annual report & accounts

Homeowners Friendly Society Group annual report & accounts for the year ended 31 December 2012

engage
Mutual Assurance

society information

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

registered office

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website: **engagemutual.com**

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

KPMG Audit plc, Statutory Auditor
(from 8 August 2012)

Deloitte LLP, Statutory Auditor
(resigned 7 August 2012)

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

Peter J Burrows BA ACA

Paul G Chandler MA MBA
(from 1 October 2012)

Andrew T Gosling MA FCA

Andrew S Haigh BSc
(resigned 24 December 2012)

Karl J D Elliott BA

Peter W Mason BSc FIA
(resigned 31 January 2013)

Nigel B Masters BSc FIA
(from 1 June 2012)

Christina M McComb BA MBA

other society officers

secretary

Andrew J Horsley MCSI FCIS

actuarial function holder and with profits actuary

Trevor M Batten FIA

board committees

audit

Andrew T Gosling (Chairman)

Christina M McComb

Peter W Mason
(resigned 31 January 2013)

Nigel B Masters
(from 11 September 2012)

David G Robinson
(until 11 September 2012)

finance

Nigel B Masters (Chairman)
(appointed to the Committee 11 September 2012 and as Chairman 1 February 2013)

Peter J Burrows

Andrew S Haigh
(resigned 24 December 2012)

Peter W Mason
(resigned 31 January 2013)

David G Robinson

corporate governance and nominations

David G Robinson (Chairman)

Peter J Burrows
(from 22 February 2013)

Paul G Chandler
(from 1 October 2012)

Andrew T Gosling

Christina M McComb

Peter W Mason
(resigned 31 January 2013)

Nigel B Masters
(from 11 September 2012)

remuneration

Christina M McComb (Chairman)

Paul G Chandler
(from 1 October 2012)

Peter W Mason
(resigned 31 January 2013)

David G Robinson

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who we are

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

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

- Engage Mutual Health offers health insurance products. Engage Health Holdings Limited is the holding company of Engage Mutual Health
- Engage Mutual Funds Limited is the provider of our child trust fund product
- Engage Mutual Services Limited is our marketing services subsidiary
- Engage Mutual Administration Limited is the principal employer, with around 200 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:

helping people help
each other live the
second half of their lives

engage with our vision…

"To be the best customer-owned business." It is, by any measure, an ambitious goal. But it is one which shapes everything we do, and how we do it.

Striving to deliver the best possible service and value that we can almost goes without saying. We want to listen, respond to and actively support the needs, views and concerns of our customers.

As a mutual, we want to build a genuine community of customers, who don't just benefit from the services we provide but interact and actively support each other.

If we get these things right then we believe that we will genuinely make a difference to our customers' lives.

Our aim is for Engage Mutual to be not just another financial institution, but a business that is valued by its customers for being much more.

chairman's introduction

The challenging business environment continued into 2012, with sluggish economic performance and a continuation of the historically low interest rates and relatively high inflation levels seen in recent years. Against this backdrop, your Society delivered another strong performance, ensuring strategic progress with continued financial stability and increasing new business sales during the year.

Despite the economic uncertainty, there was a welcome uplift in stock market performance with the FT-SE® All-Share Index growing 8.2% over the period. The news was less positive for deposits, faced with a continuing low interest rate environment which saw the Bank of England base rate remain at 0.50%.

As a customer-owned organisation, Engage Mutual exists to serve the interests of members, both today and in the future. As such, we take member feedback very seriously and we were therefore delighted that members recognised our efforts for the third year running with industry-leading satisfaction scores. We are proud of our levels of customer care and service and we will continue to seek, listen and respond to your feedback in 2013 to ensure that our high standards are maintained.

as a customer-owned organisation, Engage Mutual exists to serve the interests of members, both today and in the future.

The changing economic and social environment in which we live requires all organisations to respond and adapt as customer needs and preferences change. It is our belief that the customer ownership model, one where our social and ethical values underpin everything we do, is increasingly relevant to consumers and Government, both of which are seeking more equitable alternatives.

In our 2011 report, we set out for members the key pillars of our long-term strategy to remain a relevant and meaningful mutual in today's society. I believe that mutuality should provide clear and tangible benefits for our members, enabling them to see a better outcome for themselves, their families and the communities in which they live.

The founders and members of the earliest mutuals and co-operatives all had a sense of community; people with shared beliefs or problems coming together to help each other. Whilst today's issues are very different from those that led our Victorian ancestors to set up mutual organisations, we believe that the principles are as relevant and meaningful in today's society as they have ever been.

In 2012 we took our first steps on a journey to becoming that community-led business, piloting **engagewithyou.com**, an internet-based resource and community forum created to provide help and support for those customers looking after elderly relatives. We also launched 'engage with your community', an initiative that provides financial support to community volunteering projects nominated by members across the UK.

It is clear in listening to customers that the emerging issues faced by our ageing population in the UK, such as long-term care provision and pressures on the NHS, bring home to many of us the wider implications that living for longer is having on our health and finances. That is why we have chosen to invest in the ongoing development of our health business. In 2012 we launched our new surgery cover product to sit alongside our highly-competitive life insurance. Both are for consumers in the second half of their lives. In 2013 we anticipate launching further products and services in response to the growing and changing needs of our customers for affordable ways of helping with the costs of healthcare.

Delivering a successful and growing business is only possible with a team of highly-motivated and focused employees. We know that organisations worldwide find high employee satisfaction scores have many benefits, not only in creating an enjoyable place to work, but also in delivering a positive customer experience. We place real significance on staff engagement, which was reflected for the second-year running in our staff survey results. Benchmarked against some of the best organisations across the globe, we again achieved top-quartile performance, an excellent result and one which, when aligned to our customer satisfaction scores, shows the value of investing in people for the benefit of our membership.

There have been a number of changes to our Board over the year, the most significant being the announcement by Andrew Haigh, our former Chief Executive, that he planned to step down from his role. Andrew served the organisation for more than 15 years, 10 of them as Chief Executive. Throughout this time, he was the driving force behind the organisation's growth and strategic direction. Andrew has always been a strong advocate of a mutual business model which has customer ownership and a sense of collective community and participation at its heart, and Engage Mutual will continue to carry those principles forward. We thank Andrew for his considerable commitment and achievements during his time at Engage Mutual and we wish him well for the future.

Looking forward, Peter Burrows, Finance and Operations Director has taken on the role of Acting Chief Executive, as we undertake the process of identifying a permanent successor to lead us forward. Peter leads a highly capable team who are continuing to ensure that the organisation remains focused on the effective delivery of our plans.

We were pleased to welcome Nigel Masters and Paul Chandler to the Board as Non-Executive Directors during 2012. Paul is a recognised leader in the fair trade movement, having successfully led Traidcraft for over 11 years. Nigel is a former President of the Institute of Actuaries and brings considerable experience from within the life industry. Both add new skills and capability to our Board and are strongly committed to our values of mutuality, ethical trading and fair treatment of members. I look forward to working with them.

As planned, Peter Mason stood down as a Non-Executive Director at the end of January 2013. Peter had served Engage Mutual with distinction for many years, initially as an independent member of the Finance & Risk Committee and from 2005 as a member of the Board. As well as chairing the Finance Committee, he was also our Senior Independent Director. On a personal level, I have very much valued Peter's support and wise counsel.

As a consequence of Peter stepping down, Andrew Gosling has now taken over the role of Senior Independent Director. In this capacity, Andrew is available to our members should they have any concerns which remain unresolved after having contacted either myself, or one of the Executive Directors.

There has been progress and positive change across the organisation during 2012 and, whilst market conditions remain challenging, I believe that Engage Mutual is well placed to make the very best of the opportunities the current environment presents. We have strengthened our market position in recent years, including the acquisition and successful integration of a number of smaller businesses. The Board will continue to look for opportunities for further transactions to support our growth, subject to these making strategic and financial sense.

I believe that we have a clear and differentiated strategy focused on the needs of our customers. We have sound principles, a strong capital position and a talented leadership team who are committed to delivering continued success for Engage Mutual as a relevant, thriving, customer-owned business.

I would like to thank my fellow Board members, the management and staff of Engage Mutual and our members for their support during 2012.

David Robinson
Chairman
25 March 2013

chief executive's review

I was delighted to be appointed as Acting Chief Executive of the Society following Andrew Haigh's retirement from the Board. Andrew's legacy is a strong Society with a clear vision of its future, and therefore my priority is to continue the Society's evolutionary journey as we seek to reinvigorate the principles of mutuality in a modern day setting.

Members will need no reminder of the austere financial conditions of recent years. Throughout that period your Society has successfully maintained its financial strength, and 2012 was no exception. Our capital position remains enviably strong, and you should therefore be confident that the Society has a bright future as a thriving independent mutual, with the financial strength to continue to meet its financial commitments to members. Yet in parallel with maintaining robust finances, we have also been able to set aside funds to invest in the future, most notably in our health business.

In 2012 we concluded a number of developments that will underpin our long-term sustainability.

We refreshed our leading over 50s life insurance product, allowing us to expand our distribution reach and grow sales volumes in the year. We continued to invest in our health business, broadening our market offering as we begin to establish ourselves as a credible and caring provider.

Our commitment to providing outstanding service to members and customers remains a guiding principle, and in 2012 we again participated in the annual independent 'LAMRA Customer Satisfaction Survey', a benchmark of the leading organisations in the industry. The results from 2012, and indeed from prior years, demonstrate that our performance is consistently better than most others in the industry, and in many areas significantly so. We are proud that our customers rate us so highly, but we will not allow this to make us complacent. Our overall performance in 2012 dipped slightly, and we have already put plans in place to enhance our service in certain areas.

our commitment to providing outstanding service to members and customers remains a guiding principle.

As part of the acquisitions we made in 2010, we inherited two satellite offices in Bedford and Gloucester. Having closed those offices in November 2011, during 2012 we completed the integration into Harrogate of all acquired business and associated processes.

You will find full details of our performance and results within the Operating and Financial Review starting on page 12. However, the following are some of the highlights of 2012:

- we maintained a strong capital position with the Group's available capital resources totalling £79.9 million, nearly four times that which we are required to hold by regulatory requirements
- health cash plan new business sales totalled £0.6 million, 36% up on the prior year
- costs rose just 1% in a year when we integrated acquired businesses and continued to invest in developing our health business. This represents a fall in real terms and has been achieved in parallel with a 14% overall increase in new business sales

the results from 2012, and indeed from prior years, demonstrate that our performance is consistently better than the industry average.

- membership of the Society grew 34% to 286,504, bolstered by the admission to membership of many of our health customers. Overall customer numbers fell 1% to 498,764
- 92% of customers told us that we treat customers fairly in the recent 'LAMRA Customer Satisfaction Survey', compared to an industry average of 86%
- we enhanced our over 50s life insurance product, extending its benefits to give customers the ability to access their sum assured in the event of terminal or critical illness and providing additional support services over the duration of the policy. New over 50s life sales of £3.2 million were up 50% on the prior year
- 2012 was another difficult year for deposit savers, but against a backdrop of continued low interest rates we earned a return that was ahead of base rate by the largest amount for many years, delivering a gross return for customers of 2.4%. We also maintained our charge cap arrangement, whereby charges on deposits are capped at a maximum of £50 per annum
- both of our with profits funds are using their capital strength to return excess capital to the funds' members. Typical enhancement rates to payouts are 12.5% in the With Profits I fund and 9% in the With Profits II fund.

We remain committed to tracing former members or customers who may have forgotten that they have a policy with Engage Mutual, and by the end of 2012 the amount of such 'unclaimed assets' that we have been able to reunite with their rightful owners exceeded £2.8 million. We aim to become an active champion and advocate of our members' needs and during the year we also piloted a new website, **engagewithyou.com**, providing expert advice and an active forum for those battling with the issues of long-term care for their relatives or loved ones. We are proud of the progress that we made in that area, and importantly it provided us with learning and insight as we increasingly begin to develop the Society to adopt a wider role in the community.

The changing regulatory landscape continues to test both us and the sector in general. In 2012 we successfully implemented the requirements of the new EU Gender Directive and the UK Retail Distribution Review. We also continued our preparations in respect of the new risk and capital management regulations known as 'Solvency II', where despite repeated delays in the EU's implementation timeline and ongoing uncertainty regarding the final rules, our risk processes and capital strength are such that we remain confident of our ability to comply with the new requirements.

The impact of the division of the Financial Services Authority into two regulatory bodies, the Prudential Regulatory Authority and the Financial Conduct Authority, is as yet untested. It is imperative that the need for the industry to hold dialogue with two regulators instead of one does not result in cost increases that are ultimately borne by the consumer.

Notwithstanding these practical issues, we remain strong advocates of the need for robust regulation of the sector, with a passionate belief in good corporate governance and the fair treatment of customers. We believe that the mutual model of ownership creates a naturally more favourable environment for members, who are both the customers and owners of their business. We remain hopeful that the positive sentiment towards mutuality from across the political spectrum will at some point translate into tangible legislative action that delivers benefits for the mutual model and our members.

Our staff are the foundations upon which we build the day-to-day running of our business, and in 2012 we were awarded a gold Investors In People award in recognition of our commitment to the development and continued wellbeing of our people. Just 3% of organisations who are assessed manage to achieve the gold standard, so we were delighted to be recognised in this way. The results of an independent survey of our staff were similarly strong, showing that our people benchmark us in line with the global top quartile of businesses.

In 2012 we closed our defined benefit pension scheme to future

accrual. Defined benefit pension schemes have become increasingly unaffordable, with very few organisations outside the public sector now able to maintain them. Having closed the defined benefit scheme to new entrants in 2001, in 2012 we replaced it with a defined contribution scheme for all staff. 2012 also saw increased levels of awareness around the living wage, and I am happy to confirm that no member of staff is paid less than the living wage.

2012 also saw us continue our involvement in community and charitable support across a wide range of causes, including our local hospice, Saint Michael's, and the Steve Prescott Foundation. Furthermore, through our 'engage with your community' initiative, we donated £15,000 to three organisations nominated by our members, enabling them to support volunteering projects that make a difference to the communities in which they live.

In conclusion, I would like to extend my thanks to all our customers and staff for their continued commitment and support. Without you, the Society would not exist; but together, I believe that we can make Engage Mutual the leading customer-owned business, increasingly relevant to the daily lives of our members.

Peter Burrows
Acting Chief Executive
25 March 2013

operating and financial review

strategy

In last year's operating review, we outlined our strategic intent for the business in the next three to five years, and that intent remains unchanged.

Our vision is "To be the best customer-owned business". We will do this by building a thriving, relevant and commercially successful organisation, serving the needs of our members today and in the future.

Our mission is "Helping people help each other live the second half of their lives". This combines our strengths and expertise as a financial services organisation, with a clear, growing need for the provision of help and mutual support in making the very best of the joys, challenges and complexities of modern life.

There are three key elements to our strategy:

- we will continue to provide an increasingly relevant range of life and health insurance products, designed to deal with the emerging needs created by the increasing pressures upon health and social care in the areas of care, rehabilitation and major medical expenses. We anticipate significant growth in sales through both our traditional and new distribution channels as the market for health and protection products in the later stages of life continues to grow.
- we will be successful by helping our customers find the best outcomes to the challenges they face in dealing with the health and wellbeing of their families and themselves. We will do this by drawing together a combination of products, services and informed experts to provide insightful solutions, and by facilitating a true community amongst customers which provides an opportunity to exchange views, share experience and offer mutual support.
- we will actively encourage customer participation and involvement enabling people to help both themselves and their families. We will seek customer feedback, invigorate our customer panel, and create a platform for customers to share their views across a range of subject areas including service, communications, products and community involvement.

This strategic intent underpins every decision we take as an organisation and during 2012 we have made good progress towards delivering on that intent.

customer engagement

We took our first steps in a number of new areas in 2012, as we looked to create opportunities for our customers and their families to interact and engage with the organisation and each other.

With the help of a number of our 1,000 strong customer panel, we created **engagewithyou.com**, a pilot community website full of help, expert advice and shared personal experiences for those dealing with the challenges of long-term care for their families and friends. We were delighted by the response the site generated from customers, interest groups and members of the public, many of whom participated in debate and support around this challenging subject. As we continue to grow and develop our main website content we intend to tackle other areas of interest relevant to the lives of our customers.

Following a period of consultation with our customer panel, we introduced online voting for our Annual General Meeting (AGM) in 2012, to enable members to cast their votes without the need to participate in a postal vote or by attending the AGM. Online voting has enabled us to talk more with our customers, create time savings for our members, reduce the amount of printed materials and postage that we use, and provide additional funding for the good causes that we support, through a donation for each online vote we receive.

The service proved an immediate success with over 3,500 online votes submitted, making up almost 16% of the vote and increasing our number of voting members by 9%. 2013 will see us build on this initial success with the continuation of online voting and the introduction of electronic voting packs for those who request them.

We have made a great deal of progress in increasing engagement with customers during 2012 and we have been delighted with the response to date. We have further initiatives planned for 2013 and will continue to consult with the customer panel who provide invaluable feedback and guidance for new development.

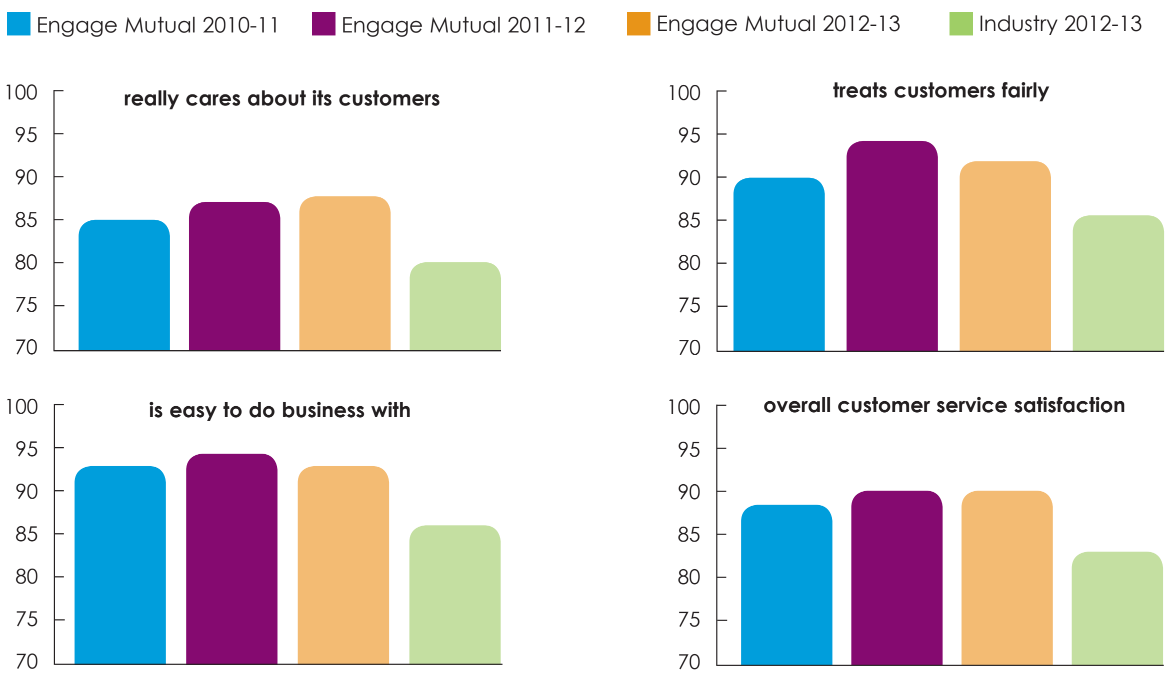
customer feedback

As a customer-owned business, feedback from our members is our life blood and so we were delighted that our continued efforts to improve our customer experience across the organisation were once again recognised in the results of the 2012 'LAMRA Customer Satisfaction Survey' (previously the Association of British Insurers Customer Impact Survey). This is the only industry-wide benchmark survey of customer service for the life insurance industry.

In our third year of participation, we again delivered market-leading results, outperforming our industry sector average in each of the six key measures, a testament to the significant and constant focus our staff place on serving our customers.

Satisfaction scores for customers with protection and regular savings products remained exceptionally strong. However, we saw a fall in the satisfaction scores of customers with lump sum investment products, something that we will look to understand and address in 2013.

A selection of the survey results is shown below.



2012 LAMRA Customer Satisfaction Survey

We also carry out our own regular customer benchmark survey throughout the year, gathering feedback from over 6,000 policyholders for service, communications, competitiveness and the effectiveness and ease of use of our website.

In testing market conditions, customers continue to be very satisfied with the services we offer, recording another year-on-year increase in overall satisfaction with our performance, which rose from an average score of 8.0 in 2011 to 8.4 out of 10 in 2012.

products and services

We took steps in 2012 to ensure that our product range was increasingly relevant to the health and well-being needs of our members and their families.

Following extensive customer research, we launched a refreshed version of our very successful over 50s life cover product. We introduced new benefits for customers, including the ability to draw down a proportion of their sum assured in the event of a serious illness and 100% of their sum assured in cases of terminal illness. We also introduced new care and support services to ensure that those whom we protect now have access to financial, physical and emotional support, in addition to the peace of mind that their families will be supported when the need arises. The over 50s life cover product has a market-leading price and a range of features and services unmatched by any other provider. As such, we expect to continue to grow our market share in 2013.

In addition to refreshing our over 50s life cover product, customer feedback informed us that many people were seeking a policy that would explicitly cover funeral costs. In response to this we have worked with our partner, The Co-operative Funeralcare, to provide customers with the ability to purchase a pre-paid funeral plan, enabling them to cover the costs of their chosen funeral.

The end of 2012 also saw us introduce a new health insurance product, over 45s surgery cover, designed to provide help and protection should customers have a need for surgery. Our intent is to provide a simple and cost-efficient alternative to the increasingly expensive private medical insurance policies that many simply cannot afford.

The product is straightforward and covers the surgical procedures most commonly required by those aged 45 and over, including hip and knee replacement, heart surgery and thyroidectomy. Customers diagnosed by their GP as requiring one of these surgical procedures can either use the proceeds of their policy to fund the procedure in a private hospital, or simply continue with NHS treatment and receive a substantial cash benefit to use as they see fit. Customers choosing to use a private hospital are able to use our personal booking service to ensure that they get the right treatment tailored to their needs, and all customers are entitled to recuperation support and medical advice via trained nursing staff.

On acquiring the majority of the life business of Ecclesiastical Life Limited in 2010, we became custodians for a number of pension plan customers, many of whom are required to purchase an annuity at the point of their retirement. We are not a specialist annuity provider so instead we introduced an Annuity Service, introducing our customers to Key Retirement Solutions (KRS), a market-leading annuity broker. KRS offer a thoughtful and competitive service to customers, often securing them an enhanced annuity value. As a result we have seen over 80% of our pension plan holders elect to take an annuity sourced via KRS, and in light of this success we hope to widen the service to all customers in 2013.

During 2012 we updated our products in order to comply with the EU Gender Directive, which required all insurance products to remove any gender bias in their pricing. In doing so we were also able to further improve the competitiveness of our over 50s life cover product.

In addition to the range of products and services we provide to our customers, we improved customer outcomes through a range of discretionary benefits and actions during 2012. We were able to make discretionary payments to a number of life insurance policyholders, whose circumstances meant their claims fell outside of the standard claims process.

Our continued determination to ensure that our customers receive a fair outcome, regardless of the formal contract is another example of the benefits of belonging to a customer-owned business.

We also continued our highly successful campaign to reunite customers with their unclaimed savings and life policy benefits, and have now reallocated £2.8 million of previously unclaimed assets, over 30% of our unclaimed asset book.

Prevention is often better than cure and we continued to promote our 'Keep it, Will it, Flag it' initiative during the year. Our aim is to reduce the instances of unclaimed assets in the future by raising awareness of the importance of keeping policy documents safe, referencing policies in wills and making next of kin aware of any policies held. As a result of our work, we hope to ensure that our customers always receive the intended benefits of the policies that we manage on their behalf.

In light of continued record low interest rates, we also continued our discretionary cap on the charges made to our Deposit Fund customers, ensuring that we limited the impact that charges had on their returns.

sales and distribution

Despite challenging market conditions and continued uncertainty in financial markets in 2012, we again managed to increase our new business sales, fuelled primarily through broker and intermediary distribution channels.

In our sixth year of working in partnership with Clydesdale Bank and Yorkshire Bank, we successfully delivered savings and protection plans to customers across their 331 strong branch network throughout the UK. We continue to work closely with the banks to ensure that our products remain relevant and appealing to their customer base and look forward to another successful year in 2013.

We also continued to develop our relationship with Benenden Healthcare Society, managing their 16,000 health cash plan customers and providing a range of health and protection products to support their new business aspirations. As a mutual society Benenden shares our customer care principles and values, to the benefit of both sets of members.

2012 saw us again make significant progress in the broker and intermediary channels with our over 50s life cover plan more than doubling sales on the previous year. An improved product offer, combined with a growing portfolio of distribution partners, provide us with the platform for further growth in 2013 as we continue to increase our share of this market.

One of our strategic aims is to grow our share of the health insurance market. That intent was backed up by the refreshing of our health broker panel and our sales team during 2012, resulting in the successful addition of a number of new accounts during the year, including O_2. We have enhanced our One Fund corporate health cash plan product in early 2013 in response to market feedback, as we continue to seek further growth in this market.

In 2012 our distribution model was impacted by the EU Gender Directive and the Retail Distribution Review. We have successfully responded to the former, and the consequences of the latter will take longer to work through the markets in which we operate. The implications for the distribution landscape are wide-ranging and we have already seen many of our larger competitors begin to reconsider the products that they provide and the distribution channels that they use. We anticipate increased competition, and we have consequently taken significant steps to differentiate both our product offer and our routes to market in order to ensure that we offer increasingly relevant and competitive solutions for our customers.

social, community and people

As a customer-owned business, we aim to make a difference to the communities in which our customers live and operate.

We are a long-standing supporter of our neighbours, Saint Michael's, a hospice which touches the lives of many in our local community. Our help has enabled Saint Michael's to continue running the Midnight Walk, an annual fundraising event that brings people of all ages together to support the delivery of their increasing range of care initiatives.

'Engage with your club' is our grass roots campaign supporting amateur rugby league clubs, bringing together volunteers in local communities to improve their facilities, which are invariably as much a community hub as sports club. The scheme saw over 60 clubs get involved during 2012 and has been recognised at all levels as a successful initiative. We intend to build on this in 2013.

2012 also saw us launch 'engage with your community', a new initiative designed to encourage customers who are actively involved in a community project to apply for support including a project budget of up to £5,000. Of the 30 applications for support that we received, three organisations were chosen:

- Cruse Bereavement Care, Cambridge;
- Tower Hamlets Street Pastors, Bethnal Green; and
- Carers Advice and Resources, Sandwell.

All of the selected organisations have already implemented the funding to great effect. As a result of the scheme's initial success we will be continuing our 'engage with your community' initiative in 2013, and we hope that more customers will choose to participate.

We also continued our support of the Steve Prescott Foundation in 2012 and have now helped the foundation raise over £100,000. Steve, a former professional rugby league player who was diagnosed with terminal cancer in 2006, raises funds for The Christie cancer hospital in Manchester and the Rugby League's benevolent fund which helps seriously injured players.

Our staff continue to support charities close to their own hearts, taking full advantage of our volunteering scheme which provides up to two working days volunteer time banking per employee per year. Personal donations saw staff again achieve the Gold Payroll Giving standard for their generosity. Together with our Gold Investors In People and top quartile staff satisfaction survey results, this tells you a great deal about the quality and values of the people working on behalf of our customers and their desire to have a positive impact on the lives of others.

financial review

In 2012 we maintained two clear financial priorities: maximising the efficiency of the group, focusing on both the integration of acquired businesses and the wider simplification of our operating processes, and investing in our strategic priority of growing our health insurance business.

This dual focus on efficiency and business development was designed to ensure that not only are we able to grow, but that in parallel we are able to reshape the group to reduce and ultimately eliminate our reliance on a number of products that the Group no longer actively offers for sale.

Our financial results for the year are described in more detail below. As always, in managing your business we have endeavoured to strike the right balance between maintaining the group's long-term financial and capital strength, and maximising the immediate financial benefits for members and customers through, for example, insurance benefits and the level of bonuses on savings policies.

capital strength

Our capital position continues to be very strong. Members can be confident that the Group is well capitalised and adequately funded to meet its financial commitments to members. Capital as measured by the Group Fund for Future Appropriations (FFA) stands at £83.9 million (2011 – £84.5 million). As detailed below, this stable position is a result of business growth offset by investment in our health business.

Capital requirements are analysed further in note 1 to the accounts, which shows that at 31 December 2012 the Group held:

- £29.5 million of excess capital over regulatory requirements for the Non Profit Fund, representing 3.8 times minimum capital requirement;
- £20.9 million of excess capital over regulatory requirements for the open Engage Mutual With Profits Fund I, representing 5.6 times minimum capital requirement; and
- £9.3 million of excess capital over regulatory requirements for the closed Engage Mutual With Profits Fund II, representing 2.8 times the minimum capital requirement.

with profits

The Group operates two with profits funds – With Profits Fund I, that we have operated since 2003, and With Profits Fund II, that we have operated since 2010 as part of the acquisition from Ecclesiastical Life Limited. Each fund is separately ring fenced for the exclusive benefit of its own members.

Engage Mutual with profits fund (With Profits Fund I)

At 31 December 2012 the fund held assets of £75.6 million. Over 2012 the overall return on the fund from a mixture of fixed income, equities and other growth assets resulted in investment growth of 5.5% with the return being shared amongst policyholders as set out in the fund's Principles and Practices of Financial Management (PPFM).

The return was against a background of fluctuating market conditions in 2012, which saw the FT-SE® All Share index rise by 8.2%.

As part of the fund's 2012 bonus declaration, regular bonus rates were maintained at current levels. In addition the levels of final bonus rates increased and market value reduction factors decreased across most classes of business, which will lead to higher payments being made to members during 2013.

Owing to the strong financial position of the fund, the Board has agreed to continue to use a proportion of the surplus assets in the fund to improve future payouts. Claims arising during 2012 on policies not already benefiting from guarantees received a typical uplift of 12.5%, and as a result, in 2012 we paid over £0.6 million to members in excess of the payments that they would otherwise have received. We are continuing to enhance payments to members in 2013.

During 2012, 3,460 new policies were written in the fund, and we continue to write this new business profitably. We therefore have no plans to close the fund to new business.

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

At 31 December 2012 the fund held assets of £98.3 million. In fluctuating market conditions the fund returned an investment performance of 6.8%. This enabled regular bonus rates to be maintained at their existing levels for regular premium life business, although they were reduced for certain other lines of business that already benefit from guaranteed levels of return.

The levels of final bonus rates have increased and market value reduction factors decreased across most classes of business.

The fund is closed to new business and in October 2011 a formal run-off plan was agreed with the FSA. This governs how, over time, the excess assets in the fund will progressively be distributed to members via enhanced claims payouts. The precise level of enhancement depends on both individual member circumstances and the ongoing investment performance of the fund, but as a guide we expect a typical enhancement to be around 9% for policies not already benefiting from guarantees. As a result, in 2012 we paid over £0.8 million to members in excess of the payments that they otherwise would have received.

life insurance business

Life insurance is the most mature part of our business which we plan to diversify and grow in the future by selling through intermediaries and the development of new distribution channels. In 2012 we extended our sales capability focusing on developing our existing relationships and initiating a number of new distribution arrangements with independent financial advisers, brokers and sales partners.

We continue to build on the strength of our over 50s life cover offering and during 2012 sales of this product grew by 50%. Sales of other life insurance products, most notably with profits policies, declined in 2012 with the result that new life insurance sales rose 7% to an annual premium income of £4.3 million.

savings business

Investment market conditions remained challenging in 2012, with the value of equity stocks improving in the final quarter but interest rates remaining consistently low. This was reflected in policy performance.

Policyholders choosing to invest in equities in 2012 have generally experienced an improvement in the value of their policy, with our main equity fund delivering an investment rise of 11.6%.

Child trust fund customers saw investment gains of 8.0%. Our customers continued to make contributions to their policies throughout the year and, as a result the fund grew 16% over the year, to £176.1 million.

We have continued to work on behalf of our policyholders investing in deposit policies. We aim to maximise returns whilst being conscious of the credit rating of the counterparties with whom we invest, and we ensure that deposits are spread across a number of different providers. This year the overall gross return of 2.4% represented a return that was ahead of base rate by the largest amount for many years.

Given the ongoing relatively low interest rate environment, we continued to cap the charges we make for managing deposit policies at a maximum of £50. Typically, this means that any amounts invested in a deposit policy in excess of £10,000 incur no additional charge. Overall, this benefited members by an additional £45,000, reducing the total charges paid by members in 2012 by 8%. Decisions regarding future charge caps will continue to be made each year, based on affordability and the prevailing rates at the time.

health business

Our health business is a key future growth area for us and we continue to invest in expanding our customer base and developing a broader range of health products and services. The short-term impact of that investment presents as losses, reflecting the natural profit profile of a general insurance business in development, although over the business lifecycle we expect to generate a profit on our investment. In 2012 we enhanced our One Fund health cash plan product for corporate customers and launched a new over 45s surgery cover product.

premiums and claims

In aggregate, premiums received across all of our business lines fell by 10% to £57.4 million. Within that total, the largest fall was the expected decline in child trust fund premiums of 27% to £9.6 million following the Government's withdrawal of the scheme, which continued the trend from last year. Life insurance premiums fell 6% to £33.2 million, largely as a result of directing our annuity customers to a specialist broker. In contrast health insurance premiums increased 4% to £6.9 million.

Aggregate claims fell by 15% to £86.5 million with health claims falling 8% to £5.2 million.

long-term business

Our long-term business, which includes life insurance and investment business, ended the year with a net transfer to the Fund for Future Appropriations (FFA) of £1.1 million.

general insurance business

As noted above our health business is relatively immature and is generating losses in the short-term as we establish its market position. We recorded a loss in 2012 of £2.8 million.

other business

Despite the Government's closure of the scheme, our child trust fund business continues to prosper. Funds under management grew to £176.1 million with income up 12% to £2.4 million. Given the closure of the scheme we expect modest but positive growth in income going forward.

Our continued successful relationship with The Co-operative Funeralcare earned us £1.0 million in income during 2012, due to customers arranging the proceeds of their life insurance policies to reduce the costs and simplify the process of arranging a funeral.

The Society's pension scheme surplus stands at £5.2 million, but we continue to adopt a prudent accounting approach and do not take credit for that surplus in the group accounts.

costs and infrastructure

Net operating expenses were £20.3 million, broadly level with the previous year. This reflects the continual drive for efficiency, both in administering acquired businesses and simplifying our existing processes. We also increased the cost-efficiency of our new business distribution.

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 require 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 management reporting.

realistic reporting

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. 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 business. We further test our evaluation by identifying potential situations which could cause our business model to fail. 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 were to occur.

Our risk assessment seeks to ensure that there is adequate capital, calculated on a best estimate basis, to meet the risks, or combinations of risk, faced by our business which have a greater than one in two hundred chance of occurring over the next twelve months.

The key risks to which we are exposed and their current relative impact on our realistic capital are represented overleaf. The charts illustrate how our risk profile has remained relatively stable over the year, which is consistent with our business activity over 2012.

risk framework

The Board is responsible for ensuring that 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. The Board receives a 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 committees which report into the Executive Committee. These sub-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 monitor and manage our risks, operate efficiently and effectively, comply with regulation and treat our customers fairly.

The European Directive referred to as 'Solvency II' has been further delayed and is currently not expected to be implemented before 1 January 2016. 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 we will meet the Solvency II capital requirements.

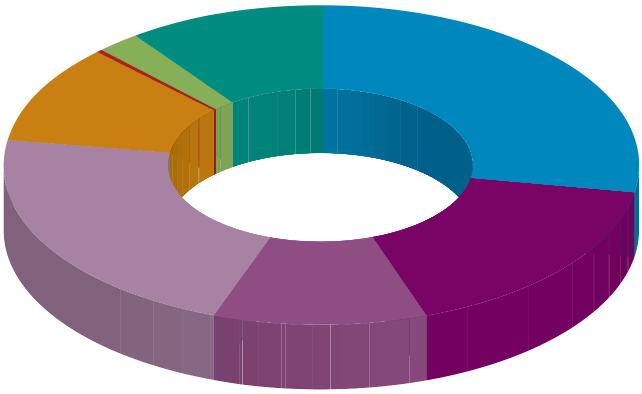
executive committees

All Executive sub-committees report into the Executive Committee which is chaired by the Chief Executive. The Executive Committee includes the Group's Executive Directors, the Actuarial Function Holder, the Group Secretary & Compliance Officer, and other Executives who report directly to the Chief Executive. The meeting is attended in part by sub-committee Chairs and the Corporate Risk Officer.

The Executive Committee has day-to-day authority for managing the affairs of the Group, including

risk profile 2012

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



risk profile 2011

- market risk
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  - expense
  - mortality
- new business risk
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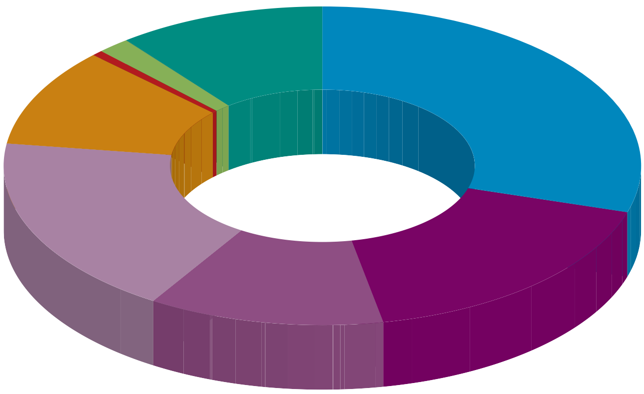


risk management and delivery of business plans and strategy. The Board and committees receive regular management information that takes into account all aspects of our business. The Board formally reviews management plans and capital forecasts twice a year, to ensure that financial projections reflect 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 lay person to interpret.

We currently present our accounts in line with UK generally accepted accounting practice (UK GAAP) for insurance companies, and in due course we expect to move to a position whereby we present accounts in line with International Financial Reporting Standards (IFRS). However, we remain mindful of the need to make this transition in a way that is both cost-effective and as meaningful as possible for members. We therefore do not expect to make such a change in 2013.

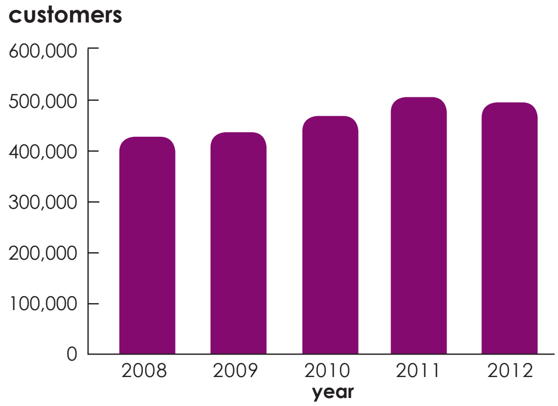
looking ahead

The Group continues to be in a strong financial position. We will continue to invest in strategic developments as we aim to build a thriving business that is increasingly better equipped to meet the needs of members. Our vision remains: to build a modern mutual organisation so that we can be "the best customer-owned business".

financial performance for the year ended 31 December 2012

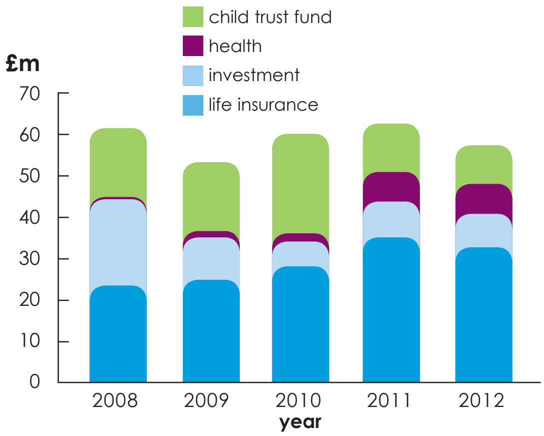
The following graphs are the main key performance indicators used to manage the business.

group customers



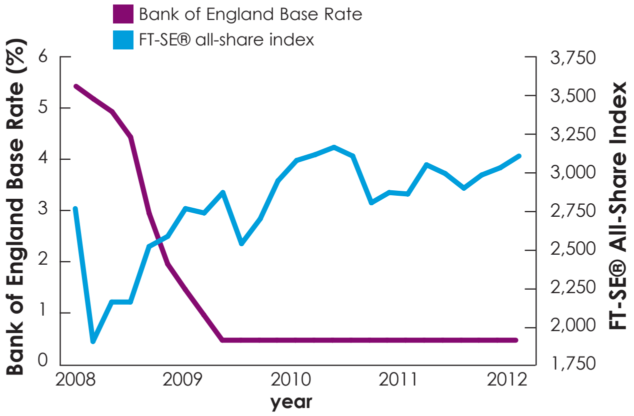
Customer numbers fell 1% to 498,764. During 2012, a number of health customers became members of the Society, increasing our membership by 34% to 286,504.

premiums from policyholders



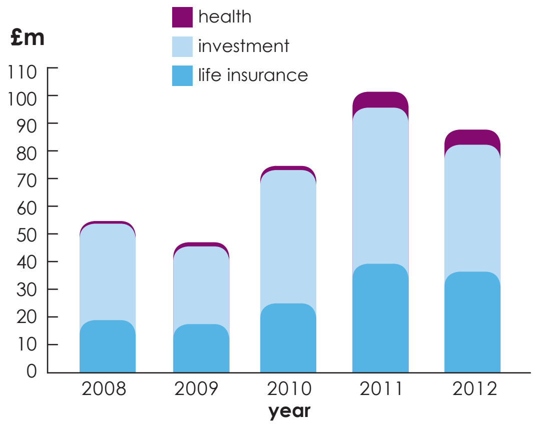
An expected fall in child trust fund premiums, combined with a decision in the year to achieve better returns for annuity customers by directing them to a third party, resulted in a fall in premiums to £57.4 million.

FT-SE® all-share index and Bank of England Base Rate



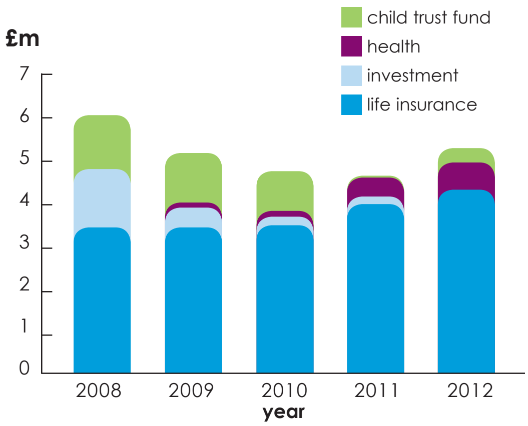
Equity markets remained relatively volatile throughout 2012, with an upwards trend in the final quarter. The FT-SE® All-Share Index ended the year up 8.2%. The Bank of England Base Rate was unchanged over the year at 0.5%.

claims paid to policyholders



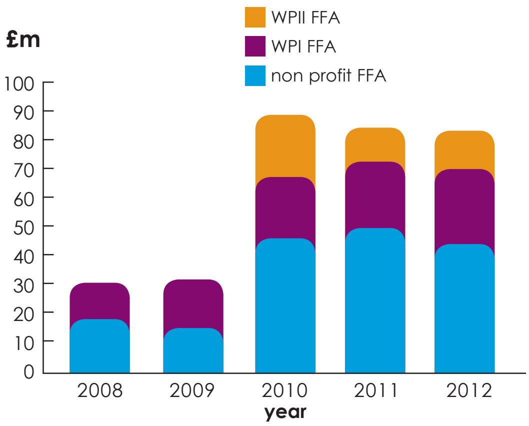
Claims paid to our customers totalled £86.5 million, comprising £36.2 million of life insurance benefits, £45.1 million of maturing investment policies and £5.2 million of health benefits.

new business performance



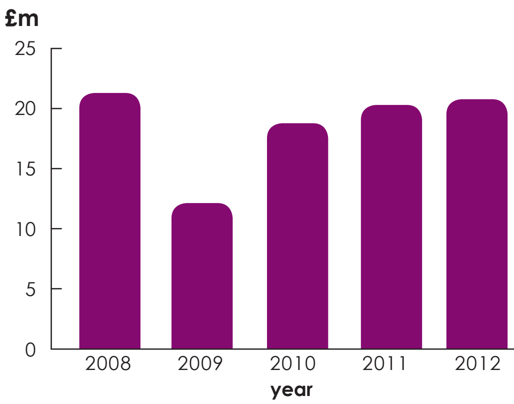
New business sales grew by 14% to £5.3 million. Within that total our market-leading over 50s whole of life protection product grew sales by 50% to £3.2 million.

group fund for future appropriations



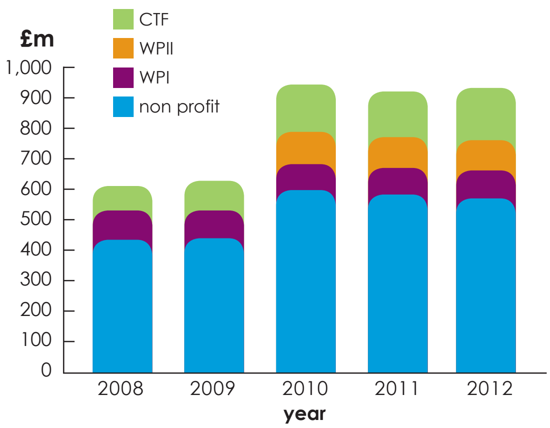
Overall the fund for future appropriations, representing funds not yet allocated to members, fell 1% to £83.9 million.

group expenses



Group expenses of £20.3 million were just 1% more than the previous year. This represents a fall in real terms, and has been achieved in parallel with a 14% increase in new business sales.

group assets



Group assets rose by 1% to £931 million.

your board of directors

David Robinson – MA FFA (63) Chairman

David joined the Board of Engage Mutual in August 2010 and was appointed Chairman in September 2010. He has extensive financial services experience, specifically from the mutual sector. He is passionate about delivering excellent customer experiences, together with a strong belief that the right people and culture deliver exceptional results for customers.

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

David is a member of the University Court and Chairman of the Audit and Risk Committee at Heriot-Watt University, Edinburgh.

Christina McComb – BA MBA (56) Vice Chairman

Chris joined the Board in May 2005 and was appointed Vice Chairman in 2009. She has wide-ranging experience of advising and 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 at Partnerships UK Plc.

She is currently a director of C5 Capital, a non-executive director of Baronsmead VCT 2, Nexeon Limited and Standard Life European Private Equity Trust plc, and a trustee of the Land Restoration Trust.

Peter Burrows – BA ACA (44) Acting Chief Executive

Peter joined the Board as Finance Director in November 2010 and was appointed Acting Chief Executive in January 2013. He is a chartered accountant with 20 years' experience gained in a combination of executive management and consulting roles, with a passionate belief in the benefits that mutuality brings both to members and wider society.

Prior to joining Engage Mutual, Peter held a number of senior finance positions with Aviva, both in the UK and 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.

He is a governor of York College, a position he has held since 2005, where he chairs the Finance & General Purposes Committee and also serves on the Remuneration and Search & Governance committees.

Paul Chandler – MA MBA (51)

Paul joined the Board in October 2012, bringing 20 years' experience as a chief executive and a strong profile as a leading advocate and exponent of fair trade. He is particularly interested in promoting ethical practices and mutuality in the financial services sector.

From 2001 until 2013 Paul was Chief Executive of Traidcraft, the UK's leading fair trade organisation. Prior to that he was Chief Executive of SPCK, the Christian publisher and bookseller, having previously spent some of his early career with Barclays Bank.

Paul is a director of the William Leech Foundation, Chair of the Council at Durham Cathedral and a fellow of St Chad's College in Durham University.

Karl Elliott – BA (40) Sales and Marketing Director

Karl became Marketing Director of the Society in October 2004 and was appointed to the Board in December 2007. Having worked in financial mutuals for over twenty years, Karl believes that a mutual business should put customer benefit, participation and a sense of collective community at the heart of all that it does.

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.

Andrew Gosling – MA FCA (57) Senior Independent Director

Andrew joined the Board in March 2011 as a non-executive director. He is a chartered accountant with over 35 years' experience in the financial services sector as a director, auditor and regulator. He is a committed supporter of mutuality and believes that mutuals are vital in providing choice to the consumer.

Until his retirement in 2010, Andrew 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 two years at the FSA, supervising some 25 building societies through the downturn of the 1990s.

Andrew is currently a non-executive director of Darlington Building Society.

Nigel Masters – BSc FIA (60)

Nigel joined the Board in June 2012 as a non-executive director. He is a fellow of the Institute and Faculty of Actuaries with over 35 years' experience in financial services. Nigel's focus is to promote the enhancement of members' benefits and services while maintaining the Society's strong capital base.

Nigel has held a number of senior actuarial positions, including Group Chief Life Actuary for Zurich Financial Services and Partner in the actuarial consulting practice at PricewaterhouseCoopers. He was previously President of the UK actuarial profession and has represented the profession on various European and international bodies.

He is a non-executive director of Wesleyan Assurance Society and Director of NMActuarial Limited.

how we manage the business

The Directors have pleasure in presenting their annual report, together with the financial statements for the year ended 31 December 2012.

business objectives

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 and partnership distribution.

subsidiary companies

Our subsidiary companies play an important role in meeting our mission of helping people help each other live the second half of their lives:

- Engage Mutual Health is the provider of our health cash plan and medical insurance business
- Engage Health Holdings Limited is the holding company of Engage Mutual Health
- 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.

The role of the subsidiaries and their 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 reviewed by the Chairman and Chief Executive on pages 6 to 11 and in the Operating and Financial Review on pages 12 to 23. The Operating and Financial Review identifies and explains the Group's Key Performance Indicators and sets out how it has performed against each during 2012.

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.

principal risks, uncertainties and going concern

The principal risks and uncertainties faced by the Group and our approach to managing them are set out in note 1.

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.

staff

The average number of staff (including Directors) employed by the Group totalled 199. The aggregate remuneration paid to Directors and staff employed by the Group, during the year, amounted to £8.9 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 bi-monthly presentations, team briefings and informal meetings with the Chief Executive and senior staff.

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.

Our staff are key to our operations and the Group supports the continued learning and development of its staff through regular analyses of training needs, an annual staff satisfaction survey and by the provision of a broad range of training opportunities.

board of directors

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

Andrew Haigh resigned as a director on 24 December 2012 and Peter Mason on 31 January 2013.

Nigel Masters was appointed as a director on 1 June 2012 and Paul Chandler on 1 October 2012 and being eligible, offer themselves for election to the Board of Directors at the 2013 AGM.

No Director had any interest either in the shares of the Society's subsidiary companies or in any contract of significance, with the Group or any of its subsidiary undertakings, at any time during the financial year.

The Society maintains Directors' and Officers' liability insurance cover in respect of legal action against its directors and officers. The insurance cover was reviewed and renewed in 2012.

The Directors in office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditor is unaware.

membership

Membership of the Society as at 31 December 2012 stood at 286,504 (2011: 213,051).

The total number of customers as at 31 December 2012 was 498,764 (2011: 503,529).

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.

diversity

We are an equal opportunities employer and the Board is in the process of implementing a formal policy on gender diversity.

supplier payment policy

It is the Group's policy and practice 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 and to further accruals from 31 December 2012. From 1 January 2013, all of the current active members became eligible to join the Group's defined contribution pension scheme.

The Directors continue to work with the Trustees to manage the defined benefit pension scheme investment policy and to maintain the financial 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 2012 we donated in excess of £24,000 to charities, which included donations to local charity, Saint Michael's as well as to The Steve Prescott Foundation. In addition we meet all the costs of maintaining the grounds that we share with Saint Michael's.

Our staff support several charities and have donated to and raised money for, amongst others, Saint Michael's, Harrogate Homeless Project, Comic Relief and BBC Children in Need during 2012. Total money raised by staff during the year was in excess of £7,300.

appointment of auditors

Our policy on rotation of auditors is such that audit services are formally reviewed at least every five years. The existing auditors are permitted to be re-appointed as part of this process.

In 2012 the Directors conducted a formal process to review the Group's external audit arrangements, inviting applications from a range of potential providers, and selected KPMG Audit Plc.

As a result, Deloitte LLP tendered their resignation on 7 August 2012 and the Directors appointed KPMG Audit Plc on 8 August 2012. The Directors would like to thank Deloitte LLP for their work over the last five years.

A resolution to appoint KPMG Audit Plc as external auditors will be proposed at the forthcoming AGM.

By Order of the Board
Andrew Horsley
Secretary
25 March 2013

corporate governance

The Board is accountable to the Society's members for the operation of the Group and to ensure that it is run in the best interests of the members.

The Board is also mindful that the effectiveness of the Board is vital to the financial strength and future success of the Society.

To ensure that the Board manages the Society in a prudent and effective manner and that it manages the risks that the Society faces, it is committed to complying with good practice in corporate governance.

The Board is of the view that, to comply with good practice in corporate governance, it should aim to adhere to the principles and provisions of the UK Corporate Governance Code annotated by the Association of Financial Mutuals 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.

As highlighted last year, the UK Corporate Governance Code introduced a requirement that Directors of larger organisations be subject to annual election by members. The Board has considered this provision in respect of the 2013 AGM and has agreed that this should not be brought in at that time. The Board is concerned that in extreme circumstances this provision could have implications for the stability of the Society which would not be in the best interests of members.

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 attendance record of each Director at those meetings and at relevant committee meetings is set out on page 31
- the Non-Executive Directors are responsible for bringing independent judgement to Board debate and decisions, and for constructively challenging the executive team which is made up of the Executive Directors and other Executive Managers
- the Non-Executive Directors meet without the Executive Directors present at least annually
- 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. As well as circulating papers as hard copies, the Board has access to its own secure website where papers are available together with additional supporting material, which acts as a library of papers for Directors
- there is regular communication between the Directors, the Chairman, the Chief Executive and the Group Secretary between meetings. When a Director is unable to attend Board or committee meetings, issues can be raised with the relevant Chairman
- 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

- each Director has access to independent professional advice, where they judge it necessary to discharge their responsibilities as Directors and have the benefit of appropriate liability insurance cover at the Society's expense
- all Directors have access to the advice and services of the Group Secretary, who is professionally qualified and is responsible for ensuring that Board procedures are complied with and advising the Board, through the Chairman, on governance matters. The Society's rules provide that the appointment and removal of the Group Secretary is a matter for the Board
- the Board currently consists of two Executive Directors and five Non-Executive Directors.

The Board is currently seeking to appoint a permanent Chief Executive, following the resignation of Andrew Haigh, and an additional Non-Executive Director.

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 no Non-Executive Director will serve the Society for longer than nine years.

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

chairman and chief executive

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

attendance of directors at board and committee meetings

Set out below are details of the Directors during 2012 and their attendance record at Board meetings and relevant committee meetings in the year.

Board Meetings	David Robinson	Christina McComb	Andrew Haigh	Peter Burrows	Paul Chandler	Karl Elliott	Andrew Gosling	Peter Mason	Nigel Masters
HFSL (10)†	10	10	9	10	2 of 2	10	10	10	5 of 5
EMFL (1)*	1	1	1	1	N/A	1	1	1	N/A
EMAL (1)**	1	1	1	1	N/A	1	1	1	N/A
EMSL (1)***	1	1	1	1	N/A	1	1	1	N/A
EMH (2)****	2	2	1 of 1	2	N/A	2	2	2	N/A
EHHL (1)*****	1	1	1	1	N/A	1	1	1	N/A

Committee Meetings

Audit (4)	3 of 3	4	N/A	N/A	N/A	N/A	4	4	1 of 1
Finance (6)	6	N/A	5	6	N/A	N/A	N/A	6	3 of 3
Corporate Governance & Nominations (2)	2	2	N/A	N/A	1 of 1	N/A	2	2	1 of 1
Remuneration (4)	4	4	N/A	N/A	1 of 1	N/A	N/A	4	3 of 3

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

performance evaluation

In 2011 the Board engaged an independent external organisation, Boardroom Review, to conduct a Board effectiveness review. The process produced a number of areas for consideration and improvements have been identified and implemented.

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 2012 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 and re-elections

The appointment of new Directors is considered by the Corporate Governance and Nominations Committee (see page 33) which makes recommendations to the Board. In normal circumstances an external agency is engaged to assist in the recruitment of Non-Executive Directors once a vacancy and the required skills and experience have been identified. Any such vacancy is advertised on the Society's website to enable suitably qualified members to apply.

Under the Society's rules, all Directors are subject to election by members at the AGM following their appointment (or at the AGM in the following year if the Director is appointed by the Board in the period between the beginning of the year and the AGM). 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.

On 1 June 2012 and 1 October 2012 respectively, Nigel Masters and Paul Chandler were appointed to the Board. Nigel and Paul will be put forward for election by members at the 2013 AGM.

Under the Society's Rules, Directors have to submit themselves for re-election at least once every three years. Subject to the above, all other Directors have been re-elected at either the 2011 or 2012 AGM, so no other Directors are put forward for re-election by members at the 2013 AGM.

Copies of the letters of appointment of the 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. Each committee is properly authorised under the rules of the Society to take decisions on behalf of the Board within the guidelines and delegations laid down by the Board. The Board is kept fully informed of the work of the committees. Any issues requiring resolution will be referred to the Board. Details of the Board committees are set out below, and their membership in 2012 is set out on page 2.

The Chairman of each committee reports to the subsequent Board meeting on the matters discussed at each committee meeting. The minutes of each committee meeting are circulated to all Directors.

audit committee

The Audit Committee consists of Christina McComb and Nigel Masters under the Chairmanship of Andrew Gosling. Peter Mason served as a member of the committee until he resigned from the Board in January 2013. All of the committee members have relevant financial sector experience. The responsibilities of the committee are in line with the provisions of the FRC 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
- 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 and the periodic review of their performance and independence and the policy on the use of the external auditor for non-audit work.

During 2012 the committee met four times in the execution of its responsibilities. During the meetings the committee considered reports on:

- the system of internal control – as well as regular reports from the internal and external auditors on control matters, the committee receives an annual paper from Internal Audit which expresses an opinion on the effectiveness of the system of internal control
- the integrity of financial statements – a paper on going concern is prepared for the committee, which considers the impact on capital, liquidity and profitability of the Group

- compliance with laws and regulations, including adherence to money laundering regulations – the committee receives regular reports from the Compliance Officer and Money Laundering Reporting Officer on conduct matters, which express an opinion on the effectiveness of the systems of internal control
- the activities of Internal Audit and external auditors – the committee receives regular reports from both the external auditor and Internal Audit and closely monitors all issues raised until they have been resolved satisfactorily by management. Both auditors have met privately with the committee during the year
- the level of non-audit fees paid to the external auditor – the committee has reviewed the level of non-audit fees paid to the external auditor throughout the year and believes that these have not impaired the independence and objectivity of 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 2012.

finance committee

The Finance Committee consists of David Robinson and Peter Burrows, under the Chairmanship of Nigel Masters. Peter Mason chaired the committee until he resigned from the Board in January 2013. The committee met six times during 2012 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 and FSA returns.

corporate governance and nominations committee

The Corporate Governance and Nominations Committee consists of the Non-Executive Directors and the Chief Executive, under the Chairmanship of David Robinson. In the opinion of the Board, the majority of members of the committee were independent Non-Executive Directors during 2012. The 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 consists of David Robinson and Paul Chandler, under the Chairmanship of Christina McComb.

Peter Mason served as a member of the committee until he resigned from the Board in January 2013. The Board considers that all members of the committee are independent for the purpose of reviewing remuneration matters.

The Chief Executive, Finance Director and the HR Director also attended meetings during the year at the request of the Chairman, except when their own remuneration was being discussed.

The duties of the committee are:

- to determine the remuneration arrangements and policy for Executive Directors and other Executives as directed by the Board, and to submit proposals to the Board for approval;
- to agree service contracts for Executive Directors and other Executives as directed by the Board, and to review these regularly;

- to set the parameters for, and keep under review, management bonus schemes;
- to receive details of the review of management remuneration carried out by the Chief Executive;
- to review the impact of any committee decision on remuneration to be disclosed in the Group Annual Financial Statements; and
- to consider other topics as defined by the Board.

The committee met four times during the year.

To ensure that the committee has sufficient independent information and advice on remuneration matters, it retains the use of Towers Watson Limited and Hays plc as its independent advisors. Whilst Hays plc provides recruitment services to the Group from time to time, the Board still considers them independent for the purposes of advising on remuneration matters.

The full terms of reference of the Audit, Finance, Corporate Governance and 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, child trust fund 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 is 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 child trust fund and health customers to full membership of the Society. Consequently, direct, individual health customers were recognised as full members of the Society with effect from 18 May 2012.

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.

The customer panel provides us with a number of members who give up their time to provide feedback and insight on product development and customer service.

All members of the friendly society who are eligible to vote are encouraged to exercise their vote at the AGM by voting in person, online or by using the proxy voting form which includes a 'vote withheld' option and pre-paid reply envelope. Alternatively, members can exercise their vote through the appointment of a proxy if the member cannot attend and vote at the meeting. An individual resolution is proposed on each separate issue including a resolution on the Annual Report and Accounts.

One of the ways in which we express our mutuality is through the provision of discretionary benefits in times of hardship or need. We continue to provide discretionary benefits from time to time whilst remaining mindful of the need for balance, fairness to all members and affordability. We will continue to operate under these principles in 2013.

system of internal control

internal control

The Board has overall responsibility for the Group's system of internal controls, which aims to safeguard the Group's assets and to ensure that proper accounting records and financial reporting processes are maintained and that the financial information used within the business and for publication is accurate, reliable and fairly presents the financial position of the Group and the results of its business operations.

The Board is also responsible for reviewing the effectiveness of the system of internal controls. This has been in place for the year under review and is regularly reviewed by the Board. The system is designed to provide reasonable assurance of effective operations and compliance with laws and regulations, although any system of internal controls can only provide reasonable, not absolute, assurance against material misstatement or loss, and can only mitigate rather than eliminate the risk of failure to achieve business objectives.

The Directors also review the effectiveness of the Group on non-financial as well as financial controls, including operational controls, risk management and the Group's high level internal control arrangements. The Group has adopted an internal control framework that contains the following key elements.

control environment

The Group's control environment is designed to create an attitude of taking acceptable business risk within clearly defined limits. The control environment includes:

- an organisational structure with clear lines for responsibility, delegation of authority and reporting requirements
- co-ordinated activity across the whole Group through Executive Committee meetings
- clearly defined policies for capital and revenue expenditure. Larger capital and revenue expenditure requires Board authorisation
- comprehensive systems of financial reporting. The annual budget and long-term plans of the Group are reviewed and approved by the Board. Results are reported against budget and remedial action is taken where appropriate
- a 'whistle-blowing' policy allows any employee to report, in confidence, suspected serious malpractice. An anti-fraud policy with guidance further supports the Code
- Internal Audit, Risk, Compliance and operational functions that review the system of internal control.

risk management

The Board and Executive have the primary responsibility for identifying the key business risks facing the Group.

The Group operates a risk management process that identifies the key risks facing the business.

The Society has a risk register that identifies the likelihood and impact of those risks occurring and the actions being taken to manage them. The information is consolidated for the Board on how the key risks are being managed. The Board has responsibility for establishing a coherent framework for the Group to manage risk in order to carry out its responsibility to ensure effective risk management and control.

control procedures

The Group's control procedures are designed to ensure complete and accurate accounting for financial transactions and to limit the potential exposure to loss of assets or fraud.

monitoring

The operation of the system of internal control is the responsibility of line management. It is subject to independent audit review and, where appropriate, review by the external auditor and external regulators.

The Audit Committee, on behalf of the Board, reviews the reports of the Group on internal control.

A key part of the process in assessing internal control by the Audit Committee is the quarterly Combined Assurance Map. The Combined Assurance Map is reported to the Audit Committee. The Directors are then able to review the system of internal controls and ensure it complies with appropriate guidance.

external audit

One of the duties of the Audit Committee is to make recommendations to the Board in relation to the appointment of the external auditors. It is intended that a resolution to appoint the external auditor be put to the Annual General Meeting on 16 May 2013.

Details of the amounts paid to the external auditors during the year for audit and other services are set out in Note 8 to the financial statements. The committee has put in place safeguards to ensure that the independence of the audit is not compromised, including a policy on the conduct of non-audit services from the external auditor. The external auditors are permitted to provide some non-audit services that are not, and are not perceived to be, in conflict with their independence. The pre-approval of the committee is required for services above certain thresholds determined by the committee.

In addition, the following assignments are prohibited from being performed by the external auditors:

- bookkeeping or other services related to the accounting records of financial services
- financial information systems – design and implementation
- actuarial services
- internal audit outsourcing services
- management functions or human resources
- any other services that the Audit Committee may determine.

The performance of the external auditor is formally monitored annually to ensure it meets the needs of the Group and the results are reported to the committee.

internal audit

Internal Audit is an independent appraisal function that derives its authority from the Board through the Audit Committee. Its primary role is to provide reasonable and effective assurance about the adequacy and effectiveness of the Group's financial control framework and risk management.

Internal Audit seeks to discharge the responsibilities set down by reviewing the processes that ensure business risks are effectively managed and reviewing the financial and operational controls that help to ensure compliance with corporate objectives, policies and procedures and external legislation. Internal Audit also acts as a source of constructive advice and best practice, assisting senior management with its responsibility to improve the process by which business risks are identified and managed and to report and advise on the proper and effective use of resources.

The information received and considered by the Audit Committee provided reasonable assurance that during 2012 there were no material breaches of control or regulatory standards and that, overall, the Group maintained an adequate system of internal control.

regulation

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.

Solvency II

We continue to work on our response to the new Solvency II European Directive which is now due to come into force on 1 January 2016. When these regulations are implemented 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.

statement of solvency

As of 31 December 2012, the Group's capital resources exceeded the minimum capital resources requirements prescribed by the FSA.

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 2012. 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.

annual general meeting (AGM)

At the AGM, the Chairman, Chief Executive and other Executive Directors give presentations on the previous year's performance and on future plans. The meeting also provides an opportunity for members to question the Chairman and Chief Executive on the resolutions to be proposed at the meeting and on any other aspect of the Society's business. All Directors attend the AGM including the Chairs of all the Board committees.

The results of the proxy votes, and the votes cast at the AGM, are publicised on the Society's website. A separate resolution is proposed on each issue, including a resolution on the Annual Report and Accounts.

statement of compliance with the annotated code

The Board considers that throughout the year ended 31 December 2012, the Society has applied the relevant principles and complied with the relevant provisions of the Annotated UK Corporate Governance Code for Mutual Insurers issued by the Association of Mutual Insurers with the following exceptions.

All Directors have the opportunity to meet with members via the AGM and are encouraged to participate in member panel discussions. Whilst all Directors had the opportunity to meet with members at the AGM, no opportunities arose over the course of the year for Directors to attend member panel discussions. It is hoped that a greater number of opportunities for participation can be created in 2013.

The UK Corporate Governance Code introduced a requirement that Directors of larger organisations be subject to annual election by members. The Board has considered this provision in respect of the 2013 AGM and has agreed that this should not be brought in at that time. The Board is concerned that in extreme circumstances this provision could have implications for the financial stability of the Society, which would not be in the best interests of members. The Board will review the position again over the course of 2013 and conclude on whether to introduce annual election by members for the AGM business in 2014.

The Chairman of the Remuneration Committee attends the AGM to answer any member issues or concerns with regard to remuneration. The Chairman of the Society did not engage with the member panel or members with significant membership rights on this issue in 2012. It is hoped that opportunities for facilitating member dialogue may be made available during 2013.

The Senior Independent Director attended the AGM to develop an understanding of the issues and concerns of members, but no additional meetings were arranged for the Senior Independent Director for this purpose over the course of 2012. It is hoped that opportunities for facilitating member dialogue could be made available during 2013.

how directors are remunerated

report of the directors on remuneration

As a mutual, we are required to prepare accounts in accordance with the Friendly Societies Act 1992 and applicable accounting standards. However, in the interests of good corporate governance, we use the disclosure requirements contained in the Companies Act 2006 as a basis for the disclosure of Directors' remuneration.

This report provides details of the remuneration of the Executive Directors and the Non-Executive Directors.

policy on remuneration for executive directors and other executives

The Remuneration Committee is responsible for the Group's Executive remuneration policy. The objective of the committee is to give the Executive Directors encouragement to enhance the Group's performance by ensuring that they are fairly and responsibly rewarded for their individual contributions.

When determining the remuneration policy for Executives, the committee considers a number of factors including:

- the need to retain good quality and highly motivated staff;
- the remuneration practices of competitor businesses; and
- compliance with the FSA code of practice.

The remuneration includes a performance related element which is linked to the achievement of business and personal objectives.

Throughout the Group we aim to ensure that our people are fairly rewarded for their contribution. To achieve this we obtain independent benchmarking data from Towers Watson Limited and set remuneration for each individual, whether Executive Director or staff member, by reference to a relevant role benchmark. The Remuneration Committee thereby ensures that Executive Director remuneration is determined using processes consistent with those adopted for all employees, and is set at a level designed to reflect similar roles carrying comparable responsibility in other organisations.

components of director remuneration

There are three components of Executive Director remuneration:

- basic salary and associated supplements, including a car allowance and medical insurance;
- performance related pay, which includes an annual element paid in the following year and a long-term element which is deferred and released over a further three years, subject to continued satisfactory business performance; and
- pension arrangements.

Each is dealt with separately below.

basic salary

It is the committee's policy to ensure that the basic salary for each Executive Director is appropriate and competitive for the responsibilities involved. Salaries are reviewed annually by the committee in February and any changes are introduced with effect from 1 March. Only basic salary is pensionable. Executive Director salaries are shown in table a.

performance related pay

The Group operates a discretionary performance related pay scheme for Executive Directors, which from 2010 combines an annual and long-term element. The committee meets annually to agree objectives and set incentive targets. The measures used to assess performance are taken from the Group's management information and balanced scorecard.

The objectives and weightings applied for 2012 reflected the need to continue to deliver sound financial performance, whilst in parallel making progress in the implementation of the Group's strategic direction, and continuing to successfully integrate acquired businesses. Hence the framework comprised:

- financial results in the year 50%
- customer community development and service 20%
- infrastructure maintenance and development 15%
- people management and development 15%.

The objectives and weightings applied for 2013 are similar to 2012, recognising the need for continued robust financial management balanced with strategic progress in terms of customer development, infrastructure maintenance and people management:

- financial results in the year 50%
- customer community development and service 20%
- infrastructure maintenance and development 20%
- people management and development 10%.

Under the combined scheme, the Chief Executive may be awarded up to a maximum of 116% of basic salary and the other Executive Directors may be awarded up to a maximum of 85% of basic salary. 40% of the award is paid in the following year, with the balance deferred over a further three years subject to continued satisfactory business performance.

Awards made under the annual element of the scheme are shown in table a. Awards and payments made under the long-term element of the scheme are included in table b.

pension arrangements

During 2012 the Society operated a defined benefit pension scheme for a number of its employees. This scheme was closed to new entrants in 2001. Any employee, including Executive Directors, joining the group after 2001 is entitled to join a defined contribution scheme.

As reported last year, the Board decided to close the defined benefit pension scheme to any future service accruals with effect from 31 December 2012. Members of the defined benefit scheme became eligible to join the defined contribution scheme from 1 January 2013. Any director or employee affected received between six months and 18 months of additional service accruals in compensation for the scheme closing, with an additional 5% uplift to basic salary from 1 January 2013.

Until leaving, Andrew Haigh was subject to the executive rules of the defined benefit pension scheme, which provided benefits based on 1/45th of pensionable salary for each year of pensionable service. He received a total of 12 months of additional service accruals in respect of compensation for the scheme closing.

Karl Elliott was subject to the standard rules of the defined benefit scheme, which provided benefits based on 1/60th of pensionable salary for each year of pensionable service. He received a total of 18 months of additional service accruals, and a 5% uplift to basic salary from 1 January 2013 in respect of compensation for the scheme closing.

Peter Burrows is a member of a defined contribution scheme and receives an employer contribution of 10% of basic salary.

Pension details are set out in tables c and d.

service contracts

Executive Directors have service contracts with a one year notice period. No Non-Executive Director has a service contract.

share options

As a mutual, we do not operate a share or share option plan.

non-executive directorships

The committee believes Non-Executive Directorships of external organisations represent an important opportunity for personal development. Accordingly, and subject to Board approval, Executive Directors may take up such appointments.

At this time Peter Burrows is a governor of York College, an educational establishment, and does not receive remuneration for this position.

non-executive directors

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

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.

The remuneration of Non-Executive Directors does not include any incentive element and Non-Executive Directors are not entitled to participate in any of the Group's pension arrangements.

Non-Executive Directors are elected for a period of three years. The Board may resolve to reappoint a Non-Executive Director at or before the expiry of their term. It is our policy to allow Non-Executive Directors to serve no more than nine years in aggregate.

Details of the year of appointment and fees of our Non-Executive Directors are shown in table e.

emoluments of directors for the year ending 31 December 2012

table a – basic salary, supplements and annual performance award

	Date of appointment to the Board	Basic Salary	Other supplements (1)	Annual performance award	Other (2)	2012 total	2011 total
		£'000	£'000	£'000	£'000	£'000	£'000
Peter Burrows	10 November 2010	152	9	36	-	**197**	197
Karl Elliott	4 December 2007	123	8	29	-	**160**	166
Andrew Haigh (2)	9 June 1999	204	15	58	344	**621**	306
Graham Henderson (3)	-	-	-	-	-	**-**	73
Total		**479**	**32**	**123**	**344**	**978**	742

notes

(1) Other supplements represents car allowance and medical insurance.

(2) Andrew Haigh resigned as a Director on 24 December 2012. In line with his service contract he received remuneration in respect of his twelve month notice period of £285,000. He also received a termination payment of £59,000.

(3) Amounts awarded in 2011 to Graham Henderson, a Director serving during 2010, represents amounts payable under the 2011 annual performance award in respect of specific criteria relating to the successful consolidation of acquired businesses.

table b – long-term performance award

	Interest brought forward	Awarded in the year	Paid in the year	Interest carried forward
	£'000	£'000	£'000	£'000
Peter Burrows	65	54	(22)	97
Karl Elliott	79	44	(31)	92
Andrew Haigh (1)	183	88	(271)	-
Total	**327**	**186**	**(324)**	**189**

notes

(1) Andrew Haigh resigned as a Director on 24 December 2012, at which point his accrued interest in the scheme vested in full.

table c – defined benefit pension details of executive directors

	Years of service	Total accrued pension at 31 December 2012	Increase in accrued pension during the year (net of inflation)	Increase in accrued pension during the year (including inflation)	Transfer value of increase in accrued pension less member contributions	Transfer value of total accrued pension at 31 December 2011	Transfer value of total accrued pension at 31 December 2012	Increase in transfer values net of members' contributions
		£'000	£'000	£'000	£'000	£'000	£'000	£'000
Karl Elliott	13	30	5	5	87	369	523	148
Andrew Haigh (1)	14	47	6	7	126	711	936	214

notes

(1) Andrew Haigh resigned as a Director on 24 December 2012.

table d – defined contribution pension details of executive directors

	Employee contribution in 2012	Employer contribution in 2012	Employee contribution in 2011	Employer contribution in 2011
	£'000	£'000	£'000	£'000
Peter Burrows	7	15	7	14
Andrew Haigh (1)	3	7	3	8

notes

(1) Andrew Haigh resigned as a Director on 24 December 2012. Until that point he participated in a defined contribution plan as his pensionable salary was in excess of the notional earnings cap set in the defined benefit scheme rules.

table e – non-executive directors' remuneration

	Date of appointment to the Board	2012 fees £'000	2011 fees £'000
David Robinson (Chairman)	3 August 2010	**60**	60
Paul Chandler (1)	1 October 2012	**9**	-
Andrew Gosling	24 March 2011	**35**	27
Peter Mason (2)	9 December 2005	**35**	35
Nigel Masters (1)	1 June 2012	**20**	-
Christina McComb	11 May 2005	**35**	35
David Hargrave (3)	-	**-**	9
Total		**194**	166

notes

(1) Nigel Masters joined the Board in June 2012 and Paul Chandler joined the Board in October 2012.

(2) Until May 2012 the fees paid in respect of Peter Mason were payable to PWM Enterprises Limited. Peter Mason resigned from the Board on 31 January 2013.

(3) David Hargrave resigned from the Board in May 2011.

statement of responsibilities of the directors

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

Friendly Society law requires the Directors to prepare Group and Society financial statements for each financial year. Under that law they have elected to prepare the Group and Society financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

- 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 judgements and estimates that are reasonable and prudent;
  - state whether applicable UK 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 its financial statements comply with the Friendly Societies Act 1992 and the regulations made under it.

The Directors are also responsible for preparing a Report of the Directors in accordance with the Friendly Societies Act 1992 and the regulations made under it.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and the Society, and to prevent and detect fraud and other irregularities.

The Directors have decided to prepare voluntarily a Directors' Remuneration Report in accordance with Schedule 8 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 made under the Companies Act 2006, as if those requirements were to apply to the Society.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the UK 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 2012, set out on pages 44-87. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK 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 and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

respective responsibilities of the Directors and auditor

As explained more fully in the Statement of Directors' Responsibilities set out on page 42 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 Board's Ethical Standards for Auditors.

scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

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 affairs of the Group and of the Society as at 31 December 2012 and of the income and expenditure of the Group and of the Society for the year then ended; and
- have been properly prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it.

opinion on other matters prescribed by the Friendly Societies Act 1992

In our opinion the Report of the Directors has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it, and the information given therein is consistent with the accounting records and the financial statements for the 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;
- 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 addition to our audit of the financial statements, the Directors have engaged us to review whether the Corporate Governance Statement reflects the Society's compliance with the eight provisions of the Annotated Corporate Governance Code for Mutual Insurers (published by the Association of Financial Mutuals) specified for our review.

Jonathan Holt
Senior Statutory Auditor
for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants
St. James Square
Manchester
M2 6DS

25 March 2013

our 2012 financial statements

group income and expenditure

for the year ended 31 December 2012

Technical Account Long-Term Business

The profit and loss account for recording long-term insurance contracts

Share dividends, interest on deposits held and realised gains on investments

Movements in value of investments held

Change in value of linked policyholders' benefits

Fund managers' charges

Group tax cost

	Notes	2012 £'000	2011 £'000
Earned premiums, net of reinsurance			
Gross premiums written	2	**33,245**	35,540
Outward reinsurance premiums	2	**(10,886)**	(10,925)
Investment income	3	**46,348**	60,757
Unrealised losses on investments	3	**(723)**	(39,561)
Other technical income	11	**5,255**	3,574
Claims incurred, net of reinsurance			
Gross claims incurred	4	**(36,236)**	(39,084)
Outward claims reinsurance	4	**5,589**	5,349
Change in long-term business provision, net of reinsurance	20	**1,345**	(3,031)
Change in gross liability for investment contracts	21	**(25,001)**	596
Other technical charges		**(3,017)**	(1,672)
Goodwill amortisation	6	**425**	(1,178)
Net operating expenses	7	**(14,167)**	(15,186)
Investment expenses and charges	3	**(776)**	(1,053)
Taxation	13	**(307)**	2,211
Transfer (to)/from fund for future appropriations	25	**(1,094)**	3,663
Balance on the long-term business technical account		**-**	-

group income and expenditure (cont.)

for the year ended 31 December 2012

Technical Account General Business

The profit and loss account for recording general insurance contracts

Premiums collected which relate to cover in the future

Claims which will be settled in the future

The total income and expenditure on the health business

	Notes	2012 £'000	2011 £'000
Earned premiums			
Gross premiums written		**6,908**	7,074
Change in unearned premiums		**9**	(415)
Claims incurred			
Claims paid		**(5,211)**	(5,235)
Change in provision for claims		**54**	(355)
Other technical charges		**(597)**	(373)
Net operating expenses	7	**(3,979)**	(2,615)
Balance on the general business technical account		**(2,816)**	(1,919)

Non-Technical Account

The profit and loss account for recording general insurance contracts plus income and expenditure from non-insurance subsidiaries

Income earned in non-insurance subsidiaries

Expenses incurred in non-insurance subsidiaries

Continuing operations	Notes	2012 £'000	2011 £'000
Balance on the long-term business technical account		**-**	-
Balance on the general business technical account		**(2,816)**	(1,919)
Other income	12	**3,545**	3,089
Net operating expenses	7	**(2,175)**	(2,343)
Pension finance income	26	**172**	189
Other costs		**-**	(33)
Taxation	13	**-**	139
Loss on ordinary activities		**(1,274)**	(878)

group statement of total recognised gains and losses

for the year ended 31 December 2012

		Notes	2012 £'000	2011 £'000
Income and expense items which differed to projected amounts on the pension scheme	Loss on ordinary activities		**(1,274)**	(878)
	Actuarial gain on pension scheme	26	**(1,056)**	1,500
Surplus in the pension scheme which has not been recognised as an asset	Change in unrecognised pension scheme surplus	26	**579**	(2,433)
	Total recognised losses in the year		**(1,751)**	(1,811)

group balance sheet
as at 31 December 2012

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	2012 £'000	2011 £'000
Negative goodwill	6	**-**	(425)
Investments			
Investment in land and buildings	14	**5,075**	6,341
Linked financial investments	16	**301,306**	321,275
Non-linked financial investments	16	**343,526**	351,520
Reinsurers' share of technical provisions			
Long-term business provision	20	**61,458**	56,691
Other assets			
Other debtors	17	**3,179**	3,074
Tangible assets	18	**479**	156
Cash at bank		**36,150**	23,547
Deferred taxation	13	**853**	853
Prepayments and accrued income			
Accrued interest and rent		**2,015**	1,863
Deferred acquisition costs	19	**460**	764
Other prepayments and accrued income		**488**	687
Total assets		**754,989**	766,346
Net pension asset	26	**-**	-
Total assets including the pension asset		**754,989**	766,346

group balance sheet (cont.)
as at 31 December 2012

Liabilities

		Notes	2012 £'000	2011 £'000
Value recognised for regulatory reserves and other surplus funds, including possible future with profit bonuses	**Fund for future appropriations**	25	**83,885**	84,542
The amount that needs to be set aside to meet future liabilities arising from our insurance contracts	**Technical provisions**			
Provision for with profits policies, insurance liabilities and other known contingencies	Long-term business provision	20	**289,922**	285,996
Maturities, surrenders and death claims awaiting processing and payment	Claims outstanding	20	**7,661**	9,585
Value of linked policyholders' benefits	**Gross liability for investment contracts**	21	**365,443**	377,771
	Creditors			
	Creditors arising out of insurance operations	23	**1,129**	2,231
	Other creditors including taxation and social security	24	**1,669**	1,443
Expenses incurred in the period yet to be processed	**Accruals and deferred income**		**5,280**	4,778
	Total liabilities		**754,989**	766,346

Approved at a meeting of the Board of Directors on 25 March 2013 and signed on its behalf by:

P J Burrows
Acting Chief Executive

D G Robinson
Chairman

A J Horsley
Secretary

society income and expenditure

for the year ended 31 December 2012

Technical Account Long-Term Business

		Notes	**2012 £'000**	2011 £'000
	Earned premiums, net of reinsurance			
	Gross premiums written	2	**33,245**	35,540
	Outward reinsurance premiums	2	**(10,886)**	(10,925)
Share dividends, interest on deposits held and realised gains on investments	Investment income	3	**45,430**	60,757
Movements in value of investments held	Unrealised losses on investments	3	**(55)**	(39,411)
	Other technical income	11	**5,722**	4,041
	Claims incurred, net of reinsurance			
	Gross claims incurred	4	**(36,236)**	(39,084)
	Outward claims reinsurance	4	**5,589**	5,349
	Change in long-term business provision, net of reinsurance	20	**1,345**	(3,031)
Change in value of linked policyholders' benefits	Change in gross liabilities for investment contracts	21	**(25,001)**	596
	Other technical charges		**(3,017)**	(1,672)
	Goodwill amortisation	6	**-**	(1,253)
	Net operating expenses	7	**(14,167)**	(14,660)
Fund managers' charges	Investment expenses and charges	3	**(776)**	(1,053)
Society tax cost	Taxation	13	**(307)**	2,211
	Transfer (to)/from fund for future appropriations	25	**(886)**	2,595
	Balance on the long-term business technical account		**-**	**-**

society balance sheet

as at 31 December 2012

Assets

Harrogate head office and Kew Gardens property

Investments held in respect of policyholder's liabilities, plus surplus investments

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

	Notes	2012 £'000	2011 £'000
Investments			
Investment in land and buildings	14	**5,075**	5,916
Investment in subsidiaries	15	**9,950**	12,300
Linked financial investments	16	**301,306**	321,275
Non-linked financial investments	16	**340,509**	344,580
Reinsurers' share of technical provisions			
Long-term business provision	20	**61,458**	56,691
Other assets			
Other debtors	17	**3,748**	4,302
Cash at bank		**35,037**	21,932
Prepayments and accrued income			
Accrued interest and rent		**1,958**	1,863
Deferred acquisition costs	19	**460**	764
Other prepayments and accrued income		**488**	357
Total assets		**759,989**	769,980

society balance sheet (cont.)

as at 31 December 2012

Liabilities

		Notes	2012 £'000	2011 £'000
Value recognised for regulatory reserves and other surplus funds, including possible future with profit bonuses	**Fund for future appropriations**	25	**94,388**	93,502
The amount that needs to be set aside to meet future liabilities arising from our insurance contracts	**Technical provisions**			
Provision for with profits policies, insurance liabilities and other known contingencies	Long-term business provision	20	**289,418**	285,996
Maturities, surrenders and death claims awaiting processing and payment	Claims outstanding	20	**7,205**	9,585
Value of linked policyholders' benefits	**Gross liabilities for investment contracts**	21	**365,443**	377,771
	Creditors			
	Creditors arising out of insurance operations	23	**767**	829
	Other creditors including taxation and social security	24	**1,675**	1,008
Expenses incurred in the period yet to be processed	**Accruals and deferred income**		**1,093**	1,289
	Total liabilities		**759,989**	769,980

Approved at a meeting of the Board of Directors on 25 March 2013 and signed on its behalf by:

P J Burrows
Acting 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.

After making appropriate enquiries, the Directors confirm they are satisfied that the Society has adequate financial resources and regulatory capital to continue in business for the next twelve months from the date of approval of these financial statements, and have concluded that there are no material uncertainties that may cast doubt about the Group's ability to continue as a going concern. Accordingly, they continue to adopt the going concern basis in the preparation of the financial statements. Further details on the financial resources, regulatory capital and risk are set out in the directors' report on page 42 and in note 1 to the accounts on pages 58 to 66.

b. Basis of consolidation

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

The General Insurance results of 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 Group has one non profit fund and two with profits funds referred to in our financial statements as follows:

- With Profits Fund I (WP1) (acquired from United Kingdom Civil Service Benefit Society Limited in 2003)
- With Profits Fund II (WP2) (acquired from Ecclesiastical Life Limited in 2010)

c. Classification of contracts

The Group classifies its products in accordance with Financial Reporting Standard 26 'Financial Instruments: Recognition and Measurement' ('FRS 26').

FRS 26 requires companies to categorise the policies they issue 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 initially classified as investment contracts can be reclassified as insurance contracts after inception, if insurance risk becomes significant.

Amounts received from and paid to policyholders of investment contracts are accounted for as deposits received (or repaid) and are not included in the premiums and claims in the technical account long-term business. For unit-linked contracts the related liability is established on the due date for payment. Fees for investment management and other services are recognised in the technical account long-term business in the period in which the services are provided. The liability for the unit-linked business is disclosed in the Balance Sheets as 'Gross liabilities for investment contracts'.

statement of accounting policies (cont.)

d. Long-term business

Premiums

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

Claims

For 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.

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 – '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 and lapse.

Amounts recoverable from reinsurers are estimated based upon the related gross insurance provisions, having due regard for collectability. The recoverability of reinsurance assets 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 any premium income.

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.

Provision is made at the year end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the company at the year end. The cost of notified but not settled claims is estimated on an individual case by case basis by the claims handlers using their experience of settling previous claims. The estimation of claims incurred but not reported (IBNR) is generally subject to a greater degree of uncertainty. IBNR claims are estimated using techniques which use past trends to forecast the expected cost of these claims.

statement of accounting policies (cont.)

f. Goodwill

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.

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 held at open market value. 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 are stated at current value.

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 or loans and receivables.

Financial assets 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 income and expenditure accounts. All changes in fair value are recognised in profit or loss as described in accounting policy G - 'Investment return'.

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 as determined by the Directors.

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 are used 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.

Rebates payable to Engage Mutual Funds Limited by external fund managers are recognised when they are receivable.

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. To the extent that the provision for cancellations differs to actual experience, the difference is netted from introductory and referral fees.

j. Fixed assets

Depreciation is provided on the cost of assets in annual instalments over their estimated lives. 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. 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

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. Linked investment contracts

Linked investment contract 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 market value of the units held (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 scheme was closed to future accruals on 31 December 2012. The financial statements reflect the changes in value of the scheme's assets less the present value of the scheme's liabilities. A pension asset is recognised in the consolidated balance sheet to the extent that the pension surplus is recoverable through either a refund or reduced future contributions.

The pension cost for the scheme is analysed between the current service cost, past service cost and net return on pension scheme. Current service cost is the actuarially calculated present value of the benefits earned by the active employees in each period. Past service costs, relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits, are recognised in the profit and loss account in the period in which they are vested. The current and past service costs are included in net operating expenses in the 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 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 are 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. There are no lease incentives.

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. Gains or losses arising on the Technical Account – General Business and Non-Technical account are also transferred to or from the fund each year.

s. Contingent reinsurance financing

The Group receives reinsurance financing on sales of its over 50s life cover from reinsurers. 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 margins emerge and is included in Other Technical Charges. Provision for future repayments is included in the calculations of the long-term business provision.

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

Other technical charges includes the repayment of reinsurance financing advances from the margins which have emerged on the reinsured over 50's life cover policies.

1. management of financial and insurance risk

a. Market risk – interest rate and equity

Interest rate risk

The Group seeks to match future benefit payments with future income from premiums and investments period by period. This is referred to as asset liability matching or ALM. When the income and payments in a period do not exactly match, the excess cash inflow must be invested or the cash shortfall must be funded at the interest rates prevailing at the time. The Group sets its reserves based on prudent assumptions about these future interest rates. As market views of future interest rates change, the reserves change. Interest rate risk is the risk that adverse interest rate changes will require reserves to be increased.

A separate interest rate risk arises from the impact of interest rate changes on unit-linked funds invested in fixed interest rate assets. Changes in current interest rates directly affect the market values of the fixed interest assets, which in turn affect unit values. A significant element of the Group's income is directly related to the value of the unit funds through annual management charges. The interest rate risk in this case is that adverse interest rate movements will reduce the value of these unit-linked funds and hence the Group's income.

Equity price risk

The Group has exposure to equity securities both directly through equity securities held and indirectly through holdings in Open Ended Investment Companies (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 relate 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 and insurance 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 and bank deposits.

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 ratings provided by rating agencies and other publicly available financial information.

Other credit risk arises from exposure to various business counterparties, including insurance intermediaries. The Group conducts appraisals of the level of risk associated with business counterparties at the inception of an agreement, as well as on an ongoing basis. 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, together with an analysis by credit rating are shown below:

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Debt securities and other fixed income securities	209.8	201.5	206.8	201.5
Loans secured by mortgage	4.9	6.2	4.9	6.2
Assets arising from reinsurance contracts held	61.5	57.8	61.5	57.8
Pooled money market instruments	2.4	16.8	2.4	9.9
Cash at Bank and in hand	36.2	23.5	35.0	22.0
Total assets bearing credit risk	**314.8**	**305.8**	**310.6**	**297.4**

Debt and other assets rated as:	**Group 2012 £m**	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
UK Government	147.2	149.2	147.2	149.2
A Rated and above	144.2	122.1	140.0	113.7
B' rated - BBB	17.3	18.4	17.3	18.4
Below BBB or not rated	6.1	16.1	6.1	16.1
Total assets bearing credit risk	**314.8**	**305.8**	**310.6**	**297.4**

Credit risk on unit-linked assets is borne by the policyholder, since policy benefits are linked directly to assets. These assets are therefore not disclosed in the above credit risk exposures.

1. management of financial and insurance risk (cont.)

c. Liquidity risk

Liquidity risk is the risk that the Society will encounter difficulty in raising funds to meet its cash commitments as they fall due. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values; or from a counterparty defaulting on repayment of a contractual obligation; or from an insurance liability falling due for payment earlier than expected; or from the inability to generate cash inflows as anticipated.

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 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 linked funds is such that in certain circumstances it may defer the payments until such time 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, on a discounted basis, net of reinsurance, is set out below.

At 31 December 2012 **Long-term business:**	**Total £m**	**Within 1 year £m**	**1 - 5 years £m**	**5 - 15 years £m**	**More than 15 years £m**
Non profit fund	94.4	2.8	14.9	31.3	45.4
With profit I	49.7	10.0	18.6	20.1	1.0
With Profit II	83.9	6.9	21.6	44.1	11.3
Total	**228.0**	**19.7**	**55.1**	**95.5**	**57.7**

At 31 December 2011 **Long-term business:**	**Total £m**	**Within 1 year £m**	**1 - 5 years £m**	**5 - 15 years £m**	**More than 15 years £m**
Non profit fund	85.8	2.7	13.7	28.0	41.4
With profit I	55.0	13.7	17.3	22.7	1.3
With Profit II	88.5	6.4	20.6	46.2	15.3
Total	229.3	22.8	51.6	96.9	58.0

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.

Investment liabilities are classed as repayable on demand and there is considered to be sufficient liquidity to meet claims as they arise, and the Society has the right to defer repayments in order to realise the corresponding linked assets. As such an analysis of expected maturity periods of the investment liabilities has not been completed.

1. management of financial and insurance risk (cont.)

d. Lapse risk

Lapse rate is a measure of the proportion of long-term policies that leave the Society over a period of time, excluding deaths and maturities. Lapse 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 allows the utilisation of FSA Policy Statement 06/14 (PS06/14). Under PS06/14 negative reserves, which are assets sat within the overall long-term business provision, 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 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, term assurance and group life business, if the mortality of the lives assured is different to that assumed. 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 annuity business would arise if annuitants lived longer than anticipated. The Group manages annuitant longevity risk by setting a prudent valuation assumption and monitoring actual experience. The Group also monitors the need for reinsurance 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. Linked contracts

For linked contracts the Group matches all the policyholder liabilities with assets on which the unit prices or value of the policies are based. There is therefore minimal interest, market or credit risk for the Group on these contracts.

Amounts payable on 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 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 maintains sufficient capital, consistent with the Group's risk profile. Further information about the risk management framework can be found in the Corporate Governance Report on pages 29 to 37.

The Society is a mutual organisation and there are no shareholders. As at 31 December 2012 the available capital resources consisted of 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.

1. management of financial and insurance risk (cont.)

h. Capital management (cont.)

The Group is subject to regulation by the Financial Services Authority (FSA). In reporting financial strength, capital resources and solvency are measured following the regulations provided by the FSA.

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. Stresses are also covered by the resilience component of the capital requirements as reported in the FSA Return. 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, change in yields on fixed income securities, 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.

The FSA requires companies to undertake capital tests using a number of market consistent approaches and to report privately to the FSA on the results. The FSA is developing the future of capital testing for insurers in the Solvency II prudential regulations. The Group (including the Society and its regulated subsidiaries) is monitoring the development of the Solvency II requirements, which it currently expects to meet.

Capital management objectives

The Group's objectives in managing capital are that:

- obligations to customers across the Group are met in full when due; and
- risks are subject to structured analysis in accordance with the risk appetite agreed by the Board; 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.

1. management of financial and insurance risk (cont.)

Sensitivities

The regulatory capital position is sensitive to changes in market conditions, due to both changes in the value of the assets as well as the effect these changes in market conditions would have on the value of the liabilities. It is also sensitive to the expense and lapse 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 tables below show the impact of the main sensitivities on the Group's long-term liabilities in both the current and prior year.

Long-Term Business Provision (LTBP) Sensitivities (£m) - 2012

	Mortality		Lapse	Expenses		Gilt Yields		Equities/Property	
Fund	**5%**	**(5)%**	**10%**	**10%**	**(10)%**	**20%**	**(20)%**	**10%**	**(10)%**
Non Profit Fund	1.2	2.3	(0.1)	4.1	(4.0)	(6.5)	7.4	n/a	n/a
With Profits Fund I	0.0	(0.0)	n/a	0.4	(0.4)	(0.9)	1.2	(0.0)	0.0
With Profits Fund 2	(0.1)	0.1	n/a	n/a	n/a	(1.8)	2.2	0.1	(0.1)
Change in LTBP	**1.1**	**2.4**	**(0.1)**	**4.5**	**(4.4)**	**(9.2)**	**10.8**	**0.1**	**(0.1)**

Long-Term Business Provision (LTBP) Sensitivities (£m) - 2011

	Mortality		Lapse	Expenses		Gilt Yields		Equities/Property	
Fund	**5%**	**(5)%**	**10%**	**10%**	**(10)%**	**20%**	**(20)%**	**10%**	**(10)%**
Non Profit Fund	1.2	2.3	(0.1)	3.8	(3.8)	(9.3)	9.7	n/a	n/a
With Profits I	0.1	(0.1)	n/a	n/a	n/a	(0.7)	0.7	(0.3)	0.3
With Profits Fund 2	(0.1)	0.1	n/a	n/a	n/a	(1.9)	1.9	0.1	(0.1)
Change in LTBP	**1.2**	**2.3**	**(0.1)**	**3.8**	**(3.8)**	**(11.9)**	**12.3**	**(0.2)**	**0.2**

The Non Profit mortality assumptions include the annuity business. The 5% increase in mortality shows the impact of increasing mortality rates on non-annuity business to 105% at 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 and insurance 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 reinsurance services
Hannover Re	Risk transfer and financial reinsurance services
National Australia Banking Group	Savings and protection distribution
Santander Asset Management	Investment management services
Insight Investments	Investment management services
Ecclesiastical Investment Managers	Investment management services
The Bank of New York Mellon	Custody services
The Bank of New York Mellon (International) Limited	Accounting and administration 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. EMFL is required to hold sufficient capital to meet regulatory capital requirements in its own right and is funded by share capital issued to the Society.

The Society wholly owns Engage Mutual Health (EMH), a company regulated by the FSA, through a holding company, Engage Health Holdings Limited (EHHL). EMH is required to hold sufficient capital to meet regulatory capital requirements in its own right and is funded by share capital issued indirectly 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) and Engage Mutual Services Limited (EMSL) are funded by inter-company loan for ongoing financing purposes.

Engage Mutual Insurance Limited (EMIL) was a wholly-owned subsidiary of the Society, and was voluntarily liquidated on 12 April 2012, at which point its net assets were repaid through a capital dividend to the Society.

Restrictions on available capital resources

The Society and its regulated subsidiaries are required to hold capital sufficient to meet the FSA'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 regulations.

The Society's total available capital resources are £79.9 million (2011: £80.9 million) of which £39.9 million (2011: £35.1 million) is held in the with profits funds and £40.1 million (2011: £45.8 million) is held in the non profit fund.

1. management of financial and insurance risk (cont.)

Available capital resources

Available capital resources as at 31 December 2012:	Non profit £'000	With profits I £'000	With profits II £'000	Total £'000
Fund for future appropriations	**53,874**	**26,109**	**14,405**	**94,388**
Adjustments in respect of subsidiary undertakings	(6,303)	-	-	(6,303)
Adjustment to assets onto regulatory basis	(3,031)	(139)	(9)	(3,179)
Adjustment to liabilities onto regulatory basis	(4,467)	(500)	-	(4,967)
Total available capital resources	**40,073**	**25,470**	**14,396**	**79,939**
Society capital requirements	(8,369)	(4,537)	(5,137)	(18,043)
Subsidiary capital requirements	(2,251)	-	-	(2,251)
Excess capital over regulatory requirements	**29,453**	**20,933**	**9,259**	**59,645**

Available capital resources as at 31 December 2011:	Non profit £'000	With profits I £'000	With profits II £'000	Total £'000
Fund for future appropriations	**57,597**	**23,147**	**12,758**	**93,502**
Adjustments in respect of subsidiary undertakings	(5,423)	-	-	(5,423)
Adjustment to assets onto regulatory basis	(545)	(219)	-	(764)
Adjustment to liabilities onto regulatory basis	(5,877)	(500)	-	(6,377)
Total available capital resources	**45,752**	**22,428**	**12,758**	**80,938**
Society capital requirements	(8,845)	(4,481)	(5,991)	(19,317)
Subsidiary capital requirements	(2,302)	-	-	(2,302)
Excess capital over regulatory requirements	**34,605**	**17,947**	**6,767**	**59,319**

1. management of financial and insurance risk (cont.)

Analysis of movement

The table below shows how the total available capital resources changed during 2012:

	Non Profit 2012 £'000	With profits I 2012 £'000	With profits II 2012 £'000	Total 2012 £'000
Opening excess capital at 1 January	34,605	17,947	6,767	59,319
Non-linked investment returns	7,253	4,127	6,711	18,091
Life assurance new business costs	(5,168)	(428)	-	(5,596)
Reinsurance commissions on new business	1,541	-	-	1,541
Subsidiary new business costs	(2,919)	-	-	(2,919)
Other*	(5,859)	(713)	(4,219)	(10,791)
Closing excess capital at 31 December	**29,453**	**20,933**	**9,259**	**59,645**

* this comprises of anything which is excluded from the other lines, namely capital (excluding new business) and reinsurance commissions.

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

Technical provisions	**2012 £'000**	2011 £'000
Linked Life	301,326	321,276
Linked Pensions	62,546	54,213
Non-Linked Life	298	624
Non-Linked Pensions	2,278	1,285
With Profit Contracts	129,906	144,034
Non-participating life insurance contracts	2,964	1,422
Non-participating pension contracts	99,072	90,599
Total technical provisions	**598,390**	613,453
Adjustment to regulatory basis of technical provisions	**3,178**	3,208
Total net technical provisions in the financial statements	**601,568**	**616,661**

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.

The Society has with profits funds with policyholder liabilities of less than £500 million. 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 prudent statutory solvency tests.

notes to the financial statements

for the year ended 31 December 2012

2. segmental analysis

a. Gross premiums

	2012 £'000	2011 £'000
Gross premium income is made up of:		
Society and Group Life Assurance and Pension Business		
Non profit non-linked contracts:		
- periodic premium	**23,190**	22,111
- single premium	**948**	3,384
With profits contracts:		
- periodic premium	**8,997**	9,792
- single premium	**110**	253
Total gross premiums written - continuing operations	**33,245**	35,540
Reinsurance ceded	**(10,886)**	(10,925)
Total earned premiums, net of reinsurance	**22,359**	**24,615**

As described in Accounting Policy D – 'Long-term contracts', in accordance with FRS 26 policies defined as investment rather than insurance contracts are accounted for on a deposit basis. The premium analysis above excludes £7,744,000 (£2011: £8,712,000) which would otherwise be included.

b. Gross new premiums

	2012 £'000	2011 £'000
Society and Group Life Assurance and Pension Business		
Non profit linked contracts:		
- periodic premium	**63**	141
- single premium	**-**	13
Non profit non-linked contracts:		
- periodic premium	**3,205**	2,141
- single premium	**95**	338
With profits contracts:		
- periodic premium	**992**	1,521
- single premium	**10**	39
Total new premiums	**4,365**	4,193

Where regular premiums are received other than annually, the regular new business premiums are included on an annualised basis.

2. segmental analysis (cont.)

c. Contributions received from child trust fund investment business

	2012 £'000	2011 £'000
Regular contributions	8,005	8,021
Government allocated contributions	290	1,401
Other single contributions	1,274	3,767
Total contributions	**9,569**	13,189

Contributions relate to business conducted by EMFL, a regulated subsidiary of the Society. The contributions received are invested, by EMFL, into a range of collective investment schemes. 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 held within the range of collective investment schemes by EMFL, as at the 31 December 2012, is £176.1 million (31 December 2011: £152.4 million).

3. investment return

	Group 2012 £'000	Group 2011 £'000	**Society 2012 £'000**	Society 2011 £'000
Income from investments	**20,778**	18,085	**20,778**	18,085
Realised gains on investments	**25,570**	42,672	**24,652**	42,672
Total investment income	**46,348**	60,757	**45,430**	60,757
Unrealised losses on investments	**(723)**	(39,561)	**(55)**	(39,411)
Investment management expenses	**(776)**	(1,053)	**(776)**	(1,053)
Total net investment return	**44,849**	20,143	**44,599**	20,293

Total net investment return includes £11,000 (2011: £85,000) of interest income on assets not held at fair value through profit and loss. Mortgage interest is included in note 11, other technical income.

4. claims incurred, net of reinsurance

	2012 £'000	2011 £'000
Society and Group - technical account - long-term business		
Gross claims paid	33,856	38,882
Change in provision for claims outstanding at year end	2,380	202
Gross claims incurred	**36,236**	39,084
Outward claims reinsurance	(5,589)	(5,349)
Total claims incurred, net of reinsurance	**30,647**	33,735

As described in Accounting Policy D – 'Long-term contracts', in accordance with FRS 26 policies defined as investment rather than insurance contracts are accounted for on a deposit basis. The claims analysis above excludes £45,073,000 (2011: £57,050,000) which would otherwise be included.

5. bonuses

The value of terminal bonuses paid to with profit policyholders in the year was £2.1 million (2011: £1.8 million).

6. goodwill

	Group £'000
Cost:	
At 1 January 2012	(425)
At 31 December 2012	**(425)**
Amortisation:	
At 1 January 2012	-
(Charge) / Credit in the year	425
At 31 December 2011	**425**
Net book value at 31 December 2012	**-**
Net book value at 31 December 2011	(425)

The outstanding negative goodwill, that arose on the acquisition of Provincial Hospital Services Association, was fully amortised in 2012 to reflect the disposal of the remaining transferred assets.

7. net operating expenses

Technical account - long-term business	Group 2012 £'000	Group 2011 £'000	Society 2012 £'000	Society 2011 £'000
Acquisition costs	5,540	6,152	5,540	6,152
Change in deferred acquisition costs	304	403	304	403
Administrative expenses	8,316	8,578	8,316	8,052
Reinsurance commissions and profit participation	7	53	7	53
Net operating expenses	**14,167**	15,186	**14,167**	14,660

Restructuring costs of £nil (2011: £533,000) are included within net operating expenses in the Technical Account – Long-Term business.

Technical account – General Business	Group 2012 £'000	Group 2011 £'000	Society 2012 £'000	Society 2011 £'000
Net operating expenses	**3,979**	2,615	**-**	-

Restructuring costs of £nil (2011: £244,000) are included within net operating expenses in the Technical Account – General Business.

Non-Technical account	Group 2012 £'000	Group 2011 £'000	Society 2012 £'000	Society 2011 £'000
Net operating expenses	**2,175**	2,343	**-**	-

Total commission paid by the Society on new business was £88,000 (2011: £802,000). Total commission paid by the Group was £3,203,000 (2011: £2,559,000).

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

8. auditor's remuneration

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

	2012 £'000	2011 £'000
Audit services		
Fees payable to the Society's auditor and its associates for the:		
Audit of the Society's annual accounts	**109**	-
Audit of the Society's subsidiaries, pursuant to legislation	**38**	-
Non-audit services		
Fees payable to the Society's auditor and its associates for other services:		
Other services pursuant to legislation	**8**	-
Other services - consultancy prior to their appointment as auditors	**50**	79
Total	**205**	79

During 2012 Deloitte LLP resigned as the Group's auditor, amounts payable to Deloitte LLP are included below:

	2012 £'000	2011 £'000
Audit services		
Fees payable to the Society's auditor and its associates for the:		
Audit of the Society's annual accounts	**-**	114
Audit of the Society's subsidiaries, pursuant to legislation	**-**	44
Non-audit services		
Fees payable to the Society's auditor and its associates for other services:		
Other services pursuant to legislation	**-**	15
Other services - consultancy	**5**	93
Total	**5**	266

	2012 £'000	2011 £'000
Fees in respect of the audit of the Homeowners Friendly Society Limited Retirement Benefit Scheme	**6**	6

notes to the financial statements

for the year ended 31 December 2012

9. operating lease rentals

Annual commitments under non-cancellable leases are as follows:

	2012 £'000	2011 £'000
Group		
Operating leases which expire:		
- within one year	**56**	68
- between two and five years	**59**	62
Total	**115**	130

Payments made under operating leases were:

	2012 £'000	2011 £'000
Hire of fixtures and fittings - rental under operating leases	**86**	108
Hire of other assets - rental under operating leases	**36**	29
Total	**122**	137

10. staff costs

	2012 £'000	2011 £'000
Wages and salaries	**7,483**	6,661
Social security costs	**716**	710
Other pension costs	**670**	568
Total staff costs	**8,869**	7,939

The average number of full time equivalent (FTE) employees in the Group during the year, including Directors, is as follows:

	2012 £'000	2011 £'000
Administration	**140**	133
Management	**26**	23
Marketing	**33**	21
Total number of staff	**199**	177

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. For details of the Directors' remuneration, please refer to the report of the Directors on remuneration, on pages 38-41.

11. other technical income, net of reinsurance

Other technical income comprises:

	Group 2012 £'000	Group 2011 £'000	**Society 2012 £'000**	Society 2011 £'000
Property rental	19	17	486	484
Mortgage interest	405	480	405	480
Reinsurance income	4,831	3,077	4,831	3,077
Total other technical income	**5,255**	3,574	**5,722**	4,041

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 reinsurance financing advances receivable in relation to the sale of new Over 50s life cover policies. Property rental in the Group is in relation to the investment property in Kew Gardens.

12. other income

Other income comprises:

	2012 £'000	2011 £'000
Annual management charges from Child Trust Fund business	2,445	2,184
Other operating income	1,100	905
Total other income	**3,545**	3,089

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

13. taxation

Analysis of the tax charge for the period is:

	Group 2012 £'000	Group 2011 £'000	**Society 2012 £'000**	Society 2011 £'000
Corporation tax				
Corporation tax credit for the year	**-**	24	**-**	-
Policyholder tax charge	**(307)**	(189)	**(307)**	(189)
Deferred tax				
Timing differences, origination and reversal	**-**	2,515	**-**	2,400
Total tax (charge) / credit	**(307)**	2,350	**(307)**	2,211

The tax charge for the Group is included in the Technical Account – Long-Term Business (£307,000 [2011: £2,211,000 credit]) and the Non-Technical Account (£nil [2011: £139,000 credit]). The charge in respect of policyholder tax relates to a tax credit allowed for in the linked investment business pricing.

13. taxation (cont.)

Reconciliation of current year tax charge:

The standard rate of current tax for the year is 24.5% for the subsidiaries (2011: 26.5%), based on the UK rate of corporation tax, and 20% for the Society (2011: 20%), based on the UK rate of income tax. The current year tax charge differs from the standard rates for the reasons set out in the following reconciliation.

	Group 2012 £'000	Group 2011 £'000	**Society 2012 £'000**	Society 2011 £'000
Loss on ordinary activities	**(1,274)**	(878)	**-**	-
Tax included in Non-Technical Account	**-**	(139)	**-**	-
Result for year after tax	**(1,274)**	(1,017)	**-**	-
Tax on result	**(312)**	(269)	**-**	-
Factors affecting tax charge:				
Accelerated capital allowances	**(11)**	(18)	**-**	-
Items disallowable in tax computation	**6**	4	**-**	-
Timing differences	**(71)**	(161)	**-**	-
Group consolidation adjustments	**(116)**	(258)	**-**	-
Prior year adjustment	**-**	(24)	**-**	-
Movement in unprovided deferred tax asset	**504**	702	**-**	-
Current corporation tax credit for the year	**-**	(24)	**-**	-

Analysis of deferred tax asset:

	Group 2012 £'000	Group 2011 £'000	**Society 2012 £'000**	Society 2011 £'000
Short-term timing differences	**853**	853	**-**	-
Total recognised deferred tax asset	**853**	853	**-**	-
Unrecognised deferred tax assets	**15,646**	16,421	**9,397**	10,980
Total	**16,499**	17,274	**9,397**	10,980

13. taxation (cont.)

Analysis of movement in recognised deferred tax asset / (provision)

	Group 2012 £'000	Group 2011 £'000	**Society 2012 £'000**	Society 2011 £'000
Provision at start of the period	**853**	(1,662)	**-**	(2,400)
Deferred tax credit to Technical Account - Long-term business	**-**	2,400	**-**	2,400
Deferred tax credit to Non-Technical Account	**-**	115		
Provision at end of the period	**853**	853	**-**	-

Deferred tax assets are included in the Balance Sheet – Assets and deferred tax liabilities are included in the Balance Sheet – Liabilities. The net amount is shown above.

14. land and buildings

Society	**Current Value 2012 £'000**	Current Value 2011 £'000	**Historical cost 2012 £'000**	Historical cost 2011 £'000
Land and buildings				
- Property occupied by the Group	**4,000**	5,100	**8,147**	8,147
- Investment property	**1,075**	816	**625**	625
Balance at 31 December	**5,075**	5,916	**8,772**	8,772

Group	**Current Value 2012 £'000**	Current Value 2011 £'000	**Historical cost 2012 £'000**	Historical cost 2011 £'000
Land and buildings				
- Property occupied by the Group	**4,000**	5,100	**8,147**	8,147
- Investment property	**1,075**	1,241	**625**	1,225
Balance at 31 December	**5,075**	6,341	**8,772**	9,372

Land and buildings are all freehold. The full external professional valuation of the property occupied by the Group was carried out by King Sturge, Chartered Surveyors at 31 December 2012. The previous valuation was at 31 December 2009.

The full external professional valuation of the investment property was carried out W Hallett & Co., Chartered Surveyors at 31 December 2011, and has been reviewed by the Directors at 31 December 2012.

The investment property in Bedford, which was acquired by the Group in 2010, as part its acquisition of PHSA, was sold in May 2012.

15. investments in group undertakings

The Society investment in subsidiaries can be analysed as follows:

	2012 **£'000**	2011 £'000
Cost at 1 January	15,850	15,850
Additions	1,000	-
Disposals	(3,350)	-
Cost at 31 December	**13,500**	15,850
Provision at 1 January	(3,550)	(3,550)
Provided in the year	(1,000)	-
Released in the year	1,000	-
Provision at 31 December	**(3,550)**	(3,550)
Carrying value at 31 December	**9,950**	12,300

On 1 January 2011, the general insurance business previously underwritten by Engage Mutual Insurance Limited was renewed with EMH. Following the run-off of the general insurance liabilities, the regulatory permissions were rescinded by the Gibraltar Financial Services Commission and the Directors voluntarily liquidated the company on 12 April 2012.

On 24 December 2012, the Society subscribed for 1,000,000 ordinary £1 shares in Engage Health Holdings Limited for a consideration of £1,000,000. On 24 December 2012, Engage Health Holdings Limited subscribed for 1,000,000 ordinary £1 shares in Engage Mutual Health for a consideration of £1,000,000.

Engage Mutual Health has made losses in the current year as investment into health insurance business has been made, and this investment is expected to continue in the short-term, accordingly a provision of £1,000,000 has been provided in the year in relation to the Society's investment.

Set out below are the Society's investments in subsidiary undertakings as at 31 December 2012, all of which are included in the consolidation; the carrying value of these subsidiaries cancel out on consolidation. All companies are incorporated in England and Wales.

Name of Subsidiary Undertaking	**Nature of Business**
Engage Mutual Funds Limited	Child Trust Fund management
Engage Mutual Administration Limited	Administration Services
Engage Mutual Services Limited	Insurance and non-regulated financial product intermediary
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.

16. financial instruments

FRS 29 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.

The financial investments held by the Group and by the Society are valued as:

Group	**Fair value**	Fair value	**Cost**	Cost
	2012	2011	**2012**	2011
	£'000	£'000	**£'000**	£'000
Shares, other variable yield securities and holdings in collective investment schemes	**216,986**	230,062	**193,562**	205,070
Debt securities and other fixed income securities	**289,883**	328,996	**268,692**	310,277
Derivatives held at fair value through profit and loss	**144**	560	**-**	573
Financial assets held at fair value through profit and loss	**507,013**	559,618	**462,254**	515,920
Loans secured by mortgage	**4,865**	6,112	**-**	6,112
Deposits with credit institutions	**120,156**	105,301	**120,156**	105,301
Accrued income and receivables	**12,798**	1,764	**12,798**	1,764
Loans and receivables	**137,819**	113,177	**132,954**	113,177
Total Group financial assets	**644,832**	672,795	**595,208**	629,097
Financial liabilities at fair value through profit and loss	**365,443**	377,771	**365,443**	377,771
Financial liabilities held at amortised cost	**2,798**	3,674	**2,798**	3,674
Total Group financial liabilities	**368,241**	381,445	**368,241**	381,445

The Group Financial assets held at fair value through profit and loss comprises £162,748,000 within level 1 and £482,084,000 within level 2. The Group financial liabilities are all within level 2.

16. financial instruments (cont.)

Society	Fair value 2012 £'000	Fair value 2011 £'000	Cost 2012 £'000	Cost 2011 £'000
Shares, other variable yield securities and holdings in collective investment schemes	**216,970**	223,435	**193,544**	198,443
Debt securities and other fixed income securities	**289,883**	328,996	**268,692**	310,277
Derivatives held at fair value through profit and loss	**144**	560	**-**	573
Financial assets held at fair value through profit and loss	**506,997**	552,991	**462,236**	509,293
Loans secured by mortgage	**4,865**	6,112	**-**	6,112
Deposits with credit institutions	**117,155**	104,987	**117,155**	104,987
Accrued income and receivables	**12,798**	1,765	**12,798**	1,765
Loans and receivables	**134,818**	112,864	**129,953**	112,864
Total Society financial assets	**641,815**	665,855	**592,189**	622,157
Financial liabilities at fair value through profit and loss	**365,443**	377,771	**365,443**	377,771
Financial liabilities held at amortised cost	**2,442**	1,837	**2,442**	1,837
Total Society financial liabilities	**367,885**	379,608	**367,885**	379,608

The Society Financial assets held at fair value through profit and loss comprises £162,748,000 within level 1 and £479,067,000 within level 2. The Society financial liabilities are all within level 2.

17. other debtors

	Group 2012 £'000	Group 2011 £'000	Society 2012 £'000	Society 2011 £'000
Amounts owed from Group undertakings	**-**	-	**1,363**	1,835
Amounts owed from policyholders	**706**	526	**706**	526
Rebates	**1,564**	1,063	**1,184**	694
Debtors arising out of reinsurance operations	**344**	1,052	**344**	1,052
Other debtors	**565**	433	**151**	195
Total debtors	**3,179**	3,074	**3,748**	4,302

18. tangible assets

Group	Motor Vehicles equipment £'000	Computer equipment £'000	Fixtures, fittings and office equipment £'000	Total £'000
Cost				
At 1 January 2012	7	790	770	1,567
Additions	-	260	234	494
Disposals	-	-	-	-
At 31 December 2012	**7**	**1,050**	**1,004**	**2,061**
Depreciation				
At 1 January 2012	5	708	698	1,411
Provided in the year	2	120	49	171
On disposals	-	-	-	-
At 31 December 2012	**7**	**828**	**747**	**1,582**
Net book value at 31 December 2012	**-**	**222**	**257**	**479**
Net book value at 31 December 2011	2	82	72	156

The charge for depreciation for the Group in the year ended 31 December 2011 was £73,000.

19. deferred acquisition costs

	2012 £'000	2011 £'000
On with profits contracts	**139**	219
On non profit contracts	**321**	545
Total deferred acquisition costs	**460**	764

The direct costs of acquiring certain policies are capitalised and are amortised in line with the expected life of the policies.

20. technical provisions

Society	Long-term business provision (LTBP) £'000	Reinsurers' share of LTBP £'000	Provision for outstanding claims £'000
At 1 January 2012	**285,996**	**(56,691)**	**9,585**
Movement in provision for outstanding claims	-	-	(2,380)
Change in Long-Term Business Provision	3,422	(4,767)	-
Balance at 31 December 2012	**289,418**	**(61,458)**	**7,205**

The above table discloses the technical provisions for the Society. Included in the Group balance sheet is a long-term business provision of £504,000 and a provision for outstanding claims of £456,000, both in respect of Engage Mutual Health.

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 (LTBP) 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 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 2012:

Class of business	Interest
Non-linked Annuities tax exempt / taxable	1.92% gross / 2.78% net
Index-linked Annuities tax exempt / taxable	1.80% gross / 1.80% net
Term Assurance / whole of life	2.26%
With Profits Fund I unitised with profits tax exempt / taxable	2.24% gross / 0.65% – 1.1% net
With Profits Fund I other tax exempt / taxable	1.74% gross / 1.68% net
With Profits Fund II with profits bond taxable	2.67% net
With Profits Fund II other tax exempt / taxable	0.86% gross / 0.60% net

20. technical provisions (cont.)

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

With profits bonuses

The LTBP includes £0.9 million (2011: £0.6 million) 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

	2012 £'000	2011 £'000
At 1 January	377,771	426,705
Deposits from policyholders in respect of investment contracts	7,744	8,712
Withdrawals to policyholders in respect of investment contracts	(45,073)	(57,050)
Annual management charges on investment contracts	(3,039)	(3,184)
Change in fair value of gross liabilities for investment contracts	28,040	2,588
At 31 December	**365,443**	377,771

As described in the Accounting Policy C – 'Classification of Contracts', in accordance with FRS 26, policies defined as investment, rather than insurance contracts are accounted for on a deposit basis.

22. provision for other risks and charges

	Group 2012 £'000	Group 2011 £'000	**Society 2012 £'000**	Society 2011 £'000
Provision as at 1 January	-	1,491	-	-
Utilised in the year		(1,491)	-	-
Provided in the year	-	-	-	-
Provision as at 31 December	-	-	-	-

The provision of £1,491,000 was fully utilised in the previous year in fulfilling various long-term contracts to which it related.

23. creditors arising out of insurance operations

Creditors are in relation to reinsurance contracts and health insurance business. Creditors also includes £300,000 (2011: £300,000) for an unexpired risk provision relating to certain classes of private medical insurance written by Engage Mutual Health. All creditors are payable within five years.

24. other creditors, including social security and taxation

	Group 2012 £'000	Group 2011 £'000	**Society 2012 £'000**	Society 2011 £'000
Amounts owed to Group undertakings	**-**	-	**782**	297
Other taxes and social security costs	**311**	270	**-**	-
Other creditors	**1,358**	1,173	**893**	711
Total	**1,669**	1,443	**1,675**	1,008

All other creditors are payable within five years.

25. fund for future appropriations

	Group 2012 £'000	Group 2011 £'000	**Society 2012 £'000**	Society 2011 £'000
Balance at 1 January	**84,542**	90,016	**93,502**	96,097
Transfer to / (from) Long-Term Business - Technical Account	**1,094**	(3,663)	**886**	(2,595)
Total recognised gains and losses	**(1,751)**	(1,811)	**-**	-
Balance at 31 December	**83,885**	84,542	**94,388**	93,502

The surplus in the pension scheme has not been recognised in 2012 and was not recognised in the prior year. Further information is included in Note 26.

26. pension commitments

Defined contribution scheme

The company operates a defined contribution stakeholder pension scheme for all employees joining the group after 29 March 2001. A number of employees have their own defined contribution pension arrangements to which the Group is equally happy to contribute. The pension cost charge for the period represents contributions payable by the company and amounted to £339,275 (2011:£337,412).

Contributions amounting to £64,838 (2011: £26,759) were payable to the scheme and are included in creditors.

Defined benefit scheme

The company operates a defined benefit pension scheme for its employees who joined before 29 March 2001. During the year the Directors reviewed the pension arrangements and took the decision to close the defined benefit pension scheme to any service accruals after 31 December 2012. Compensation, which comprises additional service accruals between 1 January 2011 and 31 December 2012, has been awarded to affected members and the cost of this is shown as past service cost.

The pension scheme is accounted for under FRS 17 'Retirement Benefits'. During 2012 the company contributed into the scheme at a rate of £559,400 (2011: £250,000), per the agreed funding schedule. An additional special contribution of £75,000 was made during 2012 (2011: £200,000). The company made no further additional contributions into the scheme to fund the cost of compensation relating to the closure of the scheme (2011: £450,000). As the scheme is closed to new entrants and will close to future accruals in 2012, under the Projected Unit Method, the service cost will increase as the remaining members reach retirement.

The contributions are determined by the Scheme Actuary on the basis of triennial valuations. 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. A full actuarial valuation of the Homeowners Friendly Society Pension Scheme was carried out as at 31 December 2010.

The assets of the defined benefit scheme are held separately from those of the company in an independently administered fund.

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

26. pension commitments (cont.)

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

	2012 % per annum	2011 % per annum	2010 % per annum
Long-term salary progression	**2.40**	-	3.55
Rate of increase in pension payments guaranteed	**3.00**	3.05	3.35
Rate of price inflation and deferred pension revaluation	**2.40**	2.15	3.55
Discount rate	**4.60**	4.75	5.25

The Government recently proposed changes to pension legislation relating to the measure of inflation being linked to increases in deferred pensions. As the scheme will be closing to additional service accruals, active members at that point will become deferred members. At the balance sheet date a gain on curtailment of nil (2011: £450,000) has been recognised.

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		
	2012 % per annum	2011 % per annum	2010 % per annum	**2012 £'000**	2011 £'000	2010 £'000
Equities	8.00	8.00	8.00	**3,456**	3,046	5,153
Gilts	2.70	2.80	-	**8,844**	9,315	-
Bonds	4.60	4.75	4.20	**8,946**	7,992	12,992
Other	0.90	1.80	1.50	**1,367**	1,098	178
Total market value of scheme assets				**22,613**	21,451	18,323
Present value of scheme liabilities				**(17,441)**	(15,700)	(15,005)
Gross surplus in scheme				**5,172**	5,751	3,318
Unrecognised surplus in scheme				**(5,172)**	(5,751)	(3,318)
Net surplus in scheme				**-**	-	-
Related deferred tax liability				**-**	-	-
Recognised pension asset				**-**	-	-

In the prior years, a composite rate of return has been calculated for corporate bonds and gilts.

26. pension commitments (cont.)

The mortality assumptions used are based on standard mortality tables which allow for future mortality improvements. Under these assumptions the average life expectancies for males and females currently aged 60 are 28.0 years (2011: 28.0 years) and 30.3 years (2011: 30.2 years) respectively.

a. Reconciliation of present value of scheme liabilities

	2012 £'000	2011 £'000
At 1 January	**(15,700)**	(15,005)
Current service cost	**(254)**	(348)
Past service cost	**(75)**	(330)
Interest cost	**(737)**	(778)
Contibutions by scheme participants	**(52)**	(52)
Benefits paid	**428**	467
Curtailments	**-**	450
Net actuarial loss	**(1,051)**	(104)
At 31 December	**(17,441)**	(15,700)

b. Reconciliation of market value of scheme assets

	2012 £'000	2011 £'000
At 1 January	**21,451**	18,323
Expected return on plan assets	**909**	967
Contributions paid by employer	**634**	972
Contibutions by scheme participants	**52**	52
Benefits paid	**(428)**	(467)
Acuarial gains	**(5)**	1,604
At 31 December	**22,613**	21,451

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

	2012 £'000	2011 £'000
Current service cost	**254**	348
Past service cost	**75**	330
Curtailment cost	**-**	(450)
Total charge	**329**	228

26. pension commitments (cont.)

d. Analysis of amounts credited to non-technical account (pension finance income)

	2012 £'000	2011 £'000
Expected return on pension scheme assets	**(909)**	(967)
Interest on pension scheme liabilities	**737**	778
Net return	**(172)**	(189)

e. Analysis of recognised gains and losses

	2012 £'000	2011 £'000
Actual return less expected return on pension scheme assets	**(5)**	1,604
Experience gains and losses arising on the scheme liabilities	**(1,051)**	(104)
Changes in assumptions underlying the present value of the scheme liabilities	**-**	-
Actuarial profit in pension scheme	**(1,056)**	1,500
Unrecognised pension asset	**579**	(2,433)
Total amount recognised in non-technical account	**(477)**	(933)

26. pension commitments (cont.)

f. History of experience gains and losses

	2012	2011	2010	2009	2008
Present value of scheme liabilities (£'000)	**(17,441)**	(15,700)	(15,005)	(13,924)	(12,773)
Fair value of scheme assets (£'000)	**22,613**	21,451	18,323	16,525	15,962
Surplus in scheme	**5,172**	5,751	3,318	2,601	3,189
Difference between the expected and actual return on scheme assets (£'000)	**(5)**	1,604	924	385	1,349
Percentage of scheme assets (%)	**(0.0)**	7.5	5.0	2.3	8.5
Experience (losses) / gains on scheme liabilities (£'000)	**(348)**	(104)	92	71	460
Percentage of present value of scheme liabilities (%)	**2.0**	(0.7)	0.6	0.5	3.6
Total amount recognised in STRGL (£'000)	**477**	933	194	3,246	150
Percentage of present value of scheme liabilities (%)	**2.7**	5.9	1.3	23.3	1.2

27. guarantees and financial commitments

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

28. statement of information relating to the Actuarial Function Holder

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

- Trevor M Batten was not a member of the Society at any time during 2012;
- no other member of his family was a member of the Society during 2012;
- Trevor M Batten is a member of the Homeowners Friendly Society Pension Scheme;
- the aggregate rate of the remuneration and benefits (excluding pension contributions) of Trevor M Batten for 2012 amounted to £117,401.

29. related party transactions

Transactions involving Directors

During 2012, three Directors together with their connected parties held insurance policies on an arms-length basis. There were no other transactions during the year.

30. post balance sheet event

On 15th March 2013, the Society subscribed for 3,000,000 ordinary shares in Engage Health Holdings Limited for a consideration of £3,000,000. On 15th March 2013 Engage Health Holdings Limited subscribed for 3,000,000 ordinary shares in Engage Mutual Health for a consideration of £3,000,000.

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'.

any questions

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