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family investments

Annual Report and Accounts
for the year ended 31 December 2006

family investments

Contents

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London E14 5AF

SOLICITORS
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Butler LLP
Minerva House
5 Montague Close
London SE1 9BB

Wedlake Bell
52 Bedford Row
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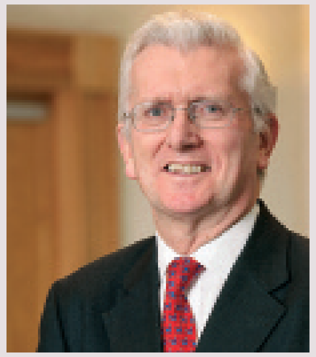


Robert Dolman, Chairman

Chairman's Review

Overview

I am pleased to report that 2006 was a year of continued achievement for the Society, building on the successful launch of our Child Trust Fund (CTF) account in 2005.

There are now 42 providers of the CTF, and we continue to maintain our position as the leading provider with approximately 145,000 new members joining us during the year. This means more than one in six of those eligible positively electing to open their CTF account with Family, thus further justifying our entry into this market.

Since its launch in April 2005 we have set up over 400,000 CTF accounts which now form a significant part of our overall business. This year we have sought to provide additional information with regard to our CTF business.

Results

In 2006 our membership increased by more than 11% to over 815,000 and at the same time we have continued to contain costs to enable us to provide continued good value to our members.

In the second year of CTF our reserves increased by £2.5m and remain comfortably in excess of statutory limits. We expect that our reserves will continue to increase in future years as surpluses gradually emerge from the significant volumes of new business written in the past two years.

Investment returns

World stock markets provided good returns again in 2006, though not as strong as in 2005. Interest rates continued to remain low although 2006 saw increases as central banks attempted to maintain downward pressure on inflation. Our managed funds generally performed well with the best performing fund, the Charities Ethical Exempt unit trust, returning 23.8% after charges. Our Family Investments Child Trust Fund unit trust returned 8.9% after charges.

Despite poor performance from the Far East Fund of -5.1% which was mainly due to the 13.1% weakening of the Japanese Yen against Sterling, the weighted average return of all the managed funds was 7.8%. The net return of our largest fund, Sovereign 3, was 7.5% and for the third consecutive year was ahead of its performance benchmark that we set for New Star Institutional Managers Limited, who manage the majority of the Society's funds.

We continue to believe that equities hold the best long term store of value, but there can be significant fluctuations in prices in the shorter term. For those Family Bond members who wish to avoid such fluctuations we offer the ability to switch their investment to our Safety First Fund, which offers capital protection.

Products

The Child Trust Fund has continued to make a significant impact since its launch in April 2005. All children born since 1 September 2002 will have one and this has introduced many more people to the concept of long term saving.

Child Trust Funds are opened with a donation from the Government (usually £250) and it is easy for anyone to top up this amount either with ad hoc lump sums or with regular payments by direct debit which can be started from just £10 a month. We have been encouraged by the increasing number of additional payments being made by parents, grandparents, uncles, aunts and friends. Around one third of our CTF accounts are now receiving additional contributions from family and friends, an excellent start but we wish to engage more families to save for the future benefit of their children.

Last year, we broadened our product range by enabling our CTF customers to invest in the Society's ethical unit trust. We established the ethical unit trust many years ago and as ethical investment has become increasingly popular it was a logical move to offer this option to CTF investors.

We have also been pleased by the continued support of members for our more traditional products through our Family and Junior Bonds, ISAs and Unit Trusts.

Customer service

Our members expect excellent service and to be treated fairly. I am pleased to report that we have seen continued service improvement in 2006 with a further reduction in complaints (30% down on 2005) and better than benchmark service to our members and our distribution partners who introduce a significant proportion of our CTF business. Nonetheless, there can be no room for complacency and where we do make mistakes, we will seek to learn from them and further improve our service.

We measure the quality of our service through a number of indicators which in 2006 included:

- Telephone answering response time average 12 seconds
- All new business applications processed within 24 hours
- 300,000 calls taken with 86% answered within 20 seconds

We continue to make further investments in both systems and the training of our people and we were pleased to receive a National Training Award in 2006 to reflect our investment in preparing our employees for the launch of CTF.

Corporate governance

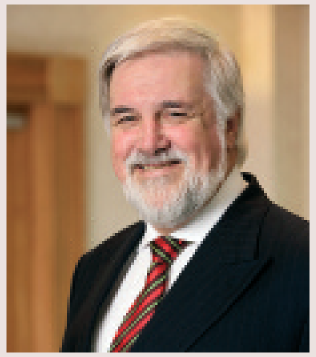
From 1 January 2006 we have sought to comply fully with the Annotated Combined Code for Mutual Insurers, which seeks to ensure a high level of Corporate Governance and provide members with more information on how their Society is run. We now disclose more information than previously and hope you find this of benefit but welcome your comments on this, or indeed any other matter related to your Society.

In 2006 we welcomed to the Committee of Management two new members, Norman Riddell and Veronica France, who have brought fresh thinking to the Committee and cover for two retirements from the Committee in 2007, David Jude and Rachael Heyhoe-Flint. Both David and Rachael have made a tremendous contribution to the Society over many years in which they have served on your Committee of Management. We thank them and wish them both well for the future.

Employees

Our employees take great pride in the success of your Society. The Committee of Management is proud of what they have achieved to date and I thank them for their efforts.

Robert Dolman, Chairman
March 2007



John Reeve, Chief Executive

Chief Executive's Operational Report

I am pleased to report that 2006 was another successful year for your Society, both in terms of investment returns and growth of membership. We were of course unable to repeat the record results achieved in 2005, which were fuelled by the unique opportunity provided by the launch of the Child Trust Fund (CTF) that, in 2005, created a market three times the size of a "normal" CTF year.

Nonetheless, we are delighted to have maintained our CTF market share and our position as the leading Child Trust Fund provider. Our 2006 results benefited from the tail end of the CTF launch and provided the second best year in the Society's history in terms of sales contribution and the number of new members joining.

Review of Activities

Our entry into the CTF market is proving to be extremely successful. By the end of 2006 we had opened almost 400,000 new accounts since the launch of the CTF with total CTF funds under management now exceeding £180m. Of these, around 145,000 new accounts were opened in 2006 with total contributions of more than £54m.

Our CTF continues to be sold primarily through partnerships with our prestigious distribution partners such as Barclays Bank, Post Office, Bounty and Sainsburys, amongst others, making our CTF product available through 18,000 retail outlets.

The Society also receives Revenue Allocated Accounts. These are CTF accounts which have not been opened by the voucher holder, whereby after a year HM Revenue and Customs allocates the accounts to providers on a rotational basis. We received our allocation of 38,000 accounts in 2006 (included in the figures above) and they are proving to be a valuable addition to our sales volumes.

The significant volumes of new business written over the past two years mean that we have been able to reduce the average administration cost per policy by taking advantage of economies of scale, and we expect this to continue. As I mentioned last year, we will continue to maintain tight control over our expenses to maintain downward pressure on costs per policy, which is essential in the context of a charge capped stakeholder product such as CTF, to enable the Society to continue to grow.

Our CTF product has no initial charge and so there is new business strain where the costs of selling and servicing the new business are not covered in the short term by the charges on the policy hence, as last year, a cash flow deficit arose in 2006, but much smaller than that which arose in 2005. We remain confident that this is a short-term phenomenon and is comfortably manageable within the Society's existing financial resources. In the longer term the Committee is confident that sales of CTF

Chief Executive's Operational Report

will add significantly to the Society's reserves.

CTF is only part of our product range and we were pleased that many existing Family and Junior Bond members continue to retain and extend their policies with us beyond their original payment terms. We also serve the Post Office workforce through our POIS division, which continues to prove a successful venture following our acquisition of POIS Assurance in 2002.

While less significant in numbers, sales of our ISAs and Unit Trusts exceeded their targets for the year.

Treating customers fairly

As mentioned in the Chairman's report, we have continued to give high priority to the fair treatment of our customers and the provision of excellent service. To further support this in 2006 we launched, with the help and input of our employees, a "values" initiative to focus on five core values:

- Professionalism
- Honesty
- Respect
- Commercial Focus
- Customer Focus

We encourage our members to let us know if we do not live up to these values.

Investment

Financial markets enjoyed a further strong year in 2006. Plentiful global liquidity helped push world markets higher, with gains made by equities, bonds, commodities and property despite central bank interest rate rises around the world. The US Federal Reserve raised interest rates to 5.25%, the European Central Bank raised rates five times throughout the year and Japan moved away modestly from its zero interest rate policy.

This did not stop equity markets from rising. For sterling-based investors, the best equity region was Europe excluding the UK, which rose more than 20%, closely followed by the UK which rose nearly 17% as measured by the FTSE All-Share Index. The FTSE 250 Index of medium-sized companies rose by more than 30%, with a number of its constituents receiving takeover approaches. The US market performed well in local currency terms but a substantial fall in the dollar wiped out gains for sterling investors. Emerging markets also performed well, with China leading the way. *Sources: Lipper & Datastream*

However a majority of Family's £1.7 billion funds under management is held in balanced funds which are prudently invested across a range of asset classes including substantial levels of fixed interest securities in order to reduce their risk level and volatility. As a result our balanced funds grew less rapidly than those invested purely in equities but nonetheless still produced returns comfortably in excess of deposit-based investments.

The Investment Sub-Committee determines the asset allocation for each of the Society's funds and sets performance benchmarks against which the returns achieved by our fund managers, New Star, are measured.

I am pleased to report that our largest fund, Sovereign, which holds more than 50% of the Society's assets again beat its performance target in 2006 returning 8.24%* before charges against a benchmark of 7.34%. At 31 December 2006 the cumulative return for the fund since New Star's appointment in 2004 was 38.76% against a target of 35.63%.

The performance of our other managed funds was more mixed where four out of seven beat their benchmark targets and we will be seeking improved results from those funds which have underperformed.

We remain very conscious that our members always have a choice where to place their savings and the Society must continue to be competitive in cost and performance. As a result we aim to offer fund choices to our members consistent with their needs and aspirations.

For instance in response to an increased desire for ethical investment we have now made our Family Charities Ethical Fund (FCET) available to CTF members as well as our Family and Junior Bond members. FCET is competitively priced and has performed well over the past five years but past performance is not necessarily a guide to the future and going forward we will need to produce consistently good returns for this fund and indeed all of our funds if we are going to maintain the trust that our members have placed in the Society.

There are good reasons to be positive for the forthcoming year. Economic growth is forecast to continue but at a slower rate than in 2006, due principally to a slowdown in US economic growth as a result of weakness in the US housing market. This growth slowdown should help keep inflation at levels considered acceptable by the central bankers, allowing short-term interest rates to decline in the second half of the year as the slowdown unfolds.

It is likely that equity markets will benefit when interest rates start to decline. At the turn of the year, many equity markets around the world, including the UK, offered good value compared to their history and in comparison to cash and bonds, despite the sharp gains they have enjoyed from the lows in March 2003.

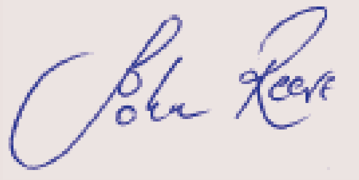
There are two main risks to this optimistic outlook, depending on how economic developments unfold. If economic growth is too strong, inflation fears will return, interest rates will rise and financial markets are likely to suffer. Alternatively, if economic growth falls significantly short of expectations, corporate earnings may disappoint and equity valuations may come under pressure.

*varying between 6.4% and 7.5% after charges

Future developments

Your Committee of Management has decided that development of the CTF product should remain central to the Society's strategy to enable us to capitalise further on its successful launch. We are pleased that the Government has decided that CTF savings will transfer automatically into ISAs when a child reaches 18, enabling savings to continue and at the same time answering parents' concerns with regard to potentially imprudent use of CTF monies when their children reach the age of majority.

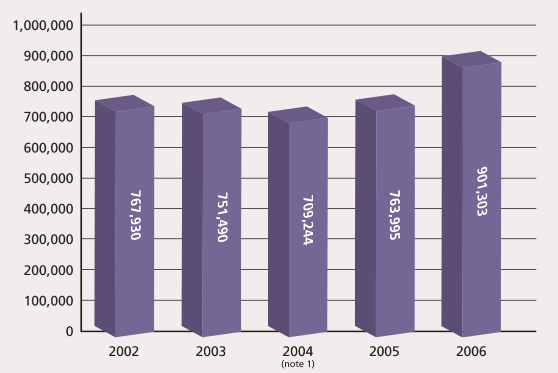
We will therefore continue to develop our systems and processes to facilitate additional contributions to CTF accounts, for the mutual benefit of both the Society and its members and to improve the cost efficiency of our administrative operations. Nonetheless, we remain open to extending our strategy beyond the CTF as we identify new opportunities.



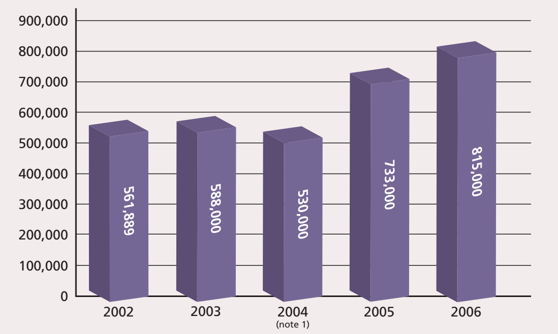
John Reeve, Chief Executive
March 2007

Key Performance Indicators

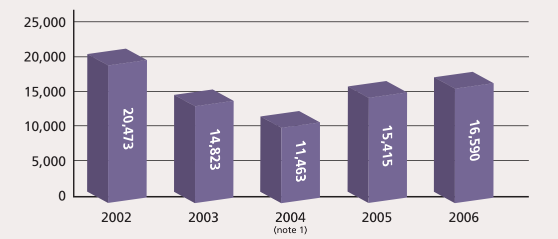
Policy Numbers



Membership

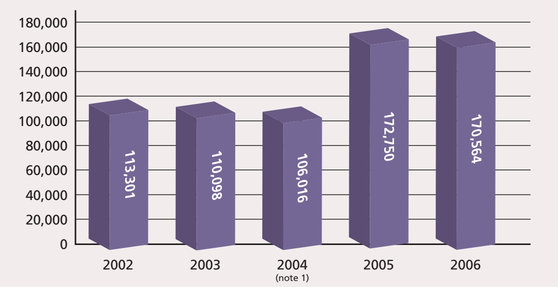


Administration Expenses – £000



Reserves – £000

Customer Contributions – £000



Funds Under Management – £000

Notes to key performance indicators:

1. During 2004 the Society transferred its with-profits pensions business to Reliance Mutual. As part of the sale we transferred assets of £254m, reserves of £18m and 17,000 members which accounts for the reduction in 2004 in the graphs above for membership, policy numbers, reserves, funds under management and contributions.

2. The impact of the Society's entry into the CTF market can clearly be seen in the graphs for membership, policies and particularly contributions, where the total contributions for the group in 2005 and 2006 are in excess of £170m, although gross premiums written within the Society, as per page 31 of the accounts, are only £73m which highlights the importance to the Group of the CTF business.

3. Reserves fell slightly in 2005 as a result of the new business strain of selling very large numbers of CTF plans, where there is no upfront charge to defray selling costs, but in the long term however this business is forecast to be profitable for the Society, and indeed in 2006 reserves started to recover.

Committee of Management

Chairman
Robert Dolman*
Mr. Dolman, aged 61, has been a member of the Committee since 1981, Vice Chairman from 1988 to 1993, and Chairman from 1993. He is a partner in a London firm of solicitors and specialises in trust and tax law.

Vice Chairman
David Jude*
Mr. Jude, aged 68, Vice Chairman and Senior Independent Director, was appointed to the Committee in 1994. He was a Director of a leading City discount house, and previously worked for the National Westminster Bank Group.

Chief Executive
John Reeve FCA
Mr. Reeve, aged 59, is a Chartered Accountant and has been a full-time executive of the Society since 1982. He joined the Committee in 1983 and has led the Society since 1987, firstly as General Manager and from 1992 as Chief Executive.

Veronica France*
Ms. France, aged 45, was appointed to the Committee in 2006. She is a business development consultant and a past Chairman of the Investment and Life Assurance Group.

Rachael Heyhoe-Flint MBE DL*
Mrs. Heyhoe-Flint MBE, aged 67, was appointed to the Committee in 1992 and has been a member of the Society for over 20 years. She runs her own marketing and public relations consultancy and is a former teacher and journalist.

Norman Riddell*
Mr. Riddell, aged 59, was appointed to the Committee in 2006. He is an investment consultant and a director of Norman Riddell & Associates Limited.

Robert Weir FCA*
Mr. Weir, aged 58, was appointed to the Committee in 1997. He was a Director of the Household Mortgage Corporation and has wide experience in financial and general management.

John Wybrew FIA*
Mr. Wybrew, aged 64, was appointed to the Committee in 1999. He is a Fellow of the Institute of Actuaries and former Chairman of a life assurance company. He is a past Chairman of the Investment and Life Assurance Group.

Finance Director
John Adams FCCA
Mr. Adams, aged 52, is a Certified Accountant and has been a full-time executive of the Society since 1986 when he was appointed Financial Controller. He was promoted to Finance Director and appointed to the Committee in 1993.

Chief Operating Officer
Rob Edwards
Mr. Edwards, aged 51, has been a full-time executive of the Society since 1988. He was appointed to the Committee in 1997, became General Manager in 2001 and Chief Operating Officer in 2006. He is responsible for overseeing the Society's Marketing, Customer Services, IT, Operational Finance and Corporate Projects functions.

Secretary and Corporate Services Director
Keith Meeres FCoI
Mr. Meeres, aged 49, joined the Society in 1993 as Compliance Officer and became Secretary in 1996. He was appointed to the Committee in 1997. He is responsible for overseeing the Society's Regulatory Compliance, Risk, Internal Audit, Human Resources and Facilities functions.

* Denotes non-executive Committee members

Committee of Management's Annual Report

The Annual Report and Accounts have been prepared in accordance with The Friendly Societies (Accounts and Related Provisions) Regulations 1994 ('the Regulations').

The Society is governed by a Committee of Management, the membership of which comprised, in 2006, the Chairman, six other independent non-executive directors and four executive directors. As stated in last year's report the number of non-executive directors increased in 2006 by two in order to ensure a smooth introduction of two new appointees to the board in preparation for the retirement of Mr. Jude and Mrs. Heyhoe-Flint at the 2007 Annual General Meeting (AGM). Immediately following the 2007 AGM the Committee of Management will revert to five non-executive directors.

The Committee is led by the Chairman whose role, along with that of the Chief Executive, has been set out and approved by the Committee. The Committee delegates management of the business to the executive directors, who meet at least monthly.

The Committee is satisfied that having considered the background and current circumstances of each non-executive director there are no relationships or issues which could affect their judgement in performing their duties. Directors' biographies and details of length of service can be found on page 10.

The Committee has reviewed the length of service of the non-executive directors and considers that they all meet the criteria of independence. In keeping with the Annotated Combined Code for Mutual Insurers, any non-executive director who has exceeded nine years service will, if still considered independent by the Committee, seek re-election on an annual basis rather than every three years. Four non-executive directors, Robert Dolman, Robert Weir, Rachael Heyhoe-Flint and David Jude, have each served in excess of nine years on the Committee. As noted above Mr. Jude and Mrs. Heyhoe-Flint will retire from the Committee immediately following the 2007 AGM. After careful consideration of their character, judgement, competence and experience the Committee continues to view Mr. Dolman and Mr. Weir as suitably independent and they will therefore stand for re-election in 2007, however their service will continue to be subject to annual review. Any term of service beyond six years for a non-executive director is also subject to rigorous review.

None of the directors had any interests in the Society or its subsidiary companies other than those interests in respect of fees or salaries paid to them as directors, those interests in respect of the policies which they hold with the Society and those interests specifically disclosed in note 22 of these Annual Report and Accounts.

Committee of Management

During 2006 the members of the Committee were as follows:

Non-executives
Robert Dolman (Chairman)
David Jude (Vice Chairman)
Veronica France (appointed February 2006)
Rachael Heyhoe-Flint
Norman Riddell (appointed February 2006)
Robert Weir
John Wybrew

Executives
John Reeve (Chief Executive)
John Adams (Finance Director)
Rob Edwards (Chief Operating Officer)
Keith Meeres (Secretary and Corporate Services Director)

Business objectives and activities of the Society and its subsidiary companies

The Group's objective is generally to promote the financial well being of its members through the provision of life assurance and savings schemes. Your Committee believes that the expectations of its members, on which the performance of the Committee should be judged, are that the Society meets or exceeds its investment benchmarks and maintains high standards of customer service. We believe also that our members expect the Society to thrive and grow in order to achieve economies of scale whilst maintaining prudent control over costs, maintaining adequate financial resources and complying with all relevant legislation and regulation.

Number of members

As at 31 December 2006, the Society had approximately 815,000 members (2005: 733,000).

Committee of Management's Annual Report

Member relations

The Committee is committed to maintaining good communications with members and is keen to develop its understanding of members' views and provide members with sufficient relevant information to enable them to understand the performance of the Society and its products. In 2006 the Society conducted independent research and surveys with a number of members which provided valuable feedback to help the Society measure and where necessary improve its services. We hope that members will continue to participate in our future surveys. Details of the Society's Member Relations Strategy are available on our website at www.family.co.uk or from the Society's Secretary.

Review of activities, key performance indicators and future developments

Please refer to the Chief Executive's Operational Report on pages 5 to 8 for his review of activities, key performance indicators and comments on future developments.

As at 31 December 2006 the Society's margins of solvency exceeded the minimum requirements, as prescribed by the Financial Services Authority, for each class of relevant business.

Financial risk management objectives

The Group is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and policyholder liabilities. In particular, the key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations from contracts with policyholders.

The most important components of this financial risk are interest rate risk and equity price risk. These risks arise from open positions in interest rate and equity products, all of which are exposed to general and specific market movements.

The Group manages these positions within an asset liability management (ALM) framework that has been developed to achieve long-term investment returns in excess of its obligations under insurance and investment contracts. The principal technique of the Group's ALM is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to contract holders. For each distinct category of liabilities, a separate portfolio of assets is maintained.

For unit-linked contracts, the liabilities to policyholders are matched with assets in the portfolio. The Society therefore is not directly exposed to the price, currency, credit or interest risk for these contracts.

Interest rate risk

The Group is exposed to interest rate risk due to the sensitivity of the value of its assets and liabilities to changes in current interest rates.

The Group monitors interest rate risk by calculating the mean duration of the investment portfolio and the liabilities issued. The mean duration is an indicator of the sensitivity of the assets and liabilities to changes in current interest rates. The mean duration of the liabilities is determined by means of projecting expected cash flows from the contracts using best estimates of mortality and voluntary terminations. No future discretionary supplemental benefits are assumed to accrue. The mean duration of the assets is calculated in a consistent manner. Any gap between the mean duration of the assets and the mean duration of the liabilities is minimised by means of buying and selling fixed interest securities of different durations.

Equity price risk

The Group is exposed to equity price risk as a result of holdings in equity investments held by both the Society's unit linked funds and by the Unit Trusts that it manages. The Group's most significant income stream is derived as a fixed percentage of the market value of the unit-linked funds and Unit Trusts. Exposures to individual companies and to equity shares in aggregate are monitored in order to ensure compliance with the relevant regulatory limits for solvency purposes. Investments held are listed and traded on the UK and other recognised stock exchanges (primarily in Europe and North America).

The Group has a defined investment policy, which sets limits on the Group's exposure to equities both in aggregate terms and by geography, industry and counterparty. This is monitored by the Investment Sub-Committee of the Committee (see page 15).

Reappointment of auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Society will be proposed at the forthcoming Annual General Meeting on 24 May 2007.

Complaints

It is the Society's policy to investigate and resolve all complaints promptly and fairly but in the event that members are not satisfied with the Society's response, the Financial Ombudsman Service provides a complaints resolution service. Full details can be obtained from the Secretary or from the Society's website at www.family.co.uk

Health and safety report

The Society is committed to maintaining high standards of health and safety and environmental controls and can report as follows:

- there were no significant accidents involving employees or visitors during the year;
- where appropriate, employees attend health and safety training, to include manual handling and display screen equipment use; and
- there is a Committee of Representatives of Employee Safety, which meets regularly and includes senior managers.

Statement of responsibilities of the Committee of Management

The directors are elected and stand for re-election every three years unless they have served on the Committee in excess of nine years in which case they stand for re-election every year. Election, or re-election, is by majority vote at the AGM.

The Friendly Societies Act 1992 ('the Act') requires the Committee to prepare Accounts for each financial year which give a true and fair view of the state of the affairs of the Society and of the Group as at the end of the financial year and of the income and expenditure of the Society and of the Group for that period. In preparing those Accounts, the Committee is required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Accounts; and
- prepare the Accounts on a going concern basis unless it is inappropriate to presume that the Society will continue in business.

The Committee confirms that it has complied with the above requirements in preparing the Accounts.

The Committee is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Society and ensure that the Accounts comply with the Act. It is also responsible for safeguarding the assets of the Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Committee is responsible for the Society's systems of control and acknowledges that such systems can provide only reasonable and not absolute assurance against material misstatement or loss.

The Committee conducts, through the Audit Committee, an ongoing review of the effectiveness of the Group's systems of internal controls and risk management and is satisfied that there are no material shortcomings. The review is undertaken by means of receiving audit and management reports, attending risk management meetings, holding discussions with executive and operational management and reviewing the risk management process.

Where significant control shortcomings or risks are identified progress is monitored until the issue is satisfactorily resolved.

In accordance with the Act, the Committee confirms that all activities carried out during the year by the Society and its subsidiary undertakings are believed to have been carried out within their respective powers.

The Committee considers that the skills and experience of the non-executive directors provide an appropriate balance to ensure that the Society is effectively managed and controlled.

Liability insurance for officers

The Committee maintained liability insurance for officers of the Society throughout the year.

Corporate governance

The Society recognises the importance of, and is committed to, high standards of corporate governance. Corporate governance, often defined as the way a firm is controlled and directed from within, has been the subject of increasing focus for mutual organisations.

The Combined Code on Corporate Governance was introduced for listed companies from 2003. A new code for life mutuals, based on the existing Combined Code, became effective for accounting periods commencing 1 January 2006 (the Annotated Combined Code for Mutual Insurers (July 2005) as amplified by the Best Practice Guidelines for Mutual Insurers (December 2005)). The Society considers the Combined Code to be closely aligned to the standards that it has set itself and has endeavoured to comply with the main principles for many years even though it has not been required to do so.

The Committee has set the values and standards for the Society and its employees, taking account of the principles of the Combined Code, and requires senior management to report to the Committee on adherence.

The Committee considers that throughout the period under review it has applied and complied with all of the relevant principles and provisions of the Annotated Combined Code for Mutual Insurers.

Committee of Management's Annual Report

The Committee is primarily responsible for the strategic direction of the Society and delegates responsibility for the day-to-day running of the business to executive management. Progress on operational matters and key initiatives is reported through Committee meetings and all initiatives involving significant expenditure, strategic change, significant perceived risk or material departure from agreed budget or strategy require Committee consideration and approval.

The division of responsibilities between Robert Dolman, Chairman and John Reeve, Chief Executive has been agreed by the Committee and documented.

David Jude, Vice Chairman, undertakes the role of Senior Independent Director and upon his retirement from the Committee following the 2007 AGM he will be replaced in those roles by Robert Weir.

Anti-fraud measures

The Society fully supports the FSA's initiative on fighting financial crime and to this end has rolled out an anti-fraud management training programme across the Group. The programme includes managing potential fraud risk and is also linked to anti-money laundering. Regular fraud risk assessment occurs within the Society with this activity underpinned through the respective corporate anti-fraud and whistle-blowing policies.

The Society is also a member of the Investment Managers Association Fraud Alert Scheme whose main objectives are to protect member assets and work with the industry in reducing financial crime.

Attendance at meetings in 2006

The following table sets out the attendance of directors at regular Committee meetings and meetings of the Audit, Nominations, Remuneration and Investment committees held in 2006. The number of meetings that each director could have attended is shown in brackets.

Details of the activities of each individual committee are summarised below and the terms of reference for each committee can be found in the "member information" section of our website www.family.co.uk.

	Committee of Management	Nominations Committee	Audit Committee	Investment Sub-Committee	Remuneration Sub-Committee
Robert Dolman	(6) 6	(2) 2	–	(8) 8	(3) 3
David Jude	(6) 6	(2) 2	(3) 3	–	(3) 3
Veronica France	(6) 6	(2) 1[2]	–	–	–
Rachael Heyhoe-Flint	(6) 6	(2) 2	–	–	–
Norman Riddell	(6) 5[1]	(2) 1[2]	–	(8) 8	–
Robert Weir	(6) 5[1]	(2) 2	(3) 3	–	–
John Wybrew	(6) 5[1]	(2) 2	(3) 3	–	(3) 3
John Reeve	(6) 6	–	–	(8) 8	–
John Adams	(6) 6	–	–	–	–
Rob Edwards	(6) 6	–	–	–	–
Keith Meeres	(6) 6	–	–	–	–

Notes:

1 Mr. Weir and Mr. Wybrew were on holiday for the April meeting. Mr Riddell was on holiday for the December meeting.

2 Ms. France and Mr. Riddell did not attend the first Nominations Committee meeting as it was the meeting at which they were appointed.

The Chairman and non-executive directors meet independently of the executive directors at least four times a year.

In support of best practice, the Committee operates the following sub-committees:

Nominations Committee

Robert Dolman (Chairman)
Veronica France
Rachael Heyhoe-Flint
David Jude
Norman Riddell
Robert Weir
John Wybrew

The Nominations Committee comprises all non-executive directors and its chairperson is appointed by the Committee of Management. It may obtain such outside legal or other independent professional advice as it deems necessary.

The Nominations Committee meets at least once a year to review the structure, size and composition of the Committee of Management. It satisfies itself that there are appropriate succession plans in place for all directors and other senior management positions, and that all directors devote sufficient time to their duties.

The Nominations Committee makes recommendations to the Committee of Management regarding membership of the Audit Committee and the Remuneration and Investment Sub-Committees.

As mentioned elsewhere, David Jude and Rachael Heyhoe-Flint will retire from the Committee of Management following the 2007 AGM and they will therefore also retire from this Committee.

Investment Sub-Committee

Robert Dolman (Chairman)
John Reeve
Norman Riddell
Roger Nightingale (external adviser)

The Investment Sub-Committee generally meets eight times a year and is responsible for monitoring the Group's investment performance and for assessing the effectiveness of the investment strategy.

Remuneration Sub-Committee

Robert Dolman (Chairman)
David Jude
John Wybrew

The Remuneration Sub-Committee meets at least once a year to review remuneration policy and determines the remuneration packages of the executive directors and senior management. It works with the Group's Human Resources department, and independent external advisers where appropriate, to assess trends in the competitor and local employment markets.

The Committee of Management has appointed Robert Weir to replace David Jude on this committee following Mr. Jude's retirement from the Committee of Management immediately following the 2007 AGM. Mr. Wybrew will become Chairman of this Sub-Committee from 25 May 2007.

Details of the directors' remuneration can be found in the Remuneration Report on pages 19 to 21.

Audit Committee

David Jude (Chairman)
Veronica France (appointed 1 January 2007)
Robert Weir
John Wybrew

The Audit Committee generally meets three times a year and assists the Committee of Management in meeting its responsibilities in respect of the systems of internal control and external financial reporting. It considers the appointment of, and fees for, the external auditors and considers the effectiveness of Internal Audit, which has unrestricted access to the Audit Committee and the Committee of Management. It also takes an independent view of the appropriateness of the Group's accounting policies and practices.

The Audit Committee also undertakes the role of a "with-profits committee" in order to oversee the Society's with-profits business in accordance with Financial Services Authority rules, in particular the Principles and Practices of Financial Management published for each with-profits fund.

On behalf of the Committee of Management, the Audit Committee reviews the independence and objectivity of the external auditors before an appointment recommendation is made to members at the AGM. The nature and extent of non-audit work and related fees are regularly reviewed by the Audit Committee, and the Committee of Management has developed a policy setting out the terms and conditions for engaging the Society's external auditors to supply non-audit services that is designed to protect objectivity and independence.

The Committee of Management has appointed Robert Weir as Chairman of this Committee with effect from 25 May 2007 in order to replace David Jude who retires from the Committee of Management immediately following the 2007 AGM.

In addition to the above sub-committees a POIS Supervisory Board and a Risk Management Committee were maintained comprising directors and senior managers:

POIS Supervisory Board

The POIS Supervisory Board meets four times a year and is responsible for monitoring the performance of the business of POIS Assurance which transferred to the Society on 2 April 2002.

Risk Management Committee

The Risk Management Committee meets regularly to review the changing risks arising both from within the Group and from changes in the external environment and to consider appropriate strategies to mitigate those risks.

The Risk Management Committee monitors the adequacy of the systems of internal control which are embedded in the operations of the Group to ensure that management is capable of responding quickly to changing risks and that procedures are in place for reporting immediately to appropriate levels of management any major control weaknesses that are identified. The Risk Management Committee provides regular reports of its activities to the Committee of Management and Audit Committee.

Performance monitoring and evaluation

Each year the Committee of Management sets key business objectives for the Society for that year and as part of its rolling three year plan based on the objectives outlined in the business objectives and activities section on page 11. Performance against these objectives is monitored by the Committee at regular intervals.

In compliance with the Annotated Combined Code for Mutual Insurers, the Committee conducts a formal evaluation annually of the performance of the Chairman and each director and of the performance of the sub-committees and Committee as a whole. In 2006 the evaluation was conducted by questionnaires and reviewed by an independent consultant who provided a summary report to the Committee. No significant issues or material points of action arose from the 2006 review. In addition the Chairman holds periodic meetings with each executive director and formal meetings with the non-executive directors to evaluate the performance of the Committee.

Employees

The Group employed an average of 289 employees during 2006 at a total cost of £11m.

The Committee believes that the development and training of employees continues to be essential in order to ensure effective management of the Society and provision of appropriate service to members.

In 2006 we were delighted to have received a National Training Award in recognition of the training provided to our employees in preparation for our launch of the Child Trust Fund.

National Training Awards
Highly Commended 2006

Equal opportunities

It is the Society's policy to treat job applicants and employees in the same way, regardless of their sex, race, ethnic origin, religion, age, sexual orientation, marital or parental status, or disability. The Society is committed to recruiting, developing, progressing and training employees on the basis of their individual aptitude, competencies and performance.

Furthermore, the Society recognises that it has clear obligations towards all its employees and the community at large to ensure that people with disabilities are afforded equal opportunities to enter employment and progress within the Society.

In addition to complying with legislative requirements affecting the disabled, the Society will follow procedures designed to provide for fair consideration and selection of disabled applicants and to satisfy their training and career development needs. With this in mind, the Society has developed and maintained a strong link with charities. It aims at any one time to have two active placements within the Society, enhancing the future prospects for the client and those employees who are involved in support and mentoring.

If employees become disabled in the course of their employment steps will be taken, through retraining or redeployment if necessary, to enable them to remain in employment with the Society wherever possible. The policy applies equally to registered and non-registered disabled employees.

In 2006 the Society took appropriate steps, including the provision of training to managers, to comply with the new age discrimination laws. The Society has also enabled its employees to participate in the Government Childcare Voucher scheme.

Employee involvement

It is the Society's belief that excellent service to members, efficiency and high productivity are best achieved in a harmonious working environment with high levels of employee involvement. Timely, consistent, open and honest communications to and between all employees are an important part of this and we have a variety of mechanisms in place to achieve this, including employee question and answer forums with the executive directors and senior management, regular team briefings and an employee forum of elected representatives who meet regularly to consult on areas of concern, health and safety and any other issues raised by employees.

The Society also encourages and provides for continuing personal development in line with corporate objectives.

In 2006 the Society launched a new Values initiative with its employees in order to build upon and maintain the high levels of service that we aim to provide to our members. We have focused on five core values, which we aim to demonstrate in all dealings with our members: professionalism, respect, honesty, customer and commercial focus.

Corporate social responsibility

Our role as an institutional investor

The majority of the Society's funds are managed by New Star Institutional Managers Limited who have outsourced their corporate governance and research and proxy voting to Research, Recommendations and Electronic Voting (RREV).

RREV analyse all resolutions of the companies in which we invest in the context of the Combined Code on Corporate Governance in the UK, and its equivalents abroad, and vote according to best practice as so defined.

Where there is a very contentious issue it is referred to the appropriate fund manager to decide how to proceed.

Environmental matters

The Society and its employees are increasingly aware of the environmental issues facing us all and, whilst we operate from a single building, and do not have a significant impact on the environment, we take our responsibilities seriously. Our head office in Brighton was built in 1991 using ozone-friendly materials wherever possible. For example our office furniture is mostly made from oak from sources where comprehensive planning and reforestation are enforced. The softwood used in the building originates from sustainable sources, and non-lead based paint is always used. In 2006 we were pleased to receive the first Environment Stewardship Award from Tandus Europe to recognise the recycling of our carpet tiles.

The building and business continues to be managed in an environmentally friendly manner. The air conditioning and heating systems are acoustically controlled to prevent noise pollution, and we recycle wherever possible, including printer toner cartridges and paper. Nonetheless in 2006 we commissioned an independent environmental monitoring survey which shows where we might make further improvements and at the same time possibly achieve cost savings.

Working in the community

Our community programme, which has won several awards, is now in its sixteenth year. The Society actively encourages employees to take an active role in supporting their local community. This philosophy of putting something back into the community not only benefits the local community, but is also an opportunity for employees to develop their skills. In 2004 the community programme was reviewed in line with the Society's key strategies and business opportunities with the launch of the CTF in 2005. This review resulted in the Society, with the support of Brighton and Hove City Council, sponsoring a series of art based workshops with nurseries. These workshops benefited not only the children, but also the teachers and the parents. The Society continued this sponsorship of nurseries in 2006 and included three Sure Start Children's Centres, offering health guidance to parents on a wide range of issues from healthy eating to smoking.

The Society continues to support our core community projects – Blatchington Mill School, Middle Street Primary School, Brighton and Hove City College and Age Concern.

We continued our initiative to invite college students to get valuable interview experience by applying for and attending mock interviews, and getting feedback on their performance. This project was also useful for hands-on training and development of the employees who took part.

In addition the Society staged the fourth annual Family Festival in June, a showcase event for the performing arts in which more than 400 young performers took part.

The Society encourages all employees to take part in our community programme, and in 2006 over 30 employees took part in employee development projects, whilst over 50 took part in challenges.

During 2006 with donations and fundraising activities £19,000 (2005: £4,000) was raised to support local charities and the local activities of national charities. Over the past eleven years the Society has raised over £110,000 for local charities. The Society has also made small donations, via the Share Foundation, to Child Trust Fund accounts of children in care. No political donations were made.

Photograph courtesy of Blatchington Mill School

Family Festival

More than 400 young performers from 13 different schools and community groups took part in the fourth annual Family Festival at Hove Town Hall on 27 June 2006.

The showcase event for performing arts included dance, drama, samba, breakdance, singing, musical theatre and even Stomping! The grand finale was a mass choir performance in which all the performers took part. By kind permission of the Brighton Festival, the young people sang 'City by the Sea' which is Brighton Festival's 40th Birthday song.

Hove Town Hall was beautifully decorated with screen printed flags created by participating students with local artists Lindsey Smith and Nancy Evans.

A Youth Arts Exhibition in the foyer gave young people and their parents the opportunity to find out about local youth arts events, activities and courses.

The event was funded and organised by Blatchington Mill School who were very grateful to receive sponsorship from Family Investments.

Photograph courtesy of Blatchington Mill School

The schools and community groups that took part were: Downs Park School, The Southern Knights, Blatchington Mill School, Westdene Primary School, West Hove Junior School, Aldrington CE School, Somerhill Junior School, Longhill High School, Stagecoach Dance Troupe, St. Andrew's CE School, Middle Street Primary School, New Moves (South East Dance) and The Blatch Children's Dance Group.

Keith Meeres, Secretary
March 2007

Remuneration Report

This report sets out the Society's policy in relation to the remuneration of directors. The report, which will be submitted to the forthcoming AGM for approval, explains how the Society has applied the Annotated Combined Code for Mutual Insurers as regards directors' remuneration. No director is involved in the determination of, or votes on, any matter relating to their own remuneration.

Remuneration Sub-Committee

The role of the Remuneration Sub-Committee is outlined on page 15.

Advisers to the Committee

During the year the Remuneration Sub-Committee engaged the services of Kelham Corporate Consulting (Kelham), a firm of independent advisers, to provide advice and guidance on directors' and senior management remuneration. Kelham also provided advice and guidance to the Society's Human Resources department during the year.

Remuneration Policy

The Society's remuneration policy is designed to attract, motivate and retain key executives, and indeed all employees, with the relevant skills to help achieve the Group's objectives and to ensure that employees are rewarded for enhancing the level of service that we provide to our members. It is also designed to achieve an effective link between pay and performance.

During the year the Sub-Committee undertook a comprehensive benchmarking exercise, again with the assistance of Kelham, as regards the remuneration of executive directors and senior management, to ensure that salaries are in line with salaries for comparable positions in similar financial organisations.

Service contracts

It is the Society's policy that the notice period of executive directors' service contracts should not exceed one year. None of the non-executive directors has a service contract.

Fees for non-executive directors are reviewed each year.

Remuneration components comprise:

Base salary

Base salaries are determined by individual performance and by reference to market salary levels obtained from independent sources. This is the only element of remuneration which is pensionable. In order to contain future pension scheme costs, from 1 January 2006, pensionable salaries will increase by a maximum of RPI. Any increase in base salary above RPI will be non-pensionable.

Long term incentive scheme

The four executive directors, together with eight senior managers, are included within a bonus scheme targeted at increasing the embedded value of the Society. Payments are capped as a percentage of salary.

The long term incentive is achieved by withholding one third of the total bonus due for a period of three years during which period the accrued amount may rise or fall as determined by the increase or reduction in the Society's embedded value.

Amounts accrued for executive directors at the year end are disclosed on the following page.

Pension

The Society operates a defined benefit pension scheme (now closed to new members) in which the executive directors participate. The scheme is non-contributory.

Other benefits

The Society provides other benefits to the executive directors including life assurance and private medical insurance.

Remuneration Report

Committee of Management remuneration

	Salary/Fees[1/2]		*Bonuses[3]*		*Other benefits[4]*		*Total*	
	2006	*2005*	*2006*	*2005*	*2006*	*2005*	*2006*	*2005*
	£'000	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*
Executives								
John Reeve	212	206	59	41	17	13	288	260
John Adams	145	141	41	29	6	3	192	173
Rob Edwards	148	141	35	17	5	6	188	164
Keith Meeres	117	107	28	14	7	5	152	126
Non-executives								
Robert Dolman	63	61	–	–	–	–	63	61
David Jude	28	26	–	–	–	–	28	26
Veronica France	20	–	–	–	–	–	20	–
Rachael Heyhoe-Flint	20	18	–	–	–	–	20	18
Norman Riddell	28	–	–	–	–	–	28	–
Robert Weir	23	20	–	–	–	–	23	20
John Wybrew	23	20	–	–	–	–	23	20
	827	**740**	**163**	**101**	**35**	**27**	**1025**	**868**

Note[1] - Non pensionable allowances paid to executives are disclosed as Salary/Fees (disclosed as 'Other benefits received' in the 2005 Annual Report and Accounts).

Note[2] - Two new non-executive directors were appointed in February 2006 to replace the two who are due to retire in May 2007. Excluding these appointments, year on year growth in the Salaries and Fees paid to the Committee of Management has increased by 5.3%.

Note[3] - Bonuses include amounts added to the long term incentive scheme.

Note[4] - Includes increase in accrued pension during the year.

Long term incentive scheme

	Value at 1.1.06 £'000	*Embedded value increase during 2006[1] £'000*	*Bonus added during 2006 £'000*	*Amount withdrawn during 2006 £'000*	*Value at 31.12.06 £'000*
Executives					
John Reeve	106	11	16	–	133
John Adams	82	9	11	–	102
Rob Edwards	13	1	11	–	25
Keith Meeres	10	1	9	–	20

Note[1] - embedded value increased by 10.6% during the year.

Pension entitlements

The executive directors have retirement benefits accruing under the Society's defined benefit pension scheme during the year. The table below sets out these benefits:

	Age	*Total accrued pension at 31.12.06[1] £'000*	*Increase in total accrued pension during 2006 £'000*	*Transfer value of accrued pension at 31.12.06[2] £'000*	*Change in transfer value during the year net of directors' contributions[3] £'000*
Executives					
John Reeve	59	113	14	1,301	368
John Adams	52	45	4	405	118
Rob Edwards	51	40	3	354	108
Keith Meeres	49	45	5	326	111

The main terms applying to the final salary pension of each executive director are that their pension is payable from normal retirement age of 65 and that a spouse's pension is payable on death at 50% of that executive director's pension.

Note[1] - The total accrued pension is the amount which the executive director would have been entitled to from normal retirement age if they had left service on 31 December 2006.

Note[2] - The transfer values have been calculated in accordance with the Actuarial Guidance Note GN11.

Note[3] - No contributions were payable by the executive directors during the year.

Independent Auditors' Report

TO THE MEMBERS OF FAMILY ASSURANCE FRIENDLY SOCIETY LIMITED

We have audited the financial statements of Family Assurance Friendly Society Limited for the year ended 31 December 2006 which comprise the primary financial statements such as the Income and Expenditure Account, the Balance Sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein. We are also required to report on the Committee of Management's Annual Report for the year ended 31 December 2006.

Respective responsibilities of the Committee of Management and Auditors

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

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Society's members as a body in accordance with the Friendly Societies Act 1992 and the Regulations made under it and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Friendly Societies Act 1992 and the Regulations made under it. In addition we report to you if, in our opinion, the Society has not kept proper accounting records, or if we have not received all the information, explanations and access to documents that we require for our audit.

We also report to you our opinion as to whether the Committee of Management's Annual Report has been prepared in accordance with the Friendly Societies Act 1992 and the Regulations made under it, and as to whether the information given therein is consistent with the accounting records and the financial statements.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Chairman's Review, the Chief Executive's Operational Report, the Committee of Management's Annual Report and the Remuneration Report. We consider the implications for our audit report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Committee of Management in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Society's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Society's and the Group's affairs as at 31 December 2006 and of the income and expenditure of the Society and the Group for the year then ended, and have been properly prepared in accordance with the Friendly Societies Act 1992 and the Regulations made under it.

- the Committee of Management's Annual Report has been prepared in accordance with the Friendly Societies Act 1992 and the Regulations made under it, and the information given therein is consistent with the accounting records and the financial statements for the financial year.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors, London
21 March 2007

Income and Expenditure Account

TECHNICAL ACCOUNT – LONG TERM BUSINESS

for the year ended 31 December 2006

Notes		*Group 2006 £'000*	*Society 2006 £'000*	*Group 2005 £'000*	*Society 2005 £'000*
2	Earned premiums	72,983	72,983	83,361	83,361
	Outward reassurance premiums	(308)	(308)	(354)	(354)
	Earned premiums, net of reassurance	72,675	72,675	83,007	83,007
3	Investment income	47,536	47,536	49,274	49,274
3	Unrealised gains on investments	14,639	14,235	113,629	111,724
3	Realised gains on investments	40,280	40,280	19,613	19,613
5	Other technical income	4,531	–	3,376	–
	Total Technical Income	**179,661**	**174,726**	**268,899**	**263,618**
	Claims incurred, net of reassurance				
	Claims paid				
	Gross amount	(166,017)	(166,017)	(186,383)	(186,383)
	Reassurers' share	124	124	144	144
		(165,893)	(165,893)	(186,239)	(186,239)
17	Change in provision for claims				
	Gross and net amount	(915)	(915)	(1,784)	(1,784)
	Net claims incurred	(166,808)	(166,808)	(188,023)	(188,023)
17	**Change in technical provisions, net of reassurance**				
	Long term business provision, net of reassurance				
	Gross amount	15,082	15,082	9,353	9,353
	Reassurers' share	(37)	(37)	(1)	(1)
		15,045	15,045	9,352	9,352
	Other technical provision, net of reassurance				
	Technical provision for linked liabilities	(3,529)	(3,529)	(64,095)	(64,095)
	Net change in technical provisions	11,516	11,516	(54,743)	(54,743)
	Other expenditure				
4	Net operating expenses	(15,000)	(15,000)	(18,938)	(18,938)
3	Investment expenses and charges	(3,543)	(3,543)	(2,595)	(2,595)
5	Other technical charges	(5,107)	–	(5,280)	–
		(23,650)	(18,543)	(26,813)	(21,533)
	Total Technical Charges	**(178,942)**	**(173,835)**	**(269,579)**	**(264,299)**
	Surplus/(deficit) of technical income over technical charges before taxation	**719**	**891**	**(680)**	**(681)**
6	Tax attributable to the long term business	134	(38)	(423)	(422)
	Surplus/(deficit) on technical account – long term business	**853**	**853**	**(1,103)**	**(1,103)**
21	Actuarial gain/(loss) on pension scheme	1,673	1,673	(1,888)	(1,888)
17	Transfer (to)/from the fund for future appropriations	**(2,526)**	**(2,526)**	**2,991**	**2,991**
	Balance on the technical account – long term business	**–**	**–**	**–**	**–**

The Group and Society have no recognised gains or losses other than those included in the movements on the Technical Account and therefore no separate statement of recognised gains and losses has been presented.

Balance Sheet

ASSETS

as at 31 December 2006

Notes		*Group 2006 £'000*	*Society 2006 £'000*	*Group 2005 £'000*	*Society 2005 £'000*
	Investments				
9	Land and buildings	2,129	2,129	3,837	3,837
10	Investments in group undertakings				
	Investments in subsidiaries	–	10,244	–	5,648
11	Other financial investments				
	Shares, variable yield securities and units in unit trusts	10,753	10,402	11,009	10,103
	Debt securities and other fixed income securities	120,783	120,783	135,473	135,473
	Deposits with credit institutions	22,290	13,919	21,323	17,044
		155,955	157,477	171,642	172,105
12	**Assets held to cover linked liabilities**	1,165,897	1,165,897	1,162,368	1,162,368
	Reassurers' share of technical provisions				
	Long term business provision	480	480	517	517
	Other assets				
13	Tangible assets				
	Fixtures, fittings and equipment	269	269	337	337
14	Other debtors	3,137	2,640	2,620	2,235
	Cash at bank and in hand	3,567	3,109	2,453	2,231
	Prepayments and accrued income				
	Accrued interest and rent	1,984	1,984	1,878	1,878
	Other prepayments and accrued income	908	908	1,071	1,071
21	**Pension asset**	2,960	2,960	568	568
		1,335,157	1,335,724	1,343,454	1,343,310

Balance Sheet

LIABILITIES

as at 31 December 2006

Notes		*Group 2006 £'000*	*Society 2006 £'000*	*Group 2005 £'000*	*Society 2005 £'000*
17	**Reserves**				
	Fund for future appropriations	48,999	48,999	46,473	46,473
17	**Technical provisions**				
	Long term business provision	109,710	109,710	124,792	124,792
	Claims outstanding	4,403	4,403	3,488	3,488
17	**Technical provision for linked liabilities**	1,165,897	1,165,897	1,162,368	1,162,368
15	**Creditors**				
	Other creditors, including taxation and social security	3,638	4,676	3,845	4,707
	Accruals and deferred income	2,510	2,039	2,488	1,482
		1,335,157	1,335,724	1,343,454	1,343,310

Approved by the Committee of Management on 21 March 2007, and signed on its behalf by:

Robert Dolman, Chairman

John Reeve, Chief Executive

Notes to the Accounts

1 PRINCIPAL ACCOUNTING POLICIES

Basis of accounting
The Accounts have been prepared in accordance with The Friendly Societies (Accounts and Related Provisions) Regulations 1994 ('Regulations') and in accordance with applicable Accounting Standards in the United Kingdom including the guidance provided by the Association of British Insurers in their Statement of Recommended Practice ('ABI SORP') dated December 2005.

Basis of consolidation
The Group Accounts comprise the assets, liabilities and profit and loss account transactions of the Society together with its subsidiary undertakings. The activities of the Society and the Group are accounted for in the Technical Account – Long Term Business. The results of subsidiary undertakings are included from the date of acquisition.

Premiums
Premiums for non-linked business are accounted for on a receivable basis. Premiums for unit-linked business are accounted for when the policy liability is established.

Outward reassurance premiums are accounted for in accordance with the contract terms when due, reflecting the period in which risk is transferred.

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

Dividends are included as investment income on the date that the shares become quoted ex-dividend. Interest, rents and expenses are included on an accruals basis.

Realised gains and losses on investments are calculated as the difference between net sales proceeds and original cost. Unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price, or if they have been previously valued, their valuation at the last balance sheet date. The movement in unrealised gains and losses recognised in the year also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Claims
Maturity claims and annuities are charged against revenue when due for payment. Surrenders are accounted for when paid or, if earlier, on the date the policy ceases to be included within the calculation of the long term business provision and/or the technical provision for linked liabilities. Death claims and all other claims are accounted for on notification.

Claims payable include all related internal and external claims handling costs. Reassurance recoveries are accounted for in the same period as the related claim.

Pensions costs
The Group operates a defined benefit pension scheme, the Family Assurance Friendly Society Limited Staff Pension Scheme ('the Scheme'). The Scheme's funds are administered by trustees and are independent of the Group's finances. The Scheme is valued every three years by a professionally qualified independent actuary, the rates of contribution payable being determined by the actuary. In intervening years the actuary reviews the continuing appropriateness of the rates.

The pension asset recognised in the balance sheet is the value of the Scheme's assets less the present value of the Scheme's liabilities.

The pension cost for the Scheme is analysed between current service cost, past service cost and net return on pension scheme assets. 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 Technical Account – Long Term Business on a straight line basis over the period in which the increase in benefits vest.

Net expected return on the pension asset comprises the expected return on the pension scheme assets less interest on pension scheme liabilities.

The actuarial gains and losses, which arise from a valuation and from updating the latest actuarial valuation to reflect conditions at the balance sheet date, are included as a separate line in the Technical Account – Long Term Business immediately above the line for transfer to or from the fund for future appropriations and are reflected in that transfer.

The defined benefit scheme is closed to new entrants. In its place the Society makes pension contributions to a defined contribution stakeholder pension scheme on behalf of new staff when they become eligible for pension benefits. Contributions are reflected in the Technical Account – Long Term Business in the period the contributions become payable.

Investments
Investments are stated at market value at the balance sheet date. Any appreciation or impairment in value during the year is accounted for in the Technical Account – Long Term Business.

Investments in subsidiary undertakings are stated at net asset value, which the directors do not believe is materially different from current value.

Land and buildings, other than those occupied by the Society, are valued by the Committee of Management at open market value, determined by reference to the indicative selling price. Land and buildings occupied by the Society are valued annually by independent professional advisors at market value based on vacant possession. No depreciation is provided on owner-occupied properties as it is considered that their useful economic lives and residual values are such that their depreciation is immaterial, both individually and in aggregate. An impairment review is also performed on owner-occupied properties.

Under the Friendly Societies Act 1992, land and buildings are required to be depreciated over their expected useful economic lives. In respect of investment properties, this requirement conflicts with the generally accepted accounting principle set out in SSAP 19, that no depreciation should be provided in respect of such investments. The Committee of Management considers that to depreciate the investment properties would not give a true and fair view and accordingly the provisions of SSAP 19 have been adopted. Depreciation is only one of the factors reflected in the annual valuations, and the amounts which might otherwise have been shown cannot reasonably be separately identified or quantified.

Unrealised gains and losses arising on the revaluation of land and buildings are taken to the Technical Account – Long Term Business.

Assets held to cover linked liabilities
Assets held to cover linked liabilities reflect the terms of the related policies and are valued on a basis consistent with the related liabilities.

Reassurers' share of technical provisions
The reassurers' share of technical provisions is calculated on a basis consistent with that of the corresponding liabilities.

Notes to the Accounts

1 PRINCIPAL ACCOUNTING POLICIES (continued)

Deferred tax
Deferred tax is calculated on a full provision basis and consists of the estimated taxation, or relief from taxation, which is expected to arise in the foreseeable future from material timing differences using expected future rates of tax where applicable. Credit is taken for relief from trading losses only to the extent that the Committee of Management anticipates that profits will absorb such losses in the foreseeable future.

Tangible assets
Tangible assets are valued at cost less depreciation or amortisation. Depreciation or amortisation is provided on tangible assets at rates calculated to write-off the cost of each asset over its expected useful life as follows:

Furniture, fixtures and fittings and office equipment	2 years
Computer hardware	4 years
Computer software	1 - 4 years

Research and development expenditure
Research and development expenditure represents computer software and product development costs incurred and written off during the year.

Foreign currencies
Assets and liabilities denominated in foreign currencies are translated into sterling at rates of exchange ruling at the balance sheet date. Foreign exchange differences, which arise principally on the investment portfolio, are included in investment gains and losses in the Technical Account – Long Term Business.

Fund for future appropriations
The fund for future appropriations incorporates amounts for which allocation has not yet been determined between the different categories of policyholders based on the Rules and Tables of the Society. Transfers to and from this fund reflect the excess or deficiency of income over expenditure arising from the business underwritten by the Society.

This fund includes surpluses arising on the former Family Life Assurance Limited closed funds and on the former POIS Assurance Limited closed fund which are ring fenced according to the transfer of engagements agreements.

Long term business provision
The long term business provision is determined by the Society's actuary following the annual investigation of the long term business, and is calculated initially on a statutory solvency basis to comply with the reporting requirements of the Integrated Prudential Sourcebook for Insurers. The calculation in respect of term assurance and annuities in payment uses the gross premium valuation method, the calculation for all other types of business uses the net premium valuation method and as such, includes explicit provision for vested bonuses (including those vesting following the current valuation). Implicit provision is made for future reversionary bonuses, but not terminal bonuses, by means of a reduction in the valuation rate of interest. The valuation is then adjusted for certain items, including the removal of certain contingency and other reserves. This adjusted basis is referred to as the modified statutory solvency basis.

The long term business provision includes the life cover and expenses associated with the linked liabilities of the Society.

Segmental reporting
In the opinion of the Committee of Management, the Group operates in one business segment being that of long term insurance and retail investment business in the United Kingdom.

2 PREMIUM ANALYSIS

All business is written in the United Kingdom and is direct business relating exclusively to individual policyholders.

		Group and Society	
		2006	*2005*
a)	**Gross premiums written:**	*£'000*	*£'000*
	Life assurance business:		
	Linked	62,326	72,316
	Non-linked	7,919	9,162
	Pension business:		
	Linked	2,351	1,541
	Annuity business	387	342
	Total gross premiums written	72,983	83,361
	Regular premiums	69,906	81,176
	Single premiums	3,077	2,185
	Total gross premiums written	72,983	83,361

		Society 2006		*Society 2005*	
		Single	*Regular*	*Single*	*Regular*
b)	**Gross new business premiums:**	*£'000*	*£'000*	*£'000*	*£'000*
	New business premiums	726	2,960	644	2,986

In classifying new business premiums the following basis of recognition is adopted:
- Incremental increases under existing policies are classified as new business premiums.
- Where regular premiums are received other than annually the regular new business premiums are on an annualised basis.
- Products substituted due to the exercise of standard contract terms are not included in the new business statistics.
- New recurrent single premium contracts, including Department for Work and Pensions rebates on certain pension products, are included in annual new business premiums to the extent that they are deemed likely to renew.

		Group	*Society*	*Group*	*Society*
		2006	*2006*	*2005*	*2005*
c)	**Contributions received for Child Trust Fund, Equity ISAs and direct unit trust investments:**	*£'000*	*£'000*	*£'000*	*£'000*
	Regular contributions	28,802	–	16,380	–
	Single contributions	68,779	–	73,009	–
		97,581	–	89,389	–

Contributions relate to business conducted by three of the Society's regulated subsidiaries, Family Equity Plan Limited, Family PEP Managers Limited and Family Investment Management Limited. The business is defined as retail investment business and accordingly the contributions received are not included in 'Earned premiums' as disclosed in the Technical Account – Long Term Business. The income and expenditure from this business is included in 'Other technical income' and 'Other technical charges' as disclosed in the Technical Account – Long Term Business (see note 5).

		Number of policies		*Number of policies*	
		Group	*Society*	*Group*	*Society*
d)	**Average number of policies on file:**	*2006*	*2006*	*2005*	*2005*
	Continuing business	901,303	549,085	763,995	601,690

3 INVESTMENT RETURN SUMMARY

	Group 2006 £'000	Society 2006 £'000	Group 2005 £'000	Society 2005 £'000
Investment income:				
Income from listed investments	35,373	35,373	38,965	38,965
Income from other investments	11,713	11,713	10,024	10,024
Net return on pension scheme (see note 21)	450	450	285	285
	47,536	47,536	49,274	49,274
Investment expenses and charges:				
Investment management expenses, including interest	(3,543)	(3,543)	(2,595)	(2,595)
Unrealised gains on investments	14,639	14,235	113,629	111,724
Realised gains on investments	40,280	40,280	19,613	19,613
Net investment return included in the Technical Account – Long Term Business	98,912	98,508	179,921	178,016

4 NET OPERATING EXPENSES

	Group 2006 £'000	Society 2006 £'000	Group 2005 £'000	Society 2005 £'000
Acquisition costs:				
Incurred in the year: Commission	1,208	1,208	955	955
Other acquisition expenses	4,616	4,616	8,454	8,454
Charge for the year	5,824	5,824	9,409	9,409
Research and development costs	1,236	1,236	1,989	1,989
Administration expenses	7,940	7,940	7,540	7,540
	15,000	15,000	18,938	18,938
Included in net operating expenses and other technical charges are:				
Depreciation charge for the year (see note 13)	255	255	388	388
Interest and similar charges made in respect of bank overdrafts	75	69	20	20
Remuneration of the Auditors in respect of audit and related services:	211	156	217	168
Statutory audit – Society	105	105	110	110
Statutory audit – Subsidiaries	37	–	39	–
Auditing of staff pension scheme	21	21	–	–
Auditing of certain unit trusts	10	–	10	–
Tax services	38	30	58	58

5 OTHER TECHNICAL INCOME AND CHARGES

	Group 2006 £'000	Society 2006 £'000	Group 2005 £'000	Society 2005 £'000
Other technical income:				
Income generated in subsidiary companies	4,531	–	3,376	–
Other technical charges:				
Expenses incurred in subsidiary companies	5,107	–	5,280	–

6 TAXATION

	Group 2006 £'000	Society 2006 £'000	Group 2005 £'000	Society 2005 £'000
UK Corporation tax:				
Current year	59	59	682	681
Tax payable on unrealised gains on unit-linked assets	60	60	70	70
Adjustments in respect of prior periods	(253)	(81)	(329)	(329)
	(134)	38	423	422

The Society's main product, the Family Bond, represents tax-exempt business under Section 460 of the Income and Corporation Taxes Act 1988. The Society also writes taxable business, principally temporary annuities, together with other life and pensions business.

A taxation liability of £119k (2005: £751k) relating to taxable business has been provided for. Taxes have been charged at various rates ranging from 20% to 30% (2005: 20% to 30%).

	Group 2006 £'000	Society 2006 £'000	Group 2005 £'000	Society 2005 £'000
Deferred tax liability:				
Unit trust deemed disposals	(230)	(230)	(155)	(155)
Unrealised capital gains on equity assets	–	–	(94)	(94)
Unrealised capital gains on property assets	(48)	(48)	–	–
Actuarial reserves	(8)	(8)	–	–
Deferred tax liability	(286)	(286)	(249)	(249)
Deferred acquisition expenses	286	286	249	249
Deferred tax balance	–	–	–	–

There is an unrecognised deferred tax asset of £627k (2005: £539k), of which £286k (2005: £249k) has been set aside to offset unrecognised deferred tax liabilities. The balance of £341k (2005: £290k) represents the net unrecognised deferred tax asset. This balance comprises, inter-alia, two principal components: ISA tax losses, which are being carried forward to future periods to offset any future taxable profits arising on ISA business, and deferred acquisition expenditure which will unwind in future periods to reduce taxable income arising from life business. The Society has taken the view that there is insufficient evidence that the net deferred tax asset will be recoverable, and has therefore decided not to recognise any benefit.

Notes to the Accounts

7 EMPLOYEE INFORMATION

	Group 2006 Number	*Society 2006 Number*	*Group 2005 Number*	*Society 2005 Number*
The average numbers of employees (including Committee of Management) during the year were:				
Marketing	14	14	20	20
Investments	10	10	10	10
Administration and finance	265	265	288	288
	289	289	318	318

	Group 2006 £'000	*Society 2006 £'000*	*Group 2005 £'000*	*Society 2005 £'000*
Staff costs for the above employees were:				
Wages and salaries	9,105	9,105	9,321	9,321
Pension costs	1,135	1,135	1,354	1,354
Social security costs	765	765	798	798
	11,005	11,005	11,473	11,473

All employees are employed and remunerated directly by the Society.

8 COMMITTEE OF MANAGEMENT EMOLUMENTS

	Group 2006 £'000	*Society 2006 £'000*	*Group 2005 £'000*	*Society 2005 £'000*
Fees and benefits to the Chairman and non-executive directors	205	205	145	145
Salaries and benefits to executive directors	631	631	601	601
Performance related bonuses	163	163	101	101
Increase in total accrued pensions	26	26	21	21
	1,025	1,025	868	868

Chairman

The aggregate remuneration paid, comprising salary and benefits, to Mr. Robert Dolman for the year ended 31 December 2006 amounted to £63k (2005: £61k).

Highest paid Committee member

The aggregate remuneration paid to Mr. John Reeve for the year ended 31 December 2006, comprising salary, benefits and the change in his accrued pension during the year, amounted to £288k (2005: £260k). Had Mr. Reeve left service and pensionable service in the Staff Pension Scheme at 31 December 2006, his deferred pension at leaving would have been £113k per annum (2005: £99k per annum).

Pension contributions

All of the executive directors had retirement benefits accruing under defined benefit pension schemes during the year. There were no other pension contributions paid by the Society for the benefit of any of the directors during the year.

Further details of the emoluments of the Committee of Management can be found in the Remuneration Report on pages 19 to 21.

Long term incentive scheme

The executive directors had benefits under a long term incentive scheme during the year. The scheme is targeted at increasing the embedded value of the Society and amounts accrued, for the benefit of the executive directors, as at 31 December 2006 are £280k (2005: £211k). Benefits are receivable three years after the bonus declaration, contingent on the overall improvement of the Society's embedded value. The criteria used for determining executive directors' bonuses are the same as those which apply to the general bonus scheme applicable to all staff and bonuses are capped as a percentage of salary.

9 LAND AND BUILDINGS

	Group 2006 £'000	*Society 2006 £'000*	*Group 2005 £'000*	*Society 2005 £'000*
Movements during the year:				
As at 1 January	3,837	3,837	4,086	4,086
Disposals	(1,750)	(1,750)	–	–
Revaluation during the year	42	42	(249)	(249)
As at 31 December	2,129	2,129	3,837	3,837
Types of land and buildings held at 31 December:				
Investment property – Freehold	–	–	2,000	2,000
Owner-occupied – Short leasehold	2,129	2,129	1,837	1,837
	2,129	2,129	3,837	3,837
Cost of land and buildings held at 31 December:				
Investment property – Freehold	–	–	2,560	2,560
Owner-occupied – Short leasehold	1,626	1,626	1,626	1,626
	1,626	1,626	4,186	4,186

Land and buildings were valued for the purpose of the 2006 and 2005 Annual Report and Accounts at open market value on vacant possession basis. The valuation of the Owner-occupied property was made by Nelson Bakewell, a firm of independent Chartered Surveyors, on 4 December 2006. The Investment property was sold during the year.

10 INVESTMENT IN GROUP UNDERTAKINGS

Subsidiaries	*Society 2006 £'000*	*Society 2005 £'000*
Ordinary shares at directors' valuation:		
As at 1 January	5,648	7,553
Purchase of Share Capital	5,000	–
Revaluation during the year	(404)	(1,905)
As at 31 December	10,244	5,648

On 8 May 2006 Family Equity Plan Limited issued 5 million £1 shares at par to the Society for cash.

The Society owns 100% of the ordinary share capital of all its subsidiaries, all of which are registered in England and Wales, are included in the Group accounts and are listed below:

Names of subsidiaries	**Nature of Business**
Family Investment Management Limited	Unit trust manager
Family Equity Plan Limited	CTF, ISA and PEP manager
Family PEP Managers Limited	PEP manager
Family Enterprise Limited	Administrative services
Family Assurance Staff Pension Scheme Trustees Limited	Corporate trustee of the Staff Pension Scheme
Post Office Insurance Society Trustees Limited	Dormant
Family.co.uk Limited	Dormant

Notes to the Accounts

11 OTHER FINANCIAL INVESTMENTS

	Group 2006 £'000	Society 2006 £'000	Group 2005 £'000	Society 2005 £'000
At cost:				
Shares, variable yield securities and units in unit trusts	8,576	8,225	8,545	7,639
Debt securities and other fixed income securities	124,428	124,428	135,680	135,680
Deposits with credit institutions	22,290	13,919	21,323	17,044
	155,294	146,572	165,548	160,363
Included in other financial investments are investments, listed on a recognised investment exchange, with market values of:				
Shares, variable yield securities and units in unit trusts	10,814	10,402	11,211	10,103
Debt securities and other fixed income securities	118,117	118,117	133,100	133,100
	128,931	128,519	144,311	143,203

12 ASSETS HELD TO COVER LINKED LIABILITIES

	Group and Society 2006 £'000	2005 £'000
Market value as at 31 December	1,165,897	1,162,368
Cost as at 31 December	986,701	1,001,596

13 TANGIBLE ASSETS

	Group and Society			
	Equipment £'000	Computer hardware £'000	Computer software £'000	Total £'000
At cost:				
As at 1 January 2006	2,105	2,400	3,806	8,311
Additions	15	155	17	187
Disposals	(26)	(392)	–	(418)
As at 31 December 2006	2,094	2,163	3,823	8,080
Accumulated depreciation:				
As at 1 January 2006	2,043	2,125	3,806	7,974
Charge for the year	70	168	17	255
Eliminated on disposals	(27)	(391)	–	(418)
As at 31 December 2006	2,086	1,902	3,823	7,811
Net book value as at 31 December 2006	8	261	–	269
Net book value as at 31 December 2005	62	275	–	337

14 OTHER DEBTORS

	Group 2006 £'000	Society 2006 £'000	Group 2005 £'000	Society 2005 £'000
Amounts falling due within one year:				
Amounts owed by linked funds	653	653	345	345
Loans to members	1,118	1,118	1,368	1,368
Taxation recoverable	410	410	36	14
Sundry debtors	956	459	871	508
	3,137	2,640	2,620	2,235

15 OTHER CREDITORS

	Group 2006 £'000	Society 2006 £'000	Group 2005 £'000	Society 2005 £'000
Due to subsidiary undertakings	–	1,281	–	1,302
Taxes payable	548	545	934	567
Sundry creditors	3,090	2,850	2,911	2,838
	3,638	4,676	3,845	4,707

16 ASSETS OF THE LONG TERM BUSINESS

	Group and Society 2006 £'000	2005 £'000
The total assets relating to the long term business are:		
Assets held to cover linked liabilities	1,165,897	1,162,368
Investments	99,560	113,902
Deposits and cash at bank	14,876	14,946
Debtors, prepayments and accrued income	3,364	3,551
Reassurers' share of technical provisions	480	517
	1,284,177	1,295,284

17 POLICYHOLDER LIABILITIES AND RESERVES IN RESPECT OF THE SOCIETY AND THE GROUP

	Long term business technical provision £'000	Technical provision for linked liabilities £'000	Claims outstanding £'000	Fund for future appropriations £'000
Technical provisions as at 1 January 2006	124,792	1,162,368	3,488	46,473
Changes in technical provisions:				
Gross change in technical provisions, net of reassurance	(15,045)	3,529	915	–
Reassurers' share of the change in technical provisions	(37)	–	–	–
Transfer to the Technical Account – Long Term Business	–	–	–	2,526
Technical provisions as at 31 December 2006	109,710	1,165,897	4,403	48,999

Notes to the Accounts

17 POLICYHOLDER LIABILITIES AND RESERVES IN RESPECT OF THE SOCIETY AND THE GROUP (continued)

Principal assumptions:

The valuation of non-linked with-profits business has been carried out using a net premium valuation method using the following principal assumptions:

	Interest rate %		*Mortality rate*	
	2006	*2005*	*2006*	*2005*
Taxable with-profits POIS fund	2.25	2.00	100% of AM80/AF80	100% of AM80/AF80
Non taxable with-profits POIS fund	3.00	2.75	100% of AM80/AF80	100% of AM80/AF80

The level of expenses included in the valuation are based on the current year's expenses allowing for cost inflation of 4%.

The principal changes to valuation assumptions made since the previous year-end were:

- an increase in the interest rates used, reflecting the change in interest yields on backing assets, and
- an increase in the level of renewal expenses and a decrease in the level of claim expenses included in the valuation, reflecting the change in the ongoing administration expense levels the Society operates at.

The overall effect of changes to assumptions has been to increase the long term business provision, net of reassurers' share, by £3.0m.

A reduction in interest rates would reduce the impact of discounting on the long term business provision, resulting in an increased provision. If, for example, the valuation interest rate were to be reduced by 0.5%, the long term business provision would increase by approximately £2.4m. This does not include the corresponding effect on the valuation of assets.

18 BONUSES AND REBATES

	Group and Society	
	2006	*2005*
	£'000	*£'000*
Cost of bonuses declared, as at 31 December:		
Other bonuses	526	592
Reversionary bonuses	726	837
	1,252	1,429

19 CAPITAL POSITION STATEMENT

Available capital resources

	UK non-profit £'000	*former POIS Assurance Limited UK with-profits £'000*	*former Family Life Assurance Limited UK with-profits £'000*	*Total £'000*
As at 31 December 2006:				
Fund for future appropriations	37,055	11,627	317	48,999
Adjustment to assets	(2,960)	–	–	(2,960)
Allocation of Group capital	(1,110)	–	–	(1,110)
Other adjustments	(2,241)	–	–	(2,241)
Total available capital resources	30,744	11,627	317	42,688
As at 31 December 2005:				
Fund for future appropriations	32,427	13,749	297	46,473
Adjustment to assets	(568)	–	–	(568)
Allocation of Group capital	(1,066)	–	–	(1,066)
Other adjustments	(30)	–	–	(30)
Total available capital resources	30,763	13,749	297	44,809

Movement in available capital resources

	UK non-profit £'000	*former POIS Assurance Limited UK with-profits £'000*	*former Family Life Assurance Limited UK with-profits £'000*	*Total £'000*
Available capital resources as at 31 December 2005	30,763	13,749	297	44,809
Effect of investment variations	1,730	(117)	546	2,159
Effect of experience variations	472	858	–	1,330
Effect of change in valuation basis	1,697	1,023	–	2,720
New business strain	(1,967)	–	–	(1,967)
New business reserves	(1,951)	–	–	(1,951)
Cost of bonuses	–	(3,886)	(526)	(4,412)
Available capital resources as at 31 December 2006	30,744	11,627	317	42,688

Notes to the Accounts

19 CAPITAL POSITION STATEMENT (continued)

Technical provisions

	UK non-profit £'000	former POIS Assurance Limited UK with-profits £'000	former Family Life Assurance Limited UK with-profits £'000	Total £'000
As at 31 December 2006:				
Unit-linked	1,164,447	–	1,450	1,165,897
With-profits liabilities	–	82,107	13,051	95,158
Non-profit liabilities	13,582	970	–	14,552
	1,178,029	83,077	14,501	1,275,607
Claims outstanding	3,130	1,273	–	4,403
Reassurance	–	(480)	–	(480)
Technical provisions in the balance sheet	1,181,159	83,870	14,501	1,279,530
As at 31 December 2005:				
Unit-linked	1,160,886	–	1,482	1,162,368
With-profits liabilities	–	92,988	13,138	106,126
Non-profit liabilities	17,591	1,075	–	18,666
	1,178,477	94,063	14,620	1,287,160
Claims outstanding	2,163	1,325	–	3,488
Reassurance	(2)	(515)	_	(517)
Technical provisions in the balance sheet	1,180,638	94,873	14,620	1,290,131

There were no material options or guarantees included within the Technical provisions at either 31 December 2006 or 31 December 2005.

Management of insurance risk

Capital management

The Society maintains sufficient capital, consistent with the Group's risk profile and the regulatory and market requirements of its business.

The Society is subject to a number of regulatory capital tests and also employs a number of realistic tests to allocate capital and manage risk. Overall, the Society meets all of these requirements and has significant resources and financial strength.

In reporting financial strength, capital and solvency is measured using the regulations prescribed by the Financial Services Authority (FSA). These regulatory capital tests are based upon required levels of solvency capital and a series of prudent assumptions in respect of the type of business written by the Society.

Capital management policies and objectives

The Society's objectives in managing its capital are:

- To match the profile of its assets and liabilities, taking into account the risks inherent in the business;
- To maintain financial strength to support new business growth;
- To satisfy the requirements of its policyholders, regulators and rating agencies;
- To retain financial flexibility by maintaining strong liquidity and access to a range of financial markets;
- To allocate capital efficiently to support growth; and
- To manage exposures to movements in interest and exchange rates.

Restrictions on available capital resources

The Society is required to hold sufficient capital to meet the FSA's capital requirements. The capital requirements for both with-profits and non-profit business are calculated on the statutory basis. Account is also taken of the Individual Capital Assessment which considers certain business risks not reflected in the statutory basis.

The Society's total available capital resources are £42.7m (2005: £44.8m) of which £11.9m (2005: £14.0m) is held in with-profits funds and £30.8m (2005: £30.8m) is held in the general fund.

The available capital is subject to certain restrictions as to its availability to meet capital requirements. The available surplus held in each with-profit fund can only be applied to meet the requirements of the fund itself or to be distributed to policyholders of that particular fund.

The available surplus held outside the with-profit funds is generally available to meet any requirements. It remains the intention of management to ensure that there is adequate capital to exceed the Society's regulatory requirements.
At 31 December 2006 the Society's available capital was 463% of the capital requirement of £9.2m (2005: 485%).

Capital resource sensitivities

The capital position is sensitive to changes in market conditions, due to both changes in the value of the assets and the effect that changes in investment conditions may have on the value of liabilities. It is also sensitive to assumptions and experience relating to expenses and persistency and, to a lesser extent, mortality.

The most significant sensitivities arise from the following three risks:

- Market risk in relation to the unit-linked business, which would arise if there were adverse changes in the value of unit-linked assets. The Society's most significant income stream is derived as a fixed percentage of the market value of unit-linked assets. A 30% decrease in the value of the unit-linked investments held by the Group would reduce available capital resources by approximately £7.2m.

- Expense risk in relation to the costs of running the business and administering the policies held by the Society, which would arise if there was an increase in expense inflation and / or the cost structure of the Society. A 1.5% increase in the rate of administration expense inflation would reduce available capital resources by approximately £2.5m.

- Persistency risk in relation to unit-linked business, which would arise if there was a significant increase in surrender rates which would deprive the Society of the future income that business provides. An increase in surrender rates of 80% would reduce available capital resources by approximately £0.6m.

The timing of any impact on capital would depend on the interaction of past experience and assumptions about future experience. In general, if experience had deteriorated or was expected to deteriorate and management actions were not expected to reduce the future impact, then assumptions relating to future experience would be changed to reflect it. In this way, liabilities would be increased to anticipate the future impact of the worse experience with immediate impact on the capital position. Examples of possible management action would be to alter the investment allocation in the unit-linked funds to reduce anticipated adverse market movements and to reduce the discretionary expenditure of the Society.

20 ACTUARIAL FUNCTION HOLDER

The Actuarial Function Holder of the Society is Mr. D Addison of Watson Wyatt Limited. The Society has requested him to furnish it with the particulars required in Section 77 of the Friendly Societies Act 1992. Mr. Addison has confirmed that neither he nor his family have any financial or pecuniary interests in the Society, with the exception of the fees paid to Watson Wyatt Limited for professional services, which in 2006 amounted to £490k (2005: £370k), of which £nil (2005: £nil) related to work in respect of transfers of engagements.

21 STAFF PENSION PROVISION

The Society operated a defined benefit pension scheme, the Family Assurance Friendly Society Limited Staff Pension Scheme ('the Scheme'). The Scheme funds are administered by trustees and are independent of the Society's finances. Contributions are paid to the Scheme in accordance with the recommendations of an independent actuary.

The defined benefit scheme is closed to new entrants. In its place the Society makes pension contributions to a defined contribution stakeholder pension scheme on behalf of new staff when they become eligible for pension benefits. The stakeholder scheme is administered by Legal & General Assurance Society Limited.

Details in respect of the scheme are provided below in accordance with FRS17.

Actuarial valuations were carried out as at 31 December 2004 and were updated to 31 December 2006 by an independent qualified actuary in accordance with FRS17. As required by FRS17, the defined benefit liabilities have been measured using the projected unit method.

The following table sets out the key FRS17 assumptions used for the Scheme. The table also sets out, as at 31 December 2006, 2005 and 2004, the fair value of assets, a breakdown of the assets into the main asset classes, the present value of the FRS17 liabilities and the surplus or deficit of the assets over the FRS17 liabilities (the gross pension asset or liability).

Assumptions	*2006*	*2005*	*2004*
Inflation	3.1%	2.9%	2.6%
Pension increases:			
pre April 1997 pension	0.0%	0.0%	0.0%
post April 1997 pension	3.1%	2.9%	2.5%
post April 2005 pension	2.2%	2.2%	–
Salary growth	3.1%	2.9%	3.6%
Discount rate	5.1%	4.9%	5.7%
Investment returns:			
Equities	7.8%	7.5%	8.0%
Bonds and cash	4.5%	4.1%	4.6%
Other assets	5.1%	4.9%	5.7%

On the basis of the assumptions used for life expectancy, a male pensioner currently aged 60 would be expected to live for a further 25.63 years (2005: 25.55 years). Allowance is made for future improvements in life expectancy.

Fair value of assets	*2006 £'000*	*2005 £'000*	*2004 £'000*
Equities	19,989	17,183	11,212
Bonds and cash	5,330	4,423	5,515
Other net assets	63	45	32
Total fair value of assets	25,382	21,651	16,759
Present value of liabilities	(22,422)	(21,083)	(16,202)
Gross pension asset	2,960	568	557

Over the year to 31 December 2006, regular contributions of £608k were made to the Scheme. In addition the Society made payments of £35,000 per month until 31 December 2006.

Future contributions from the Society will be at the rate of 16.6% of members' pensionable salaries, plus amounts equal to the Scheme's Pension Protection Fund levies and all the administration costs of the Scheme. The contribution rate will be reviewed following the next valuation, due no later than 31 December 2007.

In addition, over the year to 31 December 2006, employee AVC's totalling £54k were paid into the Scheme.

The Scheme is closed to new entrants and, under the method used to calculate pension costs in accordance with FRS17, the cost as a percentage of pensionable payroll will tend to increase as the average age of the membership increases, although in monetary terms is likely to decline.

The post retirement surplus or deficit under FRS17 moved as follows:

	2006 £'000	*2005 £'000*
Post retirement surplus as at 1 January	**568**	**557**
Contributions (employee and employer)	1,082	2,303
Operating charge:		
Current service cost (employer's part only)	(813)	(689)
Other net finance income:		
Expected return on pension scheme assets	1,488	1,217
Interest on post retirement liabilities	(1,038)	(932)
Net return credited to finance income	450	285
Actuarial gain or (loss):		
Actual return less expected return on pension scheme assets	1,749	1,756
Experience gains/(losses) arising on pension scheme liabilities	82	(270)
Loss due to changes in assumptions underlying the present value of scheme liabilities	(158)	(3,374)
Actuarial gains/(losses) recognised in the fund for future appropriations	1,673	(1,888)
Post retirement surplus as at 31 December	**2,960**	**568**

History of experience gains and losses

	2006 £'000	*2005 £'000*	*2004 £'000*	*2003 £'000*
Actual return less expected return on pension scheme assets	1,749	1,756	300	549
As a percentage of pension scheme liabilities at end of year	8%	8%	2%	4%
Experience gains/(losses) arising on pension scheme liabilities	82	(270)	(386)	(450)
As a percentage of pension scheme liabilities at end of year	0%	1%	2%	3%
Actuarial gains/(losses) recognised in the fund for future appropriations	1,673	(1,888)	880	(1,289)
As a percentage of pension scheme liabilities at end of year	7%	9%	5%	8%

22 RELATED PARTY TRANSACTIONS

Family Assurance Friendly Society Limited and its subsidiaries, (the Group), have a number of transactions between themselves all of which are undertaken in the normal course of business. As these Accounts cover the Society and the Group, no transactions or balances between Group entities, which eliminate on consolidation, require disclosure in accordance with the exemption given in FRS8.

With the exception of the information given below, no members of the Committee of Management of Family Assurance Friendly Society Limited and its key management had material transactions with any of the Group's related parties.

Mr. John Reeve (Chief Executive) and members of his family had investments in products of the Society of approximately £121k as at 31 December 2006 (2005: £102k).

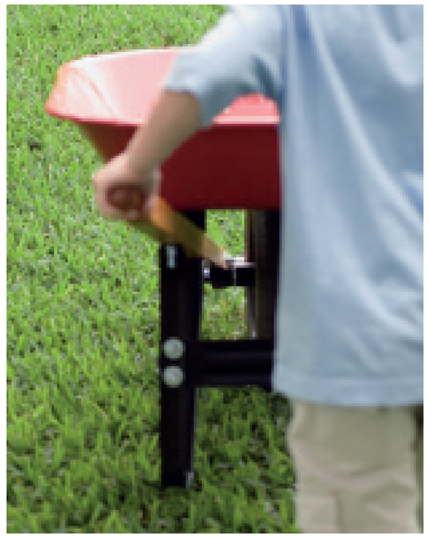
Mr. Robert Dolman (Chairman) is a partner in a London firm of solicitors which provided legal advice to the Society during the year at a cost of £9k (2005: £2k).

The Society and Group had the following investments in unit trusts managed by a subsidiary, Family Investment Management Limited, as at 31 December:

	Group 2006 £'000	*Society 2006 £'000*	*Group 2005 £'000*	*Society 2005 £'000*
Family Asset Trust	476,318	476,318	449,125	449,125
Family Charities Ethical Trust	8,559	8,559	7,240	7,240
Family Regency Unit Trust	1,735	1,442	2,311	1,457
Family Safety Net Stockmarket Unit Trust	90	–	267	–
	486,702	486,319	458,943	457,822

During 2006, the Society and Group made the following new investments of policyholders' funds into the above unit trusts. All purchases of units were made at arms length based on the buying price.

	Group 2006 £'000	*Society 2006 £'000*	*Group 2006 units*	*Society 2006 units*
Family Asset Trust	1,378	1,378	635,000	635,000
Family Charities Ethical Trust	839	839	142,000	142,000
Family Regency Unit Trust	60	–	58,136	–
Family Safety Net Stockmarket Unit Trust	16	–	8,487	–
	2,293	2,217	843,623	777,000

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