break Trust	Australia	Ordinary	100	100
Challenger Wholesale Finance Holdings Pty Ltd (formerly Interstar Finance Holdings Pty Ltd)	Australia	Ordinary	100	100
Chapel Street Air Rights Property Trust	Australia	Ordinary	100	100
Choice Lend Pty Limited	Australia	Ordinary	–	100
CLC Commercial Mortgages Trust	Australia	Ordinary	100	100
CLC Leveraged Loan Fund	Australia	Ordinary	100	100
CLC Liquidity Trust	Australia	Ordinary	100	100
CMM NIM Trust No 1	Australia	Ordinary	100	100
CMM NIM Trust No 2	Australia	Ordinary	100	100
CMM NIM Trust No 3	Australia	Ordinary	100	100
CMM NIM Trust No 4	Australia	Ordinary	100	100
CMM NIM Trust No 5	Australia	Ordinary	100	100
CMM NIM Trust No 6	Australia	Ordinary	100	100
CMM NIM Trust No 7	Australia	Ordinary	100	100
CMM NIM Trust No 8	Australia	Ordinary	100	100
CMM NIM Trust No 9	Australia	Ordinary	100	100
CMS (UK) Pty Limited	UK	Ordinary	100	100
County Court Property Trust	Australia	Ordinary	100	100
CPHIC Investments Pty Limited	Australia	Ordinary	100	100
CSF Australia Trust 1	Australia	Ordinary	–	100
CSF Australia Trust 2	Australia	Ordinary	–	100
CSF Holding Trust	Australia	Ordinary	–	100
CSF Specialised Finance LLC	Australia	Ordinary	–	100
CSPP1 Broadbeach Pty Limited	Australia	Ordinary	100	100
CSPP1 Investment Company 1 Pty Limited	Australia	Ordinary	100	100
CSPP1 Maitland Pty Limited	Australia	Ordinary	100	100
CSPP1 Mavis Court Pty Limited	Australia	Ordinary	100	100
Discovery House Trust	Australia	Ordinary	100	100
Domestic Credit Trust	Australia	Ordinary	–	100
EMIF Holdings Pty Limited	Australia	Ordinary	100	100
Encap Funds Management Pty Limited	Australia	Ordinary	100	100
Endowment Warrants Limited	Australia	Ordinary	100	100
Epping No.1 Trust	Australia	Ordinary	100	100
Epping No.2 Trust	Australia	Ordinary	100	100
Fintrack Members Pty Limited	Australia	Ordinary	–	100
Five Oceans Global Equity Extension Fund	Australia	Ordinary	95	–
Five Oceans World Fund	Australia	Ordinary	55	–
FXF Holdings Pty Limited	Australia	Ordinary	100	100

Name of entity	Country of incorporation	Class of shares	Equity holding 2010 %	Equity holding 2009 %
Goodman Fielder – North Ryde Property Trust	Australia	Ordinary	100	100
Harris Global Sovereign Bond Trust[2]	Australia	Ordinary	–	–
Hayes Park Property Trust	Australia	Ordinary	100	100
Heidelberg – Waterloo and Bowen Hills Property Trust	Australia	Ordinary	100	100
Hotel Investments Trust	Australia	Ordinary	100	100
Inexus Australian Holding Company Pty Limited	Australia	Ordinary	100	100
Interstar NZ Millennium Series 2004-A	New Zealand	Ordinary	100	–
Maitland Unit Trust	Australia	Ordinary	100	100
Mavis Court Development Co Pty Ltd	Australia	Ordinary	80	80
Mawbury Pty Limited	Australia	Ordinary	100	100
Mercury Cash Managed Trust[2]	Australia	Ordinary	–	–
Mercury Term Managed Trust[2]	Australia	Ordinary	–	–
Mortgage Support Services Pty Limited	Australia	Ordinary	–	100
MSS MF Pty Limited	Australia	Ordinary	–	100
MSS MFA Pty Limited	Australia	Ordinary	–	100
Pennley Pty Limited	Australia	Ordinary	–	100
Plan Australia Financial Services Pty Limited	Australia	Ordinary	–	100
Plan Australia Operations Pty Limited	Australia	Ordinary	–	100
Plan Australia Pty Limited	Australia	Ordinary	–	100
Plan Connect Pty Limited	Australia	Ordinary	100	100
Plan Group Holdings Pty Limited	Australia	Ordinary	–	100
Plan Group Nominees Pty Limited	Australia	Ordinary	–	100
Plan Lending Pty Limited	Australia	Ordinary	–	100
Plan NZ Limited	New Zealand	Ordinary	–	100
Plan Technologies Pty Limited	Australia	Ordinary	–	100
Professional Lenders Association Network of Australia Pty Limited	Australia	Ordinary	–	100
Professional Lenders Association Network of New Zealand Limited	New Zealand	Ordinary	–	100
Rendezvous Hotels Flinders Street Trust	Australia	Ordinary	100	100
Riverside Trust No.1	Australia	Ordinary	100	100
Riverside Trust No.2	Australia	Ordinary	100	100
Sabrand Limited	Cyprus	Ordinary	100	100
Senator House Property Trust	Australia	Ordinary	100	100
Southern Water Holding Trust	Australia	Ordinary	–	100
Talavera Herring Unit Trust	Australia	Ordinary	50	50
Talaverra Herring Pty Limited	Australia	Ordinary	100	100
The Liberty Group Consortium Pty Limited	Australia	Ordinary	100	100
TLG Holding Unit Trust	Australia	Ordinary	100	100
TLG Services Pty Limited	Australia	Ordinary	100	100
TLG Unit Trust	Australia	Ordinary	100	100
TLGH Pty Limited	Australia	Ordinary	100	100
TMA C Warehouse C Trust	Australia	Ordinary	100	100
TRE Data Centre Trust	Australia	Ordinary	100	–
TRE Data Centres Canberra Pty Ltd	Australia	Ordinary	100	–
Village Property Trust	Australia	Ordinary	100	100
Waterford County Pty Limited	Australia	Ordinary	67	67
Wavestone Aust Equity Long/Short Fund	Australia	Ordinary	69	–
Westwind Finance Plc	Ireland	Equity	100	100
Wetherill Park Property Trust	Australia	Ordinary	100	100
Women in Mortgage Business Network Pty Limited	Australia	Ordinary	100	100
Wyetree Asset Management Limited (UK) (formerly Challenger Structured Credit Management Limited (UK))	UK	Ordinary	85	85
ZCM Australia Asset Holdings Limited	Bermuda	Ordinary	100	100

1 These entities were deregistered on 09/05/10.

2 These Trusts are consolidated due to the risks borne by the Company as opposed to the % equity holding.

36. Investments in controlled entities (continued)

Assignment of warrants business

In an agreement dated 30 April 2004, the Group entered into a Deed of Assignment with Westpac Banking Corporation (WBC) whereby, all legal and beneficial rights, title and interests in respect of the following assets and liabilities were assigned to WBC.

	30 June 2010 $M	30 June 2009 $M
Shares in listed corporations held in relation to endowment warrants	38.4	44.8
Dividends receivable	–	0.3
Warrant liability	(38.4)	(45.1)
	–	–

37. Investments in associates

Name of company	Principal activity	Country of incorporation	2010 %	2009 %	30 June 2010 $M	30 June 2009 $M
Challenger MBK Fund Management Pte Limited	Funds Management	Singapore	50	50	1.6	1.6
Homeloans Limited	Mortgage Origination	Australia	23	40	26.7	46.1
Ardea Investment Management Pty Limited	Funds Management	Australia	30	30	2.4	2.8
Five Oceans Asset Management Limited	Funds Management	Australia	25	25	3.3	3.4
Greencape Capital Pty Limited	Funds Management	Australia	25	25	2.8	2.0
Kapstream Capital Pty Limited	Funds Management	Australia	25	25	4.6	4.6
Kinetic Investments Partners Limited	Funds Management	Australia	20	20	0.2	0.2
Wavestone Capital Pty Limited	Funds Management	Australia	28	28	2.0	1.9
Merlon Capital Partners Ltd	Funds Management	Australia	30	–	0.4	–
Bentham Asset Management Pty Ltd	Funds Management	Australia	49	–	0.2	–
Impairment[1]					(11.2)	(19.4)
					33.0	43.2

	30 June 2010 $M	30 June 2009 $M
Movements in carrying amount of investments in associates		
Opening balance	43.2	35.0
Investment in associates acquired in current year	0.4	6.0
Sale of interest in associates	(12.5)	–
Share of associates' net profit[2]	3.7	3.1
Dividend received	(1.8)	(0.9)
Carrying amount at the end of the financial year	33.0	43.2
Share of the associates' profit or loss:		
Profit before related income tax	5.3	4.4
Income tax expense	(1.6)	(1.3)
Profit for the year	3.7	3.1
Retained profits attributable to associates at the beginning of the financial year	5.5	2.4
Retained profits attributable to associates at the end of the financial year	9.2	5.5
Share of the associates' balance sheet:		
Assets	143.4	53.8
Liabilities	(125.5)	(14.6)
Net assets	17.9	39.2

[1] This provision for diminution in value relates to Homeloans Limited

[2] Share of associates' net profit in 2009 includes $0.5 million of discontinued operation for comparative purposes.

On 22 July, the directors of Homeloans Limited declared a return of capital of 35 cents per fully paid ordinary share (subject to shareholder approval). The shareholder meeting is scheduled to take place in September 2010.

38. Parent entity

Set out below is a statement of comprehensive income and a balance sheet for the Company for the year ended and as at 30 June:

	30 June 2010 $M	30 June 2009 $M
Statement of comprehensive income		
Revenue	180.1	128.6
Expenses	–	(2.6)
Profit before income tax	180.1	126.0
Income tax expense	(1.7)	(0.5)
Profit after income tax from continuing operations	178.4	125.5
Profit after income tax attributable to equity holders of the parent	178.4	125.5
Total comprehensive income of the parent entity	178.4	125.5
Balance sheet		
Assets		
Cash and cash equivalents	1.0	0.9
Receivables	1,113.5	735.2
Current tax assets	3.0	7.8
Deferred tax assets	36.9	124.9
Investment in controlled entities	1,121.5	1,131.9
Total assets	2,275.9	2,000.7
Liabilities		
Payables	857.7	447.0
Provisions	3.0	5.1
Total liabilities	860.7	452.1
Net assets	1,415.2	1,548.6
Equity		
Contributed equity	1,200.4	1,445.5
Equity option premium reserve	125.4	125.2
Share based payment premium reserve	66.6	57.8
Retained profits/(accumulated losses)	22.8	(79.9)
Total equity	1,415.2	1,548.6

See Note 40 for details of any contingent liabilities, contingent assets or credit commitments applicable to the parent entity.

39. Subsequent events

As at the date of this report no other matter or circumstance has arisen that has affected or may significantly affect:

(i) the Group's operations in future financial years; or

(ii) the results of those operations in future financial years; or

(iii) the Group's state of affairs in future financial years.

40. Contingent liabilities, contingent assets and credit commitments

Warranties

The Group over the course of its corporate activity has given, as a seller of companies and as a vendor of real estate properties, warranties to purchasers on several agreements which are still outstanding at 30 June 2010. Other than noted below at the date of this report, no material claims against these warranties have been received by the Group.

The Victorian State Revenue Office has raised an assessment for stamp duty in respect of certain properties acquired by the Challenger Diversified Property Group as part of the initial public offering of this entity. Challenger is disputing the assessment.

Parent Entity guarantees and undertakings

Excluded from the consolidated financial statements are the following guarantees and undertakings extended to entities in the Group by Challenger Financial Services Group Limited (the parent):

(i) Cross guarantee supporting the corporate banking facility.

(ii) Issue of letters of support in respect of certain subsidiaries in the normal course of business. The letters recognise Challenger Financial Services Group Limited has a responsibility to ensure that those subsidiaries continue to meet their obligations.

(iii) Australian Financial Services Licence (AFSL) deeds of undertaking as an eligible provider.

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.

Commitments

Challenger Life Company Limited has capital commitments that it has made to external counterparties for future investment opportunities such as development or investment purchases. At the date of this report, there are commitments totalling $334.4 million (2009: $152.6 million) in relation to these opportunities.

Other information

In the normal course of business, the Group enters into various types of business contracts that could give rise to contingent liabilities in relation to performance obligations under those contracts by certain members of the Group.

The information usually required by AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, is not disclosed 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; however, the Directors are of the opinion that no material loss will be incurred.

Directors' declaration

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

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

   (i) giving a true and fair view of the Group's financial position as at 30 June 2010 and of its performance for the year ended on that date; and

   (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*;

(b) the financial statements and notes of the Group also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board as disclosed in Note 1(ii) to the financial statements;

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

(d) this declaration has been made after receiving the declarations required to be made to the Directors in accordance with section 295A of the *Corporations Act 2001* for the financial year ended 30 June 2010.

On behalf of the Board

G A Cubbin
Director

Sydney 20 August 2010

D J Stevens
Director

Sydney 20 August 2010

Ernst & Young Centre
680 George Street
Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001
Tel: +61 2 9248 5555
Fax: +61 2 9248 5959
www.ey.com/au

Independent auditor's report to the members of Challenger Financial Services Group Limited

Report on the financial report

We have audited the accompanying financial report of Challenger Financial Services Group Limited, which comprises the balance sheet as at 30 June 2010 and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flow for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with the Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Auditor's responsibility

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

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

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

Independence

In conducting our audit we have met 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. In addition to our audit of the financial report, we were engaged to undertake the services disclosed in the notes to the financial statements. The provision of these services has not impaired our independence.

Auditor's opinion

In our opinion:

1. the financial report of Challenger Financial Services Group Limited is in accordance with the *Corporations Act 2001*, including:
   - i giving a true and fair view of the financial position of Challenger Financial Services Group Limited and the consolidated entity at 30 June 2010 and of their performance for the year ended on that date; and
   - ii complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*.
2. the financial report also complies with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 20 to 35 of the directors' report for the year ended 30 June 2010. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's opinion

In our opinion the Remuneration Report of Challenger Financial Services Group Limited for the year ended 30 June 2010, complies with section 300A of the *Corporations Act 2001*.

Ernst & Young

S J Ferguson
Partner
Sydney
20 August 2010

(a) Distribution of shares

Range	Number of shareholders	Number of shares	% of issued capital
1 – 1,000	9,213	4,599,432	0.91
1,001 – 5,000	9,865	23,771,801	4.69
5,001 – 10,000	2,004	14,860,795	2.93
10,001 – 100,000	1,326	32,631,638	6.44
100,001 and over	121	431,139,566	85.04
	22,529	507,003,232	100.00

Number of unmarketable parcels: 722.

Number of unmarketable shares: 39,255.

(b) Substantial shareholders[1]

Shareholder	Number	Percentage
National Australia Bank	41,375,113	8.28
CPU Share Plans Pty Limited	25,452,738	5.02

[1] Based on shares on issue at date of last substantial shareholder notification.

(c) Twenty largest shareholders as at 10 September 2010

	Shareholder	Shares held at end of period	% of issued capital
1.	National Nominees Limited	96,793,765	19.38
2.	J P Morgan Nominees Australia Limited	83,393,275	16.69
3.	HSBC Custody Nominees (Australia) Limited	74,510,259	14.91
4.	Citicorp Nominees Pty Limited	26,596,896	5.32
5.	CPU Share Plans Pty Ltd	25,808,531	5.17
6.	UBS Nominees Pty Ltd	25,791,288	5.16
7.	ANZ Nominees Limited	11,242,820	2.25
8.	AMP Life Limited	10,798,157	2.16
9.	Cogent Nominees Pty Limited	7,947,832	1.59
10.	UBS Nominees Pty Ltd	5,250,977	1.05
11.	Australian Reward Investment Alliance	4,787,193	0.96
12.	HSBC CUSTody Nominees (Australia) Limited	3,505,584	0.70
13.	Queensland Investment Corporation	3,258,774	0.65
14.	WIN Television NSW Pty Limited	3,046,601	0.61
15.	UBS Wealth Management Australia Nominees Pty Ltd	2,380,353	0.48
16.	Invia Custodian Pty Limited	2,181,903	0.44
17.	Cogent Nominees Pty Limited	1,706,819	0.34
18.	Mike Tilley	1,308,364	0.26
19.	Bond Street Custodians Limited	1,241,253	0.25
20.	Citicorp Nominees Pty Limited	1,229,156	0.25
		392,779,800	78.62

(d) Shares subject to restrictions

There are no shares subject to restrictions.

(e) Voting rights

On a show of hands, every member present at the meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.

(f) ASX listing

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

(g) Key dates

Shareholders may like to note the following key dates:

Ex-dividend date for the 2010 final dividend	17 September 2010
Record date for the 2010 final dividend	23 September 2010
Dividend payment date	15 October 2010

(h) Shareholder queries

Please contact Computershare Investor Services for information about the Challenger Financial Services Group Limited share registry if you have any questions about your shareholding.

Computershare Investor Services Pty Limited
Level 3, 60 Carrington Street, Sydney NSW 2000.
Investor queries 1800 780 782
Facsimile +61 2 8234 5050

To assist with all enquiries, please quote your current address and Security Reference Number (SRN) when speaking with Computershare's associates.

This page has been left blank intentionally.

This page has been left blank intentionally.

This page has been left blank intentionally.

Directory

Principal place of business and registered office in Australia

Level 15
255 Pitt Street
Sydney NSW 2000
Telephone: 02 9994 7000
Facsimile: 02 9994 7777

Directors

Peter Polson (Chairman)
Dominic Stevens (Chief Executive Officer)
Thomas Barrack Jr.
Graham Cubbin
Russell Hooper
Leon Zwier

Company secretaries

Christopher Robson
Suzanne Koeppenkastrop

Share registry

Computershare Investor Services Pty Limited
Level 3, 60 Carrington Street
Sydney NSW 2000
Telephone: 02 8234 5000
Facsimile: 02 8234 5050
Website: www.computershare.com.au

Auditor

Ernst & Young
680 George Street
Sydney NSW 2000

Internet address

www.challenger.com.au

Level 15
255 Pitt Street
Sydney NSW 2000
Telephone 02 9994 7000
Facsimile 02 9994 7777

Level 33
101 Collins Street
Melbourne VIC 3000
Telephone 02 9994 7000
Facsimile 02 9994 7777

Level 7
320 Adelaide Street
Brisbane QLD 4000
Telephone 07 3218 8000
Facsimile 07 3218 8007

Level 3
97 Pirie Street
Adelaide SA 5000
Telephone 08 7129 4402
Facsimile 08 8232 4446

Level 2
168 St Georges Tce
Perth WA 6000
Telephone 08 9223 7800
Facsimile 08 9221 2499

Caxton Hall
Level 6, 21 Palmer Street
London SW1H 0AD
Telephone +44 20 7976 3300
Facsimile +44 20 7976 3301

www.challenger.com.au

10338/CG709/0810