annual report & accounts

Homeowners Friendly Society Group annual report & accounts for the year ended 31 December 2009

engage
Mutual Assurance

society information

Engage Mutual Assurance is a trading name of Homeowners Friendly Society Limited.

registered office

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Registered and Incorporated under the Friendly Societies Act 1992

Registered No: 964F

Authorised and regulated by the Financial Services Authority

Member of the Association of Financial Mutuals (AFM)

independent service providers

auditors

Deloitte LLP
Statutory Auditors

solicitors

Addleshaw Goddard LLP

bankers

Barclays Bank Plc

board of directors

The Directors who have served during the year are:

Raymond F Pierce BA FRSA (resigned 31 May 2009)
David G Hargrave B Com MSc FIA
Andrew S Haigh BSc
Rt. Hon. Lord Clark of Windermere BA MSc PhD (retired 21 May 2009)
Karl J D Elliott BA
W Graham Henderson B Comm CA FRSA
Peter W Mason BSc FIA
Christina M McComb BA MBA

other society officers

secretary

Andrew J Horsley MCSI FCIS

actuarial function holder and with profits actuary

Trevor M Batten FIA

board committees

audit

Peter W Mason (Chairman)
David G Hargrave
Christina M McComb

finance

David G Hargrave (Chairman)
Andrew S Haigh
W Graham Henderson
Peter W Mason

nominations

Peter W Mason (Chairman)
Andrew S Haigh
David G Hargrave
Christina M McComb
Raymond F Pierce (resigned 31 May 2009)

remuneration

Christina M McComb (Chairman)
Rt. Hon. Lord Clark of Windermere (retired 21 May 2009)
David G Hargrave
Peter W Mason
Raymond F Pierce (resigned 31 May 2009)

contents

who we are

Engage Mutual Assurance is a trading name of Homeowners Friendly Society Limited. We are a mutual organisation based in Harrogate, North Yorkshire, providing simple, good value savings, life insurance and health products for over 438,000 customers throughout the country.

Within the Engage Mutual Group there are a number of subsidiary companies:

- Engage Mutual Funds Limited is a leading provider of child trust funds
- Engage Mutual Insurance Limited is our health insurance company, which offers health cash plans
- Engage Mutual Services Limited is our marketing services subsidiary
- Engage Mutual Administration Limited is the principal employer, with over 150 staff providing administrative services to the other companies in the Group.

why we exist

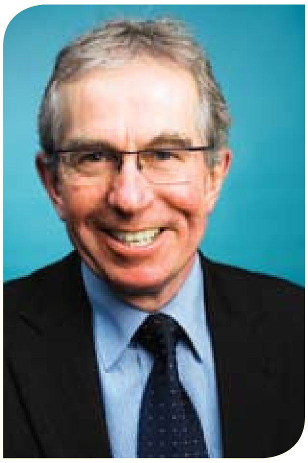
our vision:
to be the best customer owned business

our mission:
to work with families to help them secure their financial future

Our vision and mission define our purpose. As a mutual, our principal aim is to deliver our mission for our current and future customers. Engage Mutual is not simply a response to market opportunity driven by the need to deliver shareholder return. Instead, we operate as a commercial enterprise whose success is measured by the degree to which we deliver a thriving organisation, valued by its customers because it genuinely helps them secure their financial futures.

chairman's introduction

"We are pleased with the progress we made in 2009 and if this momentum is maintained, we look forward to further progress in 2010."



At the end of May 2009, Ray Pierce stepped down after ten years as Chairman of our Society. This was a period of great change and some notable successes for Engage Mutual marked by many important developments, including of course the introduction of the Engage Mutual name and brand identity. We thank Ray for his service to the Society and wish him well for the future.

As Vice Chairman since 2004 and having been involved in the Society ever since its formation, I was delighted to take over as Chairman when Ray Pierce stepped down. Your Board has asked Christina McComb to take on the role of Vice Chairman during this period of change. Christina joined the Board in 2005 and also chairs the Remuneration Committee.

The Board is currently seeking to recruit a new Chairman on a long-term basis and the Nominations Committee has appointed external consultants to help with the task. We hope to identify the new appointee before the Annual General Meeting. After that, we also expect to recruit at least one additional Non-Executive Director later in 2010. In accordance with the rules of the Society, the new Directors will be put before the members for election at the AGM in the year after their appointment.

Market conditions in 2009 remained difficult and complex. After a very weak start, equity markets recovered during the year. But at the same time, the country remained in the grip of recession, showing only modest signs of recovery in the last quarter. This negative economic environment is likely to have a lasting effect on consumers, and to affect their ability to save and buy insurance to protect their families long after the recession is officially over.

Against this backdrop, Engage Mutual performed well in 2009. Our challenge was to maintain progress towards our strategic objectives, while also making significant reductions to our total expenditure and minimising new business risk by limiting our direct marketing programmes to only the most efficient activities. As explained in the Chief Executive's Statement, and the Operating and Financial Review, we achieved these aims and are now well placed to continue our positive progress into 2010. In particular we hope to proceed with an acquisition, for which discussions started in 2009, that will bring greater scale to the Group.

Since one of our main purposes is to provide investments in which our customers' money can grow, we were pleased to see a general return to stock market growth. The FTSE® All Share Index rose by 24.96% from its low point at the start of the year.

Customers with products that invest in deposit funds, on the other hand, did less well. The prevailing low interest rates limited the returns we were able to achieve to an average of 2.48% for the year. While interest rates remain at historically extremely low levels, we will continue to work to achieve positive returns for policyholders. At the same time, though, we will also maintain our emphasis on risk management, avoiding concentration of risk with a single provider in order to provide diversification, both by using pooled funds and by spreading risk across a number of institutions.

Looking to the future, we remain cautious about the outlook. We see no reason to expect anything other than a very slow economic recovery at best, and a further recessionary period at worst. We think it is likely that interest rates will remain very low for some time, and there is a real possibility of a subsequent period of increasing inflation. In such uncertain times, we will maintain our cautious approach, keeping a careful eye on the business risks we take and maintaining tight control on Group expenditure. That said, we are pleased with the progress we made in 2009 and if this momentum is maintained, we look forward to further progress in 2010.

Finally, I am very pleased to have this opportunity to thank all of our customers and all of our staff for their continued support, and to wish customers, staff, management and the executive well for the year ahead.

David Hargrave
Chairman
25 March 2010

chief executive's statement

"Our challenge as a mutual is to run our business successfully and effectively, while always remembering our fundamental difference: that we are owned by our customers."

Engage Mutual has always been proud to be a mutual organisation, and the experience of the last two years or so helps to explain why.
It has become increasingly clear that when it comes to looking after their day-to-day financial needs, a growing number of people are actively seeking an alternative to the country's large proprietary companies.

Our challenge as a mutual is to run our business successfully and effectively, while always remembering our fundamental difference: that we are owned by our customers, answerable to them and responsible to them. That, in turn, means not only providing transparent, trustworthy, effective solutions to meet their needs, but also making sure that we inform them clearly and fully, communicate with them openly and honestly and keep them involved and engaged with our progress and our priorities as a business.

We could hardly have set our sights higher. On page 5 of this document we re-state our vision: it is still, as it has been for several years, quite simply to be this country's best customer owned business. It may be impossible to be certain that we will ever achieve that goal, but we will certainly not stop trying. At the very least, it acts as a powerful reminder of our most important responsibility: always to do our best for our customers.

Doing so will always mean setting priorities and striking balances, and 2009 was a particularly challenging year in this regard. It was a year which called for a balance between continuing to make strategic progress towards our long-term objectives; maintaining a strong capital position, which in turn required substantial reductions to our total costs; limiting new business risk; and all this while maintaining service standards for our customers.

Over the course of the year we were successful in getting this balance right. Our performance, together with important information about our approach to Risk Management and the general operations of the business, is set out in the Operating and Financial Review, starting on page 12 and the Directors' Report, starting on page 24. However, I am pleased to note the following highlights:

- 2009 was our twelfth consecutive year of net customer growth, with the total number of customers increasing by 2.4% to more than 438,000
- group assets under management for customers increased by more than 5% to £624m (including £105m in child trust funds)
- we reduced total expenditure (including marketing costs) by 40%, while new business premium income for our life funds was reduced by only 17%. The change in new business premium income is primarily due to our decision to move away from intermediary single-premium business, with its high initial commissions. Our new regular-premium life savings and protection business, which is vital to our long-term stability, actually increased by more than 3% over the year, while new contributions to the child trust fund increased by 5.3% to £17.6m
- we continue to be well-capitalised, and the Group Fund for Future Appropriations increased by £1.2m in the year
- we continued to progress towards our strategic goal of becoming an e-business, with more than 70% of new customers coming to us via the internet or over the telephone. We also launched the first phase of our online servicing capability, for customers with long-term savings plans: we will extend this to all customers in due course. A new website will be launched in 2010
- customer premiums fell by £9.9m to £34.9m, also as a direct result of our strategic move away from single-premium business, with its high initial commissions.

Our over-riding priorities are to maintain service quality and, for savings customers, to achieve good returns in the context of the overall performance of investment markets. We were naturally pleased to see strong performance in equity markets over the year but, as the Chairman noted in his report, disappointed by the continuing low level of returns available on deposit-based savings. I appreciate the difficulties this can cause for customers; please rest assured that we are working to achieve the best returns we can, while balancing the need for security and achieving the high level of diversification which we think is essential for the fund.

Increasing the efficiency of our operations further through greater scale is central to our strategy. As noted in the Chairman's Introduction, we hope to progress with our acquisition strategy in 2010. Similarly, we believe that we have a compelling proposition for members of mutual societies who may be considering a transfer of engagements and we are always willing to have open discussions as to what might be possible in that regard.

We are always conscious of our broader responsibilities as a mutual organisation. At last year's AGM, we introduced a rule change that would extend membership to all direct customers of the Engage Mutual Group – in other words, to include customers of our subsidiary companies as well as our life company. In the second half of 2010 we plan to enact the changes that will bring these rules into effect, so that we can extend democratic participation to all direct customers.

At the same time, we hope that the Government will finalise changes in legislation that will bring the Friendly Societies Act into line with other company law, so that we can introduce web-enabled notices of General Meetings and online voting for those who prefer to communicate with us in this way.

More generally, we are working to improve communications with customers at all levels. In the Operating and Financial Review, you will find details of the activities of our customer panel in 2009, along with our plans for its continued development.

As far as investment is concerned, we added significantly to our capital reserves in 2009 in order to begin our preparation for the new regulatory requirements to be introduced in 2012, usually known as "Solvency II." This will make

important changes in the way in which financial services providers assess risk, and in the capital reserves they need to hold. We have already made extensive changes in our approach to assessing and managing risk, and in our management processes, information and reporting. You will find details in the expanded Risk section of this report, on pages 17 and 51.

2010 and beyond

Looking forward, we expect 2010 to present just as many challenges as 2009, but we are confident that we are well-placed to address them. In addition to growth through merger and acquisition, we will continue to seek organic growth, on the basis of a strong Engage Mutual brand, a range of simple, good-value health, savings and protection products for families, and the differences that customers experience as a result of our mutual status. We will invest in efficient systems and effective risk management, and we will seek greater scale in order to improve our efficiency further.

Like any business, our future success is largely in our own hands, and like most businesses, achieving continuing success will depend on our ability to maintain and execute a strategy that makes sense in a complex, difficult and unpredictable business and economic environment.

I am confident that we are strongly placed in this respect – but also, in another more unusual respect. As a mutual organisation, deeply committed to providing families in this country with a real alternative to the offerings of the proprietary sector, we find ourselves at a point when our approach resonates perhaps more powerfully than ever before with the wants and needs of the people we exist to serve. I look forward to making the most of this opportunity, to the benefit of everyone involved with our organisation.

I would like to add my thanks and appreciation for the fantastic support the Society has received both from customers and from staff. I look forward to continuing progress and a strong performance in 2010.

Andrew Haigh
Chief Executive
25 March 2010

operating and financial review

strategy

We have maintained a consistent strategy in recent years. Our main priorities are:

- to develop a commercially successful mutual organisation that is increasingly valued by customers and business partners
- to meet customers' needs to provide for their families' welfare, with a range of simple, good value savings, health and insurance products
- to underpin our commitment to service and value with modern, efficient systems and processes which help make us more accessible, especially via the internet
- to seek business partners with whom we can achieve sustained growth while achieving greater efficiency and reaching out to wider customer groups, whether through distribution partnerships or through acquisition or merger with like-minded organisations
- to focus on our long-term sustainability, with efficient new business generation, overheads proportionate to our income and capital resources sufficient to support growth and provide security for customers' benefits.

In this section, we outline our continued progress against these strategic aims in 2009.

marketing and distribution

In 2009 we reduced our marketing and distribution costs significantly, making a decision to focus only on our most cost-efficient sales programmes. As a result, we withdrew from distributing single-premium investments, with their high levels of initial commission, through Independent Financial Advisers. We also reduced our direct-response advertising activity, because the results were too uncertain in the prevailing economic climate.

On the other hand, we increased our focus on the internet as a primary sales channel, and channel of communication with customers. And we continued to develop our strategic distribution partnerships, notably with National Australia Group whose Clydesdale and Yorkshire branches offer our over 50s life cover and "Vision" with profits savings policies to their customers.

We continued our sponsorship of Rugby League's Super League for a fifth year in 2009. Engage Mutual is now firmly recognised as the league sponsor, and our relationship brings us significant media exposure. Once again, match attendances, audience sizes and overall value increased on the previous year.

savings and protection

over 50s life cover

Over 50s life cover played a big part in our new business activity. We are established as one of the top five providers of this product, and we continue to invest in maintaining our competitive position, in terms of both pricing and added value. In 2009 we launched a partnership with Co-operative Funeral Care to offer customers the option to assign their policy, and therefore greatly simplify the process of arranging a funeral when the time comes. This new arrangement has been well received, with strong uptake among both new and existing customers.

We also announced a new partnership with Co-operative Legal Services, who now offer a Will writing service to Engage Mutual customers.

New entrants continue to come into this market, and we remain ever mindful of the need for a strong proposition in terms of both service and value.

tax-exempt savings plans

We offered adult and children's tax-exempt savings plans through our with profits fund, and in 2009 we substantially exceeded our sales targets for with profits policies.

The Financial Services Authority has been in much-publicised debate with the mutual insurance industry about the long-term viability of some firms' with profits funds, and, in particular, whether capital is being allocated in a way which is fair to with profits policyholders. This is a complex issue, but regardless of the outcome of the debate, we have made good progress in growing new with profits business in recent years. And the ring-fenced structure of the fund means that our with profits policyholders' capital is clearly identified, segregated and used purely for the benefit of the with profits fund.

child trust funds (CTFs)

We did very well in this market in 2009, with more than £17.6m of new contributions and a total of more than 200,000 CTFs now open. The total size of the fund, which is invested in our Open Ended Investment Company (OEIC), is now over £105m.

We took action in 2009 to simplify the administration and improve the efficiency of our CTF business. Having sought the approval of the customers involved, these changes included transferring a small number of ISAs and direct investments in the OEIC to Legal & General. The overall impact of these efficiency improvements, together with the opening of new CTFs, additional contributions into existing CTFs and investment growth, means that in 2011 we expect Engage Mutual Funds Limited, the subsidiary which operates the OEIC and manages the CTFs, to be recognised as a real asset of the Group.

With a General Election taking place this year, the future of CTFs is unclear. We are active supporters of the Tax Incentivised Savings Association, the trade body that represents CTF providers in its efforts to promote the benefits of CTFs to all political parties and to ensure that all families can continue to benefit from CTFs and develop a regular savings habit.

We have also supported the efforts of Mutuo, an organisation which aims to promote the benefits of mutuality to the Government and other opinion formers, in its publication of "The Mutuals Manifesto". The Mutuals Manifesto urges all political parties, in the lead up to the General Election, to recognise and support the role that mutuals can take as a business model in delivering services, creating value and contributing to the challenges the country faces.

health

Having added health cash plans to our product range in 2008 with the acquisition of Premier Health Benefits, our priority in 2009 was to simplify cash plan operations, improve efficiency and make a number of product improvements. We will continue this work in 2010, introducing new benefits such as the payment of claims by direct credit in order to improve both the customer experience and operating efficiency.

Health products represent a key part of our future strategy. Over the next few years, we expect our health subsidiary to play an increasingly important role both in the operations of our Group and in providing products to our customers.

communication

Open, frequent and interactive communication with our staff and our customers is a hallmark of our approach, and a vital part of what makes us different from other organisations.

The Engage Mutual Staff Forum continues to act as our consultative body. Its work is supplemented by a comprehensive staff communications programme which includes monthly 1:1 meetings, fortnightly staff briefings, quarterly progress presentations for all staff, a monthly summary of the Progress Pack provided to the Engage Mutual Board and a variety of informal communications. Early in 2010, we also launched a new staff intranet, which will further enhance communication as the year progresses.

As far as customer communication is concerned, perhaps the most distinctive component is our ongoing customer panel, with whom we consulted in 2009 on a range of different issues and opportunities. Beyond this, our internet development programme will significantly enhance the potential for customer communication and feedback. And informal contact is important too: the senior management team all participate in regular call monitoring, to make sure they stay close to customers and the issues that interest or concern them.

environmental, social and community issues

By the nature of our business, Engage Mutual does not have a major impact on the environment. That said, we have taken steps to reduce waste, particularly in the areas of print and photocopying. And our focus on conducting more and more of our business electronically, much of it online, is gradually reducing our use of a number of consumables – especially, of course, paper.

We were also re-accredited as an Investor in People on the completion of our regular review.

There is a strong tradition of support for charitable causes in the Group. We received a Gold Award for payroll giving in 2009. Support for charities often takes more active forms too. We have close ties with our near neighbour, Saint Michael's Hospice, and in 2009 participated extensively in their Midnight Walk, a big local community event which contributes a six-figure sum to the funding of the hospice each year. In 2010 we will introduce a scheme which will strengthen the link still further, and will enable staff to volunteer in a range of supporting roles.

financial review

investment performance

The results show how improving financial markets and continuing customer contributions have brought about an improvement to our balance sheet, with financial assets at £479m vs. £468m last year.

with profits

Of £94.6m of Financial Investments held by the Society, £78.5m related to the with profits fund investments held to support policy returns and bonuses. Overall this fund returned 8.4% in the year, with the return being shared between policyholders as set out in our Principles and Practices of Financial Management (PPFM).

The with profits fund return reflects our policy of increasing the investment risk profile of the fund in line with the recovery of confidence in financial markets over the year. We responded to improving market sentiment by moving policyholder investments in the year, first from cash to corporate bonds and then also in September into equity equivalent holdings, with an investment in the Insight Broad Opportunities Fund in September; subsequently, this fund increased in value by 6.6% over the rest of the year.

These investment decisions demonstrate how we use our risk framework, described below, to guide the allocation of assets in the with profits fund to take account of prevailing market conditions, and the level of capital resources to take investment risk in order to generate returns for customers. We expect that the year-end investment position and the risk framework will provide good support to our ongoing management of the fund.

Despite the improved position of the fund, we have declared zero reversionary bonuses for most policies in order to maintain maximum flexibility to pay terminal bonuses where this is justified by the policy 'asset shares' as described in our PPFM. Total terminal bonuses paid in the year were £0.3m compared to £0.5m in the prior year reflecting a poor decade for market investment returns (in particular 2008) and past declarations of reversionary bonuses. For comparison purposes, our with profits payouts on a 25 year endowment for a monthly payment of £50 maturing on 1 January 2010 would be £33,951 – an outcome comparing very favourably with many major with profits funds.

unit-linked savings plans

Linked savings policies' values increased from £373.7m to £384.7m, reflecting asset growth, additional premiums and maturities in the period. We experienced generally good performance across the main asset classes: shares and unit trusts typically met their index linked benchmarks which generally tracked returns in line with the recovery in the UK FTSE 100 Index. This increased by 22.1% in the year.

Our policy of backing savings deposit policies with investment grade deposits, and a pooled cash fund supporting our stable of linked cash deposit policies, produced an overall gross return of 2.48% in the year – a figure which compares well with the 3-month Libor benchmark of 1.19%.

Fixed income returns were lower, with our main primary pooled fund returning (0.8)% against the benchmark of (0.7)%.

The general recovery of financial markets resulted in an investment return of £41.5m, compared to a £47.6m loss in 2008. These returns restore much of the savings policy value lost through exposure to the financial market turbulence of 2008. That said, it is still true that longer term performance reflects the poor UK equity performance over the decade, with the FTSE 100 Index falling by some 22% from its high point of 6950 in December 1999 to close at 5412 in December 2009.

revenue account

The turn around in investment performance was one of the key factors behind the transfer of £3.3m to the Society's capital resources in the year (£19.4m transfer from capital resources last year).

Our Group Fund for Future Appropriations was also positively affected by the reduction in overall Group expenses from £21.6m to £12.8m in 2009. This reduction reflects management policy to scale back expenses, particularly for marketing, in the light of the uncertain economic conditions. Annualised new business reduced by 17% from £4.8m to £4.0m, but overall our level of sales efficiency improved significantly, particularly because we were able to generate an increase in commission income of £1.2m in the year.

Gross claims incurred, at £47.8m vs £53.7m in the previous year, remained in line with expectations. On the whole, it was pleasing to note that policyholders chose to continue to pay premiums for protection and savings contracts, despite prevailing economic uncertainties.

The subsidiary trading results recorded in the Non–Technical account also improved in the year as a result of both higher income and lower operating expenses. The £0.7m General Insurance gross profit included a contribution from our new health cash plan products, following our first full year of operating in this market. However, despite the underwriting profit, this activity made a loss in the period. We are addressing this by seeking to acquire and develop increased scale – a key feature of our business strategy over the next two years.

The improvements in trading results reflected in the Non-Technical account were offset in the Statement of Total Recognised Gains and Losses by a £0.6m actuarial loss on the defined benefit pension scheme, which is largely attributable to more prudent assumptions. Overall, however, the scheme has maintained a relatively robust position and the accounts record a net pension asset of £1.9m against £2.4m last year under the FRS 17 reporting basis. The Directors have considered the possibility of benefiting from this asset through either a refund or reduced future contributions, and have concluded this is not appropriate. Accordingly, the Directors have decided not to recognise this asset as part of the Group capital position.

capital and risk management

capital resources

Reported capital as measured by the Group Fund for Future Appropriations grew by 3.8% to £31.8m in the year. Society capital requirements are analysed further in Note 1 which shows that this represents £9.0m of excess capital (3.4 times minimum capital requirements) for the non profit fund, and £10.5m (3.3 times the minimum capital requirements) for the with profits fund, so both long-term funds continue to be well-capitalised.

The statutory capital position represents the net effect of emerging surpluses from in-force business less investments costs relating to new business and corporate development. Considering that in recent financial market conditions our policy has been to hold the majority of our capital resources in low risk investments which are currently generating low returns, we are pleased with the 2009 result. Additional consequences of the current climate include the fact that we must use low valuation interest rates to evaluate our liabilities, and that we have included a £0.4m write down relating to the value of our Head Office property, Gardner House, which has been re-valued because of the prevailing conditions for commercial property.

Monitoring and management of risk and its impact on capital resources represent a key area of focus within our internal management and governance practices which we operate on two bases:

statutory reporting

The accounts are presented on the basis of UK GAAP for insurance companies which requires reserving for risks and provision for standard stress tests to ensure capital resources are adequate. The statutory reserves contain an in built 'margin of prudence' to support the various risks we manage. A separate 'FSA Return' is also prepared and submitted by all Friendly Societies and Insurance Companies to our Regulator to document the detailed analysis of our results. We monitor the development of these results and the level of capital coverage noted above in monthly reporting.

realistic reporting and stress testing

Recent developments in regulatory reporting have introduced 'realistic' reporting which uses management 'best estimates' to value future insurance cash flows with specific provisions to allow for the costs of any guarantees provided to customers. We then apply a range of different stress tests and scenarios to evaluate the amount of additional risk capital that we should hold in the event that any of these risks were to materialise in practice – for example, exceptional market turbulence or global flu pandemics.

This risk evaluation process involves management consideration of the nature of the risks and how they may apply within our own business, rather than the standard 'formulaic' approach applied within the statutory reporting basis. This provides useful insight into our risk profile and so allows the Board to set appropriate levels of risk appetite and agree appropriate management actions if individual or combinations of risk events or triggers were to occur.

Our risk assessment seeks to ensure first that there is adequate capital, calculated on a best estimate basis, to meet the risks faced by our business over the next 12 months up to a one in 200 year event catastrophe level, and second that there are agreed management actions in place to deal with identified risks occurring singly or in combination.

The key risks we have evaluated and their current relative impact on our realistic capital are represented below. The chart shows that the Society is exposed to a broad cross section of risks. The impact of extreme market fluctuations or unexpected changes in the performance of our insurance products are the most significant risk groups.

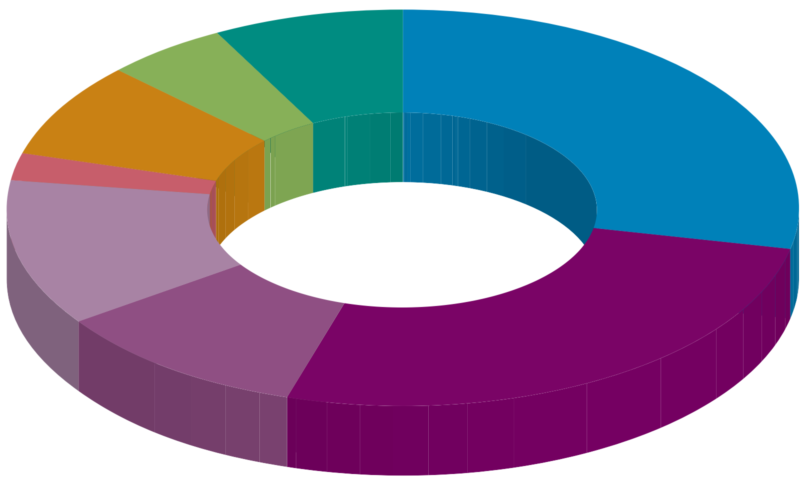
risk management

The Board is responsible for ensuring we have an appropriate risk reporting and control framework to manage and develop our business as set out in the Corporate Governance section starting on page 27.

The Board receives a monthly risk report from the Corporate Risk Officer containing a "risk

risk assessment

- market risk
- insurance risk
  - lapse
  - expense
  - mortality
- credit risk
- new business risk
- liquidity risk
- pension scheme risk
- operational risk



map" which tracks the status of current risks and the effect of mitigating management actions.

Management control and development activity is delivered through a number of committees which report into the Executive Committee and deal with the day to day management of the individual business entities in the Group.

These committees manage business performance, risk and development of strategy for the entities they represent within agreed terms of reference. In this way, they provide a clear and visible internal management framework to ensure that we manage and deliver our services efficiently and effectively, and that we comply with regulation and treat customers fairly.

committees

All committees report into the Executive Committee which is chaired by the Chief Executive. The Executive Committee has overall authority for managing the affairs of the Group, including risk management and delivery of business plans and strategy.

The Board and management committees receive monthly reporting of capital positions within a Balanced Scorecard which takes into account all aspects of our business covering financial, customer, internal process performance and staff resources.

The Board formally reviews management plans and capital forecasts twice a year, to ensure that financial projections reflect adequate capital to service our current business and to meet development plans.

growth through merger or acquisition

We have reported in prior years that we wish to add further scale to our Group through merger or acquisitions.

Our objective in pursuing such opportunities is twofold:

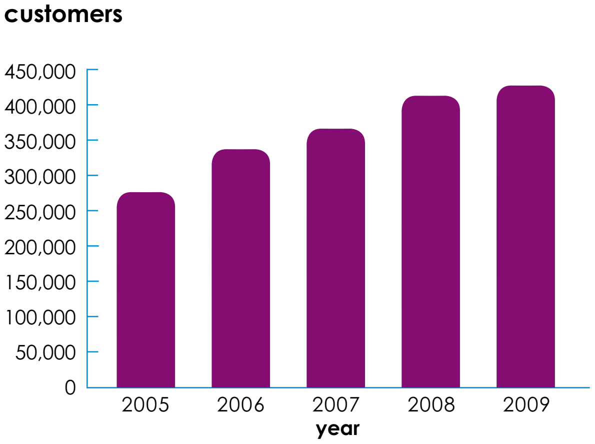
- to provide more efficient services to our customers via cost reductions achieved through economies of scale
- to extend our range of services and products to increasing numbers of customers.

We will seek to progress appropriate merger or acquisition opportunities as they arise.

financial performance for the year ended 31 December 2009

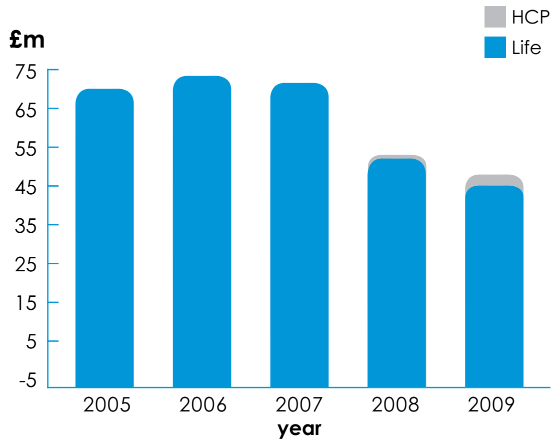
The following graphs are the main Key Performance Indicators (KPIs) used to manage the business.

group customers



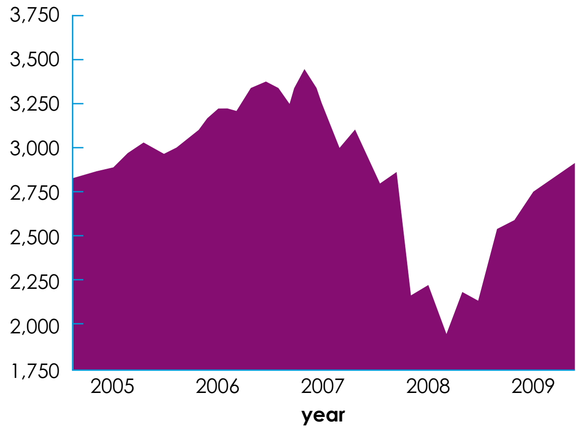
Group customers increased by 2.4% in the year to more than 438,000.

claims paid to policyholders



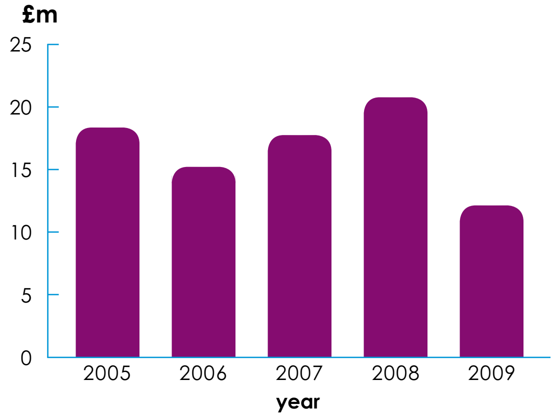
Claims paid from the life fund to members was £47.8m, which was in line with expectations.

FTSE® all share index



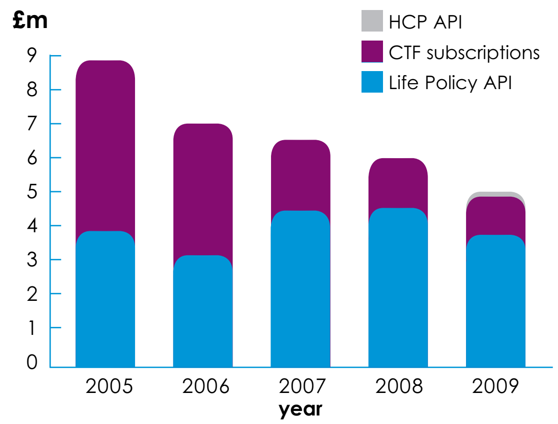
Equity performance recovered in 2009 after the difficulties of the previous year.

total group expenses



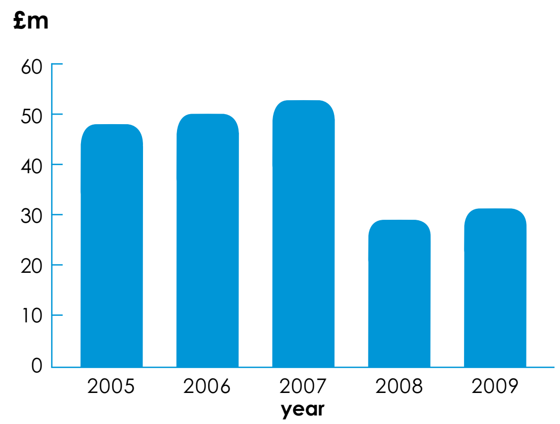
Total Group expenses (including marketing costs) were reduced by 40% in the year.

new business performance



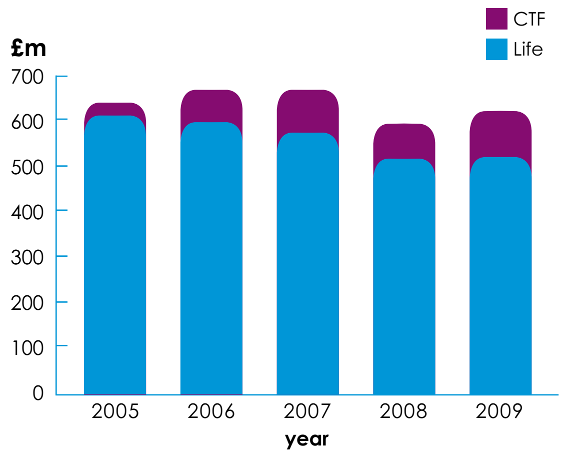
New business premiums fell by 17% in 2009, reflecting a more cautious approach and a move away from intermediary, single premium business. Regular premium life saving business increased by 3%.

group fund for future appropriations



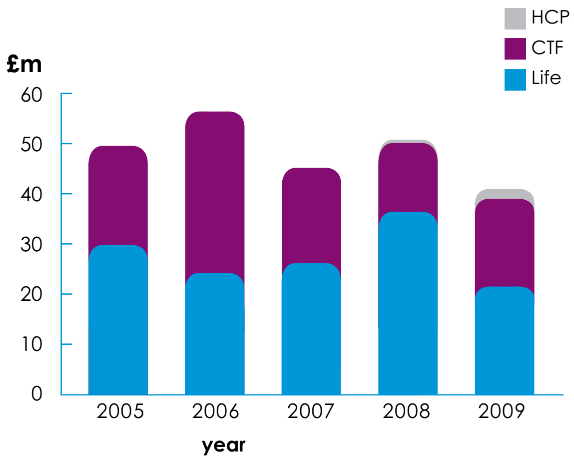
Our Group Fund for Future Appropriations demonstrates satisfactory capital support for our operations, and was increased by £1.2m in 2009.

assets under group management



The total assets under management for the Group increased to £624m, including £105m in Child Trust Funds.

premiums from policyholders



Customer premiums fell to £34.9m, also reflecting the move away from single premium business.

your board of directors

David Hargrave

B Com MSc FIA (59)
Chairman

David was appointed Chairman in 2009, having joined the Board in 1981 and served as Vice Chairman since 2004. David is a Fellow of the Institute of Actuaries with over 30 years' experience as a consultant. He is currently a Non-Executive Director at MetLife Assurance Limited and the Independent Trustee of a number of large pension funds.

Christina McComb

BA MBA (53)
Vice Chairman

Chris joined the Board in May 2005. She has extensive experience of investing in smaller companies, having spent 14 years at leading venture capital group, 3i.

In 2003, Chris became a Director of the Shareholder Executive, managing the Government's shareholder interests in a number of public-owned enterprises.

Chris is currently Head of Investment and Commercialisation at Partnerships UK Plc. She is a member of the Investors' Advisory Board of the London Technology Fund and a member of the Investment Advisory Group of Imperial Innovations Plc.

Andrew Haigh

BSc (47)
Chief Executive

Andrew became Chief Executive in March 2002. He joined the Society in 1998 and was appointed to the Board as Sales and Marketing Director in 1999. Prior to joining the Society, Andrew held senior marketing positions with NCR Corporation and National & Provincial Building Society. His early career was with Barclays Bank, British Airways and Volvo. He is a Director of the Association of Financial Mutuals and is also a Director of Mutuo, an organisation which promotes the interests of the mutual sector to Government, media and other decision makers.

Karl Elliott

BA (37)
Marketing Director

Karl became Marketing Director of the Society in October 2004 and was appointed to the Board in December 2007. He joined the Society in 1999 and carried out a number of product, marketing and distribution roles within the marketing team, including responsibility for the launch of the child trust fund and the move to the Engage Mutual brand. He represents the Society on a number of industry groups, including the Association of Financial Mutuals Communications Group and the TISA Children's Savings Council.

Graham Henderson

B Comm CA FRSA (55)
Finance Director

Graham joined the Board in February 2006 as Finance Director. He is a Chartered Accountant with 27 years of executive experience in UK blue chip financial services companies. His career includes successful experience of mergers and acquisitions, business change, IT migrations, investment policy and reporting systems, within major insurance companies. He was presented with the outstanding achievement award in the Yorkshire Finance Director of the Year awards in 2009.

Peter Mason

BSc FIA (59)
Senior Independent Director

Peter joined the Board in December 2005. He is a Fellow of the Institute of Actuaries with over 30 years' experience of financial services businesses.

He is Investment Director and Actuary at the Neville James Group, an investment management company, and is Chairman of Chesnara Plc.

how we manage the business

The Directors present their annual report, together with the financial statements for the year ended 31 December 2009.

business objectives

Our subsidiary companies are playing an important role in meeting our mission:

- Engage Mutual Funds Limited is the provider of our stakeholder child trust fund product
- Engage Mutual Administration Limited, our administration services subsidiary, provides services to the Society and its operating subsidiaries
- Engage Mutual Services Limited, our marketing services subsidiary, is an introducer of third party products and services and provides marketing services to the Society and its operating subsidiaries
- Engage Mutual Insurance Limited is the provider of our health cash plan.

The role of the subsidiaries and the impact on the finances of the Society is such that we present consolidated accounts for the Group.

The Board is committed to the ongoing development of Engage Mutual as a leading friendly society, delivering a range of good value financial products to a wide audience through direct, worksite and partnership distribution.

The Directors are of the opinion that all activities performed during the year by the Society and its subsidiaries have been carried out within their respective powers.

business review

Key business developments and the future outlook for the business of the Society and its subsidiaries are detailed in the Chief Executive's Statement, and the Operating and Financial Review on pages 8 to 19.

going concern

The Board has reviewed the summary of the guidance for Directors published by the Financial Reporting Council and concluded that in the light of:

- the published year end position on statutory solvency
- available financial resources in liquid form
- the capital projections for the Group within its agreed business plans
- the results of our Individual Capital Assessment

'There are no material uncertainties that may cast significant doubt about the company's ability to continue as a going concern.'

principal risks and uncertainties facing the business

A description of the principal risks and uncertainties facing the business of the Society and its subsidiaries is detailed in note 1.

board of directors

A list of Directors who held office during the year appears within the Society Information section on page 2.

Ray Pierce resigned on 31 May 2009 and Lord Clark retired on 21 May 2009.

Graham Henderson retires in accordance with the Society's rules and the Friendly Societies Act 1992 and, being eligible, offers himself for re-election. In addition, the Board has resolved that any Non-Executive Director who has served the Society for longer than nine years will be subject to annual re-election. As a result

David Hargrave will also stand for re-election at this year's Annual General Meeting (AGM).

As at the year end, no Director of the Society had any interest in the shares of the Society's subsidiary companies.

The Society maintains Directors' and Officers' Insurance for the Board of Directors in respect of their duties as members of the Board.

membership

Membership of the Society as at 31 December 2009 stood at 213,071 (2008: 217,430). The total number of customers was 438,507 (2008: 428,343).

complaints policy

We aim to deliver the highest possible level of service to our customers. If any customer believes that we have failed in this aim, they have recourse to our complaints procedures.

We have documented procedures for the handling and recording of complaints. We deal with all complaints with due care, ensuring that they are thoroughly investigated.

The Board of Directors regularly review the number and type of complaints received in order to monitor that complaints are properly dealt with and corrective action is taken to prevent recurrence.

Senior management deals with serious complaints. In the unlikely event that a complaint cannot be resolved to the customer's satisfaction, the customer will be made aware of the option to appeal to the Financial Ombudsman Service.

employees

The average number of Directors and staff employed by the Group, in each week of the year, totalled 150. The aggregate remuneration paid to Directors and staff employed by the Group, during the year, amounted to £7,013,000. All of the staff are employed by our Group administration services subsidiary, Engage Mutual Administration Limited.

The Society's management meets employee representatives regularly to discuss a wide range of topics, through its staff forum. Communication with and between all employees is subject to regular review and includes team briefings and informal meetings with the Chief Executive.

Engage Mutual has an equal opportunities policy for recruitment and is committed to the ongoing development of its staff. The Society has been officially recognised as an 'Investor in People' since 2001.

creditor payment policy

It is the Group's policy to settle invoices in accordance with our standard terms, unless specifically agreed otherwise in advance with suppliers.

pensions arrangements

We are committed to assisting our staff to make adequate provision for their retirement. Our defined benefit scheme closed to new members in March 2001.

The Directors are working with the Trustees to manage the pension scheme investment policy and to build on the current relative strength of the fund. This ensures that the scheme remains in a position to meet its obligations going forward in a manner which should not place a material financial strain on the Group.

For employees joining the Group since March 2001 we have a defined contribution arrangement in place whereby the Group matches the employee's contributions with a maximum corporate contribution of 10% of salary.

environmental, social and community issues

Environmental, social and community issues impacting on the business of the Society and its subsidiaries are detailed in the Operating and Financial Review starting on page 12.

In 2009 we donated in excess of £18,700 to charities, which included donations to local charity, Saint Michael's Hospice as well as donations to the Rugby League Benevolent Fund. We met all the costs of maintaining the grounds that we share with Saint Michael's Hospice.

Our staff fully support charities and have donated to the Alzheimer's Society, Jeans for Genes Day, Children in Need and Saint Michael's Hospice during 2009.

appointment of auditors

A resolution to re-appoint Deloitte LLP as Auditors will be proposed at the forthcoming Annual General Meeting.

Our policy on rotation of auditors is such that audit services are now re-tendered at least every five years.

The existing Auditors are permitted to submit a re-tender as part of this process. A full review process is conducted at least every three years.

By Order of the Board
Andrew Horsley
Secretary
25 March 2010

corporate governance

The Board is accountable to the Society's members for the operation of the Society and regards good corporate governance as being fundamental to this responsibility.

The Board is firmly of the view that, to comply with best practice in corporate governance, it should aim to adhere to the principles and provisions of the Combined Code on Corporate Governance annotated by the Association of Mutual Insurers and the Association of Friendly Societies to cover mutual insurers ("the Code").

It is our policy to observe the Code wherever appropriate for an organisation of our size, status and aspiration or to clearly explain why we feel any deviation from the Code is acceptable or necessary. The Board considers that it complies with all aspects of the Code unless the contrary is stated within this report. The Board applies principles of good governance by adopting the following procedures:

- the Board meets a minimum of six times a year for Board meetings and, in addition, meets at least twice a year for a detailed review of the Group's strategy
- the Board's principal role is to focus on the Group's strategy and ensure that the necessary resources are in place for the Group to meet its objectives and that financial control and risk management procedures are robust. In particular, its role is to provide general direction to the organisation and to safeguard the interests of members
- the Board maintains a schedule of retained powers relating to approval of the strategic aims of the Group as well as approval of policies and matters which must be approved by the Board under legislation and the Society's rules
- to ensure that the Board functions effectively, all Directors receive accurate, timely and clear information and it is the responsibility of the Chairman to ensure that this is periodically reviewed

- the Chairman also ensures that, on appointment, Non-Executive Directors receive a comprehensive tailored induction programme on the Group's business and regulatory environment. All Non-Executive Directors update their skills, knowledge and familiarity with the Group through meetings with the Executive of the Society and its employees and relevant external courses. Individual training requirements for Non-Executives are discussed during the performance evaluation process
- the Board has access to independent professional advice at the Society's expense, where they judge it necessary to discharge their responsibilities as Directors
- all Directors have access to the advice and services of the Group Secretary who is responsible for ensuring the Board procedures are complied with and advising the Board, through the Chairman, on governance matters
- the Board currently consists of three Executive Directors and three Non-Executive Directors.

The Board is currently seeking to appoint a long-term Chairman and expects to appoint an additional Non-Executive Director in 2010. During this period of renewal, the Board does not comply with the Annotated Combined Code guidelines in terms of scale. In the meantime, the Board is of the view that its current composition is adequate for the business.

attendance of directors at board and committee meetings

Board Meetings	Ray Pierce	David Hargrave	Andrew Haigh	Graham Henderson	Lord Clark	Karl Elliott	Peter Mason	Christina McComb
HFSL (10)†	2 of 4	10	10	10	3 of 4	7	9	9
EMFL (1)*	1	1	1	1	1	1	1	1
EMAL (2)**	2	2	2	2	2	2	2	2
EMSL (1)***	1	1	1	1	1	1	1	1
EMIL (6)****	2 of 2	N/A	5	N/A	N/A	N/A	N/A	N/A
Committee Meetings								
Audit (4)	N/A	4	N/A	N/A	N/A	N/A	4	4
Finance (5)	N/A	5	5	5	N/A	N/A	5	N/A
Nominations (1)	N/A	1	1	N/A	N/A	N/A	1	1
Remuneration (5)	2 of 2	3 of 3	N/A	N/A	2 of 2	N/A	3 of 3	5

* Engage Mutual Funds Limited.
** Engage Mutual Administration Limited.
*** Engage Mutual Services Limited.
**** Engage Mutual Insurance Limited.
† Homeowners Friendly Society Limited.

non-executive directors

In the opinion of the Board, each Non-Executive Director, including the Chairman, is independent in character and judgement.

The Chairman has served the Society since his first election by members in 1982. The Board is unanimously of the view that the knowledge and experience of David Hargrave remains invaluable to the Society and that the independence of his judgement will not be prejudiced by a continuation of his period in office.

The Board has resolved that any Non-Executive Director who has served the Society for longer than 9 years will be subject to annual re-election. As a result David Hargrave will stand for re-election at this year's AGM.

The Society has appointed Peter Mason as Senior Independent Director. The Senior Independent Director will be available to members, if they have concerns which contact through the Chairman, Chief Executive or Finance Director has failed to resolve (or for which such contact is inappropriate).

chairman and chief executive

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose. The Chairman is responsible for leadership of the Board and ensuring that the Board acts effectively. The Chief Executive has overall responsibility for managing the Society and its subsidiaries and for implementing the strategies and policies agreed by the Board.

performance evaluation

The Group has a formal performance evaluation system for all members of staff including the Executive Directors. The Chief Executive appraises the Executive Directors on their performance and the Chairman undertakes an appraisal of the Chief Executive.

A performance evaluation system for Non-Executive Directors has been established. The Chairman meets each Non-Executive Director annually to discuss individual performance. A meeting of the Non-Executive Directors is also held, without the Executive Directors present, to discuss collectively the performance of the Executive Directors.

In 2009 the appraisal of Non-Executive Directors took the format of a formal appraisal of each individual Director by the Chairman. This procedure identifies any individual and Board training requirements and provides the evidence for the Board to decide whether to recommend to members that a Director should be re-elected.

appointments to the board

The appointment of new Directors is considered by the Nominations Committee (see page 30) which makes recommendations to the Board.

All Directors are subject to election by members at the AGM following their appointment. In addition, all Directors must receive approval from the Financial Services Authority as an Approved Person, in order to fulfil their controlled function as a Director. Under the Society's Rules, Directors have to submit themselves for re-election at least once every three years.

Given their particular individual expertise, experience and performance to date, the Board recommends that David Hargrave and Graham Henderson be put forward for re-election by members.

The terms and conditions of appointment of Non-Executive Directors are available for inspection at our Head Office and can be viewed by contacting the Group Secretary.

board committees

The Board has established a number of committees which have their own terms of reference. Details of the principal Board Committees are set out below, and their membership in 2009 is set out on page 2.

audit committee

The Audit Committee consists of three Non-Executive Directors under the Chairmanship of Peter Mason. All of the committee members have relevant financial sector experience. The responsibilities of the committee are in line with the provisions of the Smith Guidance on Audit Committees. The main function of the committee is to assist the Board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

- the integrity of the financial statements and reviewing significant financial reporting judgements contained in them
- the effectiveness of systems of internal control and risk management processes
- the internal and external audit processes
- compliance with applicable laws and regulations
- the recommendation to the Board on the appointment, re-appointment and removal of external Auditors.

During 2009 the committee met four times in the execution of its responsibilities. During the meetings the committee considered reports on:

- the system of internal control
- the integrity of financial statements
- high level risks and associated controls
- compliance with laws and regulations, including adherence to Money Laundering regulations
- the activities of internal audit and of the external Auditors on the audit.

Reports were provided by the internal audit and compliance functions and the external Auditors. The Chairman of the Audit Committee meets regularly with the internal audit manager to discuss issues of internal control. The committee considers that it has met its responsibilities and performed its duties with appropriate levels of care and expertise during 2009.

finance committee

The Finance Committee consists of Peter Mason, Andrew Haigh and Graham Henderson, under the Chairmanship of David Hargrave. The committee met five times during 2009 to review key aspects of Group financial management in greater detail than is possible at regular Board meetings. In particular, the Board has charged the committee with providing direction and monitoring strategic progress in the management of the Society's with profits business.

nominations committee

The Nominations Committee consists of the Chairman, the Vice Chairman, the Senior Independent Director and the Chief Executive, under the Chairmanship of Peter Mason. In the opinion of the Board, the majority of members of the Nominations Committee were independent Non-Executive Directors during 2009. The Nominations Committee meets as appropriate to review the structure, size and composition of the Board and to make recommendations to the Board with regard to any adjustments that are deemed necessary. It is also responsible for identifying and nominating for the approval of the Board, candidates to fill

Board vacancies as and when they arise. Nominations for appointment to the Board are considered for approval by the full Board.

Professional recruitment consultants are appointed to ensure that vacancies are brought to the attention of a wide audience. All applicants are independently appraised by the external consultants and a short list is drawn up, prior to interview by the Board.

remuneration committee

The Remuneration Committee currently consists of the Chairman, the Vice Chairman and the Senior Independent Director, under the Chairmanship of Christina McComb. The committee meets as appropriate to determine the policy for Executive remuneration. The objective of the committee is to give Executive Directors encouragement to enhance the Group's performance by ensuring that they are fairly and responsibly rewarded for their individual and collective contributions. Further details of the committee and the remuneration policy can be found in the How We Are Remunerated section on pages 34 to 35.

Where the Group appoints remuneration consultants they are independent of the Group.

The full terms of reference of the Audit, Finance, Nominations and Remuneration Committees are available on request from the Group Secretary or by viewing our website at **engagemutual.com**.

executive sub-committees

The governance structure includes a number of Executive Sub-Committees that have responsibility for key risk areas. These committees represent the With Profits Fund, the Non Profit Fund and each of our subsidiary companies. The Sub-Committees allow the Executive to concentrate on issues at a legal entity level. Further detail of the Executive Sub-Committees is given within the Operating and Financial Review on page 19.

relations with customers

The customers of the Engage Mutual Group are currently made up of the friendly society's life fund members, CTF customers and health cash plan customers. Engage Mutual applies the same principles of value and service to all customers and encourages feedback on any aspect of the Group's activities.

In view of the increasing reliance on customers of our subsidiary companies going forward and the legal structure of a friendly society, which involves the Society operating through a series of subsidiary companies, your Board feels that it would be fairer to the customer base as a whole for subsidiary company customers to be allowed to become full members of the friendly society.

A resolution was passed at the AGM in 2009 to allow the admission of direct CTF and health cash plan customers to full membership of the friendly society. We are currently developing the mechanisms to allow such customers to become full members of the Society and we expect to announce further details later in the year.

The Engage Mutual Group has an established customer panel, consisting of around 1,500 customers, who are invited to comment on a variety of issues. Members of the Board attend meetings of the panel and use this as an opportunity to understand customers' issues and concerns.

Examples of assistance provided during 2009 by the customer panel include: insights into consumers' views of health cash plans and over 50s life cover leading to product development and continuous improvement respectively; and usability testing for our new online service and new website, both of which provided invaluable feedback into the design and content of these areas.

All members of the friendly society who are eligible to vote are encouraged to exercise their vote at the AGM by being sent a proxy voting form and pre-paid reply envelope. An individual resolution is proposed on each separate issue including a resolution on the Annual Report and Accounts.

system of internal control

The Board has delegated responsibility for managing the system of internal control to senior management. The Internal Audit function provides independent assurance to the Board on the effectiveness of the system of internal control through the Audit Committee.

The information received and considered by the committee provided reasonable assurance that during 2009 there were no material breaches of control or regulatory standards and that, overall, the Group maintained an adequate system of internal control.

regulation and solvency II

We maintain an ongoing dialogue with the FSA in order to keep our regulatory team up to date with developments and in order to address any necessary changes to business practice and policy required by developments in the comprehensive regulatory framework.

We are now planning to deliver our response to a new Solvency II European Directive. When these regulations are implemented in 2012 they will have wide ranging implications for management practice, particularly for risk and financial reporting. This means that we will seek to leverage the existing investment we have made in governance and reporting systems to fully embed risk management, evaluation and reporting in line with the new requirements. This will replace the current statutory reporting regime with more comprehensive realistic reporting standards. This will be supported by a 'use' test to satisfy the Board and the FSA that the necessary disciplines are fully understood and are embedded within our business.

We have documented our initial response to this challenge in the governance section above and the management expenses for 2009 included significant costs for implementing a new general ledger system and a Corporate Data Warehouse capability to analyse our policy data in support of Solvency II requirements. During 2011 we will begin the process of upgrading our internal actuarial models to meet the new regulatory tests.

We are seeking to implement a proportionate response to Solvency II but inevitably this will result in short term increases in costs to make the necessary upgrades in reporting systems and processes.

statement of solvency

As at 31 December 2009, the Society's capital resources for each class of relevant business exceeded the minimum capital resources requirements prescribed by the Financial Services Authority.

auditors

The Audit Committee monitors the Group's policy on the use of the external Auditors for non-audit work. The purpose of the policy is to ensure the continued independence and objectivity of the external Auditors.

The external Auditors undertook a number of non-audit assignments during 2009. In the opinion of the Audit Committee these were within the limits set out in the policy and are considered to be consistent with the professional and ethical standards expected of the external Auditors.

role as an institutional shareholder

The Group has appointed State Street Global Advisers, Legal & General Investment Management and Insight Investment Management to undertake its investment management.

The investment managers comply with the principles set out in "The responsibilities of institutional shareholders and agents – statement of principles" published by the Institutional Shareholders Committee.

The Group has requested State Street, Legal & General and Insight, where appropriate, to consider carefully the explanations given by companies in which they have invested for any departure from the Combined Code and to make reasoned judgements in each case.

Our investment managers use the Association of British Insurers (ABI) and 'Research, Recommendations & Electronic Voting' (RREV) services, as appropriate, to analyse resolutions for compliance with the Combined Code. Where the investment manager does not accept the explanation for any major departure from the Combined Code, the investment manager will enter into dialogue directly with the company in question. Our investment managers also attend AGMs of companies in which they have invested, on behalf of the Group, where it is appropriate and practicable to do so.

statement of compliance with the combined code

The Board considers that throughout the year ended 31 December 2009, the Society has applied the relevant principles and complied with the relevant provisions of the Annotated Combined Code for Mutual Insurers issued by the Association of Mutual Insurers and the Association of Friendly Societies. The exceptions are that:

- currently, at least half the Board, excluding the Chairman, is not comprised of Non-Executive Directors, determined by the Board to be independent
- the Board currently consists of three Executive Directors and three Non-Executive Directors. The Board is currently seeking to appoint a long-term Chairman and expects to appoint an additional Non-Executive Director in 2010. During this period of renewal, the Board does not comply with the Annotated Combined Code guidelines in terms of scale. In the meantime, the Board is of the view that its current composition is adequate for the business.
- the Senior Independent Director, leading the Non-Executive Directors, would ordinarily meet without the Chairman present to appraise the Chairman's performance. However, as David Hargrave is fulfiling the role of Chairman on an interim basis, this was not considered necessary in 2009.

how we are remunerated

report of the directors on remuneration

audited information

the total emoluments of the directors comprise:

Executive Directors	Salary+ £000	Bonus £000	Benefits £000	Pension Contributions £000	2009 Total £000	2008 Total £000
Andrew Haigh	210	40	–	63	313	296
Graham Henderson	152	73	2	14	241	179
Karl Elliott	110	22	–	21	153	141
Total	**472**	**135**	**2**	**98**	**707**	**616**
Non-Executive Directors						
Ray Pierce	25	–	1	–	26	60
Lord Clark	11	–	1	–	12	27
David Hargrave	50	–	–	–	50	36
Peter Mason	33	–	–	–	33	29
Christina McComb	32	–	–	–	32	27
Total	**151**	**–**	**2**	**–**	**153**	**179**

+Payments in respect of company car allowances are included in salary.

long-term benefits

The Executive Directors participate in a long-term bonus scheme, based on the long-term performance of the Group.

Payments are provided for in the financial statements of Engage Mutual Administration Limited. Andrew Haigh's and Karl Elliott's long-term bonuses as at 31 December 2009 were £60K and £33K respectively (£Nil in 2008) to be paid in two equal instalments in 2011 and 2012, subject to performance criteria.

Graham Henderson's long-term bonus as at 31 December 2009 was £Nil (paid £71,052 relating to the 2008 award during 2009).

directors' pension entitlement

The Society operates a defined benefit pension scheme for its employees. This scheme was closed to new entrants in 2001. A stakeholder pension scheme is in place for all new employees. Andrew Haigh and Karl Elliott are members of the defined benefit pension scheme.

The details of Andrew Haigh's and Karl Elliott's pensions at 31 December 2009 are shown in the table opposite. Graham Henderson participated in a defined contribution scheme.

other benefits

There were no payments made directly by the Society in respect of pensions in 2009 for former Directors or their spouses (2008: £Nil).

the table below sets out the directors' pension cost information in respect of Andrew Haigh and Karl Elliott:

Executive Directors	Accrued benefit as at 31 December 2009	Increase in accrued benefit over 2009 (excluding inflation)	Increase in accrued benefit over 2009 (including inflation)	Transfer value of increase in accrued pension less member contributions	Transfer value as at 31 December 2008	Transfer value as at 31 December 2009	Increase in transfer value over 2009	Increase in transfer value less member contributions
Andrew Haigh	31,816	4,550	4,158	56,372	258,592	506,417	247,825	238,020
Karl Elliott	17,538	2,476	2,259	24,575	99,347	230,825	131,478	126,138

un-audited information

The composition and responsibilities of the Society's Remuneration Committee are set out on page 31. The Remuneration Committee is responsible for the Group's Executive remuneration policy. The objective of the committee is to give Executive Directors encouragement to enhance the Group's performance by ensuring that they are fairly and responsibly rewarded for their individual contributions. Where possible the committee seeks to meet the standards set out in the Combined Code applicable to listed companies.

The level of remuneration is set by reference to jobs carrying similar responsibilities in similar organisations. There is a performance-related element within the remuneration, which is linked to the achievement of objectives.

Proper regard is paid to the need to retain good quality, highly motivated staff and the remuneration being paid by competitors of the Group is taken into consideration. In this respect the committee receives information inter alia from a leading firm of remuneration consultants, Towers Watson, and also receives bench-marking data where required.

The remuneration of our Non-Executive Directors is recommended by the Chairman and the Chief Executive for the Remuneration Committee to agree annually at the year end.

The remuneration is calculated on the basis of an agreed minimum number of days committed to Group business and is paid at a rate which has been confirmed as competitive when compared with other similar sized financial services organisations.

service contracts

Andrew Haigh and Karl Elliott have service contracts with a twelve month notice period. Graham Henderson has a service contract with a six month notice period. No Non-Executive Director has a service contract.

non-executive directors' remuneration

Non-Executive Directors' remuneration comprises a specified fee, which includes extra amounts for specific additional responsibilities, as set out on page 2.

executive bonus entitlements

The Society operates an annual discretionary bonus scheme for Executive Directors. The Society's policy is to ensure that Executive Directors are appropriately incentivised to meet the objectives of the business.

The Chief Executive is awarded a maximum of 66% of basic salary for achievement of Society objectives. The Finance Director and the Marketing Director are awarded a maximum of 30% of basic salary for the achievement of individual objectives.

The Society is introducing new arrangements such that from 2010, not more than 40% of the combined annual discretionary bonus and long-term benefit will be paid in the year it is awarded with the balance deferred over 3 years, subject to performance criteria.

statement of directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

The Friendly Societies Act 1992 ('the act') requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The Group and Society financial statements are required by law to give a true and fair view of the state of affairs of the Group and of the Society as at the end of the financial year and of the income and expenditure of the Group and of the Society for the financial year.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgments and estimates that are reasonable and prudent
- state whether applicable United Kingdom Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Society will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society and enable them to ensure that the financial statements comply with the Act.

They are also responsible for safeguarding the assets of the Group and Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

independent auditor's report

To the members of Homeowners Friendly Society Limited.

We have audited the Group and individual financial statements (the 'financial statements') of Homeowners Friendly Society Limited ("the Society") for the year ended 31 December 2009 which comprises the Group and Society Income and Expenditure Accounts, the Group Statement of Total Recognised Gains and Losses, the Group and Society Balance Sheets, the Statement of Accounting Policies and the related notes 1 to 29. These financial statements have been prepared under the accounting policies set out therein. We are also required to report on the Directors' Report for the year ended 31 December 2009.

This report is made solely to the Society's members, as a body, in accordance with section 73 of the Friendly Societies Act 1992. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an Auditors' Report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

respective responsibilities of the directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out opposite in the Directors' Responsibilities Statement.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Friendly Societies Act 1992. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Chief Executive's Statement and the Operating and Financial Review and Controls and Risk management section that is cross referred from the Directors' Report.

In addition we report to you if, in our opinion, the Society has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding remuneration of the Directors and other transactions is not disclosed.

We review whether the Corporate Governance Report reflects the Society's compliance with the nine provisions of the Combined Code on Corporate Governance – An Annotated Version for Mutual Insurers recommended for our review by the Myners Review of the Governance of Life Mutuals, and we report if it does not. We are not required to consider whether the Directors' statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report as described in the contents section, and consider whether it is consistent with the audited financial statements.

We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Society and the Group, consistently applied and adequately disclosed. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material mis-statement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Society's and the Group's affairs as at 31 December 2009 and of the income and expenditure of the Society and the Group for the year then ended
- the financial statements have been properly prepared in accordance with the Friendly Societies Act 1992
- the Directors' Report has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it, and the information given therein is consistent with the accounting records and the financial statements for the year.

Stephen Williams
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and
Statutory Auditors
Leeds, United Kingdom

25 March 2010

our 2009 financial statements

group income and expenditure

for the year ended 31 December 2009

Technical Account Long-Term Business

		notes	2009 £'000	2008 £'000
	Continuing operations			
	Earned premiums, net of reinsurance			
	Gross premiums written	2	**34,967**	44,875
	Outward reinsurance premiums	2	**(10,868)**	(10,348)
Share dividends, interest on deposits held and realised gains on investments	Investment income	3	**15,758**	9,410
Movements in value of investments held	Unrealised gains / (losses) on investments	3	**26,159**	(56,791)
	Other technical income	10	**77**	137
	Claims incurred, net of reinsurance			
	Gross claims incurred	4	**(47,842)**	(53,749)
	Outward claims reinsurance	4	**3,945**	3,466
	Change in long-term business provision, net of reinsurance	20	**3,297**	5,176
Change in value of linked policyholders' benefits	Change in technical provisions for linked liabilities	20	**(11,038)**	54,201
	Net operating expenses	6	**(9,152)**	(16,836)
Fund managers' charges	Investment expenses and charges	3	**(464)**	(242)
Group charge to corporation tax	Taxation	12	**1**	-
	Transfer (to) / from fund for future appropriations	24	**(4,840)**	20,701
	Balance on the long-term business technical account		**-**	-

group income and expenditure (cont.)

for the year ended 31 December 2009

Technical Account General Business

The total income and expenditure on the health cash plan business

	notes	2009 £'000	2008 £'000
Continuing operations			
Earned premiums			
Gross premiums written		**1,865**	736
Change in unearned premiums		**(3)**	(74)
Claims incurred			
Claims paid		**(1,084)**	(405)
Change in provision for claims		**(39)**	(97)
Net operating expenses	6	**(1,056)**	(262)
Balance on the general business technical account		**(317)**	**(102)**

Non-Technical Account

Income earned in non-life subsidiaries

Expenses incurred in non-life subsidiaries

	notes	2009 £'000	2008 £'000
Continuing operations			
Balance on the general business technical account		**(317)**	(102)
Other income	11	**2,461**	1,368
Net operating expenses	6	**(2,575)**	(4,501)
Pension finance income	25	**(2)**	175
Deferred taxation		**-**	-
Loss on ordinary activities		**(433)**	(3,060)

group statement of total recognised gains and losses

for the year ended 31 December 2009

		notes	2009 £'000	2008 £'000
	Loss on ordinary activities		**(433)**	(3,060)
Income and expense items which differed to projected amounts on the pension scheme	Actuarial loss on pension scheme	25	**(645)**	(150)
Surplus in the pension scheme which has not been recognised as an asset	Unrecognised pension scheme surplus	25	**(2,601)**	-
	Total recognised gains and losses in the year		**(3,679)**	(3,210)

group balance sheet

for the year ended 31 December 2009

Assets

Harrogate head office and Kew Gardens property

Value of unit-linked investments

Accumulated sales costs that are associated with acquiring new policies and are spread over several years

	notes	2009 £'000	2008 £'000
Investments			
Investment in land and buildings	13	**5,916**	6,316
Financial investments	15	**94,642**	94,543
Assets held to cover linked liabilities	16	**384,701**	373,663
Reinsurers' share of technical provisions			
Long-term business provision	20	**24,469**	30,429
Debtors	17	**4,206**	482
Other assets			
Tangible assets	18	**97**	185
Cash at bank		**2,571**	4,706
Deferred taxation	12	**-**	893
Prepayments and accrued income			
Accrued interest and rent		**2**	492
Deferred acquisition costs	19	**1,041**	988
Other prepayments and accrued income		**1,794**	1,822
Total assets excluding the pension asset		**519,439**	514,519
Net pension asset	25	**-**	2,296
Total assets including the pension asset		**519,439**	516,815

group balance sheet (cont.)

for the year ended 31 December 2009

Liabilities

		notes	**2009 £'000**	2008 £'000
Value recognised for regulatory reserves and other surplus funds, including possible future with profit bonuses	**Fund for future appropriations**	24	**31,777**	30,616
	Technical provisions			
Provision for with profits policies and other known contingencies	Long-term business provision	20	**88,332**	97,589
Maturities, surrenders and death claims awaiting processing and payment	Claims outstanding	20	**5,398**	6,253
Value of unit-linked policyholders' benefits	**Technical provisions for linked liabilities**	20	**384,701**	373,663
	Provisions for other risks and charges	21	**598**	1,848
	Creditors			
	Creditors arising out of insurance operations	22	**3,506**	1,233
	Other creditors including taxation and social security	23	**2,045**	2,860
Expenses due in the period yet to be processed	**Accruals and deferred income**		**3,082**	2,753
	Total liabilities		**519,439**	516,815

Approved at a meeting of the Board of Directors on 25 March 2010 and signed on its behalf by:

A S Haigh
Chief Executive

D G Hargrave
Chairman

A J Horsley
Secretary

society income and expenditure

for the year ended 31 December 2009

Technical Account Long-Term Business

		notes	2009 £'000	2008 £'000
	Continuing operations			
	Earned premiums, net of reinsurance			
	Gross premiums written	2	**34,967**	44,875
	Outward reinsurance premiums	2	**(10,868)**	(10,348)
Share dividends, interest on deposits held and realised gains on investments	Investment income	3	**15,758**	9,410
Movements in value of investments held	Unrealised gains / (losses) on investments	3	**26,159**	(56,791)
	Other technical income	10	**577**	645
	Claims incurred, net of reinsurance			
	Gross claims incurred	4	**(47,842)**	(53,749)
	Outward claims reinsurance	4	**3,945**	3,466
	Change in long-term business provision, net of reinsurance	20	**3,297**	5,176
Change in value of linked policyholders' benefits	Change in technical provisions for linked liabilities	20	**(11,038)**	54,201
	Net operating expenses	6	**(10,683)**	(17,551)
Fund managers' charges	Investment expenses and charges	3	**(464)**	(242)
Society charge to corporation tax	Taxation	12	**1**	-
	Transfer (to) / from fund for future appropriations	24	**(3,809)**	20,908
	Balance on the long-term business technical account		**-**	-

society balance sheet

for the year ended 31 December 2009

Assets

Harrogate head office and Kew Gardens property

With profits fund and surplus investments

Value of unit-linked investments

Accumulated sales costs that are associated with acquiring new policies and are spread over several years

	notes	2009 £'000	2008 £'000
Investments			
Investment in land and buildings	13	**5,916**	6,316
Investment in subsidiaries	14	**13,150**	12,300
Financial investments	15	**90,966**	92,109
Assets held to cover linked liabilities	16	**384,701**	373,663
Reinsurers' share of technical provisions			
Long-term business provision	20	**24,469**	30,429
Debtors	17	**8,466**	6,057
Cash at bank		**1,721**	2,447
Prepayments and accrued income			
Accrued interest and rent		**2**	492
Deferred acquisition costs	19	**1,041**	988
Other prepayments and accrued income		**1,406**	1,239
Total assets		**531,838**	526,040

society balance sheet (cont.)

for the year ended 31 December 2009

Liabilities

		notes	2009 £'000	2008 £'000
Value recognised for regulatory reserves and other surplus funds, including possible future with profit bonuses	**Fund for future appropriations**	24	**46,294**	42,485
	Technical provisions			
Provision for with profits policies and other known contingencies	Long-term business provision	20	**88,332**	97,589
Maturities, surrenders and death claims awaiting processing and payment	Claims outstanding	20	**5,398**	6,253
Value of unit-linked policyholders' benefits	**Technical provisions for linked liabilities**	20	**384,701**	373,663
	Provisions for other risks and charges	21	**598**	1,848
	Creditors			
	Creditors arising out of insurance operations	22	**3,294**	1,233
	Other creditors including taxation and social security	23	**2,132**	1,013
Expenses due in the period yet to be processed	**Accruals and deferred income**		**1,089**	1,956
	Total liabilities		**531,838**	526,040

Approved at a meeting of the Board of Directors on 25 March 2010 and signed on its behalf by:

A S Haigh
Chief Executive

D G Hargrave
Chairman

A J Horsley
Secretary

statement of accounting policies

for the year ended 31 December 2009

a. Basis of presentation

The Group financial statements have been prepared in compliance with the Friendly Societies (Accounts and Related Provisions) Regulations 1994, Friendly Societies Act 1992, and in accordance with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("ABI SORP"), in December 2005 and as amended in December 2006.

The financial statements have been prepared in accordance with applicable accounting standards. A summary of the more important Group accounting policies is set out below.

As stated in the Directors' Report starting on page 24, the Directors have concluded there are no material uncertainties that may cast significant doubt about the Society's ability to continue as a going concern.

In the prior year the underwriting result generated by Engage Mutual Insurance Limited (EMIL) of £160,000 was included in the non-technical account under the caption 'General Insurance Gross Profit'. In addition, the net operating expenses of EMIL of £262,000 were included within 'Net Operating Expenses' within the non-technical account. This presentation was on the basis that the results of EMIL were not material to the Group.

In the current year, the Directors have revisited this conclusion and determined that the results of EMIL are material. In accordance with the Friendly Societies Act 1992, a technical account general business has been presented to show the results of EMIL.

In addition to reviewing the presentation of the results of EMIL, the Directors have also elected to include a Statement of Total Recognised Gains and Losses in the current year. In the prior year, the actuarial loss on the Group's defined benefit pension scheme of £150,000 was presented within the non-technical account, as permitted by the Friendly Societies Act 1992. In the current year the actuarial loss is shown within the Statement of Total Recognised Gains and Losses.

b. Basis of consolidation

The consolidated financial statements incorporate the assets, liabilities, and results of the Society and its subsidiary undertakings drawn up to 31 December each year.

The General Insurance results of EMIL, have been consolidated into the income and expenditure – technical account general business.

The ongoing results of other subsidiary undertakings are included in the income and expenditure – non-technical account. The net results are included in the Fund for Future Appropriations for the Group. The activities of the Society and Group are accounted for in the income and expenditure accounts.

c. Long-term insurance contracts

Premiums
Long-term business premiums, including reinsurance premiums, are credited when they become due for payment. New business premiums, including single premiums, are recognised when they are received.

Claims
For long-term business death claims are accounted for when notified to the Society. Annuity payments are recorded when due. Maturities and surrenders are recorded on the earlier of the date when paid or when the policy ceases to be included within the Long-Term Business Provision and / or the Technical Provision for Linked Liabilities. Reinsurance recoveries are credited to match the relevant gross amounts.

Deferred acquisition costs
The costs of acquiring new insurance contracts are deferred to the extent that they are recoverable out of future revenue margins. Such costs are disclosed as an asset in the balance sheet. The rate of amortisation of the deferred acquisition cost assets is consistent with an appropriate assessment of the pattern of receipt of future revenue margins over the period the relevant contracts are expected to remain in force.

Policyholder liabilities under insurance contracts
See accounting policy I – 'Long-term business provision' and policy J – 'Technical provisions for linked liabilities'.

Reinsurance
Long-term business is ceded to reinsurers under contracts to transfer part or all of one or more of the following risks: mortality, morbidity, persistency and expenses.

The amounts that will be recoverable from the reinsurers are estimated based upon the gross provisions, having due regard for collectability. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of each of the reinsurance companies. The reinsurers' share of claims incurred, included in note 4, reflects the amounts receivable from the reinsurers in respect of claims incurred during the period. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the income and expenditure – technical account as part of net premium income when payable.

d. Technical account general business

The general business net profit which is consolidated in the income and expenditure – technical account general business includes general business premiums and claims.

Premiums
General business premiums comprise the total premiums due for the whole period of cover excluding insurance premium tax. Unearned premiums are calculated as the unexpired element of risk spread on a straight line basis across the period of the policy.

Claims
General business claims incurred comprise claims paid during the financial year together with the movement in the provision for outstanding claims, including claims incurred but not reported. Claims outstanding comprise provisions for the estimated cost of settling all claims incurred but unpaid at the balance sheet date whether reported or not. Provisions for claims outstanding are based on information available and the eventual outcome may vary from the original assessment.

e. Investment return

Investment return comprises all investment income, realised gains and losses and movements in unrealised gains and losses, net of investment expenses.

Dividends on equity holdings are included as investment income on the date the equity shares are quoted ex dividend and are stated net of the dividend withholding tax. Interest, including mortgage interest, rent and expenses are accounted for on an accruals basis.

Dividends on accumulation share holdings in open ended investment companies (OEICs) and accumulation unit holdings in unit trusts are included as investment income on the date the dividend voucher is received. Since the income is rolled up in the unit price the total return is always included in the investment return.

Realised gains and losses on investments are calculated as the difference between sale proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the fair value at the balance sheet date and their purchase price or their fair value at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

f. Investments

Land and buildings
Land and buildings are valued at open market valuation. Full valuations are made by independent professionally qualified valuers every three years. In the intervening years these valuations are updated by the Directors with assistance of independent professional advice as required. Full valuations may be made in the intervening periods where economic conditions in the property market would suggest it is necessary.

Land and buildings occupied by the Group are valued in accordance with generally recognised methods of valuation. The aggregate unrealised surplus or deficit is included in the technical account. It is the Society's practice to maintain these assets in a continual state of repair and to extend and make improvement thereto from time to time; accordingly, the Directors consider that the lives of these assets are so long and residual values, based on prices prevailing at the time of acquisition or subsequent valuation, are so high that any depreciation would be immaterial.

Investments in Group undertakings and participating interests
In the balance sheet of the Society, investments in Group undertakings and participating interests are stated at cost, unless their realisable value has been impaired, in which case they are valued at their realisable value or value in use as appropriate.

Other financial investments
Other financial investments consist of listed investments, loans secured on residential properties, units in authorised unit trusts, shares in OEICs, and deposits. Listed investments are included at market value.

Shares in OEICs and units in unit trusts are included at the published price. Deposits are included at current value. Mortgage loans are included at amount outstanding less any provision for unrecoverable amounts.

statement of accounting policies (cont.)

for the year ended 31 December 2009

g. Non-technical account

Revenue is recognised as follows:

Fee income paid to Engage Mutual Administration Limited in relation to the provision of Third Party Administration services is recognised when the services are provided, to the extent the amounts are considered recoverable.

Management charges payable to Engage Mutual Funds Limited, as the Authorised Corporate Director (ACD) of Engage Mutual Investment Funds Limited, are recognised on an accruals basis and are deducted from the OEIC fund.

Introductory and referral fees earned by Engage Mutual Services Limited are recognised on inception of the underlying arrangement. Where necessary, provisions for cancellations are made at the time the fees are recognised, and are deducted from the revenue.

h. Fixed assets

Depreciation is provided on the cost of assets in annual instalments over their estimated lives.
The rates of depreciation applied per annum are as follows:

Fixtures, fittings and office equipment	20% straight line
Computer equipment	25% straight line

The cost of new computer software is depreciated in full in the year in which it is incurred and eliminated from the accounts after five years.

i. Long-term business provision

The long-term business provision is determined by the Society's Actuarial Function Holder following his annual investigation of the long-term business, which is based on methods and assumptions that have been approved by the Board of Directors. It is calculated initially to comply with the reporting requirements under the Prudential Sourcebook for Insurers. This statutory solvency basis of valuation is then adjusted by eliminating certain reserves required under Friendly Society Regulations. This adjusted basis is referred to as the modified statutory solvency basis. The long-term business provision includes the non-linked liabilities in respect of linked business.

No explicit provision is made for future final (terminal) bonuses under this basis. Implicit provision for part of future yearly (reversionary) bonuses is included in the long-term business provision.

j. Technical provision for linked liabilities

Liabilities under unit-linked contracts are recognised when the units are created and are dependent on the value of the underlying unit-linked assets.

k. Taxation

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax assets and liabilities are recognised in accordance with the provisions of Financial Reporting Standard 19 'Deferred Taxation' ('FRS 19'). The Society has chosen not to apply the option available under FRS 19 of discounting such assets and liabilities to reflect the time value of money. Except as set out in FRS 19, deferred tax is recognised in respect of all timing differences that have originated but not reversed by the balance sheet date. Deferred tax assets are recognised only to the extent that it is regarded as more likely than not that they will be recovered.

l. Pension costs

The Group operates a defined benefit pension scheme for staff whose employment commenced before 6 April 2001. The pension asset recognised in the consolidated balance sheet is the value of the scheme's assets less the present value of the scheme's liabilities less amounts which are not recoverable through a refund or reduced future contributions.

The pension cost for the scheme is analysed between the current service cost, past service cost and net return on pension scheme. Current service cost is the actuarially calculated present value of the benefits earned by the active employees in each period. Past service costs, relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits, are recognised in the profit and loss account in the period in which they are vested. The current and past service costs are included in net operating expenses in the income and expenditure – non-technical account.

Net expected return on the pension asset comprises the expected return on the pension assets less interest on scheme liabilities and is included in pension finance income in the income and expenditure – non-technical account.

Actuarial gains and losses (changes in the surpluses or deficits due to experience of gains and losses) are shown in the statement of total recognised gains and losses.

The Group operates a defined contribution scheme for staff whose employment commenced after 6 April 2001. Payments to this scheme are treated as an expense when due. They are included in net operating expenses in the income and expenditure – non-technical account.

m. Foreign currency

Assets and liabilities held in foreign currencies are translated to sterling at rates of exchange ruling at the end of the year. Income and expenditure denominated in foreign currencies are translated at the appropriate rates prevailing during the year.

n. Operating leases

Operating lease payments are accounted for on a straight line basis over the term of the lease.

o. Cash flow statement

The Society, being a mutual life assurance company, is exempt from the requirement under Financial Reporting Standard 1 'Cash Flow Statements' ('FRS 1') to produce a cash flow statement.

p. Fund for future appropriations

The fund for future appropriations represents all funds, the allocation of which has not yet been determined by the end of the financial year. Any surplus or deficit arising on the income and expenditure – technical account is transferred to or from the fund on an annual basis.

notes to the financial statements

for the year ended 31 December 2009

1. management of financial risk

a. Market risk

Interest rate risk

Interest rate risk arises primarily from investments in fixed income securities. The value of fixed interest securities is directly affected by the change in the level of interest rates. An increase in interest rates will mean the value of fixed interest securities will fall and conversely a decrease in interest rates will mean the value of fixed interest securities will increase. The with profits fund uses fixed interest securities as part of an asset liability matching (ALM) framework. Any increase or decrease in interest rates will affect the carrying value of the assets, whilst affecting to a lesser extent the value of the policyholder liabilities thus changing the amount of available capital resources for the with profits policyholders.

On the unit-linked and OEIC funds which the Group manages the interest rate risk is borne by our policyholders since the value of the policyholders' liability relates directly to the increase or decrease in the value of the underlying assets held on their behalf. However, a significant element of income for the Group is derived as a fixed percentage of the market value of unit-linked and OEIC assets and as such any changes in the value of assets impacts future income.

Equity price risk

The Group has exposure to equity securities through both directly held equity securities in companies and indirectly through holdings in OEICs and Authorised Unit Trusts which in turn invest, partially and wholly, in equity securities. Exposure to individual companies is managed to ensure compliance with regulatory limits for solvency purposes.

The Group has in place a number of agreements with the Group's Investment Managers to ensure that investment transactions are managed within agreed mandates and benchmarks and which limit the exposure in aggregate terms to equity investments, as well as between specific sectors and asset classes. The Investment Managers' Agreements (IMAs) on the with profit fund have a range of limits within which the Investment Managers work. The Executive Capital, Investment and Risk Committee (CIRC) receives regular reports from the Investment Managers on performance versus benchmarks and asset allocations.

On the unit-linked and OEIC funds which the Group manages the equity price risk is borne by our policyholders since the value of the policyholders' liability relates directly to the increase or decrease in the value of the underlying assets held on their behalf. However, a significant element of income for the Group is derived as a fixed percentage of the market value of unit-linked and OEIC assets and as such any changes in the value of assets impacts future income.

Market risk in relation to with profits business, would arise if adverse changes in the value of the assets supporting the business could not be offset fully by reduced payouts to policyholders due to the effect of guarantees and options.

b. Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when they fall due. The Group is primarily exposed to credit risk in relation to its reinsurance arrangements, both in relation to the reinsurers' share of the long-term business provision and in relation to amounts they owe on claims which the Group has already paid.

Reinsurance is used to manage insurance risk. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim, the Group remains liable for the payment to the policyholder. The Group monitors the financial strength of its reinsurance counterparties by reviewing credit grades provided by rating agencies and other publicly available financial information.

1. management of financial risk (cont.)

c. Liquidity risk

Liquidity risk is the risk that cash may not be available when obligations become due for payment.

The Group manages a significant value of tax-exempt savings plans based on wholesale cash deposits and maintains a prudent liquidity profile in relation to such deposits. Amounts payable on unit-linked contracts are generally payable on demand and the Group is responsible for ensuring there is sufficient liquidity in the investment portfolio to ensure payments can be made as they fall due. However, the terms of the unit-linked policies state that in certain circumstances payments may be deferred until such time as liquid assets can be realised.

With profits contracts can be surrendered before maturity for a cash surrender value. The Group has discretion to impose market value reductions (MVRs) on early surrender which reduce the amount payable. MVRs are a way of ensuring an equitable treatment between policyholders surrendering and those remaining in the with profits fund and also contribute to managing liquidity risk.

d. Lapse risk

Persistency is the number of long-term policies which remain in force over a period of time, excluding deaths and maturities. Persistency risk arises where the percentage of policies remaining in force is different than anticipated. Whilst this does not impact the financial strength of the company at the balance sheet date it does impact the future income streams into the Group.

e. Expense risk

When calculating the value of the policyholder liabilities, a prudent allowance is made for future expenses. To the extent that future expenses differ from this allowance the Group is exposed to expense risk.

A significant proportion of the Group's internal management information and governance activity is geared to monitoring the levels of ongoing management and acquisition expenses to confirm that they remain within expected levels set within our product terms and pricing assumptions.

f. Mortality risk

Mortality risk in relation to whole of life business, which would arise if mortality of the lives assured was heavier than that assumed, possibly due to an epidemic or catastrophe. The Group manages mortality risk by using reinsurance arrangements which transfer a large percentage of the mortality risk to our reinsurance partners in return for an agreed reinsurance premium.

1. management of financial risk (cont.)

g. Capital management

The Society and its regulated subsidiaries maintain sufficient capital, consistent with the Group's risk profile. Further information about the risk appetite and risk management framework can be found in the Corporate Governance section on pages 27 to 33.

The Society is a mutual organisation and there are no shareholders. As at 31 December 2009 the available capital resources were made up by the Fund for Future Appropriations (FFA). The FFA is the surplus accumulated that has not yet been allocated to policies. It forms the working capital of the Group and is available to meet risk and capital requirements, as well as any uncertain additional liabilities that may arise in the future.

The Society is subject to a number of regulatory capital tests and also employs a number of market consistent tests to allocate capital and manage the Group's risks. Overall, the Society and its regulatory subsidiaries meet all of these requirements.

In reporting financial strength, capital resources and solvency are measured following the regulations prescribed by the Financial Services Authority (FSA). Currently these regulatory capital tests are based upon the statutory solvency capital and a series of prudent assumptions in respect of the type of business written.

Modified statutory solvency, as measured by the FSA rules, and reported in these financial statements sets liabilities on a prudent basis so that the margins of prudence are expected to be sufficient to withstand shocks or stresses. The resulting Statutory reserves are tested to ensure that we do not breach our minimum capital requirements on a number of tests including one-off falls in the price of equities as well as one-off reductions in income. Additional reserves are also held to ensure that the Society can be expected to discharge its responsibilities to policyholders at all times up until their policies mature.

Capital management objectives

The Group's objectives in managing capital are that:

- the aggregate risk exposure of the Group is to be managed to ensure that the capital resources available always meet the minimum capital requirements set out by the FSA; and
- the Group will ensure that all risks are subject to structured analysis in accordance with the risk appetite agreed by the Board, and that the overall risks carry adequate potential rewards; and
- sufficient capital resources are available to fund the growth of the Society.

Capital resource sensitivities

The capital position is sensitive to changes in market conditions, due to both changes in the value of the assets as well as the effect these changes in market conditions would have on the value of the liabilities. It is also sensitive to the expense and persistency experience and to a lesser extent improvements in mortality.

The timing of any impact on capital would depend on the interaction of past experience and assumptions about future experience. In general, if experience had deteriorated or was expected to deteriorate, and management actions were not expected to reduce the future impact, then assumptions would be changed so that liabilities would be increased with immediate impact on the capital position.

Further details of how the capital objectives and related risks are managed are included in the Operating and Financial Review starting on page 12.

notes to the financial statements

for the year ended 31 December 2009

1. management of financial risk (cont.)

Operational risk – key suppliers / business partners

As part of our risk review and capital management we consider all aspects of the operational risks relating to our internal processes and business model. Within the evaluation we consider our resilience and protections against financial or operational failure of key suppliers.

Our strategic suppliers and the Group services they provide to us are as follows:

Strategic supplier	Services provided
Munich Re	Risk Transfer and Financial Reassurance services
National Australia Banking Group	Savings and protection distribution
State Street Global Advisors	Investment Management Services
Insight Investments	Investment Management Services
Legal and General Investment Managers	OEIC Investment Management Services
Bank of New York Mellon	Investment accounting, custody and pricing services
Oracle	Database management for policy administration
Microsoft	Software and operating systems for end user computing
Barclays	Principal banker
Deloitte	Professional advice and audit services
Addleshaw Goddard	Legal services

Funding of subsidiary undertakings

Engage Mutual Funds Limited (EMFL) is a wholly owned subsidiary of Homeowners Friendly Society Limited (HFSL) and is regulated by the FSA. Engage Mutual Insurance Limited (EMIL) is a wholly owned subsidiary of HFSL and is regulated by the Financial Services Commission Gibraltar (FSCG). EMFL and EMIL are required to hold sufficient capital to meet regulatory capital requirements in their own right. EMFL along with EMIL are funded by share capital issued to the Society.

The value of assets held to meet the liabilities of the Society and its regulated subsidiaries' capital requirements is determined in accordance with FSA regulations. The value of the subsidiaries is restricted to amounts which are likely to be recovered.

Engage Mutual Administration Limited (EMAL) is funded by an inter-company loan for ongoing financing purposes.

Engage Mutual Services Limited (EMSL) has net assets to fund its activities. To the extent these do not provide sufficient working capital the Society will provide an inter-company loan.

Restrictions on available capital resources

The Society and its regulated subsidiaries are required to hold capital sufficient to meet the FSA's and FSCG's minimum capital requirements. Account is also taken of the Individual Capital Assessment which considers some of the risks the business faces not covered by the statutory basis.

The available capital resources held in the with profits fund are normally only available to meet the capital requirements or be allocated to policyholders of the fund. There are no restrictions on the available capital held in the non profit fund.

The value of assets held to meet the Society and its regulated subsidiaries' capital requirements is determined in accordance with FSA and FSCG regulations.

The Society's total available capital resources are £30.2m (2008: £27m) of which £15.0m (2008: £11.9m) is held in the with profits fund and £15.2m (2008: £15.1m) is held in the non profit fund.

notes to the financial statements

for the year ended 31 December 2009

1. management of financial risk (cont.)

Available capital resources

	Non profit £'000	With profits £'000	Total £'000
Available capital resources as at 31 December 2009:			
Fund for future appropriations	**29,897**	**16,397**	**46,294**
Adjustments in respect of subsidiary undertakings	(13,441)	-	(13,441)
Adjustment to assets onto regulatory basis	(529)	(380)	(909)
Adjustment to liabilities onto regulatory basis	(700)	(1,000)	(1,700)
Total available capital resources	**15,227**	**15,017**	**30,244**
Society capital requirements	(3,809)	(4,518)	(8,327)
Subsidiary capital requirements	(2,374)	-	(2,374)
Excess capital over regulatory requirements	**9,044**	**10,499**	**19,543**

	Non profit £'000	With profits £'000	Total £'000
Available capital resources as at 31 December 2008:			
Fund for future appropriations	**29,871**	**12,614**	**42,485**
Adjustments in respect of subsidiary undertakings	(12,406)	-	(12,406)
Adjustment to assets onto regulatory basis	(703)	(109)	(812)
Adjustment to liabilities onto regulatory basis	(1,710)	(600)	(2,310)
Total available capital resources	**15,052**	**11,905**	**26,957**
Society capital requirements	(2,896)	(2,818)	(5,714)
Subsidiary capital requirements	(2,238)	-	(2,238)
Excess capital over regulatory requirements	**9,918**	**9,087**	**19,005**

Analysis of movement

The table below shows how the excess capital over regulatory requirements has changed during 2009:

	Non profit 2009 £'000	**With profits 2009 £'000**	**Total 2009 £'000**
Opening excess capital at 1 January	9,918	9,087	19,005
Non-linked investment returns	(91)	6,414	6,323
Life assurance new business costs	(6,763)	(534)	(7,297)
Reinsurance commissions on new business	2,873	-	2,873
Subsidiary new business costs	(905)	-	(905)
Other	4,012	(4,468)	(456)
Closing excess capital at 31 December	**9,044**	**10,499**	**19,543**

notes to the financial statements

for the year ended 31 December 2009

1. management of financial risk (cont.)

The technical provisions as set out in the Society's regulatory returns and used to determine the regulatory capital resources are:

	2009 £'000	2008 £'000
Technical provisions		
Unit-linked		
– Unit insurance contracts	384,701	373,355
– Non unit insurance contracts	1,005	597
Non participating insurance contracts	933	2,243
Participating insurance contracts	63,493	66,454
Total technical provisions	**450,132**	442,649

The following guarantees which would have a material value to policyholders are:

- maturity values – on conventional and unitised with profits policies there is a guarantee that on the maturity date there will be a minimum payout of the sum assured plus any declared bonuses.
- return of premium guarantees – on certain unitised with profits policies there is a guarantee that an amount not less than the initial premium will be paid out on the policies' 5th, 10th and each subsequent 10th anniversary. An explicit charge is made for this guarantee.

Whilst not specifically a guarantee or option, payouts on conventional and unitised with profits policies are smoothed over time to reduce the effect of short term fluctuations in investment returns. This primarily applies to payouts on maturities, however, it can apply to a lesser extent on early surrender of certain policies.

A loan of £3m was made from the with profits fund to the non profit fund in 2008 and was contingent on margins emerging on part of the non profit fund business. As the loan is contingent it has no impact on the accounts. The interest and repayment are assessed annually and the terms of the contract were determined on an arms-length basis. In 2009 £1m of the loan was repaid. The loan is between the two funds of the Society and hence cancels out when preparing the total forms in the Society FSA Return.

The Society has a with profits fund with policyholder liabilities of less than £500m. As such it is not within the FSA Realistic external reporting regime which requires life insurers to measure liabilities on a market consistent basis which values options and guarantees at fair value. However, we do use realistic reporting in our internal management reporting for the management of the with profits fund. Realistic reporting is based on management best estimates and fair value as evidenced by established market prices wherever possible. It therefore represents a better view of the economic risk faced by the Group than the more prudent Statutory solvency tests.

Our use of realistic external reporting will be accelerated by the need to report under a new European Insurance Directive known as Solvency II. This will be adopted within the UK before October 2012. We are therefore developing our reporting systems and disciplines to meet these evolving Realistic reporting requirements which will overtake our current Individual Capital Assessment (ICA) under which we currently report to the FSA.

notes to the financial statements

for the year ended 31 December 2009

2. segmental analysis

a. Gross premiums written

	2009 £'000	2008 £'000
Gross premium income is made up of:		
Society and Group Life Assurance Business		
Non profit linked contracts:		
- periodic premium	**7,643**	9,123
- single premium	**2,134**	11,978
Non profit non-linked contracts:		
- periodic premium	**19,608**	18,426
With profit contracts:		
- periodic premium	**5,189**	5,246
- single premium	**393**	102
Total gross premiums written	**34,967**	44,875
Reinsurance ceded	(10,868)	(10,348)
Total earned premiums, net of reinsurance	**24,099**	**34,527**

b. Gross new annualised premiums

	2009 £'000	2008 £'000
Society and Group Life Assurance Business		
Non profit linked contracts:		
- periodic premium	**266**	193
- single premium	**213**	1,198
Non profit non-linked contracts:		
- periodic premium	**2,178**	2,758
With profit contracts:		
- periodic premium	**1,256**	630
- single premium	**39**	10
Total new annualised periodic premiums	**3,952**	4,789

notes to the financial statements

for the year ended 31 December 2009

2. segmental analysis (cont.)

c. Contributions received from child trust fund and OEIC investments	2009 £'000	2008 £'000
Regular contributions	7,229	6,740
Government allocated contributions	8,906	8,181
Other single contributions	1,514	1,837
Total contributions	**17,649**	16,758

Contributions relate to business conducted by EMFL, a regulated subsidiary of the Society. The contributions received are invested, by EMFL, in Engage Mutual Investment Funds, an investment company with variable capital (ICVC), which is a separate legal entity to the Society. As such the contributions received are not included in the income and expenditure accounts, nor are the assets included in the balance sheet.

The value of assets under management in Engage Mutual Investment Funds ICVC as at the 31 December 2009 was £105.3m (31 December 2008 £78.3m).

All General Insurance business written by EMIL relates to health insurance.

3. investment return

Society and Group	**2009 £'000**	2008 £'000
Income from land & buildings	**-**	-
Income from other investments – listed	**13,994**	16,188
Realised gains / (losses) on investments	**1,764**	(6,778)
Total investment income	**15,758**	9,410
Unrealised gains / (losses) on investments	**26,159**	(56,791)
Investment management expenses	**(464)**	(242)
Total investment return	**41,453**	(47,623)

notes to the financial statements

for the year ended 31 December 2009

4. claims incurred, net of reinsurance

Society and Group – technical account – long-term business	**2009 £'000**	2008 £'000
Gross claims paid	48,697	54,179
Change in provision for claims outstanding at year end	(855)	(430)
Gross claims incurred	**47,842**	53,749
Outward claims reinsurance	(3,945)	(3,466)
Total claims incurred, net of reinsurance	**43,897**	**50,283**

5. bonuses

The value of terminal bonuses paid to with profits policyholders in the year was £0.3m (2008: £0.5m).

6. net operating expenses

Technical account – long-term business	**Group 2009 £'000**	Group 2008 £'000	**Society 2009 £'000**	Society 2008 £'000
Acquisition costs	6,203	13,358	6,976	13,623
Exceptional costs associated with onerous contracts	-	2,400	-	2,400
Change in deferred acquisition costs	(53)	(529)	(53)	(529)
Administrative expenses	5,874	5,332	6,632	5,782
Reinsurance commissions and profit participation	(2,872)	(3,725)	(2,872)	(3,725)
Total net operating expenses	**9,152**	16,836	**10,683**	17,551

Technical account – general business	**Group 2009 £'000**	Group 2008 £'000	**Society 2009 £'000**	Society 2008 £'000
Net operating expenses	**1,056**	262	**-**	-

Non-Technical account	**Group 2009 £'000**	Group 2008 £'000	**Society 2009 £'000**	Society 2008 £'000
Net operating expenses	**2,575**	4,501	**-**	-

Total commission paid by the Society on new business funds was £250,000 (2008: £1,837,000). Total commission paid by the Group was £1,868,000 (2008: £1,837,000).

Expenses incurred in the subsidiary companies are included in net operating expenses in the income and expenditure – non-technical account.

notes to the financial statements

for the year ended 31 December 2009

7. auditors remuneration

During the year the Group obtained the following services from the Society's auditor and its associates at costs as detailed below:

	2009 £'000	2008 £'000
Audit services		
Fees payable to the Society's auditor and its associates for the:		
Audit of the Society's annual accounts	**81**	86
Audit of the Society's subsidiaries, pursuant to legislation	**39**	33
Non-audit services		
Fees payable to the Society's auditor and its associates for other services:		
Other services pursuant to legislation	**12**	12
Tax services	**9**	43
Other services – due diligence	**138**	-
Total	**279**	174

	2009 £'000	2008 £'000
Fees in respect of the audit of the Homeowners Friendly Society Limited Retirement Benefit Scheme	**6**	6

8. operating lease rentals

Annual commitments under non-cancellable leases are as follows:

Group	2009 £'000	2008 £'000
Operating leases which expire:		
- within one year	**7**	8
- between two and five years	**124**	83
Total	**131**	91

8. operating lease rentals (cont.)

Payments made under operating leases were:	**2009 £'000**	2008 £'000
Hire of fixtures and fittings - rental under operating leases	**107**	109
Hire of other assets - under operating leases	**8**	11

9. staff costs

	2009 £'000	2008 £'000
Wages and salaries	5,755	5,562
Social security costs	597	563
Other pension costs	661	757
Total staff costs	**7,013**	6,882

The average weekly number of employees in the Group, including Directors, during the year was comprised as follows:

	2009 No.	2008 No.
Administration	**109**	116
Management	**22**	21
Marketing	**19**	26
Total number of staff	**150**	163

All staff are employed and remunerated by Engage Mutual Administration Limited, the Group administration company. As such no staff are employed directly by the Society.

notes to the financial statements

for the year ended 31 December 2009

10. other technical income, net of reinsurance

Other technical income comprises:	**Group 2009 £'000**	Group 2008 £'000	**Society 2009 £'000**	Society 2008 £'000
Property rental	15	20	515	528
Bank interest	61	93	61	93
Mortgage interest	1	4	1	4
Other income	-	20	-	20
Total other technical income	**77**	137	**577**	645

Other Technical Income in the Society is in relation to rental charged to its subsidiary Engage Mutual Administration Limited, for the use of Gardner House. It also includes interest on Bank Deposits and Mortgages. Property rental in the Group is in relation to the investment property in Kew Gardens.

11. other income

Other income comprises:	**2009 £'000**	2008 £'000
Income arising from OEIC investment management activity	1,254	1,128
Other operating income	1,207	240
Total other income	**2,461**	1,368

Other income principally relates to amounts receivable from third party insurance intermediary commissions.

notes to the financial statements

for the year ended 31 December 2009

12. taxation

The current tax charge is:	**Group 2009 £'000**	Group 2008 £'000	**Society 2009 £'000**	Society 2008 £'000
Corporation tax at 20% and 22% (Society), at 28% (Group subsidiaries)	1	-	1	-
Adjustment to corporation tax and income tax payable and recoverable relating to prior year	-	-	-	-
Tax credits recoverable on dividends	-	-	-	-
Total	**1**	-	**1**	-

Tax assets are recognised to the extent there is sufficient evidence that the asset is recoverable. Deferred tax assets in respect of timing differences relating to trading losses carried forward have been recognised as below:

	Group 2009 £'000	Group 2008 £'000	**Society 2009 £'000**	Society 2008 £'000
Recognised deferred tax assets	-	-	-	-
Unrecognised deferred tax assets	12,852	16,777	9,114	12,085
Total	**12,852**	16,777	**9,114**	12,085

13. land and buildings

Society and Group	**Current value 2009 £'000**	Current value 2008 £'000	**Historical cost 2009 £'000**	Historical cost 2008 £'000
Land and buildings				
- Property occupied by the Group	**5,100**	5,500	**8,147**	8,147
- Investment property in Kew Gardens	**816**	816	**625**	625
Balance at 31 December	**5,916**	6,316	**8,772**	8,772

Land and buildings are all freehold. The Society's Head Office was valued on an 'open market value' basis as at 31 December 2009, by independent valuers King Sturge – RICS, Chartered Surveyors, Leeds in accordance with the current edition of The Appraisal and Valuation Standards published by the Royal Institution of Chartered Surveyors.

The property in Kew Gardens was valued on an 'open market value' basis as at 31 December 2008, by independent valuers Drivers Jonas – RICS, Chartered Surveyors, London in accordance with the Statement of Asset Valuation Practice and Guidance Notes published by the Royal Institution of Chartered Surveyors.

14. investments in group undertakings

The Society investment in subsidiaries can be analysed as follows:

	2009 £'000	2008 £'000
Cost at 1 January	14,850	9,850
Additions	850	5,000
Cost at 31 December	**15,700**	14,850
Provision at 1 January	(2,550)	(2,550)
Provision at 31 December	**(2,550)**	(2,550)
Carrying value at 31 December	**13,150**	12,300

On 9 April 2009, the Society subscribed for 200,000 ordinary £1 shares in EMIL for a consideration of £200,000. The Society subscribed for a further 400,000 ordinary shares in EMIL on 1 December 2009 for a consideration of £400,000, and a further 250,000 ordinary shares in EMIL on 23 December 2009 for a consideration of £250,000.

Set out below are the Society's investments in subsidiary undertakings as at 31 December 2009, all of which are included in the consolidation. Engage Mutual Insurance Limited is incorporated in Gibraltar, all other companies are incorporated in England and Wales.

Name of Subsidiary Undertaking	Nature of Business
Engage Mutual Funds Limited	OEIC management
Engage Mutual Administration Limited	Administration Services
Engage Mutual Services Limited	Insurance and non-regulated financial product intermediary
Engage Mutual Insurance Limited	General insurance

The subsidiaries are wholly owned by the Society.

notes to the financial statements

for the year ended 31 December 2009

15. other financial investments

Society and Group	**Current value 2009 £'000**	Current value 2008 £'000	**Cost 2009 £'000**	Cost 2008 £'000
Shares, other variable yield securities and holdings in collective investment schemes	32,992	492	31,602	985
Debt securities and other fixed income securities	57,952	90,672	59,122	87,057
Loans secured by mortgage	22	49	22	49
Deposits with credit institutions	-	-	-	-
Accrued income and receivables	-	896	-	895
Total financial investments held by the Society	**90,966**	**92,109**	**90,746**	**88,986**
Debt securities and other fixed income securities	**3,676**	2,434	**3,676**	2,434
Total financial investments held by the Group	**94,642**	**94,543**	**94,422**	**91,420**
Assets held to cover linked liabilities (see note 16)	384,701	373,663	356,100	372,416
Total financial assets held by the Group	**479,343**	**468,206**	**450,522**	**463,836**

16. assets held to cover linked liabilities

Society and Group	**Current value 2009 £'000**	Current value 2008 £'000	**Historical cost 2009 £'000**	Historical cost 2008 £'000
Shares, other variable yield securities and unit trusts	150,370	130,206	135,230	142,299
Debt securities and other fixed income securities	103,932	182,996	90,471	169,656
Deposits with credit institutions	130,611	60,000	130,611	60,000
Net current assets	(212)	461	(212)	461
Total assets held to cover linked liabilities	**384,701**	373,663	**356,100**	372,416

notes to the financial statements

for the year ended 31 December 2009

17. debtors

	Group 2009 £'000	Group 2008 £'000	Society 2009 £'000	Society 2008 £'000
Amounts owed from Group undertakings	**-**	-	**4,606**	5,712
Amounts owed from policyholders	**419**	342	**352**	318
Amounts owed from intermediaries	**896**	94	**618**	-
Debtors arising out of reinsurance operations	**2,880**	-	**2,880**	-
Other debtors	**11**	46	**10**	27
Total debtors	**4,206**	482	**8,466**	6,057

18. tangible assets

Group	**Computer equipment £'000**	**Fixtures, fittings and office equipment £'000**	**Total £'000**
Cost			
At 1 January 2009	703	689	1,392
Additions	75	-	75
Disposals	(45)	-	(45)
At 31 December 2009	733	689	**1,422**
Depreciation			
At 1 January 2009	638	569	1,207
Provided in the year	87	76	163
On disposals	(45)	-	(45)
At 31 December 2009	680	645	**1,325**
Net book value at 31 December 2009	53	44	**97**
Net book value at 31 December 2008	65	120	185

The charge for depreciation for the Group in the year ended 31 December 2008 was £204,000.

notes to the financial statements

for the year ended 31 December 2009

19. deferred acquisition costs

	2009 £'000	2008 £'000
On with profits insurance contracts	380	109
On non profit insurance contracts	661	879
Total deferred acquisition costs	**1,041**	988

20. technical provisions

Society and Group	Long-term business provision (LTBP) £'000	Reinsurers' share of LTBP £'000	Provision for outstanding claims £'000	Technical provision for linked liabilities £'000
At 1 January 2009	**97,589**	**(30,429)**	**6,253**	**373,663**
Change in other technical provisions	-	-	-	11,038
Movement in provision for outstanding claims	-	-	(855)	-
Transfer to Technical Account	(9,257)	5,960	-	-
Balance at 31 December 2009	**88,332**	**(24,469)**	**5,398**	**384,701**

Uncertainties and estimation techniques

One of the purposes of insurance is to enable policyholders to protect themselves against uncertain future events. Insurance companies accept the transfer of uncertainty from policyholders and seek to add value through the aggregation and management of these risks. The uncertainty inherent in insurance is inevitably reflected in the financial statements of insurance companies and principally arises in respect of the technical provisions of the company.

As a consequence of this uncertainty, the insurance company needs to apply sophisticated estimation techniques to determine the appropriate provisions.

Long-term business provisions (LTBPs) are computed using statistical or mathematical techniques, which are expected to give approximately the same results as if an individual liability were calculated for each long-term contract. The computations are made by suitably qualified personnel (employed by the Group) on the basis of recognised actuarial methods. This methodology takes into account the risks and uncertainties of the particular classes of long-term business written and the results are certified by the professionals undertaking the valuations.

notes to the financial statements

for the year ended 31 December 2009

20. technical provisions (cont.)

Process for determining assumptions

The process used to determine the assumptions is intended to result in conservative estimates of the most likely, or expected, outcome. The assumptions are checked to ensure they are consistent with observed market practice or other published information.

For insurance contracts the Group regularly considers whether the current liabilities are adequate. The assumptions that are considered include the expected number and timing of deaths, other claims and investment returns, over the period of risk exposure. A reasonable allowance is made for the uncertainty within the contracts.

The principal assumptions underlying the calculation of the LTBP are:

Mortality – a base mortality table is selected which is most appropriate for each type of contract taking into account rates charged to the Society by reinsurers.

Valuation Rates of Interest – these are set in relation to the risk adjusted yields on the underlying assets as per the regulations and guidance from the FSA.

Expenses – these assumptions are determined from the results of an internal expenses investigation with additional margins for prudence.

The LTBP has been calculated on the basis of the following principal interest assumptions for 2009:

Class of business	Interest (per annum)
Linked assurance tax-exempt / taxable	3.5% gross / 2.8% net
Term assurance / whole of life	2.8%
With profits tax-exempt / taxable	2.0% gross / 1.6% net

The mortality assumptions have been based on actual experience with the addition of prudent margins.

With profits bonuses

The LTBP includes £0 (2008: £0) for reversionary bonuses to be declared. The cost of any bonuses is included in "Change in long-term business provision" in the income and expenditure account – Long-Term Business – Technical Account. The cost of terminal bonuses on with profits policies is included in "Gross claims incurred" in the income and expenditure account – Long-Term Business – Technical Account.

21. provision for other risks and charges

At the balance sheet date there is a provision of £598,000 (2008: £1,848,000) in relation to obligations to external companies under various long term contracts. The Directors approved a business plan which reflects the current economic environment whereby we have significantly reduced the planned volume of direct marketing activity. This action has the effect of making a number of long-term contracts which support our sales and distribution activities onerous as we will not recover the expected benefits as anticipated. We have therefore provided for the net unavoidable loss associated with these commitments.

22. creditors arising out of insurance operations

All creditors are in relation to reinsurance contracts and are payable within a period of five years.

23. other creditors, including social security and taxation

	Group 2009 £'000	Group 2008 £'000	Society 2009 £'000	Society 2008 £'000
Amounts owed to Group undertakings	-	-	872	-
Other taxes and social security costs	162	216	-	40
Other creditors	1,883	2,644	1,260	973
Total	**2,045**	2,860	**2,132**	1,013

All creditors are payable within five years.

24. fund for future appropriations

	Group 2009 £'000	Group 2008 £'000	Society 2009 £'000	Society 2008 £'000
Balance at 1 January	30,616	54,527	42,485	63,393
Transfer from / (to) income and expenditure account – Long-Term Business – Technical Account	4,840	(20,701)	3,809	(20,908)
Total recognised gains and losses	(3,679)	(3,210)	-	-
Balance at 31 December	**31,777**	30,616	**46,294**	42,485
Less recognised FRS 17 net pension asset	-	(2,296)	-	-
FFA excluding pension asset at 31 December	**31,777**	28,320	**46,294**	42,485

The surplus in the pension scheme has not been recognised in 2009. Further information is included in note 25.

25. pension commitments

The Group operates a defined contribution stakeholder pension scheme for all employees joining the Group after 5 April 2001. In the year total employer contributions under this scheme were £224,318 (2008: £268,357).

Employees starting before 5 April 2001 are included in the defined benefit pension scheme. The assets of the defined benefit scheme are held separately from those of the Group in an independently administered fund. The contributions are determined by the Scheme Actuary on the basis of triennial valuations. During 2009 the company contributed into the scheme at a rate of 20% (15% ordinary and an additional 5% discretionary). Contributions were at the same rate in 2008 and will continue at the same rate in 2010. In 2009 the pension cost charge also included a special contribution of £200,000.

A full actuarial valuation is performed every three years by the Scheme Actuary, and is updated annually to calculate the present value of scheme liabilities on the basis prescribed in FRS 17. A full actuarial valuation of the Homeowners Friendly Society Pension Scheme was carried out as at 1 January 2008. The scheme is closed to new entrants. This means that, under the Projected Unit Method, the service cost will increase as the remaining members reach retirement. Scheme assets are stated at their market value at 31 December 2009.

The mortality assumptions used are based on the '00 series' tables, with future improvements in line with the P92 Medium Cohort improvement factors, subject to a minimum level of improvement of 1% p.a. for males and 0.5% p.a. for females. Under these assumptions the average life expectancies for males and females currently aged 60 are 26.4 years and 28.5 years respectively.

The funding level of the defined benefit pension scheme is set in the full triennial valuation and is not based on the FRS 17 methodology which is used for financial reporting purposes. The Directors have agreed a schedule of normal contributions with the Scheme Actuary and the trustees and are also making additional special contributions. The Directors have reviewed the recoverability of the FRS 17 pension surplus through either a refund or reduced future contributions and have restricted the surplus to zero in line with the accounting policy.

25. pension commitments (cont.)

The other major assumptions used by the Actuary to calculate scheme liabilities were:

	2009 % per annum	2008 % per annum	2007 % per annum
Long-term salary progression	**4.65**	4.50	4.90
Rate of increase in pension payments guaranteed	**3.60**	3.00	3.40
Discretionary rate of increase in pensions payment	**-**	-	-
Rate of price inflation and deferred pension revaluation	**3.65**	3.00	3.40
Discount rate	**5.70**	5.80	5.80

The total assets and liabilities in the Homeowners scheme and the expected rates of return were:

	Long-term rate of return expected at 31 December			Value at 31 December		
	2009 %	2008 %	2007 %	**2009 £'000**	2008 £'000	2007 £'000
Equities	**7.75 pa**	7.50 pa	7.50 pa	**4,437**	3,473	6,261
Bonds	**4.25 pa**	3.80 pa	4.50 pa	**11,959**	11,811	10,190
Other	**1.25 pa**	3.00 pa	6.00 pa	**129**	678	83
Total market value of scheme assets				**16,525**	15,962	16,534
Present value of scheme liabilities				**(13,924)**	(12,773)	(13,145)
Gross surplus in scheme				**2,601**	3,189	3,389
Unrecognised surplus in scheme				**(2,601)**	-	-
Net surplus in scheme				**-**	3,189	3,389
Related deferred tax liability				**-**	(893)	(949)
Recognised pension asset				**-**	2,296	2,440

25. pension commitments (cont.)

a. Reconciliation of movement in scheme liabilities

	2009 £'000	2008 £'000
At 1 January	**(12,773)**	(13,145)
Current service cost	**(356)**	(417)
Past service cost	**(29)**	(77)
Interest cost	**(714)**	(754)
Contributions by scheme participants	**(61)**	(67)
Benefits paid	**1,039**	488
Net actuarial (loss) / profit	**(1,030)**	1,199
At 31 December	**(13,924)**	(12,773)

b. Reconciliation of market value of scheme assets

	2009 £'000	2008 £'000
At 1 January	**15,962**	16,534
Expected return on plan assets	**712**	929
Contributions paid by employer	**444**	269
Contributions by scheme participants	**61**	67
Benefits paid	**(1,039)**	(488)
Actuarial gains / (losses)	**385**	(1,349)
At 31 December	**16,525**	15,962

notes to the financial statements

for the year ended 31 December 2009

25. pension commitments (cont.)

c. Analysis of amount charged to income and expenditure – non-technical account (included in the net operating expenses)

	2009 **£'000**	2008 £'000
Current service cost	**356**	417
Past service cost	**29**	77
Total charge	**385**	494

d. Analysis of amount credited to income and expenditure – non-technical account (included in the pension finance income)

	2009 **£'000**	2008 £'000
Expected return on pension scheme assets	**712**	929
Interest on pension scheme liabilities	**(714)**	(754)
Net return	**(2)**	175

notes to the financial statements

for the year ended 31 December 2009

25. pension commitments (cont.)

e. Analysis of amount credited to the statement of total recognised gains and losses

	2009 £'000	2008 £'000
Actual return less expected return on pension scheme assets	**385**	(1,349)
Experience gains and losses arising on the scheme liabilities	**71**	460
Changes in assumptions underlying the present value of the scheme liabilities	**(1,101)**	739
Actuarial loss in pension scheme	**(645)**	(150)
Unrecognised pension asset	**(2,601)**	-
Total amount recognised in the statement of total recognised gains and losses	**(3,246)**	(150)

f. History of experience gains and losses

	2009	2008	2007	2006	2005
Present value of scheme liabilities (£'000)	**(13,924)**	(12,773)	(13,145)	(13,729)	(13,322)
Fair value of scheme assets (£'000)	**16,525**	15,962	16,534	15,278	13,868
Surplus / (deficit) in scheme (£'000)	**2,601**	3,189	3,389	1,549	546
Difference between the expected and actual return on scheme assets (£'000)	**385**	1,349	114	612	1,178
Percentage of scheme assets (%)	**2.3**	8.5	0.7	4.0	8.5
Experience gains / (losses) on scheme liabilities (£'000)	**71**	460	38	(92)	(446)
Percentage of present value of scheme liabilities (%)	**0.5**	3.6	0.3	0.7	3.4
Total amount recognised in the statement of total recognised gains and losses (£'000)	**3,246**	150	1,572	841	(738)
Percentage of present value of scheme liabilities (%)	**23.3**	1.2	12.0	6.1	5.5

26. guarantees and financial commitments

Homeowners Friendly Society has made a commitment to its subsidiaries to provide ongoing funding through purchasing shares and providing loans.

notes to the financial statements

for the year ended 31 December 2009

27. statement of information relating to the actuarial function holder

The Actuarial Function Holder of the Society is Mr T M Batten, an employee of the Society. The following information has been provided, in accordance with Section 77 of the Friendly Societies Act 1992:

- Mr T M Batten was not a member of the Society at any time during 2009
- no other member of his family was a member of the Society during 2009
- Mr T M Batten is a member of the Homeowners Friendly Society defined benefit pension scheme
- the aggregate rate of the remuneration and benefits (excluding pension contributions) of Mr T M Batten for 2009 amounted to £117,998.

28. related party transactions

Transactions involving directors

During 2009, three Directors together with their connected parties held insurance policies on an arms-length basis. There were no other transactions during the year.

OEIC funds

At 31 December 2008 Homeowners Friendly Society owned units with a value of £7.3m in the Engage Mutual OEIC. Legal and General provided investment management services for these funds. As part of an efficiency project the units were sold on 17 December 2009 and the investments moved to comparable funds with Legal and General Investment Management (LGIM). LGIM is now both fund manager and investment manager for these funds.

29. ultimate parent company

Homeowners Friendly Society and its subsidiaries (the Group) have a number of transactions between themselves all of which are undertaken in the normal course of business. As these Accounts cover the Society and the Group, no transactions or balances between Group entities, which eliminate on consolidation, require disclosure in accordance with the exemption given in FRS 8 'Related Party Disclosures'.

notes

any questions

call free on 0800 028 1045*

*Calls may be recorded for security and training purposes. Calls are free from UK landlines only.

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