# annual report & accounts

**Homeowners Friendly Society Group annual report & accounts for the year ended 31 December 2010**

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:**

David G Robinson MA FFA (appointed 3 August 2010)
Peter J Burrows BA ACA (appointed 10 November 2010)
David G Hargrave B Com MSc FIA (retires 12 May 2011)
Andrew S Haigh BSc
Karl J D Elliott BA
W Graham Henderson B Comm CA FRSA (resigned 9 November 2010)
Peter W Mason BSc FIA
Christina M McComb BA MBA

## other society officers

**secretary**
Andrew J Horsley MCSI FCIS

**actuarial function holder and Engage Mutual with profits actuary**
Trevor M Batten FIA

**Engage Mutual (ELL) with profits actuary**
Andrew J Sanders MA FIA – Towers Watson

## board committees

**audit**
Peter W Mason (Chairman)
David G Hargrave (retires 12 May 2011)
Christina M McComb
David G Robinson

**finance**
David G Hargrave (Chairman) (retires 12 May 2011)
Peter J Burrows
Andrew S Haigh
Peter W Mason
David G Robinson

**nominations**
Peter W Mason (Chairman)
Andrew S Haigh
David G Hargrave (retires 12 May 2011)
Christina M McComb
David G Robinson

**remuneration**
Christina M McComb (Chairman)
David G Hargrave (retires 12 May 2011)
Peter W Mason

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# who we are

Engage Mutual Assurance is a trading name of Homeowners Friendly Society Limited. We are a mutual organisation with our headquarters in Harrogate, North Yorkshire and offices in Gloucester and Bedford. We provide simple, good value savings, life insurance and health products for around 500,000 customers.

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

- Engage Mutual Funds Limited is the provider of our child trust fund product
- Engage Mutual Health replaced Engage Mutual Insurance Limited this year as our health insurance company and offers health cash plans. Engage Health Holdings Limited is the holding company of Engage Mutual Health
- 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 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

"The progress made by the Society in recent years gives us a solid platform on which to build for the future and our mutual status also gives the Society some distinct advantages not available to proprietary businesses."

As the recently-appointed Chairman of Engage Mutual, I am very pleased to be writing this introduction to the 2010 Report and Accounts. Having spent almost all of my career in the mutual insurance sector, I have a natural affinity with mutuals and have already seen much to be positive about in Engage Mutual’s market stance and also its progress, especially in recent years. I look forward to playing an active part in guiding the Society so that it is well positioned to achieve long-term success.

However, my first duty as your new Chairman is to thank my fellow Director, David Hargrave, for fulfilling the role of Chairman so well over the previous 16 months and also for his dedicated service over many years. David has been involved with the Society from its very inception, initially as an adviser during the planning stage for the creation of what became Homeowners Friendly Society and then as a Director for thirty years. He has decided to stand down at this year’s AGM. His contribution and experience will be missed; we wish him well for the future.

We also said farewell at the end of the year to our Finance Director, Graham Henderson. Graham joined as Finance Director in 2006 and quickly became a key member of the team. In his place, I am delighted to welcome new Finance Director, Peter Burrows, who joined us in November 2010 from Aviva, where he held a number of senior finance positions, having previously worked at Ernst & Young. He is already making a strong contribution to the business.

We also welcome a new Non-Executive Director, Andrew Gosling who joined the Board in March 2011. Andrew was until recently Finance Director of Yorkshire Building Society and is also a former partner of Ernst & Young. As prescribed in our rules, Andrew will stand for election at our Annual General Meeting in 2012.

2010 was a successful year for Engage Mutual, with sound progress on a number of fronts; number of customers, assets under management, business efficiency and importantly the overall financial health of the Society. We also made two important acquisitions during 2010. As foreshadowed in last year's report, we acquired part of the long-term insurance business of Ecclesiastical Life Limited, bringing greater scale to the business and the potential for lower unit costs - of benefit to both current and new customers. We also acquired health insurance specialist, Provincial Hospital Services Association, enabling us to expand our product offering. I would like to welcome the new members, customers and staff from both of these organisations to the Engage Mutual Group.

We were pleased to see combined stock market growth in 2010, with the FT-SE® All Share Index increasing by 10.9% during the year. This brought positive returns for customers invested in stock market based products but the challenge of low interest rates continued for deposit based policies. Maintaining the best rates we can for customers with deposit based policies, while keeping a close eye on risk will continue to be a priority.

Whilst 2010 was undoubtedly a good year for the Society, we cannot afford to be complacent. The financial services market is undergoing some significant changes and if Engage Mutual is going to thrive in future it will need to adapt to these new market norms. Fortunately, the progress made by the Society in recent years gives us a solid platform on which to build for the future and our mutual status also gives the Society some distinct advantages not available to proprietary businesses.

However, being mutual is not an automatic passport to success; we still need a sound strategy that is implemented well. Key to this are good products that are fairly priced, supported by excellent service; and also a strong relationship with our members. These are the principles that will continue to guide us as we seek to secure Engage Mutual's position as one of the UK's best mutuals.

I would like to close with two observations from my first months in this role. First, I have very much enjoyed getting to know many of the staff in Engage Mutual. The people I have met have all been enthusiastic, able and committed to making the business a success.

I have also formed a positive first impression of our customers. As a mutual organisation, Engage Mutual is owned by and run on behalf of its members. In the best mutual organisations, this vital difference is reflected in different, closer and more positive relationships. Making the most of that difference is both our challenge and our opportunity. My thanks to all our customers for their continued support.

**David Robinson**
Chairman
24 March 2011

# chief executive's statement

"With two acquisitions, strong performance across our existing business and continuing tight cost control, results for 2010 were very encouraging."

I usually begin these statements with a comment about the value and importance of our mutuality, and this year is no exception. Mutual organisations are clearly different from proprietary businesses. At a high level, this difference is clearly reflected in our sense of who we are, why we exist and what we are trying to achieve, which you will find laid out on pages 4 and 5 of this document.

In more practical terms, my colleagues and I are equally clear about the obligations upon all of us: to ensure that the business is successful, and that it both maintains and implements a strategy that will enable it to continue to succeed in the future.

As far as building a successful business is concerned, 2010 was a good year, which saw tangible results from the hard work of previous years, including the completion of two acquisitions.

The most significant of these resulted in the transfer to Engage Mutual of part of the long-term insurance business of Ecclesiastical Life Limited (ELL). This transaction has brought us 15,000 new customers, with some 25,000 policies and £270 million of additional assets under management. The new members who transferred from ELL are very welcome as new members of the Society.

The second acquisition was Provincial Hospital Services Association (PHSA), a not-for-profit healthcare provider specialising in cash plans and private medical insurance. This acquisition greatly strengthens our position in the healthcare market, and positions us well for further development and growth. PHSA has now changed its name to Engage Mutual Health. At the end of 2010, we asked all the health cash plan policyholders of our Gibraltar based subsidiary, Engage Mutual Insurance Limited, to transfer their arrangements to Engage Mutual Health. This transfer has now been completed and, as a result, all our healthcare customers are provided with policies by one, UK registered and FSA regulated subsidiary.

With two acquisitions, strong performance across our existing business and continuing tight cost control, results for 2010 were very encouraging. You will find more details in the Operating and Financial Review, starting on page 12.

However, I am pleased to note the following highlights:

- the number of Engage Mutual customers grew for the thirteenth consecutive year. It reached a total of more than 467,000, an increase of 7% on the previous year. The transfer of Benenden's Health Cash Plan in January 2011 (see below) takes that total to around 500,000
- group assets including CTF assets, grew significantly. At the end of the year the total was £946 million, an increase of £322 million on the figure a year earlier
- we delivered our first operating profit for the health business which was launched in 2008. We also saw premiums rise for health products by 21% in 2010 and the outlook is very positive for continued growth in 2011
- we paid more than £30 million in insurance benefits to customers
- cost control remained strong, with no costs increasing faster than our agreed budgets
- we continue to be well-capitalised. The acquisitions I mentioned earlier had a very positive effect on our capital position and in 2010 the Group Fund for Future Appropriations increased to £90 million (an increase of 177%, see note 25 on page 80)
- we have also made good progress in readiness for the introduction of the new European regulatory requirements known as Solvency II, which will be implemented in 2012 (more on this on page 22)
- we launched a new website in the middle of the year, making it easier for customers to deal with us online.

Our products and services generally performed well for our customers in 2010. As noted in the Chairman's introduction, it was a good year for our investment customers, who enjoyed the benefits of strong stock market performance. However, a combination of very low interest rates and creeping inflation continues to be unhelpful to customers with policies which are invested in deposits. We are well aware of these challenges and continue to work with deposit takers and fund managers to secure the best returns we can for our members.

Developments in one other important product area were less positive. I am referring to Child Trust Funds (CTFs), the tax-free children's saving schemes introduced by the previous Government. The new Government has changed the rules on these, so that no new CTFs could be opened from 1st January 2011 and no additional payments will be added by the Government to existing CTFs. The change removes from the financial landscape what was fast becoming an important first step for children and families to develop a savings habit.

Child Trust Funds had become a growing success for Engage Mutual, with many thousands of new customers coming to the Society as a result of investing their £250 or £500 voucher. However, throughout our involvement with CTF, we have been careful not to become dependent on them and we were able to take the Government's announcement in our stride in 2010.

While much of last year was about progress, I would like to comment on one development that we chose to delay in 2010. I had indicated in last year's report that we hoped to enact a rule change that was approved in 2009 which would extend membership of the Society to customers of our subsidiaries. We expected to be able to time this change with the introduction of electronic communication and voting for our AGM, which would greatly reduce the costs. These changes were also dependent on the Government introducing amendments to legislation to make the electronic communications possible for friendly societies. Unfortunately the changes were not passed last year and we chose not to progress with the extension of membership as a result. We now hope to revisit the subject in the course of 2011, in context of a wider review of strategy and in the expectation that the necessary legislation will indeed be passed.

## looking to the future

In early 2011 we announced a partnership agreement with Benenden Healthcare Society to develop and deliver their Benenden Health Cash Plan. Like PHSA and ELL, Benenden is a mutual organisation which shares our values, and I am confident that we will work together to the benefit of both organisations and their members and customers.

As well as looking out for opportunities like this, we must also continue to make sure that our thinking on the benefits of mutuality continues to develop, keeping pace with changes in the world in which we all live. There's a huge range of trends we need to consider, including:

- the growing role of the internet in millions of people's day-to-day lives
- at a time of Government cutbacks, the growing need for individuals to take more responsibility for the wellbeing of themselves and their families
- the rapidly-ageing UK population, with a long-term rise in the number of people aged over 50
- the loss of trust by consumers in many parts of the financial services market and the need for all businesses to ensure that they act in ways that are deserving of the trust of their customers.

We look to the future from a position of strength. As a successful organisation, with a high-quality workforce, nearly half a million customers and a clear commitment to building on our deeply-rooted mutual values, I believe we are absolutely in the right place at the right time. I would like to close by thanking customers and staff for their outstanding support.

**Andrew Haigh**
Chief Executive
24 March 2011

# operating and financial review

## strategy

2010 saw us stick to our long term strategic principles, our key priorities being:

- 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 likeminded 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.

## marketing and distribution

In response to the continued uncertainty within the financial markets and the fragile levels of consumer confidence, 2010 saw us continue with our strategy of delivering highly efficient marketing activity, through the combination of targeted campaigns and tight cost control, focusing explicitly on those areas where return was most certain.

Our relationship with Clydesdale and Yorkshire Banks continued to prosper in 2010 with substantial levels of savings and protection plans being sold through their nationwide network of branches. In a show of unity and true partnership, teams from both organisations also joined together in June to take on the National Three Peaks, raising much needed funds for Help the Hospices and The Steve Prescott Foundation.

We also worked hard to secure a new partner, Benenden Healthcare, which resulted in the transfer of the administration of their existing book of over 30,000 health cash plan customers, as well as launching a new health cash plan product in early 2011.

We are delighted to be working with an organisation that shares our passion and commitment to acting in the best interests of members and we see great potential for a long and successful relationship.

Given the increasing number of customers now using the internet to research, purchase and administer their financial affairs, it seemed highly appropriate to redevelop our website, engagemutual.com. The new site, taking feedback from customer panel members, has been designed to broaden appeal to existing and new customers alike, with more relevant content, functionality and potential for feedback and interaction. The numbers of customers buying new products and using the site to administer their policy has shown a healthy increase in the second half of the year and we expect to continue developing our online capability further in 2011.

Our sponsorship of rugby league's Super League entered its sixth year. We were also very proud to support the Steve Prescott Foundation in its great work raising funds for TryAssist, the Rugby League Benevolent Fund and The Christie hospital in Manchester.

## protection and savings

### over 50s life cover

As one of the country's leading providers, over 50s life cover continues to play a significant part in our new business growth. In 2010 we extended our distribution of the product to include an increasing number of Independent Financial Advisers and Brokers, with great success. Alongside our existing direct and partner based arrangements this means that we are able to serve more customers through more outlets than ever before.

Building on the introduction of our relationship with Co-operative Funeralcare and Co-operative Legal Services, we were also able to assist many of our customers in making plans for their funerals by assigning the proceeds of their policy. We also provided the families of our customers with access to legal services and probate advice when dealing with the estates of their loved ones. We plan to do much more in 2011 to ensure that our products and services remain good value and relevant to our customers' needs.

### tax-exempt savings plans

We continued to offer adult and children's tax-exempt savings plans through one of our with profits funds, both direct to customers and also via Clydesdale Yorkshire Bank. We again exceeded our sales targets for with profits policies during the year as more and more savers took advantage of their tax exempt limit.

The Financial Services Authority has continued to challenge 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. As we outlined in last year's report, this is a complex issue, but regardless of the outcome of the debate, we continue to make good progress in growing new with profits business. The ring-fenced structure of our funds means that our with profits policyholders' capital remains clearly identified, segregated and used purely for the benefit of the policyholders in each of those funds.

### child trust funds (CTFs)

Despite growing levels of savings and additional contributions into child trust funds, the challenging economic environment meant that the coalition Government saw it appropriate to close down Child Trust Funds (CTF) and cease making payments to children at age 7. As such, we decided to stop taking new CTFs as of the end of 2010. The decision comes as a real disappointment to us, as we now manage £143 million of funds on behalf of over 215,000 CTF customers, and have developed a successful CTF business since the scheme was launched in 2005.

We had already taken steps in 2009 to simplify the administration and improve the efficiency of our CTF business and we will continue to seek further improvements in 2011.

### health

Health continues to play a leading role in our future strategy, as our customers find themselves increasingly in need of cost effective help and support in managing their health needs.

We have greatly bolstered our capability and scale in the market in 2010, most notably through the introduction of the Provincial Hospital Services Association (PHSA) business, which is outlined in more detail in the financial review below. In addition, our operations team has worked to increase both the quality and efficiency of service we provide to customers, a good example being the introduction of direct credit payments for claims, enabling funds to be paid without delay into customer bank accounts.

Prior to concluding on the transfer arrangements, the former Directors had committed £2 million of PHSA's surplus as a charitable donation. The donation will support ongoing medical research and education relating to diseases of the elderly at Cambridge University.

As mentioned earlier, we added further scale and new product development to our healthcare portfolio in early 2011 through our new relationship with Benenden Healthcare and we believe there remains significant further opportunity to grow new business within this sector of the market.

### communication and customer feedback

One of the challenges of introducing two new locations (Gloucester and Bedford as a result of the acquisitions), with many new product and customer types is the ability to maintain our high standards of communication with our staff and customers. The structured approach we apply, coupled with our inherent desire to be as open and transparent as possible, gives us a good platform from which to build.

As an example, our staff intranet ensures effective coverage across the three office locations, providing real time information and updates. This, coupled with a diverse and comprehensive range of formal and informal communications, means that we are able to cover a great deal of ground and consult with staff on a wide range of issues relating both personally to them and to the effective running of our business. The Engage Mutual Staff Forum acts as our formal consultative body.

With regard to our customers understanding our communications, we again made significant strides in 2010. The part transfer of the

Ecclesiastical Life business meant that we had to develop a detailed and at times complex communications programme across mail, telephone and internet to ensure that all of our customers were kept fully up to date with progress throughout the year and were given every opportunity to find out more should they so wish. The result of those efforts was a resoundingly positive vote in favour of the transfer, for which we thank those who participated.

A more formal approach to customer feedback was instigated in 2010, with a combination of rolling customer surveys being supported by the collection of over 1,300 pieces of individual feedback from customers during the year. This information enables us to keep a keen eye on the issues most important to our customers and make improvements to those products, services and communications that matter the most to our customers. We also decided to take part in the Association of British Insurers' 'Customer Impact Survey' which gives us benchmark comparisons of our service against that of similar organisations.

We ensure that our senior management team keep close to the issues of concern and interest on the minds of our customers with regular call monitoring sessions and frequent reviews of customer correspondence.

As a consequence, there are now many examples of where direct feedback is positively influencing our actions. Whether it is improvements to our annual statement communications, ensuring that we provide a clear and simple explanation of performance during the period, or customer panel members assisting with the design and content of our new web site, we are increasingly seeing the needs and concerns of our customers being reflected in our day to day activity.

**environmental, social and community issues**

While Engage Mutual does not have a significant impact upon the environment, we are mindful of our role in the local and wider community. In delivering fewer paper based communications and minimising bureaucracy, we have looked to reduce the amount of waste paper and printed material we produce. An increase in customer self service users and internet based applications has greatly assisted us in achieving that goal. Internally we continue to focus on getting the most out of our resources and reducing waste wherever possible to ensure that we act responsibly in playing our part to delivering a more sustainable future.

Staff at Engage Mutual have a desire to help and support people, whether that is our customers, each other, our local community or charities. 2010 has seen our staff climbing mountains, growing moustaches, running, walking, painting, baking and dressing up all in support of charities and good causes.

We continued to actively support our closest neighbour, Saint Michael's Hospice in 2010, providing both financial support and a raft of volunteers and fundraisers throughout the year.

## financial review

In financial terms, 2010 was a transformational year for the Group. Not only was our underlying financial performance strong, we also successfully completed two complex and material business acquisitions. These transactions give us greater scale and a stronger capital base, and they also provide a more robust trading platform from which we aim to develop and grow the Society in future years.

### acquisitions

#### Ecclesiastical Life Limited (ELL)

Following approval at our 2010 AGM and subsequent High Court approval, on 1 December 2010, customers of part of ELL's long term insurance business were successfully transferred to the Group. As a result our customer numbers grew by around 15,000 and assets under management increased by approximately £270 million.

A major part of the business acquired from ELL is a with profits fund, which is now formally closed to new business. This fund remains financially ring-fenced for the benefit of its members, in a similar way to the Group's original with profits fund, which remains separately ring-fenced.

The transfer brings financial benefits to both the Group and its new members. The Group now has greater scale, resulting in lower ongoing unit costs for customers. The Group also has a much improved capital position, as the ELL business acquired presents a number of financial synergies from which we are able to benefit, including capital reserving and taxation. Members joining from ELL benefit similarly from cost efficiency, with increased certainty of the charges to be borne by their fund, and also have the financial security of knowing that following the transfer, action has been taken by the Group to make the Engage Mutual (ELL) with profits fund 'self sufficient'. In other words, the fund now has sufficient ring-fenced assets to be able to meet all of its financial obligations to members as they fall due.

### Provincial Hospital Services Association (PHSA)

On 30 September 2010, we acquired PHSA, a not for profit healthcare provider specialising in health cash plans and private medical insurance. As a result, our healthcare customer numbers grew by around 7,000 and we took on additional annualised premium income of around £1.5 million per annum.

Broadly speaking, this represents a near doubling in size of our healthcare business and provides a platform for us to grow our healthcare offering. We believe healthcare will play an increasingly important part in our business as we seek to develop a comprehensive range of simple products to help our customers meet their life and health needs.

Although smaller than the ELL acquisition, the PHSA acquisition was also capital enhancing.

## capital

The group is very adequately capitalised and is now in a much stronger capital position than it has been in recent years. Reported capital as measured by the Group Fund for Future Appropriations grew by 177% in the year to £90 million.

In addition to the immediate asset impact of the ELL and PHSA acquisitions, the ELL acquisition has enabled us to take advantage of FSA Policy Statement 06/14, which governs reserving and capital requirements for insurers. As a result we are able to recognise as capital the reserving benefit arising from the matching of our original whole of life assurance business with the annuity business acquired from ELL.

Capital requirements are analysed further in note 1 to the accounts, which shows that at 31 December 2010 the Group had:

- £29.9 million of excess capital over its regulatory requirements for the Non Profit Fund, representing 3.5 times minimum capital requirement;
- £18.0 million of excess capital over its regulatory requirements for the original Engage Mutual With Profits Fund, representing 5.8 times minimum capital requirement; and
- £14.6 million of excess capital over its regulatory requirements for the recently acquired Engage Mutual (ELL) With Profits Fund, representing 3.4 times minimum capital requirement.

## life insurance and health

Life insurance and healthcare products are an increasingly important part of our business. In 2010 we paid out £28.9 million of life insurance and £1.3 million of healthcare benefits to our customers, supporting them in times of need.

In January 2011 we commenced a strategic partnership with Benenden Healthcare Society (Benenden), a mutual healthcare society with more than 930,000 members, to deliver and further develop their health cash plan product which is marketed exclusively to Benenden members. The partnership has no impact on our 2010 financial statements, but we expect it to make a material difference to the financial performance of our healthcare operation in 2011, building further on the progress made in 2010.

## with profits

The Society now has two with profits funds, the Engage Mutual With Profits Fund that we have operated since 2003, following the transfer of the engagements of UK Civil Service Benefit Society, and the Engage Mutual (ELL) With Profits Fund which we acquired in 2010 from Ecclesiastical Life Limited, as noted above. The funds are separately ring-fenced for the exclusive benefit of their members.

### Engage Mutual With Profits Fund

At 31 December 2010 the Engage Mutual With Profits fund held assets of £80.3 million. Over 2010 the fund returned investment growth of 6.2%, with the return being shared amongst policyholders as set out in the fund's Principles and Practices of Financial Management (PPFM). The fund return reflects our policy of managing the investment risk profile of the fund according to its financial strength.

During 2010 we increased our holding in the Insight Broad Opportunities Fund with the aim of improving long term returns and payout prospects for policyholders. The fund's year-end capital position and overall risk framework provides good support to our ongoing management of the fund during 2011.

Despite the improving position of the fund, we continue to declare zero reversionary bonuses for most policies in order to maintain maximum flexibility in our investment policy and to pay terminal bonuses where these are justified by the underlying policy 'asset shares' as described in our PPFM. From 1 July 2011 we expect to re-introduce terminal bonuses on maturing ten year tax free savings plans.

The fund continues to grow, in terms of both assets and policy numbers, and we continue to write profitable new business. We therefore have no plans to close this fund to new business.

### Engage Mutual (ELL) With Profits Fund

As noted above, on 1 December 2010 we acquired the with profits fund of ELL. At 31 December 2010 the fund held assets of £113.4 million.

As part of the transfer from ELL, the fund was closed to new business and bespoke investment actions were undertaken in December 2010 to reduce the amount of investment risk in the fund. This enables us to demonstrate that going forward, the fund can be managed on a 'self sufficient' basis without expecting to require capital support from the Non Profit Fund.

The appropriate governance processes are now in progress to agree a formal fund run-off plan that will determine how the surplus assets in the fund will ultimately be allocated to the members of the fund. This work will complete in 2011.

### **unit-linked savings plans**

The unit-linked savings business continues to make up a significant part of the balance sheet and has been augmented in the current year with business transferred from the Ecclesiastical Non Profit Fund bringing the total to £426.7 million.

Policyholders choosing to invest in equities have benefited from the continuing improvement in equity values with our main equity fund returning growth of 14.5%. Fixed income returns were significantly improved on last year with a return of 7.0%.

We have continued to work on behalf of our policyholders investing in deposit policies, aiming to maximise returns whilst being conscious of the credit rating of the counterparties with whom we invest. The overall gross return for the year was 1.5% which compares well with the 3-month LIBOR benchmark of 0.7%.

### **revenue account**

Long-term business gross premiums written rose to £185.1 million, although as shown in note 2 to the accounts, this rise is largely the result of accounting for the ELL acquisition, which included a reinsurance arrangement during the transfer period with an associated

£157.8 million reinsurance premium receivable. Offsetting the reinsurance premium is an increase in provisions for both long term business and investment contracts, where the reinsurance arrangement has had a similar impact in aggregate and results in a commensurate increase.

Removing the one-off impact of this acquisition, on a like-for-like basis premium income rose 5% to £26.4 million. In a difficult financial environment, we remain focused on providing good value products to our customers, and are pleased that customers continue to be able to prioritise life insurance, healthcare and savings products for themselves and their families.

Operating efficiency continues to be a prime focus for us, and the apparent rise in long-term business operating expenses shown on the face of the technical account does not reflect the true nature of our expense base. There are two significant distorting factors. Firstly, the one-off costs of acquisitions in 2010 of £1.6 million, and secondly, a change in the legal form of our reinsurance arrangements with the result that reinsurance financing advances are now shown within other technical income, whereas previously the equivalent amounts were offset against expenses. Adjusting for these items, on a like-for-like basis our Group operating expenses reduced by 10% on the prior year.

Our Group Fund for Future Appropriations was positively affected by the acquisitions and, as noted above, the subsequent adoption of PS06/14. This year we transferred £35.7 million (2009: £5.1 million) from the technical account to the Fund for Future Appropriations. This contributes to our improved capital position, and provides us with capital strength, some of which we will use in future years to grow and develop the business and increase the product range and benefits that we are able to offer to customers.

General business relates to our health cash plan product, and includes three months of trading performance of the acquired PHSA business resulting in a 21% rise in earned premiums to £2.3 million. We started our health cash plan business in 2008, and we are pleased that in 2010 it recorded a profit, albeit marginal, for the first time (2009: £0.3 million loss). This was a result of growing premiums and reducing expenses over the year.

Having acquired PHSA in 2010, and then subsequently established the partnership with Benenden as detailed above, we are confident that our health business will continue to prosper and grow even more rapidly in 2011.

The non-technical account represents our non-insurance business, including Child Trust Fund policies and expenses incurred by subsidiary companies. Other income grew significantly, up 43% to £3.5 million, reflecting the success of our partnership with Co-operative Funeralcare whereby customers can utilise the proceeds of their policies to reduce the costs and simplify the process of arranging a funeral, and increased income from Child Trust Fund policies reflecting the improved investment performance experienced by our customers over the year. In contrast, operating expenses grew to £5.3 million (2009: £2.6 million), the rise mainly being due to the recognition in 2010 of £2.1 million of committed marketing costs.

The total recognised losses were £0.7 million (2009: £3.7 million), the improvement being due to changes in the actuarial valuation and movements on the surplus relating to the defined benefit pension scheme.

In February 2011 the group commenced a consultation period with the expectation that the defined benefit pension scheme for staff would close to future accrual at the end of 2012. The scheme closed to new entrants in 2001 and only a small minority of employees are now members. The Group is continuing to make additional contributions to the scheme above the normal funding rate, and considers that full closure of the scheme would require it to make a one-off contribution to the scheme such that the scheme is adequately funded to meet all its future liabilities. As such, even though the scheme has an accounting surplus net of taxation of £2.6 million (2009: £1.9 million) on an FRS17 basis, the Directors have concluded that there is no likelihood of the Group benefiting from that accounting surplus and have not recognised it as an asset. The action to cease future accruals at the end of 2012 does not precipitate closure of the scheme.

## risk management

Monitoring and management of risk, and particularly its impact on capital resources, is fundamental to our business. We monitor our capital adequacy on two distinct bases:

### statutory reporting

The accounts are presented on the basis of UK GAAP for insurance companies, which requires us to reserve for risks and to make provision in line with standard stress tests to ensure that our capital resources are adequate. The statutory reserves contain an in-built margin of prudence to support the various risks that we manage.

A separate return is also prepared and submitted by all Friendly Societies and Insurance Companies to the FSA, our regulator, which documents a detailed analysis of our results. We monitor the development of these results and the level of capital coverage noted above in our internal monthly reporting.

### realistic reporting

Recent developments in regulatory reporting have introduced 'realistic reporting', which instead of standard stress tests uses the best estimates of management to value future cash flows and the associated risks. 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.

This risk evaluation process involves management consideration of the nature of the risks and how they may apply within our own business. 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 twelve months up to a one in two hundred 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 Group is exposed to a broad cross section of risks and that following the ELL acquisition our risk profile is more balanced than in prior years.

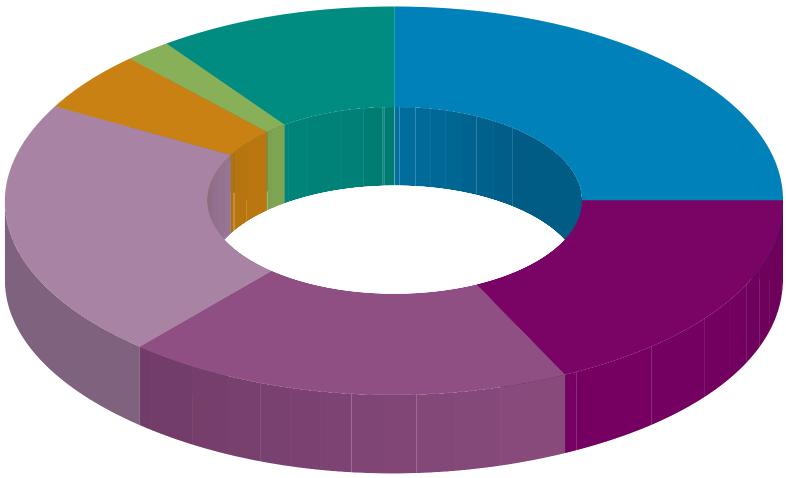
**risk assessment 2010**

- market risk

insurance risk

- lapse
- expense
- mortality

- new business risk
- liquidity risk
- pension scheme risk
- operational risk



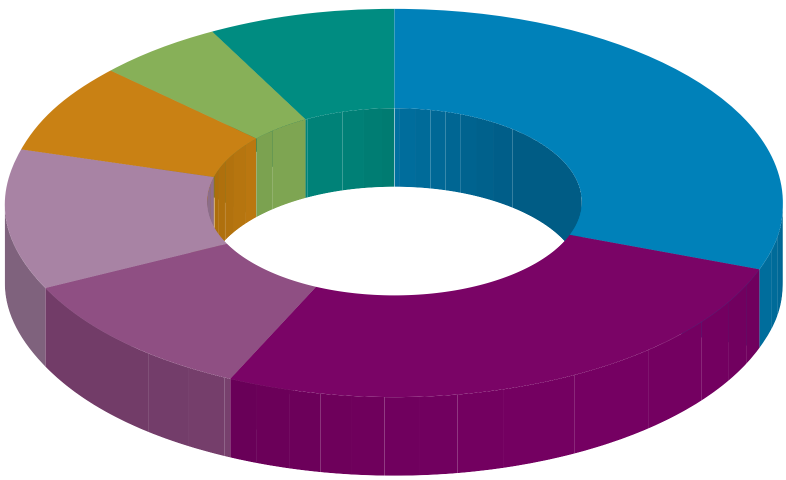
**risk assessment 2009**

- market risk

insurance risk

- lapse
- expense
- mortality

- new business risk
- liquidity risk
- pension scheme risk
- operational risk



## risk framework

The Board is responsible for ensuring we have an appropriate risk reporting and control framework to manage and develop our business. This is set out in more detail later within the Corporate Governance section of this report, starting on page 31. The Board receives a monthly risk report from the Corporate Risk Officer which tracks the status of current risks and the effect of mitigating management actions.

Management control is delivered through a number of risk committees which report into the Executive Committee. These committees manage business performance and risk within agreed terms of reference. In this way, they provide a clear and visible internal management framework to ensure that we manage our risks, operate efficiently and effectively, comply with regulation and treat our customers fairly.

The European Directive referred to as 'Solvency II' will be implemented from the end of 2012. Solvency II will have wide ranging implications for the way all insurance companies manage their risks, capital and associated management processes.

Our plans to manage our business and risk in a way that is not just compliant with Solvency II, but also maximises the commercial benefits that the new regulation brings, are progressing in accordance with our defined timelines. Based on current proposals, we are confident that Solvency II will not require us to seek additional capital.

## committees

All Executive Sub-Committees report into the Executive Committee which is chaired by the Chief Executive. The Executive Committee includes the Group's other Executive Directors, the Actuarial Function Holder, Corporate Risk Officer, Company Secretary, and other Executives who report directly to 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 committees receive regular management information that takes into account all aspects of our business. 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.

### financial reporting

Financial reporting standards, particularly for groups such as ourselves who undertake relatively complex insurance and investment activities on behalf of members, continue to change rapidly. Whilst the increased levels of standardisation and enhanced levels of disclosure are generally positive, one unfortunate side effect is that financial statements are becoming increasingly difficult for the layperson to interpret.

With the acquisition of ELL in 2010 we acquired various financial contracts of a different nature to that which we have traditionally managed. As such we took the opportunity to adopt a number of financial reporting standards that deal with the accounting for these (and other) financial instruments, and have restated our prior year financial results as appropriate. The impact on our financial statements of doing this is explained in more detail in the statement of accounting policies b.

We are determined that our accounts should remain both useful for members and in line with evolving best accounting practice. As such we expect to move to a position whereby we present accounts fully in line with International Financial Reporting Standards, but are mindful of the need to make this transition in a way that is most cost effective.

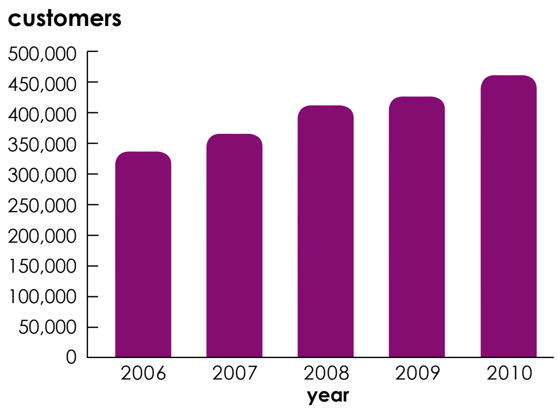
### looking ahead

The Group is in a strong financial position and has a firm base on which to continue to meet the current and future needs of its customers. Our vision remains: to build a modern mutual organisation and be the best customer owned business.

# financial performance for the year ended 31 December 2010

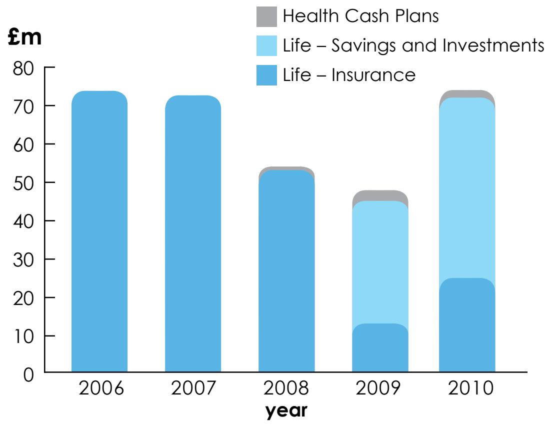
The following graphs are the main Key Performance Indicators (KPIs) used to manage the business.

**group customers**



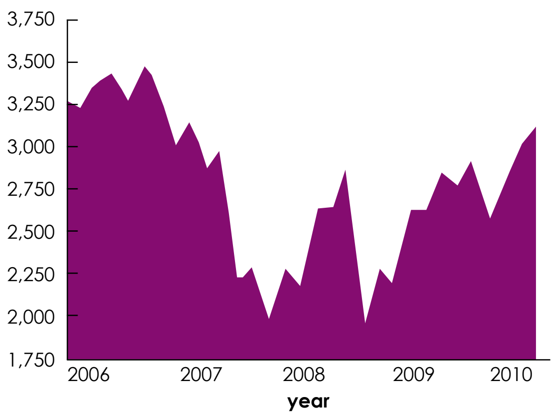

Group customers increased by 7% in the year to more than 467,000, with the two acquisitions adding 22,000 new customers.

**claims paid to policyholders**



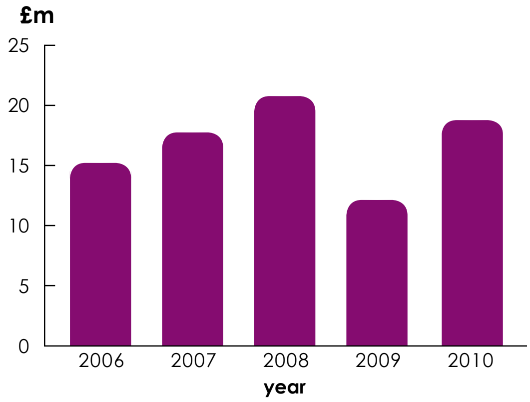

Total claims paid to customers was £75.3m, comprising £28.9m of insurance policy payments, £1.3m of health cash plan benefits and £45.1m of maturing savings policies.

**FT-SE® all share index**



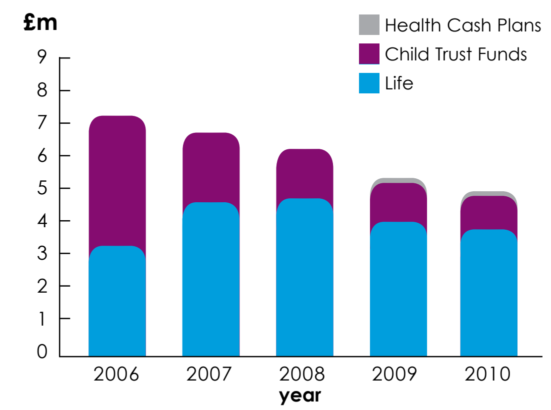

Equity returns in 2010 were strong and continued the recovery seen in the prior year.

**group expenses**



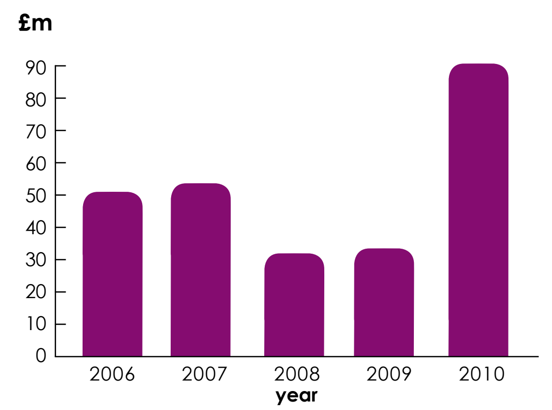

Total expenses increased, largely due to one-off costs associated with the acquisitions and a presentational change in the way we account for a new reinsurance agreement. On an underlying basis, both our life business (insurance and savings) and general insurance business (health cash plans) operating expenses reduced by 10%.

### new business performance



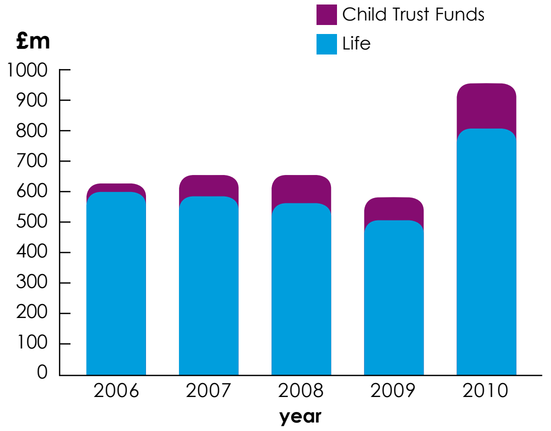

New business premiums fell by 9% in 2010. The largest fall was in Child Trust Fund sales, down 17%, and following changes in legislation we expect this trend to continue in 2011.

### group fund for future appropriations



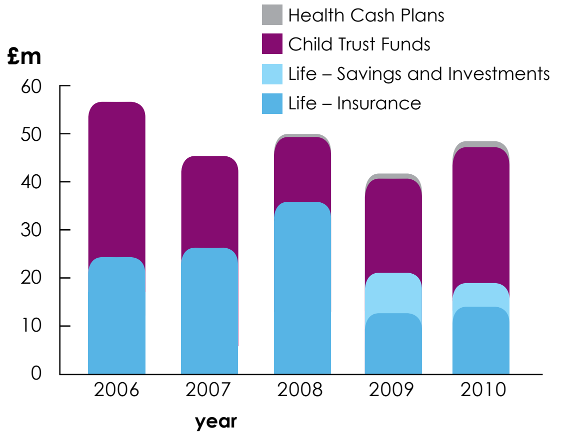

Our Group Fund for Future Appropriations demonstrates excellent capital support for our business, and increased significantly in 2010 to £90.0m. This includes amounts in our two with profits funds which are separately ringfenced.

### group assets




Total group assets increased 52% to £946m, including £143m for Child Trust Funds. The significant increase includes £270m of assets transferred in respect of the Ecclesiastical Life Limited acquisition.

### premiums from policyholders




Net premiums from customers increased 15% to £49.6m. This reflects strong increases in both health cash plan and Child Trust Fund premiums, although following legislative changes we expect Child Trust Fund premiums to reduce in future years.

# your board of directors

### David Robinson – MA FFA (61) Chairman

David joined the Board of Engage Mutual in August 2010 and was appointed Chairman in September 2010.

A Fellow of the Faculty of Actuaries, David has almost 40 years' experience in financial services, which has seen him set up and run insurance business, Bright Grey as well as having held senior roles at Scottish Provident and Royal London.

David is currently a member of the University Court and Chairman of the Audit Committee at Heriot-Watt University, Edinburgh and is a Non-Executive Director of The One Place Capital Limited.

### Christina McComb – BA MBA (54) Vice Chairman

Chris joined the Board in May 2005 and was appointed Vice Chairman in 2009. She has extensive experience of investing in smaller companies, having spent 14 years at leading venture capital group, 3i.

Chris also has experience of the public sector, having been a Director of the Shareholder Executive from 2003-2006, managing the Government's shareholder interests in a number of public-owned enterprises and latterly as Director and Head of Investment and Commercialisation at Partnerships UK Plc. She is currently a non-executive director of Baronsmead VCT 2 and Nexeon Limited and is also a member of the Investment Advisory Group of Imperial Innovations Plc.

### Andrew Haigh – BSc (48) 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.

## Peter Burrows – BA ACA (42) Finance Director

Peter joined the Board as Finance Director in November 2010. He is a chartered accountant with 20 years' experience gained in a combination of executive management and consulting roles.

Prior to joining the Society, Peter held a number of senior finance positions with Aviva plc, both in the UK and most recently in Europe. Before that he held senior management positions with Ernst & Young, where he advised financial services businesses on financial, risk management and governance matters.

## Karl Elliott – BA (38) 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 the launch and development of 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.

## Andrew Gosling – MA FCA (55)

Andrew joined the Board in March 2011 as a Non-Executive Director. He is a Chartered Accountant with over 30 years' experience, most of it in the financial services sector as a Director, auditor or regulator. Until his retirement last summer, he was Finance Director of Yorkshire Building Society, where he also sat on both the Risk and Asset & Liability Committees.

Before joining the Yorkshire, he was a partner in Ernst & Young, leading the firm's financial services practice in the North of England. He also spent 2 years at the FSA, supervising some 25 building societies through the downturn of the 1990s.

## Peter Mason – BSc FIA (60) 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 2010.

## 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 Health replaced Engage Mutual Insurance Limited and PHSA as the provider of our health cash plan and medical insurance business
- Engage Health Holdings limited is the holding company of Engage Mutual Health.

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.

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

## 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 12.

## 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

that there are no material uncertainties that may cast significant doubt about the Group'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.

Graham Henderson resigned on 9 November 2010. David Hargrave retires as a member of the Board at the Annual General Meeting (AGM) in 2011.

David Robinson was appointed as a Director on 3 August 2010 and Peter Burrows on

10 November 2010. David and Peter, both being eligible, offer themselves for election to the Board of Directors.

Andrew Gosling was appointed as a Director on 24 March 2011 and will stand for election to the Board of Directors at the AGM in 2012.

Karl Elliott retires in accordance with the Society's rules and the Friendly Societies Act 1992 and, being eligible, offers himself for re-election.

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 2010 stood at 215,576 (2009: 213,071).

The total number of customers as at 31 December 2010 was 467,140 (2009: 438,507).

## complaints policy

We aim to deliver a high standard 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 reviews 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 staff (including Directors) employed by the Group totalled 151. The aggregate remuneration paid to Directors and staff employed by the Group, during the year, amounted to £6.5 million including pension and National Insurance contributions. All of our staff are employed by our Group administration services subsidiary, Engage Mutual Administration Limited.

The Group'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 quarterly presentations, 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 within 30 days of receipt, unless specifically agreed otherwise in advance with suppliers.

## pensions arrangements

We are committed to assisting our staff to make adequate provision for their retirement.

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.

Our defined benefit scheme closed to new members in March 2001. A consultation was started in February 2011 with current active members with a view to ceasing further accruals from 31 December 2012. At this point members will join the Group's defined contribution pension scheme.

The Directors continue to work 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.

## 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 2010 we donated in excess of £16,300 to charities, which included donations to local charity, Saint Michael's Hospice as well as donations to TryAssist, the Rugby League's Benevolent Fund and to The Steve Prescott Foundation. In addition we meet all the costs of maintaining the grounds that we share with Saint Michael's Hospice.

Our staff support several charities and have donated to and raised money for, amongst others, Macmillan Cancer Support, Saint Michael's Hospice, Movember and The Steve Prescott Foundation during 2010. Total money raised by staff during the year was in excess of £10,600.

## appointment of auditors

A resolution to re-appoint Deloitte LLP as statutory 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
24 March 2011

# corporate governance

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

The Board is 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 explain clearly 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 and employees and through attending 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 four Non-Executive Directors.

The Board is currently seeking to appoint an additional Non-Executive Director. 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.

## non-executive directors

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

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.

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

## attendance of directors at board and committee meetings

| Board Meetings | David Robinson | David Hargrave | Andrew Haigh | Graham Henderson | Peter Burrows | Karl Elliott | Peter Mason | Christina McComb |
|---|---|---|---|---|---|---|---|---|
| HFSL (14)† | 6 of 6 | 14 | 14 | 11 of 11 | 3 of 3 | 13 | 14 | 14 |
| EMFL (3)* | N/A | 3 | 3 | 3 | N/A | 3 | 3 | 3 |
| EMAL (2)** | N/A | 2 | 2 | 2 | N/A | 2 | 2 | 2 |
| EMSL (2)*** | N/A | 2 | 2 | 2 | N/A | 2 | 2 | 2 |
| EMIL (5)**** | N/A | N/A | 5 | N/A | N/A | N/A | N/A | N/A |
| EMH (3)***** | 3 | 3 | 3 | 1 of 1 | N/A | 3 | 3 | 3 |
| EHHL (2)****** | 2 | 2 | 2 | 1 of 1 | N/A | 2 | 2 | 2 |

**Committee Meetings**

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Audit (4) | 1 of 1 | 4 | N/A | N/A | N/A | N/A | 4 | 4 |
| Finance (5) | 2 of 2 | 5 | 5 | 4 of 4 | 1 of 1 | N/A | 5 | N/A |
| Nominations (2) | N/A | 2 | 2 | N/A | N/A | N/A | 2 | 2 |
| Remuneration (5) | N/A | 5 | N/A | N/A | N/A | N/A | 4 | 5 |

* Engage Mutual Funds Limited.
** Engage Mutual Administration Limited.
*** Engage Mutual Services Limited.
**** Engage Mutual Insurance Limited.
***** Engage Mutual Health.
****** Engage Health Holdings Limited.

† Homeowners Friendly Society Limited.

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 2010 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 34) 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 Robinson and Peter Burrows be put forward for election, and Karl Elliott 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 2010 is set out on page 2.

## audit committee

The Audit Committee consists of four 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 2010 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 2010.

## finance committee

The Finance Committee currently consists of David Robinson, Peter Mason, Andrew Haigh and Peter Burrows, under the Chairmanship of David Hargrave. The committee met five times during 2010 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 Group's with profits business, monitoring of the Group's investment strategy, monitoring of the Group's investment performance, reviewing the principles underlying the capital management of the Group, product pricing for all Group products, expense analysis, monitoring and FSA returns.

## nominations committee

The Nominations Committee consists of the Non-Executive Directors 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 2010. 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 Non-Executive Directors, 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 38 to 39.

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 Funds, the Non Profit Fund and each of our key business areas. The Sub-Committees allow the Executive to concentrate on issues at a Group level.

## 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 insurance 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 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 customers to full membership of the Society. We are currently developing the mechanisms to allow such customers to become full members of the Society.

The Engage Mutual Group has an established customer panel, consisting of around 1,000 customers, who are invited to comment on a variety of issues.

In 2010 we completely redesigned our website, engagemutual.com, to create a more informative and interactive environment for customers. The customer panel provided us with a number of members who gave up their time to provide feedback and insight on the website design, content and layout, all of which has led to a very successful first 6 months for the new site.

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 2010 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 continue to work on our response to the 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. 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 and 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 are continuing the process of upgrading our internal actuarial models to facilitate 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 2010, the Group'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 2010. 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, Insight Investment Management and Ecclesiastical 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, Insight and Ecclesiastical Investment Managers 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 annotated combined code

The Board considers that throughout the year ended 31 December 2010, 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 four Non-Executive Directors. The Board is currently seeking to appoint an additional Non-Executive Director.

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.

Following its review of the Combined Code, the FRC published a revised UK Corporate Governance Code (on which the Annotated Combined Code is based) in May 2010. This revised Code will apply to reporting periods beginning on or after 29 June 2010 and therefore does not apply to our financial year ended 31 December 2010 or our AGM business in 2011.

The Board notes the recommendation in the new Code that Directors of larger organisations be subject to annual election by members. The Board intends to carefully consider the implementation of annual election, including monitoring member views, and expects to form a concluded view during the course of 2011 on whether annual election is appropriate for the Society.

# 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 | Pension Contributions £'000 | 2010 Total £'000 | 2009 Total £'000 |
|---|---|---|---|---|---|
| Andrew Haigh | 210 | 60 | 47 | 317 | 313 |
| Peter Burrows (appointed 10 Nov 2010) | 22 | – | 2 | 24 | – |
| Karl Elliott | 120 | 26 | 23 | 169 | 153 |
| Graham Henderson (resigned 9 Nov 2010) | 140 | 73 | 13 | 226 | 241 |
| **Total** | **492** | **159** | **85** | **736** | **707** |

| Non-Executive Directors | | | | | |
|---|---|---|---|---|---|
| David Robinson (appointed 3 Aug 2010) | 20 | – | – | 20 | - |
| David Hargrave | 56 | – | – | 56 | 50 |
| Peter Mason | 35 | – | – | 35 | 33 |
| Christina McComb | 35 | – | – | 35 | 32 |
| **Total** | **146** | **–** | **–** | **146** | **115** |

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

### long-term bonus

The Executive Directors participate in a long-term bonus scheme.

Awards are paid over a number of years. Payments are provided for in the financial statements of Engage Mutual Administration Limited as shown in the table below.

### directors' pension entitlement

The Society operates a defined benefit pension scheme for a number of its employees. This scheme was closed to new entrants in 2001. 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 2010 are shown in the table opposite.

Graham Henderson and Peter Burrows each joined the Society after March 2001 and therefore joined a defined contribution scheme.

### other benefits

There were no payments made directly by the Society in respect of pensions in 2010 for former Directors or their spouses (2009: £Nil).

| Executive Directors | Interest brought forward £'000 | Awarded in the year £'000 | Vested in the year £'000 | Interest carried forward £'000 |
|---|---|---|---|---|
| Andrew Haigh | 60 | **90** | **(30)** | **120** |
| Peter Burrows (appointed 10 Nov 2010) | - | **-** | **-** | **-** |
| Karl Elliott | 33 | **39** | **(17)** | **55** |
| Graham Henderson (resigned 9 Nov 2010) | - | **-** | **-** | **-** |
| **Total** | 93 | **129** | **(47)** | **175** |

**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 2010 | Increase in accrued benefit over 2010 (excluding inflation) | Increase in accrued benefit over 2010 (including inflation) | Transfer value of increase in accrued pension less member contributions | Transfer value as at 31 December 2009 | Transfer value as at 31 December 2010 | Increase in transfer value over 2010 | Increase in transfer value less member contributions |
|---|---|---|---|---|---|---|---|---|
| Andrew Haigh | 34,562 p.a. | 1,268 p.a. | 2,746 p.a. | 37,200 | 506,417 | 591,917 | 85,500 | 75,668 |
| Karl Elliott | 21,403 p.a. | 3,050 p.a. | 3,865 p.a. | 50,002 | 230,825 | 308,220 | 77,395 | 71,741 |

## un-audited information

The composition and responsibilities of the Society's Remuneration Committee are set out on page 34. 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, 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. Peter Burrows 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 Executive Directors also participate in the long-term bonus scheme.

Not more than 40% of the combined annual discretionary bonus and long-term bonus 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 financial statements of Homeowners Friendly Society Limited for the year ended 31 December 2010 which comprise the Group and Society Income and Expenditure Accounts, the Group Statement of Total Recognised Gains and Losses, the Group and Society Balance Sheets and the related notes 1 to 32. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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 auditor's 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 or 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 auditor

As explained more fully in the Statement of Directors' Responsibilities, the Directors are responsible for preparing financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Boards Ethical Standards for Auditors.

### scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### opinion on financial statements

In our opinion the financial statements:

- give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the Society's and the Group's affairs as at 31 December 2010 and of the income and expenditure of the Society and the Group for the year then ended; and
- have been properly prepared in accordance with the Friendly Societies Act 1992.

## opinion on other matters prescribed by the Friendly Societies Act 1992

In our opinion 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 financial statements for the financial year.

## matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Friendly Societies Act 1992 requires us to report to you if, in our opinion:

- proper accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents that we require for our audit.

In accordance with our instructions from the Society we review whether the Corporate Governance Statement reflects the Society's compliance with the eight provisions of the Annotated Combined Code specified by the Association of Financial Mutuals.

**Stephen Williams**
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and
Statutory Auditors
Leeds, United Kingdom
24 March 2011

# our 2010 financial statements

# group income and expenditure

for the year ended 31 December 2010

## Technical Account Long-Term Business

| | | notes | 2010<br>£'000 | 2009<br>Restated<br>£'000 |
|---|---|---|---|---|
| | **Earned premiums, net of reinsurance** | | | |
| | Gross premiums written – continuing operations | 2 | **26,440** | 25,190 |
| | Gross premiums written – acquisitions | 2 | **158,647** | - |
| | Outward reinsurance premiums | 2 | **(10,843)** | (10,868) |
| Share dividends, interest on deposits held and realised gains on investments | Investment income | 3 | **43,837** | 15,758 |
| Movements in value of investments held | Unrealised gains on investments | 3 | **1,687** | 26,159 |
| | Other technical income | 11 | **2,882** | 77 |
| | **Claims incurred, net of reinsurance** | | | |
| | Gross claims incurred | 4 | **(28,928)** | (16,309) |
| | Outward claims reinsurance | 4 | **4,960** | 3,945 |
| | Change in long-term business provision, net of reinsurance | 20 | **(70,947)** | 3,563 |
| Change in value of linked policyholders' benefits | Change in gross liability for investment contracts | 21 | **(80,323)** | (32,794) |
| | Other technical charges | | **(566)** | - |
| | Goodwill amortisation | 6 | **1,143** | - |
| | Net operating expenses | 7 | **(12,595)** | (9,152) |
| Fund managers' charges | Investment expenses and charges | 3 | **(684)** | (464) |
| Group corporation tax credit | Taxation | 13 | **1,007** | 1 |
| | **Transfer to fund for future appropriations** | | | |
| | Continuing operations | 25 | **(30,841)** | (5,106) |
| | Acquisitions | 25 | **(4,876)** | - |
| | **Balance on the long-term business technical account** | | **-** | - |

# group income and expenditure (cont.)

for the year ended 31 December 2010

## Technical Account General Business

The total income and expenditure on the health cash plan business

| | notes | 2010 £'000 | 2009 £'000 |
|---|---|---|---|
| **Earned premiums** | | | |
| Gross premiums written – continuing operations | | **1,811** | 1,865 |
| Change in unearned premiums – continuing operations | | **58** | (3) |
| Gross premiums written – acquisitions | | **354** | - |
| Change in unearned premiums – acquisitions | | **33** | - |
| **Claims incurred** | | | |
| Claims paid | | **(1,334)** | (1,084) |
| Change in provision for claims | | **70** | (39) |
| Net operating expenses | 7 | **(956)** | (1,056) |
| **Balance on the general business technical account** | | | |
| Continuing operations | | **74** | (317) |
| Acquisitions | | **(38)** | - |
| **Total balance** | | **36** | **(317)** |

## Non-Technical Account

Income earned in non-insurance subsidiaries

Expenses incurred in non-insurance subsidiaries

| | notes | 2010 £'000 | 2009 £'000 |
|---|---|---|---|
| **Continuing operations** | | | |
| Balance on the long term business technical account | | **-** | - |
| Balance on the general business technical account | | **36** | (317) |
| Other income | 12 | **3,527** | 2,461 |
| Net operating expenses | 7 | **(5,327)** | (2,575) |
| Pension finance income / (expense) | 27 | **72** | (2) |
| Taxation | | **748** | - |
| **Loss on ordinary activities** | | **(944)** | **(433)** |

# group statement of total recognised gains and losses

## for the year ended 31 December 2010

Income and expense items which differed to projected amounts on the pension scheme

Surplus in the pension scheme which hasn't been recognised as an asset

| | notes | **2010 £'000** | 2009 £'000 |
|---|---|---|---|
| Loss on ordinary activities | | **(944)** | (433) |
| Actuarial profit/(loss) on pension scheme | 27 | **523** | (645) |
| Change in unrecognised pension scheme surplus | 27 | **(717)** | (2,601) |
| **Recognised gains and losses in the year** | | **(1,138)** | **(3,679)** |
| Prior year adjustment | 1 | 469 | - |
| **Total recognised gains and losses in the year** | | **(669)** | **(3,679)** |

# group balance sheet

## as at 31 December 2010

## Assets

Harrogate head office, Bedford office and Kew Gardens property

Investments held in respect of policyholders' liabilities, and surplus investments

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

| | notes | **2010** **£'000** | 2009 Restated £'000 |
|---|---|---|---|
| **Goodwill and intangible assets** | 6 | **753** | - |
| **Investments** | | | |
| Investment in land and buildings | 14 | **6,416** | 5,916 |
| Financial investments | 16 | **730,980** | 479,343 |
| **Reinsurers' share of technical provisions** | | | |
| Long-term business provision | 20 | **31,765** | 24,469 |
| **Other assets** | | | |
| Other debtors | 17 | **6,955** | 4,206 |
| Tangible assets | 18 | **121** | 97 |
| Cash at bank | | **19,791** | 2,571 |
| Deferred taxation | 13 | **738** | - |
| **Prepayments and accrued income** | | | |
| Accrued interest and rent | | **2,102** | 2 |
| Deferred acquisition costs | 19 | **1,167** | 1,041 |
| Other prepayments and accrued income | | **1,457** | 1,794 |
| **Total assets excluding the pension asset** | | **802,245** | 519,439 |
| Net pension asset | 27 | – | – |
| **Total assets including the pension asset** | | **802,245** | 519,439 |

# group balance sheet (cont.)

## as at 31 December 2010

### Liabilities

| | notes | 2010 £'000 | 2009 Restated £'000 |
|---|---|---|---|
| **Fund for future appropriations** | 25 | **90,016** | 32,512 |
| **Technical provisions** | | | |
| Long-term business provision | 20 | **258,039** | 87,597 |
| Claims outstanding | 20 | **9,383** | 5,398 |
| **Gross liability for investment contracts** | 21 | **426,705** | 384,701 |
| **Provisions for other risks and charges** | 22 | **1,491** | 598 |
| **Creditors** | | | |
| Deferred taxation | | **2,400** | - |
| Creditors arising out of insurance operations | 23 | **4,927** | 3,506 |
| Other creditors including taxation and social security | 24 | **4,672** | 2,045 |
| **Accruals and deferred income** | | **4,612** | 3,082 |
| **Total liabilities** | | **802,245** | 519,439 |

Value recognised for regulatory reserves and other surplus funds, including possible future with profit bonuses

Provision for with profits policies, insurance liabilities and other known contingencies

Maturities, surrenders and death claims awaiting processing and payment

Value of linked policyholders' benefits

Expenses due in the period yet to be processed

Approved at a meeting of the Board of Directors on 24 March 2011 and signed on its behalf by:

A S Haigh
Chief Executive

D G Robinson
Chairman

A J Horsley
Secretary

# society income and expenditure

## for the year ended 31 December 2010

### Technical Account Long-Term Business

| | | notes | 2010 £'000 | 2009 Restated £'000 |
|---|---|---|---|---|
| | **Earned premiums, net of reinsurance** | | | |
| | Gross premiums written – continuing operations | 2 | **26,440** | 25,190 |
| | Gross premiums written – acquisitions | 2 | **158,647** | - |
| | Outward reinsurance premiums | 2 | **(10,843)** | (10,868) |
| Share dividends, interest on deposits held and realised gains on investments | Investment income | 3 | **43,837** | 15,758 |
| Movements in value of investments held | Unrealised (losses) / gains on investments | 3 | **(3,313)** | 26,159 |
| | Other technical income | 11 | **3,348** | 577 |
| | **Claims incurred, net of reinsurance** | | | |
| | Gross claims incurred | 4 | **(28,928)** | (16,309) |
| | Outward claims reinsurance | 4 | **4,960** | 3,945 |
| | Change in long-term business provision, net of reinsurance | 20 | **(70,947)** | 3,563 |
| Change in value of linked policyholders' benefits | Change in gross liabilities for investment contracts | 21 | **(80,323)** | (32,794) |
| | Other technical charges | | **(566)** | - |
| | Goodwill amortisation | 6 | **(3,600)** | - |
| | Net operating expenses | 7 | **(12,892)** | (10,683) |
| Fund managers' charges | Investment expenses and charges | 3 | **(684)** | (464) |
| Society corporation tax credit | Taxation | 13 | **1,007** | 1 |
| | **Transfer to fund for future appropriations** | | | |
| | Continuing operations | 25 | **(26,010)** | (4,075) |
| | Acquisitions | 25 | **(133)** | - |
| | **Balance on the long-term business technical account** | | **-** | - |

# society balance sheet

## as at 31 December 2010

## Assets

Harrogate head office and Kew Gardens property

Investments held in respect of policyholders' liabilities, and surplus investments

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

| | notes | 2010 £'000 | 2009 Restated £'000 |
|---|---|---|---|
| **Goodwill and intangible assets** | **6** | **1,253** | **-** |
| **Investments** | | | |
| Investment in land and buildings | 14 | **5,916** | 5,916 |
| Investment in subsidiaries | 15 | **12,300** | 13,150 |
| Financial investments | 16 | **720,966** | 475,667 |
| **Reinsurers' share of technical provisions** | | | |
| Long-term business provision | 20 | **31,765** | 24,469 |
| **Other assets** | | | |
| Other debtors | 17 | **7,326** | 8,466 |
| Cash at bank | | **17,863** | 1,721 |
| **Prepayments and accrued income** | | | |
| Accrued interest and rent | | **2,102** | 2 |
| Deferred acquisition costs | 19 | **1,167** | 1,041 |
| Other prepayments and accrued income | | **1,031** | 1,406 |
| **Total assets** | | **801,689** | 531,838 |

# society balance sheet (cont.)

as at 31 December 2010

## Liabilities

| | | notes | 2010 £'000 | 2009 Restated £'000 |
|---|---|---|---|---|
| Value recognised for regulatory reserves and other surplus funds, including possible future with profit bonuses | **Fund for future appropriations** | 25 | **96,097** | 47,029 |
| Provision for with profits policies, insurance liabilities and other known contingencies | **Technical provisions** | | | |
| | Long-term business provision | 20 | **258,039** | 87,597 |
| Maturities, surrenders and death claims awaiting processing and payment | Claims outstanding | 20 | **9,383** | 5,398 |
| Value of linked policyholders' benefits | **Gross liabilities for investment contracts** | 21 | **426,705** | 384,701 |
| | **Provisions for other risks and charges** | 22 | **-** | 598 |
| | **Creditors** | | | |
| | Deferred taxation | | **2,400** | - |
| | Creditors arising out of insurance operations | 23 | **4,659** | 3,294 |
| | Other creditors including taxation and social security | 24 | **1,883** | 2,132 |
| Expenses due in the period yet to be processed | **Accruals and deferred income** | | **2,523** | 1,089 |
| | **Total liabilities** | | **801,689** | 531,838 |

Approved at a meeting of the Board of Directors on 24 March 2011 and signed on its behalf by:

A S Haigh
Chief Executive

D G Robinson
Chairman

A J Horsley
Secretary

# statement of accounting policies

## a. Basis of accounting

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 United Kingdom accounting standards.

As stated in the Directors' report on page 28, the Directors have concluded there are no material uncertainties that may cast significant doubt about the Group's ability to continue as a going concern.

## b. Change of accounting policy

The accounts for the year ending 31 December 2010 (and the prior year comparative figures) reflect the adoption, for the first time, of the following Financial Reporting Standards:

FRS 25 – Financial Instruments: Disclosure and Presentation

FRS 26 – Financial Instruments: Recognition and Measurement

FRS 29 – Financial Instruments: Disclosure

The most significant impacts on the accounts arising from the introduction of these standards are described below.

The new standards require companies to categorise the policies they administer as 'investment' contracts or 'insurance' contracts. Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event could cause an insurer to pay the significant additional benefits in any scenario, excluding scenarios that lack commercial substance, at the inception of the contract. Such contracts remain insurance contracts until all rights or obligations are extinguished or expire. Contracts can be reclassified as insurance contracts after inception if insurance risk becomes significant.

Any contracts not considered to be insurance contracts under FRS 26 are classified as investment contracts and must be 'deposit accounted'. The unit linked contracts held by the Society have been classified as investment contracts on this basis. As such the liability for the unit linked business has been disclosed in the Balance Sheets as 'Gross liabilities for investment contracts'. Last year the liability for unit linked contracts was included in the Balance Sheet technical provisions.

Premiums collected under non-participating investment contracts are not accounted for through the Technical Account – Long-Term Business, except for the investment income attributable to those contracts, but are accounted for directly through the balance sheet as an adjustment to the investment contract liability.

Claims in respect of investment contracts are taken direct to the 'Gross liabilities for investment contracts' in the Balance Sheets, rather than being recorded as claims in the Technical Account – Long-Term Business.

# statement of accounting policies (cont.)

## b. Change of accounting policy (continued)

The prior year restatement has had the following impact on the Group financial statements:

| Technical Account - Long-Term Business (extract) | 2009 As reported £'000 | 2009 Change £'000 | 2009 Restated £'000 |
|---|---|---|---|
| Gross premiums written – continuing operations | 34,967 | (9,777) | 25,190 |
| Gross claims incurred | (47,842) | 31,533 | (16,309) |
| Change in long-term business provision, net of reinsurance | 3,297 | 266 | 3,563 |
| Change in gross liabilities for investment contracts | - | (32,794) | (32,794) |
| Change in technical provisions for linked liabilities | (11,038) | 11,038 | - |
| **Balance Sheet - Assets (extract)** | | | |
| Financial investments | 94,642 | 384,701 | 479,343 |
| Assets held to cover linked liabilities | 384,701 | (384,701) | - |
| **Balance Sheet - Liabilities (extract)** | | | |
| Fund for future appropriations | (31,777) | (735) | (32,512) |
| Gross liability for investment contracts | - | (384,701) | (384,701) |
| Technical provision for linked liabilities | (384,701) | 384,701 | - |
| **Overall effect of restatement** | | (469) | |

FRS 29 requires the addition of extra information in order to provide a better explanation about how the organisation manages its exposure to risk from different types of financial instrument. This is reflected in the following notes:

Note 1 – Management of financial risk

Note 16 – Financial instruments

FRS 29 has not had any impact on the carrying value of the amounts reported in the financial statements.

## c. 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 Engage Mutual Insurance Limited and Engage Mutual Health, have been consolidated into the Technical Account – General Business.

The ongoing results of other subsidiary undertakings are included in the 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.

Following the acquisition of part of the long-term business of Ecclesiastical Life Limited (ELL) the Group now has two separate with profits funds referred to in our financial statements as follows:

Engage Mutual with profits fund – With Profits Fund I

Engage Mutual (ELL) with profits fund – With Profits Fund II

# statement of accounting policies (cont.)

## d. Long term business

**Premiums**

Long term insurance 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.

As explained above, FRS26 requires premiums in respect of investment contracts to be deposit accounted, hence these are not included in the Technical Account – Long-Term Business in 2010 and prior year comparative amounts have been restated.

**Claims**

For insurance contracts death claims are accounted for when notified to the Group. 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. Reinsurance recoveries are credited to match the relevant gross amounts.

As explained above, FRS26 requires claims in respect of investment contracts to be deposit accounted, hence these are not included in the Technical Account – Long-Term Business in 2010 and prior year comparative amounts have been restated.

**Deferred acquisition costs**

Certain directly attributable costs of acquiring new insurance contracts are deferred. Such costs are disclosed as an asset in the balance sheet. The deferred acquisition costs are amortised in line with the expected life of the policies.

**Policyholder liabilities**

See accounting policy K - 'Valuation of insurance liabilities' and policy L - 'Unit-linked investment contracts'.

**Reinsurance**

Long-term insurance 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.

Amounts recoverable from reinsurers are estimated based upon the related gross insurance 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, disclosed in note 4, reflects the amounts received and receivable from reinsurers in respect of claims incurred during the period. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the Technical Account – Long-Term Business when payable, offset against gross premium income.

During the course of the year, as part of the acquisition of most of the long term business of Ecclesiastical Life Limited, a reinsurance agreement was entered into in order to gain economic exposure to the underlying benefits from 1 January 2010. Further details are included in note 26.

## e. General business

**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 an estimate of 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.

# statement of accounting policies (cont.)

## f. Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary at the date of acquisition. Goodwill is recognised as an asset. Where goodwill is regarded as having useful economic life it is amortised over the period of that life up to a maximum of 20 years. Goodwill is reviewed for impairment annually. Any impairment is recognised immediately in the technical account and is not subsequently reversed.

Goodwill has arisen during the year following the acquisition of the majority of the long-term business of Ecclesiastical Life Limited and the acquisition of Provincial Hospital Services Association. Further details are included in notes 6 and 26.

Negative goodwill arises where the cost of acquisition is less than the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary at the date of acquisition. Negative goodwill is recognised as a deferred credit in the balance sheet and is amortised over its useful economic life.

## g. 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.

## h. 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 Group'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 sufficiently long and residual values, based on prices prevailing at the time of acquisition or subsequent valuation, are sufficiently 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.

**Recognition and derecognition of financial instruments**

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all the risks and rewards of the asset. Purchases and sales of financial assets are accounted for at the trade date; that is the date that the Group commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

## h. Investments (continued)

**Financial investments**

The Group classifies its financial investments as either financial assets at fair value through profit or loss (designated as held for trading) or loans and receivables.

Financial investments at fair value through profit or loss are initially recognised and subsequently measured at fair value in the balance sheet with transaction costs taken directly to the long term business technical account. All changes in fair value are recognised in profit or loss as described in the 'Investment return' accounting policy.

The methodology for determining the fair value for financial assets is as follows:

- listed and other quoted investments are carried at stock exchange bid values at the balance sheet date;
- linked investments, including redeemable debt and other fixed income securities, and listed and other quoted investments, are stated at bid prices; and
- unlisted investments are carried at fair value

Loans and receivables, comprising mortgages and other loans, are recognised when cash is advanced to borrowers. These are carried at amortised cost using the effective interest method. To the extent that the loan is uncollectable, it is written off as impaired. Subsequent recoveries are credited to the long term business technical account.

**Derivative financial instruments**

Derivative financial instruments include financial instruments that derive their value from underlying equity instruments. All derivatives are initially recognised in the balance sheet at their fair value, which usually represents their cost, including any premium paid. They are subsequently re-measured at their fair value with changes in the fair value recognised immediately in net investment return. All derivatives are carried as assets when the fair values are positive and as liabilities when the fair values are negative. None of the derivative financial instruments used by the Group qualify for hedge accounting.

The notional or contractual amounts associated with derivative financial instruments are not recorded as assets or liabilities on the balance sheet as they do not represent the fair value of these transactions. Collateral pledged by way of cash margins on futures contracts is recognised as an asset on the balance sheet within cash and cash equivalents.

## i. Non-technical account

**Revenue is recognised as follows:**

Fee income paid to Engage Mutual Administration Limited in relation to the provision of 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 associated 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.

## j. 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 |
| Motor Vehicles | 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.

# statement of accounting policies (cont.)

## k. Valuation of insurance liabilities

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.

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.

## l. Unit-linked investment contracts

Unit-linked liabilities are measured at fair value as their value is directly linked to the market value of the underlying portfolio of assets. The fair value of a unit-linked contract is equal to the value of the units allocated to the contracts i.e. the unit reserve.

## m. Taxation

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws enacted or substantially enacted at 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.

## n. 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.

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 income and expenditure account in the period in which they are vested. The current and past service costs are included in net operating expenses in the 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 charged to 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 Non-Technical Account.

# statement of accounting policies (cont.)

## o. 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 is translated at the appropriate rates prevailing during the year.

## p. Operating leases

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

## q. 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.

## r. 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 Technical Account – Long-Term Business is transferred to or from the fund on an annual basis.

## s. Contingent reassurance financing

The Group receives reassurance financing on sales of its over 50s life cover from reassurers. The financing repayment is contingent upon margins emerging on the business in future years. The advances are receivable at the inception of a policy and are included as income within Other Technical Income in the Technical Account Long-Term Business. The repayment of the financing advance is repayable as the surpluses emerge and is included in Other Technical Charges. Provision for future repayments is included in the calculations of the long-term business provision.

## t. Other technical income

Other technical income includes contingent reassurance financing receivable as stated above.

## u. Other technical charges

Other technical charges includes the repayment of reassurance financing advances from the surpluses which have emerged on the reassured over 50s life cover policies.

# notes to the financial statements

for the year ended 31 December 2010

## 1. management of financial risk

### a. Market risk – interest rate and equity

**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 Group uses fixed interest securities as part of an asset liability matching (ALM) framework. Any increase or decrease in interest rates will have different impacts on the carrying values of assets and liabilities, changing the amount of available capital resources.

On the unit-linked and OEIC funds which the Group manages the fixed interest risk is borne by our policyholders, since the value of the policyholders' liabilities relates directly to 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 both directly through equity securities held 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 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.

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' liabilities relates directly to 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.

## 1. management of financial risk (cont.)

### b. Market risk – credit

Credit risk is the risk that counterparties 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, and on corporate bonds.

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.

The Group does not have significant credit risk relating to amounts due from contract holders since policy benefits are directly related to the payment of outstanding premiums.

The assets bearing credit risk, excluding unit-linked assets, together with an analysis by credit rating are shown below:

| | **Group 2010 £m** | Group 2009 £m | **Society 2010 £m** | Society 2009 £m |
|---|---|---|---|---|
| Debt securities and other fixed income securities | 163.5 | 43.3 | 163.5 | 43.3 |
| Loans secured by mortgage | 7.7 | - | 7.7 | - |
| Assets arising from reinsurance contracts held | 4.6 | 2.9 | 4.6 | 2.9 |
| Pooled money market instruments | 13.1 | 18.4 | 3.1 | 14.7 |
| Cash at bank and in hand | 19.8 | 4.7 | 17.9 | 1.7 |
| **Total assets bearing credit risk** | **208.7** | 69.3 | **196.8** | 62.6 |

| **Debt and other assets rated as:** | **Group 2010 £m** | Group 2009 £m | **Society 2010 £m** | Society 2009 £m |
|---|---|---|---|---|
| UK Government | 73.9 | 43.3 | 73.9 | 43.3 |
| A rated and above | 96.1 | 26.0 | 84.2 | 19.3 |
| B rated - BBB | 21.5 | - | 21.5 | - |
| Below BBB or not rated | 17.2 | - | 17.2 | - |
| **Total assets bearing credit risk** | **208.7** | 69.3 | **196.8** | 62.6 |

No assets held by the Group or by the Society are past due or impaired.

# notes to the financial statements

for the year ended 31 December 2010

## 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 Group policy on the unit-linked funds is such that in certain circumstances it may defer the payments 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 the discretion to impose market value reductions (MVRs) on early surrender which reduce the amount payable. MVRs contribute to managing the liquidity risk in the with profits funds as well as ensuring an equitable treatment between policyholders surrendering and those remaining in the with profits funds.

An analysis of the expected maturity periods of the policyholder insurance liabilities, net of reassurance, is set out below.

| At 31 December 2010 | Total | Within 1 year | 1 - 5 years | 5 - 15 years | More than 15 years |
|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Long-term business:** | | | | | |
| Non Profit Fund | 75,460 | 2,550 | 12,540 | 24,840 | 35,530 |
| With Profits Fund I | 55,250 | 9,170 | 24,170 | 20,020 | 1,890 |
| With Profits Fund II | 90,140 | 4,730 | 14,910 | 37,300 | 33,200 |
| Total | 220,850 | 16,450 | 51,620 | 82,160 | 70,620 |

Due to the long term nature of the insurance liabilities and the requirement of the Group's investment policies to hold a significant proportion of liquid assets there is always sufficient liquidity to meet claims as they arise.

A prior year analysis has not been completed as it is felt that the merits of this information are outweighed by the complexity of work required.

Investment liabilities are classed as repayable on demand and there is always sufficient liquidity to meet claims as they arise. As such an analysis of expected maturity periods of the investment liabilities has not been completed.

# notes to the financial statements

for the year ended 31 December 2010

## 1. management of financial risk (cont.)

### d. Lapse risk

Persistency is a measure of the proportion of long-term policies which remain in force over a period of time, excluding deaths. Persistency risk arises where the value of policies remaining in force is different to that anticipated.

The methodology for calculating the long-term business provision for the majority of whole of life business has changed in the current year through utilisation of PS06/14. Under PS06/14 negative reserves are permitted subject to an allowance for lapses. Higher lapses will lead to the negative reserves being lower.

### 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.

The Group has rigorous internal management information and governance activity in order to ensure that the levels of ongoing management and acquisition expenses remain within expected levels.

### f. Mortality and longevity risk

Mortality risk arises in relation to whole of life business, if the mortality of the lives assured is different to that assumed, possibly due to an epidemic or catastrophe. The Group manages mortality risk at a portfolio level by using reinsurance arrangements which transfer a large percentage of the mortality risk to our reinsurance partners in return for an agreed reinsurance premium.

Longevity risk in relation to the transferred annuity business, which would arise if annuitant lives were to be longer than anticipated. The Group manages annuitant longevity by setting a prudent valuation assumption and monitoring actual experience. The Group also monitors the need for reassurance as a tool for managing longevity risk. An increase in longevity would expect to be offset, to an extent, by a decrease in mortality on the whole of life business, and vice versa.

### g. Unit-linked contracts

For unit-linked contracts the Group matches all the policyholder liabilities with assets on which the unit prices are based. There is therefore no interest, price or credit risk for the Group on these contracts.

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 Group policy on the unit-linked funds is such that in certain circumstances it may defer the payments until such time as liquid assets can be realised.

### h. Capital management

The Society and its regulated subsidiaries maintain sufficient capital, consistent with the Group's risk profile. Further information about risk management framework can be found in the Corporate Governance Report on pages 31 to 37.

The Society is a mutual organisation and there are no shareholders. As at 31 December 2010 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.

# notes to the financial statements

for the year ended 31 December 2010

## 1. management of financial risk (cont.)

### i. Capital management (cont.)

The Group 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. The Group (including the Society and its regulated subsidiaries) meets 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 Group 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:

- obligations to customers across the Group are met in full; and
- 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; and
- 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.

**Sensitivities**

The capital position is sensitive to changes in market conditions, due both to 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 changes 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 future impact, then assumptions relating to future experience would be changed. In this way, liabilities would be increased to anticipate the future impact of the worse experience with immediate impact on the capital position.

In managing the capital position the Board has quantified the impacts of the principal risks faced. The table below shows the impact of the main sensitivities on the Society's long term liabilities.

**Long-Term Business Provision (LTBP) Sensitivities (£000)**

| | Mortality | | Lapse | Expenses | | Gilt Yields | | Equities/Property | |
|---|---|---|---|---|---|---|---|---|---|
| **Fund** | **5%** | **(5)%** | **10%** | **10%** | **(10)%** | **20%** | **(20)%** | **10%** | **(10)%** |
| Non Profit Fund | 2,535 | 3,891 | 151 | 3,966 | (3,966) | (8,147) | 8,847 | n/a | n/a |
| With Profits Fund I | 134 | (127) | n/a | n/a | n/a | (1,349) | 1,471 | 144 | (40) |
| With Profits Fund II | (43) | 51 | n/a | 1,166 | (874) | (2,081) | 1,228 | (491) | (249) |
| **Increase/(decrease) in LTBP** | **2,626** | **3,815** | **151** | **5,132** | **(4,840)** | **(11,577)** | **11,546** | **(347)** | **(289)** |

The Non Profit mortality assumptions include the transferred annuity business. The 5% increase in mortality shows the impact of increasing mortality rates on non-annuity business to 105% of the expected rate. The 5% fall in mortality sensitivity shows the impact of reducing mortality rates on annuity business to 95% of the expected rate. A decrease in mortality on annuities would expect to be offset, to an extent, by a decrease in mortality on the whole of life business, and vice versa, but this sensitivity is not included above.

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

## 1. management of financial risk (cont.)

**Operational risk – key suppliers / business partners**

As part of our risk 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 services they provide to us are as follows:

| Strategic Supplier | Services provided |
|---|---|
| Munich Re | Risk transfer and financial reassurance services |
| Hannover Re | Risk transfer and financial reassurance services |
| National Australia Banking Group | Savings and protection distribution |
| State Street Global Advisers | Investment management services |
| Insight Investments | Investment management services |
| Legal and General Investment Managers | OEIC investment management services |
| Ecclesiastical Investment Managers | 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 |

**Funding of subsidiary undertakings**

Engage Mutual Funds Limited (EMFL) is a wholly owned subsidiary of Homeowners Friendly Society Limited (the Society) and is a company regulated by the FSA. Engage Mutual Insurance Limited (EMIL) is a wholly owned subsidiary of the Society and is a company 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 is 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.

Engage Mutual Health (EMH) and Engage Health Holdings Limited (EHHL) do not require any funding from the Society since both subsidiaries are trading in a net asset position and have sufficient capital to cover any regulatory capital requirements.

**Restrictions on available capital resources**

The Society and its regulated subsidiaries are required to hold capital sufficient to meet the FSA's and FSC'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 funds are normally only available to meet the capital requirements or be allocated to policyholders of those funds. 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 £84.3m (2009: £30.2m) of which £42.3m (2009: £15.0m) is held in the with profits funds and £42.0m (2009: £15.2m) is held in the non profit fund.

# notes to the financial statements

for the year ended 31 December 2010

## 1. management of financial risk (cont.)

### Available capital resources

| Available capital resources as at 31 December 2010: | Non Profit Fund £'000 | With Profits Fund I £'000 | With Profits Fund II £'000 | Total £'000 |
|---|---|---|---|---|
| Fund for future appropriations | **52,556** | **22,994** | **20,547** | **96,097** |
| Adjustments in respect of subsidiary undertakings | (5,692) | - | - | (5,692) |
| Adjustment to assets onto regulatory basis | (598) | (420) | - | (1,018) |
| Adjustment to liabilities onto regulatory basis | (4,269) | (800) | - | (5,069) |
| **Total available capital resources** | **41,997** | **21,774** | **20,547** | **84,318** |
| Society capital requirements | (7,760) | (3,753) | (5,980) | (17,493) |
| Subsidiary capital requirements | (4,329) | - | - | (4,329) |
| **Excess capital over regulatory requirements** | **29,908** | **18,021** | **14,567** | **62,496** |

| Available capital resources as at 31 December 2009: | Non Profit Fund £'000 | With Profits Fund I £'000 | With Profits Fund II £'000 | Total £'000 |
|---|---|---|---|---|
| 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** |

**Analysis of movement**

The table below shows how the excess capital over regulatory requirements has changed during 2010:

| | Non Profit Fund 2010 £'000 | With Profits Fund I 2010 £'000 | With Profits Fund II 2010 £'000 | Total 2010 £'000 |
|---|---|---|---|---|
| Opening excess capital at 1 January | 9,044 | 10,499 | - | 19,543 |
| Non-linked investment returns | 4,546 | 6,925 | 1,798 | 13,269 |
| Life assurance new business costs | (4,150) | (780) | - | (4,930) |
| Reinsurance commissions on new business | 1,818 | - | - | 1,818 |
| Subsidiary new business costs | (909) | - | - | (909) |
| Change in valuation basis | 25,400 | - | - | 25,400 |
| Other | (5,841) | 1,377 | 12,769 | 8,305 |
| **Closing excess capital at 31 December** | **29,908** | **18,021** | **14,567** | **62,496** |

The methodology for calculating the reserves for the majority of whole of life business has changed in the current year through the utilisation of PS06/14. This change in valuation basis has released negative reserves.

# notes to the financial statements

for the year ended 31 December 2010

## 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:

| Technical provisions | **2010 £'000** | 2009 £'000 |
|---|---|---|
| Unit-linked investment business | | |
| - Unit reserves | 424,091 | 384,701 |
| - Non unit reserves | 2,614 | 1,005 |
| Non participating insurance contracts | 52,326 | 933 |
| Participating insurance contracts | 178,870 | 63,493 |
| **Total technical provisions** | **657,901** | 450,132 |

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 With Profits Fund I 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 arm's length basis. In 2009 £1m of the loan was repaid and the balance was settled in 2010. The loan was between two funds of the Society and hence cancels out on consolidation.

The Society has with profits funds 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, valuing options and guarantees at fair value. However, we use realistic techniques in our internal management reporting for the management of the with profits funds. 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 formulaic statutory solvency tests.

Our use of realistic techniques will be formalised by the need to report under a new European Insurance Directive known as Solvency II. This will be adopted in the UK within the next few years. We are therefore developing our reporting systems and disciplines to meet these evolving realistic reporting requirements which will supersede the Individual Capital Assessment (ICA) under which we currently report to the FSA.

# notes to the financial statements

for the year ended 31 December 2010

## 2. segmental analysis

### a. Gross premiums

| Gross premium income is made up of: | **2010** **£'000** | 2009 Restated £'000 |
|---|---|---|
| **Society and Group Life Assurance Business** | | |
| **Non profit non-linked contracts:** | | |
| - periodic premium | **20,190** | 19,608 |
| - single premium | **-** | - |
| **With profit contracts:** | | |
| - periodic premium | **5,984** | 5,189 |
| - single premium | **266** | 393 |
| **Total gross premiums written - continuing operations** | **26,440** | 25,190 |
| **Non profit non-linked contracts:** | | |
| - periodic premium | **315** | - |
| - single premium | **281** | - |
| - reinsurance accepted | **157,797** | - |
| **With profit contracts:** | | |
| - periodic premium | **254** | - |
| - single premium | **-** | - |
| **Total gross premiums written - acquisitions** | **158,647** | - |
| Reinsurance ceded | (10,843) | (10,868) |
| **Total earned premiums, net of reinsurance** | **174,244** | 14,322 |

As described in Accounting Policy B – 'change of accounting policy', FRS 26 has been adopted this year. Policies now classified as investment contracts, rather than insurance contracts are accounted for on a deposit basis. Consequently the premium analysis above does not include £6,761k (2009: £9,777k) of gross premiums written on investment business, which would have previously been included here.

### b. Gross new annualised premiums

| | **2010** **£'000** | 2009 £'000 |
|---|---|---|
| **Society and Group Life Assurance Business** | | |
| **Non profit linked contracts:** | | |
| - periodic premium | **178** | 266 |
| - single premium | **16** | 213 |
| **Non profit non-linked contracts:** | | |
| - periodic premium | **1,750** | 2,178 |
| **With profit contracts:** | | |
| - periodic premium | **1,725** | 1,256 |
| - single premium | **26** | 39 |
| **Total new annualised periodic premiums** | **3,695** | 3,952 |

# notes to the financial statements

for the year ended 31 December 2010

## 2. segmental analysis (cont.)

| c. Contributions received from Child Trust Fund and OEIC investments | 2010 £'000 | 2009 £'000 |
|---|---|---|
| Regular contributions | 7,714 | 7,229 |
| Government allocated contributions | 13,972 | 8,906 |
| Other single contributions | 2,562 | 1,514 |
| **Total contributions** | **24,248** | 17,649 |

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 2010 was £143.5m (2009: £105.3m).

## 3. investment return

| | **Group 2010 £'000** | Group 2009 £'000 | **Society 2010 £'000** | Society 2009 £'000 |
|---|---|---|---|---|
| Income from other investments - listed | **11,502** | 13,994 | **11,502** | 13,994 |
| Realised gains on investments | **32,335** | 1,764 | **32,335** | 1,764 |
| **Total investment Income** | **43,837** | 15,758 | **43,837** | 15,758 |
| Unrealised gains on investments | **1,687** | 26,159 | **(3,313)** | 26,159 |
| Investment management expenses | **(684)** | (464) | **(684)** | (464) |
| **Total investment return** | **44,840** | 41,453 | **39,840** | 41,453 |

# notes to the financial statements

for the year ended 31 December 2010

## 4. claims incurred, net of reinsurance

| Society and Group - technical account - long-term business | 2010 £'000 | 2009 Restated £'000 |
|---|---|---|
| Gross claims paid | 13,437 | 17,164 |
| Inward claims reinsurance | 11,505 | - |
| Change in provision for claims outstanding at year end | 3,986 | (855) |
| **Gross claims incurred** | **28,928** | 16,309 |
| Outward claims reinsurance | (4,960) | (3,945) |
| **Total claims incurred, net of reinsurance** | **23,968** | **12,364** |

As described in Accounting Policy B – 'change of accounting policy', FRS 26 has been adopted this year. Policies now classified as investment contracts, rather than insurance contracts are accounted for on a deposit basis. Consequently the claims analysis above does not include £45,099k (2009: £31,533k) of claims incurred, which would have previously been included here.

## 5. bonuses

The value of terminal bonuses paid to with profit policyholders in the year was £1.9m (2009: £0.3m)

## 6. goodwill

| | **Group** ELL Acquisition **£'000** | **Group** PHSA Acquisition **£'000** | **Group** Total **£'000** | **Society** ELL Acquisition **£'000** |
|---|---|---|---|---|
| **Cost:** | | | | |
| At 1 January 2010 | - | - | - | - |
| Arising on acquisition | 4,853 | (5,243) | (390) | 4,853 |
| **At 31 December 2010** | **4,853** | **(5,243)** | **(390)** | **4,853** |
| **Amortisation:** | | | | |
| At 1 January 2010 | - | - | - | - |
| (Charge) / credit in the year | (3,600) | 4,743 | 1,143 | (3,600) |
| **At 31 December 2010** | **(3,600)** | **4,743** | **1,143** | **(3,600)** |
| **Net book value at 31 December 2010** | **1,253** | **(500)** | **753** | **1,253** |
| Net book value at 31 December 2009 | - | - | - | - |

Positive goodwill, which has arisen during the year on the acquisition of the majority of the long-term business of Ecclesiastical Life Limited, was amortised by £3,600,000 which was in line with the benefits realised in the transaction.

Negative goodwill, which has arisen on the acquisition of Provincial Hospital Services Association was amortised by £4,743,000 which was in line with the monetary assets acquired. The outstanding negative goodwill of £500,000 will be amortised in line with the use of the underlying property asset.

Further details are included in Note 26.

## 7. net operating expenses

| Technical account - long-term business | Group 2010 £'000 | Group 2009 £'000 | Society 2010 £'000 | Society 2009 £'000 |
|---|---|---|---|---|
| Acquisition costs | 4,720 | 6,203 | 4,720 | 6,976 |
| Acquisition project costs | 1,625 | - | 1,625 | - |
| Change in deferred acquisition costs | (126) | (53) | (126) | (53) |
| Administrative expenses | 6,283 | 5,874 | 6,580 | 6,632 |
| Reinsurance commissions and profit participation | 93 | (2,872) | 93 | (2,872) |
| **Total net operating expenses** | **12,595** | 9,152 | **12,892** | 10,683 |

| Technical account – general business | Group 2010 £'000 | Group 2009 £'000 | Society 2010 £'000 | Society 2009 £'000 |
|---|---|---|---|---|
| **Net operating expenses** | **956** | 1,056 | **-** | - |

| Non-Technical account | Group 2010 £'000 | Group 2009 £'000 | Society 2010 £'000 | Society 2009 £'000 |
|---|---|---|---|---|
| **Net operating expenses** | **5,327** | 2,575 | **-** | - |

Total commission paid by the Society on new business was £390,000 (2009: £250,000). Total commission paid by the Group was £1,669,000 (2009: £1,868,000).

Expenses incurred in the subsidiary companies are included in net operating expenses in the Non-Technical Account.

# notes to the financial statements

for the year ended 31 December 2010

## 8. auditor's remuneration

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

| | 2010 £'000 | 2009 £'000 |
|---|---|---|
| **Audit services** | | |
| Fees payable to the Group's auditor and its associates for the: | | |
| Audit of the Group's annual accounts | **196** | 81 |
| Audit of the Group's subsidiaries, pursuant to legislation | **58** | 39 |
| **Non-audit services** | | |
| Fees payable to the Group's auditor and its associates for other services: | | |
| Other services pursuant to legislation | **12** | 12 |
| Tax services | **-** | 9 |
| Other services - due diligence | **377** | 138 |
| Other services - consultancy | **4** | - |
| **Total** | **647** | 279 |

Due diligence services represent incremental costs associated with the transactions and have therefore been capitalised. Further information is included in note 26.

| | 2010 £'000 | 2009 £'000 |
|---|---|---|
| Audit of the Homeowners Friendly Society Limited Retirement Benefit Scheme | **6** | 6 |

## 9. operating lease rentals

Annual commitments under non-cancellable leases are as follows:

| | 2010 £'000 | 2009 £'000 |
|---|---|---|
| **Group** | | |
| Operating leases which expire: | | |
| - within one year | **-** | 7 |
| - between two and five years | **127** | 124 |
| **Total** | **127** | 131 |

Payments made under operating leases were:

| | 2010 £'000 | 2009 £'000 |
|---|---|---|
| Hire of fixtures and fittings - rental under operating leases | **106** | 107 |
| Hire of other assets - rental under operating leases | **22** | 8 |

# notes to the financial statements

for the year ended 31 December 2010

## 10. staff costs

| | **2010 £'000** | 2009 £'000 |
|---|---|---|
| Wages and salaries | 5,433 | 5,755 |
| Social security costs | 503 | 597 |
| Other pension costs | 601 | 661 |
| **Total staff costs** | **6,537** | 7,013 |

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

| | **2010 No.** | 2009 No. |
|---|---|---|
| Administration | **113** | 109 |
| Management | **21** | 22 |
| Marketing | **17** | 19 |
| **Total number of staff** | **151** | 150 |

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.

## 11. other technical income, net of reinsurance

Other technical income comprises:

| **Technical account - long-term business** | **Group 2010 £'000** | Group 2009 £'000 | **Society 2010 £'000** | Society 2009 £'000 |
|---|---|---|---|---|
| Property rental | 28 | 15 | 494 | 515 |
| Bank interest | (2) | 61 | (2) | 61 |
| Mortgage interest | 379 | 1 | 379 | 1 |
| Reassurance financing advance | 2,477 | - | 2,477 | - |
| **Total other technical income** | **2,882** | 77 | **3,348** | 577 |

Other technical income in the Society includes rental charged to its subsidiary Engage Mutual Administration Limited, for the use of Gardner House. It also includes interest on bank deposits, mortgages and reassurance financing advances receivable in relation to sales of new over 50s life cover policies. Property rental in the Group is in relation to the investment property in Kew Gardens.

# notes to the financial statements

for the year ended 31 December 2010

## 12. other income

Other income comprises:

| | **2010 £'000** | 2009 £'000 |
|---|---|---|
| Income arising from OEIC investment management activity | 1,818 | 1,254 |
| Other operating inome | 1,709 | 1,207 |
| **Total other income** | **3,527** | 2,461 |

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

## 13. taxation

The current tax credit is:

| | **Group 2010 £'000** | Group 2009 £'000 | **Society 2010 £'000** | Society 2009 £'000 |
|---|---|---|---|---|
| Corporation tax at 20% and 22% (Society) | **1,007** | 1 | **1,007** | 1 |
| Corporation tax at 28% (Group Subsidiaries) | **-** | - | **-** | - |
| **Total** | **1,007** | 1 | **1,007** | 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 forwards have been recognised as below:

| | **Group 2010 £'000** | Group 2009 £'000 | **Society 2010 £'000** | Society 2009 £'000 |
|---|---|---|---|---|
| Recognised deferred tax assets | **738** | - | **-** | - |
| Unrecognised deferred tax assets | **18,909** | 12,852 | **13,667** | 9,114 |
| **Total** | **19,647** | 12,852 | **13,667** | 9,114 |

A deferred tax asset of £738,000 has been recognised in 2010 (2009: nil) for Engage Mutual Funds Limited. At the end of 2010 the company ceased to write Child Trust Fund business and is expected to move to operating profitably in the future.

## 14. land and buildings

| **Society** | **Current value 2010 £'000** | Current value 2009 £'000 | **Historical cost 2010 £'000** | Historical cost 2009 £'000 |
|---|---|---|---|---|
| **Land and buildings** | | | | |
| - Property occupied by the Group | **5,100** | 5,100 | **8,147** | 8,147 |
| - Investment property in Kew Gardens | **816** | 816 | **625** | 625 |
| **Balance at 31 December** | **5,916** | 5,916 | **8,772** | 8,772 |

| **Group** | **Current value 2010 £'000** | Current value 2009 £'000 | **Historical cost 2010 £'000** | Historical cost 2009 £'000 |
|---|---|---|---|---|
| **Land and buildings** | | | | |
| - Property occupied by the Group | **5,600** | 5,100 | **8,747** | 8,147 |
| - Investment property in Kew Gardens | **816** | 816 | **625** | 625 |
| **Balance at 31 December** | **6,416** | 5,916 | **9,372** | 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.

As part of the acquisition of PHSA the Group acquired a property in Bedford, which is occupied by the Group and was valued on an 'open market value' basis as at 31 December 2009. This valuation was completed by Horner Surveying Services – RICS, Chartered Surveyors, Bedford in accordance with the Statement of Asset Valuation Practice and Guidance notes published by the Royal Institution of Chartered Surveyors. This accounts for the rise in the value of property occupied by the Group.

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.

# notes to the financial statements

for the year ended 31 December 2010

## 15. investments in group undertakings

The Society investment in subsidiaries can be analysed as follows:

| | **2010** **£'000** | 2009 £'000 |
|---|---|---|
| Cost at 1 January | 15,700 | 14,850 |
| Additions | 150 | 850 |
| **Cost at 31 December** | **15,850** | 15,700 |
| Provision at 1 January | (2,550) | (2,550) |
| Provided in the year | (1,000) | - |
| **Provision at 31 December** | **(3,550)** | (2,550) |
| **Carrying value at 31 December** | **12,300** | 13,150 |

On 18 August 2010, the Society subscribed for 1 ordinary £1 share in EHHL for a consideration of £1.

On 10 December 2010, the Society subscribed for 150,000 ordinary £1 shares in EMFL for a consideration of £150,000.

A provision of £1m has been provided for during the year in relation to the Society's investment in Engage Mutual Insurance Limited, a wholly owned subsidiary, since the company ceased to trade on 31 December 2010. The net book value of the subsidiary represents the realisable value of the company's assets.

Set out below are the Society's investments in subsidiary undertakings as at 31 December 2010, 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 |
| Engage Health Holdings Limited | Holding company for Engage Mutual Health |
| Engage Mutual Health | General insurance |

The subsidiaries are wholly owned by the Society except for Engage Mutual Health which is wholly owned by Engage Health Holdings Limited.

# notes to the financial statements

for the year ended 31 December 2010

## 16. financial instruments

| Group | Current value 2010 £'000 | Current value 2009 £'000 | Cost 2010 £'000 | Cost 2009 £'000 |
|---|---|---|---|---|
| **Financial assets held for trading** | | | | |
| Shares, other variable yield securities and holdings in collective investment schemes | 297,191 | 183,362 | 233,197 | 166,832 |
| Debt securities and other fixed income securities | 301,741 | 165,560 | 282,752 | 153,269 |
| Derivatives held at fair value through profit and loss | 1,348 | - | 1,348 | - |
| **Loans and receivables** | | | | |
| Loans secured by mortgage | 7,653 | 22 | 7,653 | 22 |
| Deposits with credit institutions | 122,375 | 130,611 | 122,375 | 130,611 |
| Accrued income and receivables | 672 | (212) | 672 | (212) |
| **Total Group financial assets** | **730,980** | **479,343** | **647,997** | **450,522** |

| Group | Current value 2010 £'000 | Current value 2009 £'000 | Cost 2010 £'000 | Cost 2009 £'000 |
|---|---|---|---|---|
| **Financial liabilities** | | | | |
| Financial liabilities at fair value through profit and loss | 426,705 | 384,701 | 426,705 | 384,701 |
| Financial liabilities held at amortised cost | 9,599 | 5,551 | 9,599 | 5,551 |
| **Total Group financial liabilities** | **436,304** | **390,252** | **436,304** | **390,252** |

| Society | Current value 2010 £'000 | Current value 2009 £'000 | Cost 2010 £'000 | Cost 2009 £'000 |
|---|---|---|---|---|
| **Financial assets held for trading** | | | | |
| Shares, other variable yield securities and holdings in collective investment schemes | 297,191 | 183,362 | 233,197 | 166,832 |
| Debt securities and other fixed income securities | 291,727 | 161,884 | 272,738 | 149,593 |
| Derivatives held at fair value through profit and loss | 1,348 | - | 1,348 | - |
| **Loans and receivables** | | | | |
| Loans secured by mortgage | 7,653 | 22 | 7,653 | 22 |
| Deposits with credit institutions | 122,375 | 130,611 | 122,375 | 130,611 |
| Accrued income and receivables | 672 | (212) | 672 | (212) |
| **Total Society financial assets** | **720,966** | **475,667** | **637,983** | **446,846** |

| Society | Current value 2010 £'000 | Current value 2009 £'000 | Cost 2010 £'000 | Cost 2009 £'000 |
|---|---|---|---|---|
| **Financial liabilities** | | | | |
| Financial liabilities at fair value through profit and loss | 426,705 | 384,701 | 426,705 | 384,701 |
| Financial liabilities held at amortised cost | 6,542 | 5,426 | 6,542 | 5,426 |
| **Total Society financial liabilities** | **433,247** | **390,127** | **433,247** | **390,127** |

The derivatives held are put spread options to provide some downside protection to the With Profits Fund II equity portfolio. An option premium is paid at the inception of the contract and the value of the options changes depending on how the underlying FTSE 100 Share Index moves. No additional amounts are payable over and above the option premium.

# notes to the financial statements

for the year ended 31 December 2010

## 16. financial instruments (cont.)

FRS29 Financial Instruments: Disclosures, requires disclosure of the fair value measurement basis for valuing financial instruments. The valuation method for each category of financial instrument must be disclosed by reference to three 'levels':

Level 1 – The unadjusted quoted price where there is an active market for buying and selling the financial instrument.

Level 2 – Valuation techniques based on observable inputs, either directly (as prices) or indirectly (derived by prices). This includes financial instruments with a quoted market price but no active market.

Level 3 – Valuation techniques using significant unobservable inputs, which have a significant impact on the instrument's valuation.

Management consider that the carrying amounts of all Financial Assets and Liabilities recorded at amortised cost in the financial statements are approximate to their fair value.

All financial investments held by the Group and by the Society are within the Level 1 measurement basis, with the exception of the derivatives which are within the Level 2 measurement basis.

## 17. other debtors

| | **Group 2010 £'000** | Group 2009 £'000 | **Society 2010 £'000** | Society 2009 £'000 |
|---|---|---|---|---|
| Amounts owed from Group undertakings | **-** | - | **904** | 4,606 |
| Amounts owed from policyholders | **466** | 419 | **466** | 352 |
| Amounts owed from intermediaries | **1,723** | 896 | **1,303** | 618 |
| Debtors arising out of reinsurance operations | **4,551** | 2,880 | **4,551** | 2,880 |
| Other debtors | **215** | 11 | **102** | 10 |
| **Total debtors** | **6,955** | **4,206** | **7,326** | **8,466** |

# notes to the financial statements

for the year ended 31 December 2010

## 18. tangible assets

| Cost: | Motor vehicles £'000 | Computer equipment £'000 | Fixtures, fittings and office equipment £'000 | Total £'000 |
|---|---|---|---|---|
| At 1 January 2010 | - | 733 | 689 | 1,422 |
| Additions | 12 | 48 | 24 | 84 |
| **At 31 December 2010** | 12 | 781 | 713 | **1,506** |
| **Depreciation** | | | | |
| At 1 January 2010 | - | 680 | 645 | 1,325 |
| Provided in the year | 3 | 26 | 31 | 60 |
| **At 31 December 2010** | 3 | 706 | 676 | **1,385** |
| **Net book value at 31 December 2010** | 9 | 75 | 37 | **121** |
| Net book value at 31 December 2009 | - | 53 | 44 | 97 |

The charge for depreciation for the Group in the year ended 31 December 2009 was £163,000.

## 19. deferred acquisition costs

| | **2010 £'000** | 2009 £'000 |
|---|---|---|
| On with profits contracts | 420 | 380 |
| On non profit contracts | 747 | 661 |
| **Total deferred acquisition costs** | **1,167** | 1,041 |

# notes to the financial statements

for the year ended 31 December 2010

## 20. technical provisions

| Society and Group | Long-term business provision (LTBP) £'000 | Reinsurers' share of LTBP £'000 | Provision for outstanding claims £'000 |
|---|---|---|---|
| **At 1 January 2010** | **87,597** | **(24,469)** | **5,398** |
| Movement in provision for outstanding claims | - | - | 3,985 |
| Transfer of With Profits Fund II | 92,256 | (57) | - |
| Change in Long-Term Business Provision | 78,186 | (7,239) | - |
| **Balance at 31 December 2010** | **258,039** | **(31,765)** | **9,383** |

**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 are computed using statistical and other 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.

**Process for determining assumptions**

The process used to determine any assumptions used 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 principle assumptions underlying the calculation of the long-term business provision 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 2010:

| Class of business | Interest |
|---|---|
| Linked assurance tax-exempt / taxable | 3.5% gross / 2.8% net |
| Term assurance / whole of life | 2.8% |
| With Profits Fund I tax-exempt / taxable | 2.0% gross / 1.6% net |
| With Profits Fund II tax-exempt / taxable | 2.5% gross / 1.7% net |
| Annuities tax-exempt / taxable | 2.8% gross / 2.5% net |

## 20. technical provisions (continued)

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

**With profits bonuses**

The LTBP includes £2.2m (2009: £nil) for reversionary bonuses to be declared. The cost of any bonuses is included in "Change in Long Term Business Provision" in the Long-Term Business – Technical Account. The cost of terminal bonuses on with profits policies is included in "Gross claims incurred" in the Long-Term Business – Technical Account.

## 21. gross liabilities for investment contracts

| | **2010**<br>**£'000** | 2009<br>Restated<br>£'000 |
|---|---|---|
| At 1 January | 384,701 | - |
| Reclassification of liabilities on adoption of FRS 26 | - | 373,663 |
| Deposits from policyholders in respect of investment contracts | 6,780 | 9,777 |
| Withdrawals to policyholders in respect of investment contracts | (45,099) | (31,533) |
| Annual management charges on investment contracts | (2,889) | (2,821) |
| Change in fair value of gross liabilities for investment contracts | 83,212 | 35,615 |
| **At 31 December** | **426,705** | 384,701 |

As described in Accounting Policy B – 'change of accounting policy', following the adoption of FRS26, policies now defined as investment, rather than insurance contracts are accounted for on a deposit basis.

Amounts described as 'Deposits from Policyholders' would previously have been classified as premiums, whilst those described as 'Withdrawals to Policyholders' would have been included as claims.

## 22. provision for other risks and charges

| | **Group**<br>**2010**<br>**£'000** | Group<br>2009<br>£'000 | **Society**<br>**2010**<br>**£'000** | Society<br>2009<br>£'000 |
|---|---|---|---|---|
| Provision as at 1 January | **598** | 1,848 | **598** | 1,848 |
| Utilised in the year | **(598)** | (1,250) | **(598)** | (1,250) |
| Provided in the year | **1,491** | - | **-** | - |
| **Provision as at 31 December** | **1,491** | 598 | **-** | 598 |

At the balance sheet date there is a provision of £1,491,000 (2009: £598,000) in relation to external companies under various long term contracts. The Directors approved a business plan which reflects the current economic environment whereby we continue with modest volumes of direct marketing activity. The effect of this makes 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 the commitments.

# notes to the financial statements

for the year ended 31 December 2010

## 23. creditors arising out of insurance operations

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

## 24. other creditors, including social security and taxation

| | **Group 2010 £'000** | Group 2009 £'000 | **Society 2010 £'000** | Society 2009 £'000 |
|---|---|---|---|---|
| Amounts owed to Group undertakings | **-** | - | **169** | 872 |
| Other taxes and social security costs | **261** | 162 | **-** | - |
| Other creditors | **4,411** | 1,883 | **1,714** | 1,260 |
| **Total** | **4,672** | 2,045 | **1,883** | 2,132 |

All other creditors are payable within five years.

## 25. fund for future appropriations

| | **Group 2010 £'000** | Group 2009 £'000 | **Society 2010 £'000** | Society 2009 £'000 |
|---|---|---|---|---|
| Balance at 1 January | | 30,616 | | 42,485 |
| FRS 26 prior year adjustment | | 469 | | 469 |
| Balance at 1 January (as restated) | **32,512** | 31,085 | **47,029** | 42,954 |
| Transfer from Long-Term Business - Technical Account | **35,717** | 5,106 | **26,143** | 4,075 |
| Transfer of With Profits Fund II FFA | **22,925** | - | **22,925** | - |
| Total recognised gains and losses | **(1,138)** | (3,679) | **-** | - |
| **Balance at 31 December** | **90,016** | 32,512 | **96,097** | 47,029 |

The surplus in the pension scheme has not been recognised in 2010 and was not recognised in the prior year. Further information is included in Note 27.

On 1 December 2010 With Profits Fund II was transferred to the Society. The value of the fund's net assets at the point of transfer was £22.9m. This value is ring-fenced for the future benefit of the policyholders within the fund.

## 26. business acquisitions

During the year the Group made two acquisitions; the acquisition of part of the long term business of Ecclesiastical Life Limited (ELL), comprising non profit business and a with profit fund, and the acquisition of Provincial Hospital Services Association (PHSA).

**ELL transaction**

The Society acquired from ELL the Engage Mutual (ELL) With Profits Fund business (With Profits Fund II) and additional non profit business on 30 November 2010 through a court approved Scheme. The Society settled an outstanding contingent loan of £3.6m between the transferred non profit business and Ecclesiastical Insurance Office, the parent company of ELL, at the date of transfer.

The assets and liabilities of With Profits Fund II are ring fenced and would usually only be for the benefit of those policyholders as described in the Scheme. The value of the assets and liabilities at the date of transfer is set out below:

| **With Profits Fund II** | Book value of net assets on acquisition £'000 | Fair value adjustments £'000 | Fair values on acquisition £'000 |
|---|---|---|---|
| Financial investments | 121,761 | - | 121,761 |
| Long term business provision (LTBP) | (92,256) | - | (92,256) |
| Reinsurer's share of LTBP | 57 | - | 57 |
| Net debtors / (creditors) | (6,637) | - | (6,637) |
| Fund for future appropriations | (22,925) | - | (22,925) |
| **Net assets acquired** | | | - |
| Consideration | | | - |
| **Goodwill** | | | - |

A reinsurance arrangement was put in place effective on 1 January 2010 in advance of the transfer of non profit business later in the year. Under the terms of the reassurance treaty the Society received a lump sum reinsurance premium which was equal to the value of the non profit liabilities transferred. This arrangement has been accounted for as follows:

| | £'000 |
|---|---|
| Premium income | 148,681 |
| Change in long-term business provision, net of reinsurance | (96,859) |
| Change in gross liability for investment contracts | (51,822) |
| **Total impact on technical account** | **-** |

Further reinsurance premiums were receivable under this arrangement and totalled £157,797,000.

## 26. business acquisitions (cont.)

The cashflows of this business between 1 January 2010 and 30 November 2010 were transferred between the Society and ELL each month. On 30 November 2010 the Society became the primary insurer through the Scheme and the reinsurance arrangements cancelled out.

Acquired assets and liabilities, fair value adjustments and consideration at the point of transfer were:

| Non profit business | Book value of net assets on acquisition £'000 | Fair value adjustments £'000 | Fair values on acquisition £'000 |
|---|---|---|---|
| Net assets on acquisition | - | - | - |
| **Net assets acquired** | **-** | **-** | **-** |
| Consideration | | | (3,600) |
| Incremental costs associated with the transaction | | | (1,253) |
| **Goodwill** | | | **4,853** |

Consideration is calculated as the difference between the value of assets and liabilities on the conclusion of the reassurance arrangements with ELL.

In summary the results of the ELL transferred business are included in the technical account on the following basis:

With Profits Fund II – as primary insurer from 1 December 2010 to 31 December 2010.

Acquired non profit business – from 1 January 2010 to 30 November 2010 as reinsurer and 1 December 2010 to 31 December 2010 as primary insurer. Consequently the full year results are included in the Technical Account – Long-Term Business.

The business transferred from the Non Profit Fund and With Profits Fund II represented part of the whole business of ELL and it is not possible to split out the performance of these two specific portfolios for the periods prior to acquisition.

**PHSA transaction**

On 30 September 2010 Engage Health Holdings Limited (EHHL), a wholly owned subsidiary of the Society, acquired the general insurer PHSA. PHSA was a company limited by guarantee and the legal structure of the transaction was that EHHL was appointed as the sole corporate trustee.

Subsequently the company converted into an unlimited company with shares, with EHHL owning the single issued and paid up share. The company was subsequently renamed Engage Mutual Health (EMH).

Acquired assets and liabilities, fair value adjustments and goodwill arising on consolidation for the Group are as follows:

| | Book value of net assets on acquisition £'000 | Fair value adjustments £'000 | Fair values on acquisition £'000 |
|---|---|---|---|
| Financial investments | 7,505 | - | 7,505 |
| Technical provisions | (239) | - | (239) |
| Net debtors / (creditors) | (2,023) | - | (2,023) |
| **Net assets acquired** | **5,243** | **-** | **5,243** |
| Consideration | | | - |
| **Negative goodwill** | | | **(5,243)** |

The performance of the PHSA business prior to acquisition is not material to the Group accounts and is therefore not disclosed.

# notes to the financial statements

for the year ended 31 December 2010

## 27. 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 £226,366 (2009: £224,318). Contributions amounting to £27,533 (2009: £22,802) were payable to the scheme and are included in Group creditors.

Employees who joined the Group before 5 April 2001 are members of 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 2010 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 2009, and are expected to remain the same next year. An additional special contribution of £200,000 was made during 2010 (2009: £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 2010.

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 out in the full triennial valuation and is not based on the FRS17 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 FRS17 pension surplus through either a refund or reduced future contributions and have restricted the surplus to zero in line with the accounting policy.

The Government recently proposed changes to pension legislation relating to measure of inflation being linked to increases in pensions. At the balance sheet date the legislation has not been enacted and, as such, no account has been taken in the pension disclosures of these prospective changes.

In February 2011 the Group commenced a consultation period with the expectation that the defined benefit pension scheme for staff would close to future accrual at the end of 2012.

The consultation was ongoing at the Balance Sheet date therefore has not been reflected in the financial statements.

## 27. pension commitments (cont.)

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

| | **2010 % per annum** | 2009 % per annum | 2008 % per annum |
|---|---|---|---|
| Long-term salary progression | **3.55** | 4.65 | 4.50 |
| Rate of increase in pension payments guaranteed | **3.35** | 3.45 | 3.00 |
| Rate of price inflation and deferred pension revaluation | **3.55** | 3.65 | 3.00 |
| Discount rate | **5.25** | 5.70 | 5.80 |

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

| | Long-term rate of return expected at 31 December | | | Value at 31 December | | |
|---|---|---|---|---|---|---|
| | **2010 %** | **2009 %** | 2008 % | **2010 £'000** | **2009 £'000** | 2008 £'000 |
| Equities | **8.00 pa** | 7.75 pa | 7.50 pa | **5,153** | 4,437 | 3,473 |
| Bonds | **4.20 pa** | 4.25 pa | 3.80 pa | **12,992** | 11,959 | 11,811 |
| Other | **1.50 pa** | 1.25 pa | 3.00 pa | **178** | 129 | 678 |
| Total market value of scheme assets | | | | **18,323** | 16,525 | 15,962 |
| Present value of scheme liabilities | | | | **(15,005)** | (13,924) | (12,773) |
| Gross surplus in scheme | | | | **3,318** | 2,601 | 3,189 |
| Unrecognised surplus in scheme | | | | **(3,318)** | (2,601) | - |
| Net surplus in scheme | | | | **-** | - | 3,189 |
| Related deferred tax liability | | | | **-** | - | (893) |
| **Recognised pension asset** | | | | **-** | - | 2,296 |

## 27. pension commitments (cont.)

### a. Reconciliation of present value of scheme liabilities

| | 2010 £'000 | 2009 £'000 |
|---|---|---|
| At 1 January | **(13,924)** | (12,773) |
| Current service cost | **(329)** | (356) |
| Past service cost | **-** | (29) |
| Interest cost | **(782)** | (714) |
| Contibutions by scheme participants | **(53)** | (61) |
| Benefits paid | **484** | 1,039 |
| Net actuarial loss | **(401)** | (1,030) |
| **At 31 December** | **(15,005)** | (13,924) |

### b. Reconciliation of market value of scheme assets

| | 2010 £'000 | 2009 £'000 |
|---|---|---|
| At 1 January | **16,525** | 15,962 |
| Expected return on plan assets | **854** | 712 |
| Contributions paid by employer | **451** | 444 |
| Contibutions by scheme participants | **53** | 61 |
| Benefits paid | **(484)** | (1,039) |
| Actuarial gains | **924** | 385 |
| **At 31 December** | **18,323** | 16,525 |

### c. Analysis of charges to non-technical account (included in net operating expenses)

| | 2010 £'000 | 2009 £'000 |
|---|---|---|
| Current service cost | **329** | 356 |
| Past service cost | **-** | 29 |
| **Total charge** | **329** | 385 |

## 27. pension commitments (cont.)

| d. Analysis of amounts credited to non-technical account (pension finance income) | 2010 £'000 | 2009 £'000 |
|---|---|---|
| Expected return on pension scheme assets | **(854)** | (712) |
| Interest on pension scheme liabilities | **782** | 714 |
| **Net (credit) / charge** | **(72)** | 2 |

| e. Analysis of recognised gains and losses | 2010 £'000 | 2009 £'000 |
|---|---|---|
| Actual return less expected return on pension scheme assets | **924** | 385 |
| Experience gains and losses arising on the scheme liabilities | **92** | 71 |
| Changes in assumptions underlying the present value of the scheme liabilities | **(493)** | (1,101) |
| **Actuarial profit/(loss) on pension scheme** | **523** | (645) |
| Unrecognised pension asset | **(717)** | (2,601) |
| **Total amount recognised in the statement of total recognised gains and losses** | **(194)** | (3,246) |

# notes to the financial statements

for the year ended 31 December 2010

## 27. pension commitments (cont.)

| **f. History of experience gains and losses** | **2010** | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|
| Present value of scheme liabilities (£'000) | **(15,005)** | (13,924) | (12,773) | (13,145) | (13,729) |
| Fair value of scheme assets (£'000) | **18,323** | 16,525 | 15,962 | 16,534 | 15,278 |
| Surplus in scheme (£'000) | **3,318** | 2,601 | 3,189 | 3,389 | 1,549 |
| Difference between the expected and actual return on scheme assets (£'000) | **924** | 385 | 1,349 | 114 | 612 |
| Percentage of scheme assets (%) | **5.0** | 2.3 | 8.5 | 0.7 | 4.0 |
| Experience gains / (losses) on scheme liabilities (£'000) | **92** | 71 | 460 | 38 | (92) |
| Percentage of present value of scheme liabilities (%) | **0.6** | 0.5 | 3.6 | 0.3 | 0.7 |
| Total amount recognised in STRGL (£'000) | **194** | 3,246 | 150 | 1,572 | 841 |
| Percentage of present value of scheme liabilities (%) | **1.3** | 23.3 | 1.2 | 12.0 | 6.1 |

## 28. guarantees and financial commitments

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

## 29. 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 2010;
- no other member of his family was a member of the Society during 2010;
- Mr T M Batten is a member of the Homeowners Friendly Society Pension Scheme;
- the aggregate rate of the remuneration and benefits (excluding pension contributions) of Mr T M Batten for 2010 amounted to £120,500.

# notes to the financial statements

for the year ended 31 December 2010

## 30. related party transactions

**Transactions involving directors**

During 2010, three Directors together with their connected parties held insurance policies on an arms-length basis. There were no other transactions during the year.

## 31. ultimate parent company

Homeowners Friendly Society and its subsidiaries (collectively 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'.

## 32. subsequent events

**European Court of Justice Gender Ruling**

The EU Gender Directive became law in Member States in 2007. This Directive prohibits discrimination on grounds of sex in the access to and supply of goods and services. On 1 March 2011 the European Court of Justice ruled the derogating provision in the Directive permitting sex-specific differences in insurance premiums and benefits to be invalid. This means that from 21 December 2012 insurance companies will no longer be able to differentiate insurance premiums and benefits on the grounds of gender. The Society understands the ruling will apply prospectively, and thus impact future new business cashflows. It should also be noted that the ruling is on a Directive and hence needs to be enacted into member state law before it becomes legally binding on insurance companies. This is a non adjusting post balance sheet event and has no impact on balance sheet at the 31 December 2010. It is not yet possible to quantify the ultimate impact on future cash flows.

**Health reorganisation**

The health insurance business carried on by EMIL renews periodically. As part of a reorganisation the renewals on or after 1 January 2011 will renew with EMH.

During 2010 a distribution agreement for Health Insurance was agreed with the Benenden Healthcare Society Limited. This includes distribution of new business as well as renewals of existing business, both of which will be underwritten from 1 January 2011 by EMH.

Neither of these events has any impact on the accounts for the year ending 31 December 2010.

**Defined benefits pension scheme**

As disclosed in note 27, a consultation with the active members of the defined benefits pension scheme commenced in February 2011 and is ongoing at the balance sheet date. This has no impact on the financial statements.

notes:

notes:

any questions

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