a clear view

Homeowners Friendly Society Group
annual report & accounts for the year
ended 31 December 2006

engage
Mutual Assurance

society information

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

registered office

Hornbeam Park Avenue, Harrogate HG2 8XE

telephone: 01423 855000

e-mail: mail@engagemutual.com

website: **engagemutual.com**

Registered and Incorporated under the Friendly Societies Act 1992

Registered No: 964F

Authorised and regulated by the Financial Services Authority

Member of the Association of Mutual Insurers (AMI) and the Association of Friendly Societies (AFS)

independent service providers

auditors

KPMG Audit Plc
Registered Auditor

solicitors

Addleshaw Goddard

bankers

Barclays Bank Plc

board of directors

Raymond F Pierce BA FRSA

David G Hargrave BCom MSc FIA

Andrew S Haigh BSc

Rt. Hon. Lord Clark of Windermere BA MSc PhD

Penelope J Hemming

W Graham Henderson B Comm CA FRSA (appointed 23 February 2006)

C Christopher Lazenby (resigned 30 June 2006)

Peter W Mason BSc FIA

Christina M McComb BA MBA

other society officers

secretary

Andrew J Horsley MSI FCIS

actuarial function holder

Trevor M Batten FIA

board committees

audit

Peter W Mason (appointed as Chairman 1January 2006)

Rt. Hon. Lord Clark of Windermere

David G Hargrave (resigned as Chairman 1 January 2006)

Christina M McComb

finance & risk

David G Hargrave (Chairman)

Andrew S Haigh

W Graham Henderson

Peter W Mason

nominations

Raymond F Pierce (Chairman)

Andrew S Haigh

David G Hargrave

remuneration

Christina M McComb (Chairman)

Rt. Hon. Lord Clark of Windermere

Penelope J Hemming

Raymond F Pierce

contents

our mission is to enable people to protect their welfare.

We will do this by providing our customers with accessible, simple, value for money, protection and savings products.

chairman's report

for the year ended 31 December 2006

A fourth consecutive year of stock market growth in 2006 ensured that the majority of our customers with savings policies saw further improvement in their returns in 2006. This is pleasing to report and we hope that with our innovative new range of protected savings products, the first of which was introduced in November 2006, customers will choose to add to their savings with **engage** in 2007.

Although the year was certainly not without challenge, we continued to make good progress in the implementation of our long term strategies in 2006. Our continued success as a provider of Child Trust Funds (CTF) has given a valuable boost to our new business volumes.

We will minimise risk through diversification of the products we offer and the ways in which we offer them to both current and potential customers. Progress in all aspects of our strategic development is set out in detail in the Chief Executive's Business Review. The outcome for the year was a net increase in our customer base of more than 21%, combined with strong cost control and improving sales efficiency. However, we remain keen not to rely solely on CTF for our future growth and are developing other product initiatives.

2006 was our second year of operations as **engage** Mutual Assurance. There is no doubt that the transition has had a positive effect and good progress continues to be made in building awareness of the new name. Last year I explained that we had already made the formal changes to the names of the Society's subsidiaries and had adopted the new name as a trading style for the Society itself. This approach proved simple and effective to operate. It remains our intention to formally change the name of the Society in due course, but with no immediate requirement to do so, we have decided that it would be a more effective use of resources to continue on the current basis for a further year.

Changes to the recommended arrangements for corporate governance of life mutuals have been under great scrutiny in recent years, particularly following the recommendations of the Myners Review on the subject in 2005. We continue to support the principles of good governance and have developed our approach to Corporate Governance accordingly.

How organisations approach risk management is a subject which has received a great deal of attention over the last twelve months. We have made a number of improvements to what we believe were our already robust risk management processes. These changes have further improved the clarity of our risk reporting and will ensure continued, effective and regular consideration of risk at all levels within the Society.

We have welcomed the FSA's "Treating Customers Fairly" (TCF) initiative as another opportunity for the financial services industry to establish clear principles by which it will serve its customers. That said, as a mutual, we have always recognised that our sole purpose is to serve our customers and that our ongoing relationship with our customers is therefore our most precious asset. So, while TCF has done little to change our outlook, which was already firmly focused on the customer, it does provide a useful reference point and further check that our plans and strategies fit with the purpose of the organisation.

To support our governance activities, the Board has adopted a resolution with regard to TCF and receives regular TCF updates from one of the Non-Executive Directors who chairs a combined Executive and Non-Executive sub-committee which reviews our TCF progress and performance.

Last year we announced the formation of a Customer Panel. We are pleased to report that several hundred customers have now joined the panel and continue to encourage more customers to join.

We made a number of changes to our Board Committees in 2006. Peter Mason now chairs the Audit Committee, David Hargrave has taken on Chairmanship of the Finance and Risk Committee and Christina McComb chairs the Remuneration Committee.

As I mentioned in my last report, Graham Henderson joined the Board in February 2006. Graham has already made an excellent contribution to our progress and has now extended his original 18 month commitment to a permanent contract.

Chris Lazenby, Operations Director, left the Society in June. We thank Chris for his service and wish him well for the future.

Looking forward, the Society faces many challenges if it is to deliver a modern, effective and efficient operation in what is an increasingly demanding and competitive environment. Our priority remains to offer our customers value, quality and excellent service. As you will read in the Chief Executive's Business Review, we made good progress in 2006, building momentum for growth through the year. We will encourage the Executive, Management and Staff of the Society to continue this good work into 2007 and the Board and I thank them and, most importantly, our customers, for their ongoing commitment and support.

Raymond F Pierce
Chairman

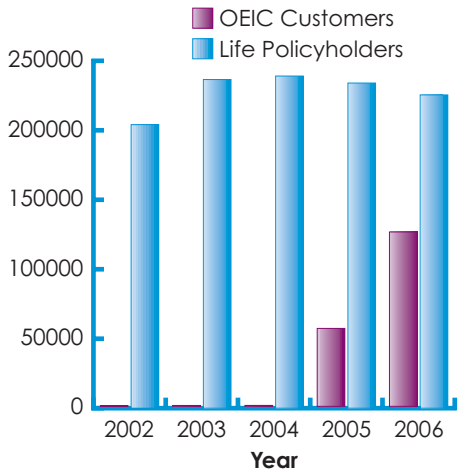
29 March 2007

chief executive's business review

for the year ended 31 December 2006

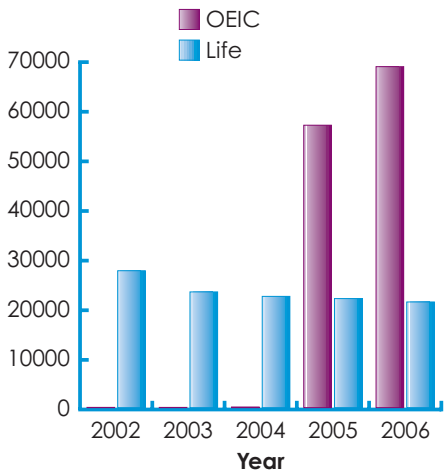
The following graphs are the main Key Performance Indicators (KPI's) used to manage the business.

Group Customers



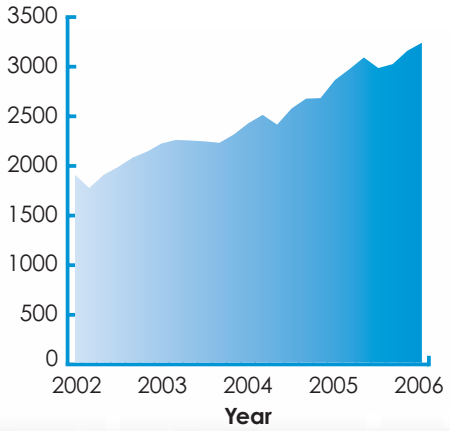
Our customer base continues to grow through increasing numbers of Child Trust Funds (CTF).

New Business Volume



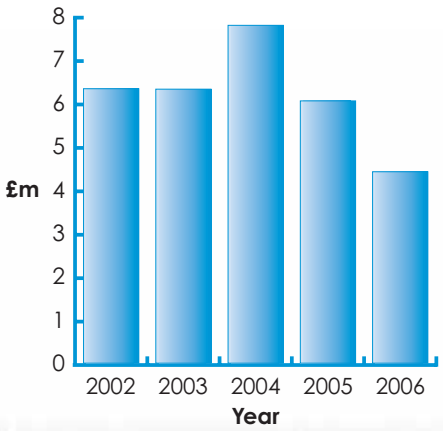
New business policy volumes reflect continuing growth in our CTFs and steady performance in our traditional markets.

FTSE® All Share Index



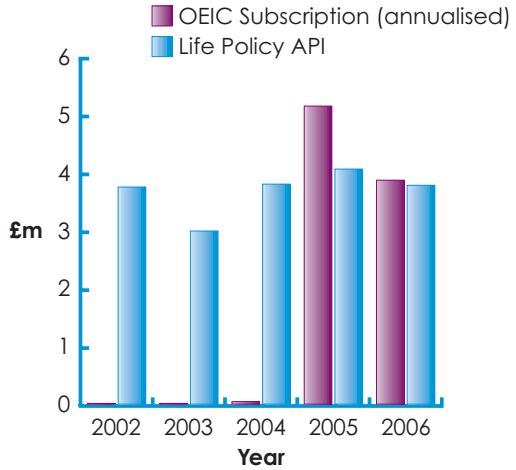
Growth in the all share index reflects the 4th consecutive year of positive performance in equity markets.

Group Administration Expenses



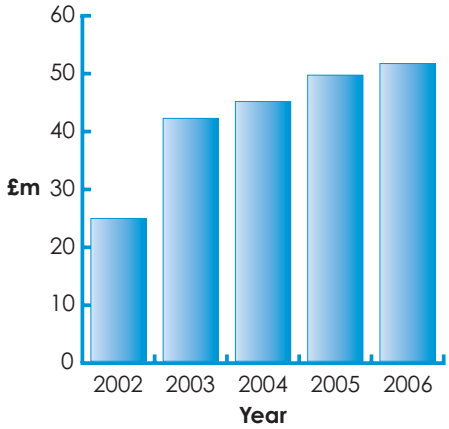
Group administrative expenses reflect our continued focus on tight control over ongoing expenses.

New Business Performance



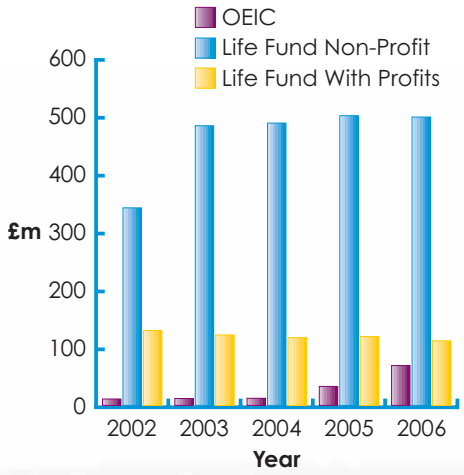
New business premium income remains satisfactory. OEIC new business in 2005 was augmented as the launch of CTF included births from September 2003 onwards.

Group Fund For Future Appropriations



The continuing growth in our Fund for Future Appropriations demonstrates satisfactory capital support for our operations.

Assets Under Group Management



Assets under management reflect a stable position in traditional products with rapid growth in CTF OEIC assets (which under accounting standards is not reflected in the Group consolidated accounts).

chief executive's business review (cont.)

Providing all our customers with good value and quality service is at the heart of everything we do. Our range of products and services is designed to meet the changing needs of modern families to provide for their futures and the future of those they care about. The broad direction and purpose of **engage** Mutual Assurance is defined by our mission statement.

We have followed a strategy of growth by attracting new customers and, should the opportunity arise, transfer from other mutuals. We aim to facilitate this growth with increasingly efficient business operations, which make the most of new technology to sell and administer policies and communicate with customers. In particular, we believe that the internet provides a significant opportunity to develop the organisation. Therefore, for the immediate future, our objective is to become the leading direct internet provider of simple, good value savings and protection products for families.

customer growth

2006 proved to be another important year, both in terms of the actual business written and the development of new, high quality distribution relationships which will support our growth plans in 2007.

Our customer growth strategy can be summarised as follows:

- focus on a broad market, with particular emphasis on families
- broaden the product range to ensure we can meet the changing needs of our customers
- provide our customers with excellent service and value
- develop new, cost efficient ways to reach customers
- build awareness of **engage** as a good value, family oriented, financial services brand

We were pleased to see our total customer base show a net increase of 21% to 350,000, in particular due to the dramatic impact Child Trust Fund (CTF) has had on our ability to attract new families to **engage**.

New business was strong in the second half of 2006, following rather lower volumes in the first half of the year. The membership of the life fund fell slightly during the year but we expect to see the strong sales performance, which ended 2006, continue and lead to further growth in 2007.

The corresponding new business volumes are represented in two of the charts at the front of this Business Review. For life assurance policies we show new regular premiums and one tenth of the new single premiums for the year. Under normal financial reporting conventions we would show the Open Ended Investment Company (OEIC) sales (that is the investment scheme through which we operate the CTF accounts) in terms of the total premiums received. However, for ease of comparison, we have taken one tenth of the voucher amounts and a standard premium value for each new account. The total figure for new OEIC subscriptions was £32m for the year.

We paid out more than £78m in benefits to customers in 2006 in a combination of encashment and life cover claims. In the same period we collected more than £34m in premiums into the life funds.

We have worked throughout the year to maintain a competitive position for our Over 50s life cover product. This continues to be a very important part of our product portfolio and we are delighted to be one of the top 5 providers in this market and the leading provider of Over 50s life cover via the internet.

chief executive's business review (cont.)

The Child Trust Fund (CTF) is now firmly established in our product portfolio and also played a key role in building new business volume during 2006. We are registered as one of the product providers to receive accounts allocated by HM Revenue & Customs for parents who have not chosen a provider within twelve months of the birth of their child. In addition, we are a leading internet provider of stakeholder CTFs. The combined result of internet distribution of CTFs and Over 50s plans is a great achievement and we will continue to focus our efforts on the development of this critically important channel in 2007.

In addition to our ongoing distribution relationships with ASDA, Yorkshire Building Society and a number of other building societies, we were very pleased to launch a new arrangement with Park Row. Park Row is one of the major financial adviser companies and a subsidiary of Royal Liver. We also launched a new relationship with Damart, one of the leading direct providers of warm winter clothing, and reached agreement with National Australia Group to distribute products through their Yorkshire Bank and Clydesdale Bank brands in 2007.

When I wrote my report last year, I informed customers of the progress we had made in our first year of operations as **engage** Mutual Assurance. We have continued to invest in building the awareness of the **engage** brand through a targeted programme of sports sponsorship with the **engage** Super League and the **engage** International Open Bowls Tournament. Both of these competitions offer significant television exposure plus the opportunity to extend the sponsorship into community activity. As a result of the sponsorship programme, we have achieved good progress in two key measures – brand awareness and marketing efficiency.

We are always keen to have open discussions with other societies who are thinking about the possibility of transferring their engagements. We believe that with our modern systems, strong governance, clear vision, successful new business platform and, most important, culture and commitment to mutuality, we have a compelling offer for the members of any transferring society.

We completed the transfer of UK Civil Service Benefit Society in 2003 which has proved very beneficial for all the members concerned. We hope to progress similar arrangements with other societies in 2007.

controls and risk management

While pursuing our plans for growth, we have been keen to strengthen our systems of control and risk management. We revised our risk management processes in 2006, including the introduction of a specific risk management function within the Society.

The Society is well capitalised, although we have identified capital as one of the key risks we face as our strategy unfolds. An example being, if we grow quickly we may find that our current capital resources are insufficient to fund the short term capital required to meet the cost of sales. We have investigated various options and sources of additional funding which would be available, should the need for additional capital arise.

It is also possible that we could invest in growth strategies which ultimately prove to be unsuccessful. If left unchecked, this would have a damaging effect on our capital position. In order to help deal with this risk, we have invested in new management information systems during 2006 to further strengthen the information received by management and the Board. This will enable us to identify problems early enough to deal with them in a timely manner.

We spent significant time in 2006 analysing the full range of risks the Society might face in order to ensure we had sufficient capital resources to manage under stress situations. This analysis informed the "Individual Capital Assessment" (ICA) which is prepared for the Financial Services Authority as part of their ongoing programme of monitoring. The ICA provides an assessment of the capital resources of the organisation under stress conditions as an alternative view to the traditional "statutory" method of assessing minimum capital requirements. The report demonstrated that our capital position is also strong when viewed on this basis. Further detail on capital resources is given in note 15 to the Accounts.

chief executive's business review (cont.)

financial performance

The development of our internet capabilities and the transition of much of our new business to this channel has enabled us to streamline our operational processes. As a result we have been able to reduce our headcount and associated operating costs during the year, in a period when we were attracting significant volumes of new business. The impact of these efficiency savings will be realised in the 2007 operating costs and offer the prospect of a strong performance for the year. We will seek further savings in 2007 through the continued transition of both new business and servicing operations to the internet.

We have improved our approach to cost and capital allocations within the Group to more clearly represent the individual roles, performance of and investment in our subsidiary companies. Our two key subsidiaries are **engage** Mutual Administration Limited, which employs all the staff and provides the operating capability for the Group, and **engage** Mutual Funds Limited which provides our Equity ISA and Child Trust Funds (CTF). The increased capital investment in subsidiaries in 2006 reflects the significant investment in CTF in particular. The outlook for the subsidiaries is positive, with **engage** Mutual Administration Limited already trading profitably.

engage Mutual Funds Limited is showing strong growth (the OEIC fund, in which CTFs are invested, has now grown to more than £60m). This is only our second year of CTF operations. The product is very low charge, and with the relatively small sums invested it therefore requires a highly efficient operation. We have been very pleased to see the efficiency of our CTF operations improve as the number of policies has increased.

It will be a number of years until **engage** Mutual Funds Limited is in a position to accumulate sufficient surpluses to cover the cost of sale of the policies and deliver an operating profit.

As stated in the Controls and Risk Management section of this report, the overall capital position of the Society remains strong with capital resources well in excess of the minimum required on both a statutory basis and realistic basis.

investment performance

2006 proved to be the fourth consecutive year of growth in investment returns with profits generally improving through the year following a sell-off in May. The UK FTSE® All Share Index rose by more than 13% driven by high levels of corporate takeovers and improving earnings. Stock market based investments should be regarded with a medium to long term time frame ie, five to ten years. Customers should be aware that the value of stock market based investments can fall as well as rise and in some circumstances investors may not get back all they have invested. The Bank of England base rate rose from 4.50% to 5.00% over the course of the year, which gave average base rates over the course of 2006 similar to that in 2005. Rising interest rates depressed our total return on Gilt holdings as their capital values fell as a consequence. The rise in rates maintained the average rate for our customers whose policies are invested in cash deposits. The tax free return for such policies remained steady at 4.85% before charges.

social, community and environmental issues

We take our social and environmental responsibilities seriously even though the net impact that the organisation has on the environment is minor in comparison to that of many other types of organisation. Even so, we have introduced schemes to reduce waste and increase opportunities for recycling and will continue to develop this approach into 2007.

We remain keen to develop initiatives which enable us to serve the less well off or to find initiatives which help us extend our reach through partnership with like minded organisations. In 2006, we re-established a relationship with Leeds City Credit Union to help them with their initiative to provide CTFs for their members.

We have a long standing relationship with a local Hospice to which we provide support in a number of different ways. We have also established an association with a charity called SmartRisk, which seeks to educate young people to reduce and manage the risks they take.

As an employer we were pleased to have our Investors in People accreditation renewed in 2006 and to be awarded the higher level achievement of a Leadership and Management award. We seek the views and input of staff through the **engage** Forum, a consultative body, and a staff feedback survey. We addressed a number of issues raised in the 2005 staff feedback survey and were pleased to see a positive response in the 2006 survey last year, with improved scores in all key areas.

outlook for 2007

We made good progress in all areas of our strategy during 2006 –

- we are now well established as a provider of financial services to families and as one of the leading providers of CTFs.
- we have developed an innovative range of new savings products which will be available for sale in 2007.
- we have added top quality distribution partners to our existing portfolio and made excellent progress in developing internet distribution through **engagemutual.com.**
- awareness of the **engage** brand has grown dramatically and we have cost effective mechanisms to build that awareness still further in 2007.
- we have invested in essential infrastructure such as IT, contact centre technology and our internet capabilities to ensure that we can continue to increase our efficiency.

In view of the above, we are very positive about the outlook for 2007 as we offer customers a wider range of quality products, supported by more efficient systems and processes.

thanks

Finally, it only remains for me to add my thanks to the staff of the Society for an incredibly busy and productive 2006 and all our customers for their continued support as we look forward to a strong performance in 2007.

Andrew Haigh
Chief Executive

29 March 2007

board of directors

Ray Pierce BA FRSA (61) **Chairman**

Ray joined the Board, and was appointed Chairman, in 1999. He has extensive experience in the financial services industry, in both general management and strategic marketing roles. Ray was a Director of Guardian Royal Exchange Plc and has also held senior positions at The Mortgage Corporation and American Express. He is Deputy Chairman of Thinc Group Limited, and a Director of Guinness Flight Venture Capital Trust Plc. Ray is also Chairman of Sense International, an international development charity, and Chairman of the Board of Trustees of the National Motor Museum.

David Hargrave BCom MSc FIA (56) **Vice Chairman**

David joined the Board in 1981 and was re-appointed as Vice Chairman in 2004 having served in this position during 1998/1999. David is an Actuary and in 1995 formed David Hargrave Limited, an independent company specialising in project-based financial consultancy. He is also the independent trustee of a number of pension funds.

Andrew Haigh BSc (44) **Chief Executive**

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

Rt. Hon. Lord Clark of Windermere BA MSc PhD (67) **Non-Executive Director**

Lord Clark joined the Society as a consultant in 1982 and became a Director in 1989. He left to join the Cabinet in 1997 as Chancellor of the Duchy of Lancaster being responsible for, amongst other things, the machinery of Government, including IT. Lord Clark, who rejoined the Board in 1999, was MP for South Shields from 1979 until his elevation to the House of Lords in July 2001. He is currently Chairman of the Forestry Commission, and a Non-Executive Director of Thales Plc and Carlisle United Football Club Limited.

Penny Hemming (59) **Non-Executive Director**

Penny joined the Board in October 2004 having served as CBI Regional Director for Yorkshire and the Humber since 1995, giving her a wide understanding of all issues confronting businesses today. She also spent 16 years in the City as a stockbroker and currency broker. Penny is a Director of the healthcare company, YorkTest, a member of the Advisory Board of the University of Bradford School of Management and was appointed a Deputy Lieutenant of West Yorkshire in 2000.

Graham Henderson B Comm CA FRSA (52) **Finance Director**

Graham joined the Board in February 2006 as Finance Director. He is a Chartered Accountant with over 20 years of experience in senior financial roles in financial services companies. He has held executive roles in Lloyds Bank, Royal Insurance, Britannia Life and Britannic Assurance. These have been finance related but have involved significant elements of change management, corporate finance and business planning.

Peter Mason BSc FIA (56) **Non-Executive Director**

Peter joined the Board in December 2005. He is a Fellow of the Institute of Actuaries with over 30 years of experience of financial services businesses. He is Investment Director and Actuary at the Neville James Group, an investment management company, and holds Non-Executive Directorships at Countrywide Plc and Chesnara Plc.

Christina McComb BA MBA (50) **Non-Executive Director**

Christina joined the Board in May 2005. She has extensive experience of investing in smaller companies, having spent 14 years at leading venture capital group, 3i. In 2003, Christina became a Director of the Shareholder Executive, a new department established in the Cabinet Office to manage the Government's shareholder interests in a number of public-owned enterprises. Christina is currently Head of Investment and Commercialisation at Partnerships UK Plc. She is a member of the Investors Advisory Board of the London Technology Fund and a member of the Investment Advisory Group of Imperial Innovations Plc. She is a Governor of Surbiton High School and Treasurer of the Griffin Society.

directors' report

The Directors present their annual report, together with the financial statements for the year ended 31 December 2006.

business objectives

The mission of **engage** is to enable people to protect their welfare. We will do this by providing our customers with accessible, simple, value for money protection and savings products. Our major subsidiaries are playing an increasingly important role in meeting the mission:

- **engage** Mutual Funds Limited is the provider of our stakeholder Child Trust Fund, along with our Equity ISA product.
- **engage** Mutual Administration Limited, our administration services subsidiary, provides services to the Society, its operating subsidiaries and to external organisations.
- **engage** Mutual Services Limited is a non-regulated (as defined by the Financial Services & Markets Act 2000) introducer of third party products and services.

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

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

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

business review

Key business developments and the future outlook for the business of the Society and its subsidiaries are detailed in the Chief Executive's Business Review on pages 6 to 13 which includes key performance indicators.

principal risks and uncertainties facing the business

A description of the principal risks and uncertainties facing the business of the Society and its subsidiaries are detailed in the Controls and Risk Management section of the Chief Executive's Business Review on page 11.

board of directors

A list of Directors who held office during the year appears within the 'society information' on page 2.

Chris Lazenby resigned on 30 June 2006.

David Hargrave retires in accordance with the Society's rules and the Friendly Societies Act 1992 and, being eligible, offers himself for re-election. In addition, the Board has resolved that any Director who has served the Society for longer than nine years will be subject to annual re-election. As a result Lord Clark will also stand for re-election at this year's AGM and both David Hargrave and Lord Clark will stand for re-election at the AGM in 2008.

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

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

statement of solvency

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

membership

Membership of the Society as at 31 December 2006 stood at 225,468 (2005: 234,015).

complaints policy

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

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

The Board of Directors regularly reviews the number and type of complaints received to monitor that complaints are properly dealt with and corrective action has been taken to prevent recurrence.

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

employees

The average number of Directors and staff employed by the Group, in each week of the year, totalled 172. The aggregate remuneration paid to Directors and staff employed by the Group, during the year, amounted to £5,147,000. All of the staff are employed by our third party administration services subsidiary, **engage** Mutual Administration Limited.

directors' report (cont.)

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

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

creditor payment policy

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

pensions arrangements

We are committed to assisting our staff to make adequate provision for their retirement. Our defined benefit scheme closed to new members on 29 March 2001. The Directors are working with the Trustees to seek to manage the pension scheme investment policy, to build on the current relative strength of the fund, to ensure that the scheme remains in a position to meet its obligations going forward in a manner which should not place a material financial strain on the Society.

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

disclosure of information to auditors

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Society's Auditors are unaware; and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Society's Auditors are aware of that information.

social, community and environmental issues

Social, community and environmental issues impacting on the business of the Society and its subsidiaries are detailed in the Chief Executive's Business Review on pages 12 to 13.

In 2006 we donated £10,172 to charities, which included donations to local charities, St Michael's Hospice as well as donations to SmartRisk, The Carer's Resource, Children in Need and Medicines san Frontieres. We met all the costs of maintaining the grounds that we share with our local Hospice.

Our staff fully support charities and have donated £1,273 to Children in Need, Cancer Research, Traidcraft, Jeans for Genes, The Kepplewray Project and SmartRisk as well as donations to local charities, St Michael's Hospice and Age Concern Knaresborough.

engage was officially recognised in February 2006 as having one of the country's most successful Give as You Earn schemes and was awarded the Payroll Giving Gold Award. This award recognised the number of our employees who had enrolled on the scheme.

re-appointment of auditors

A resolution to re-appoint KPMG Audit Plc as Auditor will be proposed at the forthcoming Annual General Meeting. Our policy on rotation of Auditors has been changed, such that audit services are now re-tendered every five years. The existing Auditors are permitted to submit a re-tender as part of this process. A full review process is conducted every three years.

By Order of the Board

Andrew Horsley
Secretary

29 March 2007

corporate governance report

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

It has been the Society's policy to follow the principles of the Combined Code on Corporate Governance matters for a number of years. As a result, the Board has welcomed the recommendations of the Myners Review and the introduction of the Annotated Combined Code. The Board is firmly of the view that, to comply with best practice in corporate governance, it should aim to adhere to the principles and provisions of the Combined Code on Corporate Governance annotated by the Association of Mutual Insurers and the Association of Friendly Societies to cover mutual insurers ("the Code").

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

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

- to ensure that the Board functions effectively, all Directors receive accurate, timely and clear information and it is the responsibility of the Chairman to ensure that this is periodically reviewed;
- the Chairman also ensures that, on appointment, Non-Executive Directors receive a comprehensive tailored induction programme on the Group's business and regulatory environment. All Non-Executive Directors update their skills, knowledge and familiarity with the Group through meetings with the Executive of the Society and its employees and relevant external courses. Individual training requirements for Non-Executives are discussed during the performance evaluation process;
- the Board has access to independent professional advice at the Society's expense, where they judge it necessary to discharge their responsibilities as Directors;
- all Directors have access to the advice and services of the Group Secretary who is responsible for ensuring the Board procedures are complied with and advising the Board, through the Chairman, on governance matters;
- the Board currently consists of two Executive Directors and six Non-Executive Directors. The size and composition of the Board is kept under review to ensure that there is adequate succession planning for Executive and Non-Executive Directors and that there are sufficient skills and experience represented on the Board for the direction of the Group's activities. The Board is of the opinion that its composition is appropriate for the business.

attendance of directors at board and committee meetings

	Ray Pierce	David Hargrave	Andrew Haigh	Graham Henderson	Lord Clark	Penny Hemming	Chris Lazenby	Peter Mason	Christina McComb
Board Meetings									
HFSL (10)†	9	10	10	10	10	7	4 of 4	10	10
eMFL (4)*	4	4	4	3 of 3	4	3	2 of 2	3 of 3	4
HMSL (1)††	1	1	1	N/A	1	N/A	1	N/A	N/A
eMAL (1)**	1	1	1	N/A	1	1	1	N/A	N/A
eMSL (2)***	2	2	2	1 of 1	2	2	2	1 of 1	1 of 1
Committee Meetings									
Audit (4)	N/A	3	N/A	N/A	4	N/A	N/A	4	4
Finance (7)	N/A	7	5 of 5	7	N/A	N/A	N/A	7	N/A
Nominatons (1)	1	1	1	N/A	N/A	N/A	N/A	N/A	N/A
Remuneration (4)	4	N/A	N/A	N/A	4	2	N/A	N/A	4

*Homeowners Investment Fund Managers Limited changed its name to **engage** Mutual Funds Limited (eMFL) on 25 January 2006.

** Homeowners Financial Administration Limited changed its name to **engage** Mutual Administration Limited (eMAL) on 20 April 2006.

*** UK Friendly Insurance Services Limited changed its name to **engage** Mutual Services Limited (eMSL) on 22 March 2006.

† Homeowners Friendly Society Limited.

†† Homeowners Membership Services Limited.

corporate governance report (cont.)

non-executive directors

In the opinion of the Board, each Non-Executive Director, including the Chairman, is independent in character and judgement. The Vice Chairman, David Hargrave has served the Society since his first election by members in 1982. Lord Clark has served the Society, as a Non-Executive Director, from 1989 until he left to join the Cabinet in 1997. Lord Clark re-joined the Board in 1999. The Board is unanimously of the view that David Hargrave's and Lord Clark's knowledge and experience remain invaluable to the Society and that the independence of their judgement will not be prejudiced by a continuation of their period in office.

The Board has resolved that any Director who has served the Society for longer than nine years will be subject to annual re-election. As a result Lord Clark will also stand for re-election at this year's AGM and both David Hargrave and Lord Clark will stand for re-election at the AGM in 2008.

The Society appointed Peter Mason as Senior Independent Director on 25 January 2007. The Senior Independent Director will be available to members, if they have concerns which contact through the Chairman, Chief Executive or Finance Director has failed to resolve (or for which such contact is inappropriate).

It is the Board's intention that, during 2007, the Non-Executive Directors, led by the Senior Independent Director, will meet without the Chairman present to appraise the Chairman's performance. The Non-Executive Directors also meet without the Executive Directors present at least once a year.

chairman and chief executive

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

performance evaluation

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

A performance evaluation system for Non-Executive Directors has been established. The Chairman meets each Non-Executive Director annually to discuss individual performance. A meeting of the Non-Executive Directors is also held, without the Executive Directors present, to discuss collectively the performance of the Executive Directors. During 2006 the Non-Executive Directors did not meet without the Chairman present to appraise his performance.

In 2006 the appraisal of Non-Executive Directors took the format of a formal appraisal of each individual Director by the Chairman. This procedure identifies any individual and Board training requirements and provides the evidence for the Board to decide whether to recommend to members that a Director should be re-elected.

appointments to the board

The appointment of new Directors is considered by the Nominations Committee (see page 24) which makes recommendations to the Board. All Directors are subject to election by members at the Annual General Meeting (AGM) following their appointment. In addition, all Directors must receive approval from the Financial Services Authority as an Approved Person in order to fulfil their controlled function as a Director. Under the Society's Rules, Directors have to submit themselves for re-election at least once every three years.

At the AGM to be held in 2007, members will be asked to elect Graham Henderson and re-elect Lord Clark and David Hargrave.

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

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

board committees

The Board has established a number of Committees which have their own terms of reference. Details of the principal Board Committees, including their membership during 2006, are set out below.

audit committee

The Audit Committee consists of four Non-Executive Directors under the Chairmanship of Peter Mason. Three of the Committee members, Peter Mason, Christina McComb and David Hargrave, have relevant financial sector experience. The other Committee member is Lord Clark. The responsibilities of the Committee are in line with the provisions of the Smith Guidance on Audit Committees. The main function of the Committee is to assist the Board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

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

During 2006 the Committee met four times in the execution of its responsibilities. During the meetings the Committee considered reports on:

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

Reports were provided by the Internal Audit, Risk and Compliance functions and the external Auditors. The Chairman of the Audit Committee meets regularly with the Internal Auditor to discuss issues of internal control. The Committee considers that it has met its responsibilities and performed its duties with appropriate levels of care and expertise during 2006.

finance & risk committee

The Finance & Risk Committee consists of Peter Mason, Andrew Haigh, Graham Henderson, under the Chairmanship of David Hargrave. The Committee met seven times during 2006 to review key aspects of Group financial management and risk quantification in greater detail than is possible at regular Board meetings. In particular, the Board has charged the Committee with providing direction and recommending strategy in the areas of management of the Society's with profits business, management of the Group's investment strategy, monitoring of the Group's investment performance, review of the principles underlying capital management of the Group, product pricing for all Group products, the expense analysis and FSA returns.

corporate governance report (cont.)

nominations committee

The Nominations Committee consists of the Chairman, the Vice Chairman and the Chief Executive. The majority of members of the Nominations Committee were not independent Non-Executive Directors during 2006. The Nominations Committee meets as appropriate to review the structure, size and composition of the Board and to make recommendations to the Board with regard to any adjustments that are deemed necessary. It is also responsible for identifying and nominating for the approval of the Board, candidates to fill Board vacancies as and when they arise.

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

remuneration committee

The Remuneration Committee currently consists of the Chairman of the Society and three independent Non-Executive Directors, under the Chairmanship of Christina McComb. The Committee meets as appropriate to determine the policy for Executive remuneration. The objective of the Committee is to give Executive Directors encouragement to enhance the Society's performance by ensuring that they are fairly and responsibly rewarded for their individual and collective contributions. Further details of the Committee and the remuneration policy can be found in the Report of the Directors on Remuneration on pages 26 to 28.

Where the Society appoints remuneration consultants, they have no other connection with the Society.

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

executive sub-committees

The governance structure has been improved this year with the introduction of a number of Executive Sub-Committees that have responsibility for key risk areas. These Committees are: Sales, Operations, Product, Unit Pricing, Resourcing, Compliance and Capital & Risk.

relations with customers

The customers of the **engage** Group are made up of the friendly society's life fund members and non-life customers of its open ended investment subsidiary company. **engage** applies the same principles of value and service to all customers and encourages feedback on any aspect of the Group's activities.

The **engage** Group has established a Customer Panel, consisting of over 500 customers, who are invited to comment on a variety of issues. It is the intention of the Society that members of the Board will attend meetings of the panel and use this as an opportunity to understand customers' issues and concerns.

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

system of internal control

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

The information received and considered by the Committee provided reasonable assurance that during 2006 there were no material breaches of control or regulatory standards and that, overall, the Group maintained an adequate system of internal control.

auditor

The Group has a policy on the use of the external Auditor for non-audit work which is implemented by the Audit Committee. The purpose of the policy is to ensure the continued independence and objectivity of the external Auditor. The external Auditor, KPMG Audit Plc, undertook a number of non-audit assignments during 2006 and these were conducted within the limits set out in the policy and are considered to be consistent with the professional and ethical standards expected of the external Auditor in this regard.

role as an institutional shareholder

The Group has appointed State Street Global Advisers, Legal & General Investment Management and more recently, in 2006, Insight Investment Management to undertake its investment management.

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

The Group has requested State Street, Legal & General and Insight, where appropriate, to consider carefully the explanations given by companies in which they have invested for any departure from the Combined Code and to make reasoned judgements in each case. Our investment managers use the Association of British Insurers (ABI) and 'Research, Recommendations & Electronic Voting' (RREV) services, as appropriate, to analyse resolutions for compliance with the Combined Code. Where the investment manager does not accept the explanation for any major departure from the Combined Code, the investment manager will enter into dialogue directly with the company in question. Our investment managers also attend AGMs of companies in which they have invested, on behalf of the Society, where it is appropriate and practicable to do so.

statement of compliance with the combined code

The Board considers that throughout the year ended 31 December 2006, the Society has applied the relevant principles and complied with the relevant provisions of the Annotated Combined Code for Mutual Insurers issued by the Association of Mutual Insurers / Association of Friendly Societies. The following are exceptions:

- a Senior Independent Director was not appointed during 2006. However, Peter Mason was appointed to this role on 25 January 2007;
- no meetings of the Non-Executive Directors without the Chairman present were held;
- the majority of members of the Nominations Committee are not independent Non-Executive Directors;
- the annual performance evaluation of Non-Executive Directors did not include the Chairman; and
- David Hargrave and Lord Clark, being the two Non-Executive Directors who have served longer than nine years, have not been subject to annual re-election, but it is intended that such arrangements will be introduced in 2007.

report of the directors on remuneration

audited information

the total emoluments of the Directors comprise:

Executive Directors	Salary £'000	Bonus £'000	Benefits £'000	Pension contributions £'000	Compensation for loss of office £'000	**2006 Total £'000**	2005 Total £'000
Andrew Haigh (Chief Executive)	184	-	1	34	-	**219**	239
Graham Henderson (appointed 23 Feb 2006)	118	-	-	-	-	**118**	-
Chris Lazenby (resigned 30 June 2006)	57	-	-	5	113	**175**	129
Total	**359**	**-**	**1**	**39**	**113**	**512**	368
Non-Executive Directors							
Ray Pierce (Chairman)	60	-	-	-	-	**60**	61
Lord Clark of Windermere	26	-	1	-	-	**27**	27
David Hargrave	36	-	-	-	-	**36**	37
Penny Hemming	24	-	-	-	-	**24**	24
Peter Mason	29	-	-	-	-	**29**	1
Christina McComb	27	-	-	-	-	**27**	14
Total	**202**	**-**	**1**	**-**	**-**	**203**	164

long-term benefits

The Executive Directors participate in a long-term bonus scheme, based on the long-term performance of the Group. As Graham Henderson was on a fixed-term contract he did not participate in the scheme in 2006. Graham Henderson only joined the long-term bonus scheme in January 2007.

Payments are provided for in the financial statements of **engage** Mutual Administration Limited, but are not payable until January 2009 for Andrew Haigh and June 2009 for Graham Henderson.

Andrew Haigh's long-term bonus as at 31 December 2006 was £nil (£70,000 in 2005).

directors' pension entitlement

The Society operates a defined benefit pension scheme for its employees. This scheme was closed to new entrants on 29 March 2001. A stakeholder pension scheme is in place for all new employees. Andrew Haigh is a member of the defined benefit pension scheme. The details of Andrew Haigh's pension at 31 December 2006 are shown in the table below. There was no entitlement to pension benefits for Graham Henderson in 2006.

other benefits

There were no payments in respect of pensions in 2006 for former Directors and their spouse's (2005: £3,000).

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

Accrued benefit as at 31 December 2006	Increase in accrued benefit over 2006 (excluding inflation)	Increase in accrued benefit over 2006 (including inflation)	Transfer value of increase in accrued pension less member contributions	Transfer value as at 31 December 2005	Transfer value as at 31 December 2006	Increase in transfer value over 2006	Increase in transfer value less member contributions
£20,714 p.a.	**£2,274 p.a.**	**£2,918 p.a.**	**£24,441**	**£167,710**	**£233,682**	**£65,972**	**£57,472**

report of the directors on remuneration (cont.)

un-audited information

Graham Henderson was employed through Executive Interim Management (EIM) for the period of 1 January 2006 to 22 February 2006 to provide Finance Director services to the Group. A total of £33,958 was paid to EIM in this period.

The composition and responsibilities of the Society's Remuneration Committee are set out on page 24. The Remuneration Committee is responsible for the Group's Executive remuneration policy. The objective of the Committee is to give Executive Directors encouragement to enhance the Society's performance by ensuring that they are fairly and responsibly rewarded for their individual contributions. Where possible the Committee seeks to meet the standards set out in the Combined Code applicable to listed companies.

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

Proper regard is paid to the need to retain good quality, highly motivated staff and the remuneration being paid by competitors of the Society is taken into consideration. In this respect the Committee receives information inter alia from a leading firm of remuneration consultants, Hay, and also receives benchmarking data where required.

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

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

service contracts

Andrew Haigh has a service contract with a twelve month notice period. Graham Henderson has a service contract with a six month notice period (having transferred from a fixed-term contract in February 2007).

No Non-Executive Director has a service contract.

non-executive directors' remuneration

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

executive bonus entitlements

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

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

statement of directors' responsibilities

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

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

The Group and Society financial statements are required by law to give a true and fair view of the state of affairs of the Group and of the Society as at the end of the financial year and of the income and expenditure of the Group and of the Society for the financial year.

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

- select suitable accounting policies and then apply them consistently;
- make judgments 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 financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Society will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society and enable them to ensure that its financial statements comply with the Friendly Societies Act 1992 and the regulations made under it.

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

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

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

independent auditor's report

to the members of Homeowners Friendly Society Limited

We have audited the Group and Society financial statements of Homeowners Friendly Society Limited for the year ended 31 December 2006 which comprise Group and Society Income and Expenditure Accounts, the Group and Society Balance Sheets 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 Directors' Report for the year ended 31 December 2006.

In addition to our audit of the financial statements, the Directors have engaged us to audit the information in the Report of the Directors on Remuneration that is described as having been audited, which the Directors have decided to prepare as if the Society were required to comply with the requirements of Schedule 7A to the Companies Act 1985.

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

respective responsibilities of the directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and UK accounting standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 29.

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

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

In addition to our audit of the financial statements, the Directors have engaged us to review their Corporate Governance Report as regards the Society's compliance with provisions C1.1, C2.1, C3.1, C3.2, C3.3, C3.4, C3.5, and C3.6 of the Annotated Combined Code for Mutual Insurers published in July 2005 jointly by the Association of Mutual Insurers and the Association of Friendly Societies ("the Annotated Code"). We review whether the Corporate Governance Report reflects the Society's compliance with the eight provisions of the Annotated Code specified for our review and we report if it does not. We are not required by the terms of our engagement to consider whether the statements of the Directors on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Society's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and Accounts and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and 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 UK Generally Accepted Accounting Practice, of the state of affairs of the Group and of the Society as at 31 December 2006 and of the income and expenditure of the Group and of the Society for the year then ended, and have been properly prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it;
- the Directors' Report has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it and the information given therein is consistent with the financial statements for the financial year; and
- the part of the Report of Directors on Remuneration which we were engaged to audit has been properly prepared in accordance with Schedule 7A to the Companies Act 1985, as if those requirements were to apply to the Society.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Leeds

29 March 2007

group income and expenditure

for the year ended 31 December 2006

Technical Account Long-Term Business

	notes	2006 £'000	2005 £'000
Continuing Operations			
Earned premiums			
Gross premiums written	2	34,335	38,633
Outward reinsurance premiums		(8,002)	(6,735)
Total earned premiums, net of reinsurance		**26,333**	31,898
Investment income	**3**	**35,712**	37,045
Unrealised gains on investments	**3**	**10,166**	28,841
Other technical income		**216**	174
Total technical income		**72,427**	97,958
Claims incurred			
Gross claims incurred	4	78,255	72,926
Outward claims reinsurance		(2,651)	(1,987)
Total claims incurred, net of reinsurance		**75,604**	70,939
Change in other technical provisions			
Change in long-term business provision	14	(6,574)	(5,801)
Change in long-term business provision, reinsurers' share	14	(4,128)	(1,809)
Change in technical provisions for linked liabilities	14	(8,943)	10,291
Total change in other technical provisions		**(19,645)**	2,681
Other charges			
Net operating expenses	5	11,560	16,377
Investment expenses and charges		416	298
Tax attributable to the long-term and linked business	20	2	278
Total other charges		**11,978**	16,953
Total technical charges		**67,937**	90,573
Deficit transferred from non-technical account		**2,310**	2,831
Transfer to fund for future appropriations	**9**	**2,180**	4,554
Balance on the long-term business technical account		**-**	-

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

Increased value of investments held

Policy surrender, maturity and death payments

Change in value of linked policyholders' benefits

Fund managers' charges

Group charge to corporation tax

group income and expenditure (cont.)

for the year ended 31 December 2006

Non-Technical Account

Income earned in non-life subsidiaries

Expenses incurred in non-life subsidiaries

	notes	2006 £'000	2005 £'000
Continuing Operations			
Other income		858	387
Net operating expenses	5	(4,244)	(2,649)
Pension finance income	18	235	169
Actuarial gain / (loss) on pension scheme	18	841	(738)
Deficit of expenses over income		**(2,310)**	(2,831)
Deficit transferred to the group technical account - long-term business	9	**2,310**	2,831
Balance on the non-technical account		**-**	-

All recognised gains and losses in relation to long-term business are dealt with in the Group income and expenditure – Long-Term Business – Technical Account, and all recognised gains and losses in relation to subsidiaries are dealt with in the Group income and expenditure account – Non-Technical Account.

group balance sheet

as at 31 December 2006

Assets

	notes	2006 £'000	2005 £'000
Investments			
Investment in land and buildings	10	6,300	6,300
Financial investments	10	122,703	134,359
Total investments		**129,003**	140,659
Assets held to cover linked liabilities	**11**	**447,618**	456,561
Reinsurers' share of technical provisions			
Long-term business provision	**14**	**8,732**	4,604
Other assets			
Debtors	8	572	530
Tangible assets	12	592	805
Cash at bank		4,881	3,255
Total other assets		**6,045**	4,590
Prepayments and accrued income			
Accrued interest and rent		5,691	5,772
Deferred acquisition costs		-	859
Other prepayments and accrued income		2,700	977
Total prepayments and accrued income		**8,391**	7,608
Total assets excluding the pension asset		**599,789**	614,022
Pension asset	18	1,549	546
Total assets		**601,338**	614,568

Harrogate head office and Kew Gardens property

With Profits Fund and surplus investments

Value of unit-linked investments

Fixtures, fittings and computer hardware

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

The surplus in Group defined benefit pension scheme as measured and recognised under the FRS 17 accounting standard

group balance sheet

as at 31 December 2006

Liabilities

	notes	2006 £'000	2005 £'000
Fund for future appropriations	**9**	**51,596**	49,416
Technical provisions			
Long-term business provision	14	91,552	98,126
Claims outstanding	14	5,245	6,768
Total technical provisions		**96,797**	104,894
Technical provisions for linked liabilities	**14**	**447,618**	456,561
Creditors			
Creditors arising out of insurance operations	16	1,591	261
Other creditors including taxation and social security	17	1,416	2,818
Total creditors		**3,007**	3,079
Accruals and deferred income		**2,320**	618
Total liabilities		**601,338**	614,568

Money held for regulatory reserves and other surplus funds, including possible future with profits bonuses

Provision for with profits policies and other known contingencies

Maturities, surrenders and death claims awaiting processing and payment

Value of unit-linked policyholders' benefits

Expenses due in the period yet to be processed

Approved at a meeting of the Board of Directors on 29 March 2007 and signed on its behalf by:

R F Pierce - Chairman

A S Haigh – Chief Executive

A J Horsley – Secretary

society income and expenditure

for the year ended 31 December 2006

Technical Account Long-Term Business

	notes	2006 £'000	2005 £'000
Continuing Operations			
Earned premiums			
Gross premiums written	2	34,335	38,633
Outward reinsurance premiums		(8,002)	(6,735)
Total earned premiums		**26,333**	31,898
Investment income	**3**	**35,712**	37,045
Unrealised gains on investments	**3**	**10,166**	28,841
Other technical income	**13**	**747**	688
Total technical income		**72,958**	98,472
Claims incurred			
Gross claims incurred	4	78,255	72,926
Outward claims reinsurance		(2,651)	(1,987)
Total claims incurred, net of reinsurance		**75,604**	70,939
Change in other technical provisions			
Change in long-term business provision	14	(6,574)	(5,801)
Change in long-term business provision, reinsurers' share	14	(4,128)	(1,809)
Change in technical provisions for linked liabilities	14	(8,943)	10,291
Total change in other technical provisions		**(19,645)**	2,681
Other charges			
Net operating expenses	5	11,560	16,377
Investment expenses and charges		416	298
Tax attributable to the long-term and linked business	20	2	278
Total other charges		**11,978**	16,953
Total technical charges		**67,937**	90,573
Transfer to fund for future appropriations	**9**	**5,021**	7,899
Balance on the long-term business technical account		**-**	-

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

Increased value of investments held

Policy surrender, maturity and death payments

Change in value of linked policyholders' benefits

Fund managers' charges

Society charge to corporation tax

All recognised gains and losses in relation to long-term business are dealt with in the Society income and expenditure – Long-Term Business – Technical Account.

society balance sheet

as at 31 December 2006

Assets

	notes	2006 £'000	2005 £'000
Investments			
Investment in land and buildings	10	6,300	6,300
Investment in subsidiaries	10	7,300	-
Financial Investments	10	122,703	134,359
Total investments		**136,303**	140,659
Assets held to cover linked liabilities	**11**	**447,618**	456,561
Reinsurers' share of technical provisions			
Long-term business provision	**14**	**8,732**	4,604
Other assets			
Debtors	8	7,048	7,204
Cash at bank		1,180	3,006
Total other assets		**8,228**	10,210
Prepayments and accrued income			
Accrued interest and rent		5,691	5,772
Deferred acquisition costs		-	859
Other prepayments and accrued income		2,353	684
Total prepayments and accrued income		**8,044**	7,315
Total assets		**608,925**	619,349

Harrogate head office and Kew Gardens property

With Profits Fund and surplus investments

Value of unit-linked investments

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

society balance sheet (cont.)

as at 31 December 2006

Liabilities

	notes	2006 £'000	2005 £'000
Fund for future appropriations	9	**60,833**	55,812
Technical provisions			
Long-term business provision	14	91,552	98,126
Claims outstanding	14	5,245	6,768
Total technical provisions		**96,797**	104,894
Technical provisions for linked liabilities	14	**447,618**	456,561
Creditors			
Creditors arising out of insurance operations	16	1,591	261
Other creditors including taxation and social security	17	588	1,203
Total creditors		**2,179**	1,464
Accruals and deferred income		**1,498**	618
Total liabilities		**608,925**	619,349

Money held for regulatory reserves and other surplus funds, including possible future with profits bonuses

Provision for with profits policies and other known contingencies

Maturities, surrenders and death claims awaiting processing and payment

Value of unit-linked policyholders' benefits

Expenses due in the period yet to be processed

Approved at a meeting of the Board of Directors on 29 March 2007 and signed on its behalf by:

R F Pierce - Chairman

A S Haigh – Chief Executive

A J Horsley – Secretary

notes to the accounts

at 31 December 2006

1. accounting policies

Basis of presentation

The Accounts are prepared on the basis of the accounting policies set out below. The Accounts have been prepared in compliance with the Friendly Societies (Accounts and Related Provisions) Regulations 1994 and with the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance Business ("ABI SORP"), dated December 2005. In implementing the requirements of these regulations, the Society has adopted a modified statutory solvency basis for determining technical provisions. The true and fair override provisions of the Companies Act 1985 have been invoked in relation to investment properties (see accounting policies on Investments below).

The Society has adopted Financial Reporting Standard 27 'Life Assurance' ('FRS 27'). FRS 27 requires the presentation of a capital position statement and disclosures about the nature and management of the Society's capital resources; this is included in note 15. There has been no effect on the income and expenditure accounts or the balance sheet.

The Accounts comply with applicable accounting standards.

Basis of consolidation

The Group Accounts comprise the assets, liabilities, and income and expenditure account transactions of the Society and its subsidiary undertakings. The ongoing results of subsidiary undertakings are included within the Non-Technical Account. The net results are included in the Fund for Future Appropriations for the Group. The activities of the Society and Group are accounted for in the income and expenditure accounts.

Income and expenses incurred in the subsidiaries previously reported under Other Technical Income and Other Technical Charges in the income and expenditure account – Technical Account have been reclassified and are now included under appropriate headings in the income and expenditure account – Non-Technical Account. There is no overall effect on the income and expenditure or on total assets, although some expenses have been reclassified.

Premiums

Premiums are credited when they become due. Reinsurance premiums are charged when they become payable.

Claims

Death claims are recorded on the basis of notifications received. Annuity payments are recorded when due. Maturities and surrenders are recorded on the earlier of the date when paid or when the policy ceases to be included within the Long-Term Business Provision and/or the Technical Provision for Linked Liabilities. Reinsurance recoveries are credited to match the relevant gross amounts.

1. accounting policies (continued)

Investment income and expenses

Investment income and expenses include dividends, interest, rents, gains and losses on the realisation of investments and related expenses. Dividends are included as investment income on the date that 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 are calculated as the difference between the valuation of investments at the balance sheet date and their original 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 years in respect of investment disposals in the current period.

Investments

Investments consist of land and buildings, listed investments, loans secured on house purchases, units in authorised unit trusts, shares in open ended investment companies (OEICs), subsidiary companies and deposits. Land and buildings are included on the basis of independent valuations. Listed investments are included at mid-market value. Units in unit trusts are included at published bid prices. OEICs are included at the published price. Subsidiary companies are valued at the cost of share capital less any provisions. Deposits are included at current value. Mortgage loans are included at amount outstanding less any provision for unrecoverable amounts.

The freehold property investments are valued at open market value. In accordance with SSAP 19, no depreciation is provided in respect of freehold investment properties. This is a departure from the requirements of the Regulations, which require all properties to be depreciated. Depreciation is only one amongst many factors reflected in the valuation of properties and accordingly the amount of depreciation, which might otherwise have been charged, cannot be separately identified or quantified. The Directors consider that this policy results in the Accounts giving a true and fair view.

Deferred acquisition costs

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

1. accounting policies (continued)

Technical provisions

The Long-Term Business Provision is determined by the Society's Actuarial Function Holder following his annual investigation of the long-term business, which is based on methods and assumptions that have been approved by the Board of Directors. It is calculated initially to comply with the reporting requirements under chapter 1.2 of the Prudential Sourcebook for Insurers. This statutory solvency basis of valuation is then adjusted by eliminating certain reserves required under Friendly Society Regulations. This adjusted basis is referred to as the modified statutory solvency basis. The Long-Term Business Provision includes the non-linked liabilities in respect of linked business.

No explicit provision is made for future Final (terminal) bonuses under this basis. Implicit provision for part of future Yearly (reversionary) bonuses is included in the Long-Term Business Provision.

The Technical Provision for Linked Liabilities is based on the actuarial valuation of the related assets.

Fund for future appropriations

The Fund for Future Appropriations represents all funds, the allocation of which has not yet been determined by the end of the financial year. Any surplus or deficit arising on the Technical Account is transferred to or from the fund on an annual basis.

Deferred taxation

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

Fixed assets

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

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

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

Cash flow statement

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

1. accounting policies (continued)

Foreign currencies

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

Pensions

The Group operates a defined benefit pension scheme for staff whose employment commenced before 30 March 2001. The Group accounts for the defined benefit scheme under Financial Reporting Standard 17 'Retirement Benefits' ('FRS 17'). The cost of providing benefits is determined using the Projected Unit Method with actuarial valuations being carried out at each balance sheet date. Under the Projected Unit Method the service cost will increase as the remaining members reach retirement. The costs and returns on the pension scheme are taken through the income and expenditure account. Actuarial gains and losses are recognised in full in the period in which they occur.

The current service cost (the increase in the scheme liabilities arising from employee service in the current period) and any past service costs (the cost of improvements to benefits for service relating to prior periods) are included in Net Operating Expenses in the Non-Technical Account. Interest costs (the unwinding of the discount on scheme liabilities) net of the expected return on scheme assets are included in pension finance income in the Non-Technical Account. Actuarial gains and losses (changes in the surpluses or deficits due to experience of gains and losses) are charged to the Non-Technical Account.

The Group operates a defined contribution scheme for staff whose employment commenced after 29 March 2001. Payments to this scheme are treated as an expense when due. They are included in Net Operating Expenses in the Non-Technical Account.

2. premium analysis

a. Gross premiums written

Society and Group Life Assurance Business	2006 £'000	2005 £'000
Linked contracts:		
Periodic premium	13,546	16,363
Single premium	483	192
Non-linked contracts:		
Periodic premium	14,184	12,529
With profits periodic premium	6,115	6,554
With profits single premium	7	2,995
Total gross premiums written	**34,335**	38,633
Reinsurance ceded	(8,002)	(6,735)
Total net premiums written	**26,333**	31,898

b. Gross new annualised premiums

Society and Group Life Assurance Business	2006 £'000	2005 £'000
Linked contracts	254	143
Non-linked contracts	3,091	3,913
Total new annualised periodic premiums	**3,345**	4,056

c. Contributions received for Child Trust Fund and OEIC investments

	2006 £'000	2005 £'000
Regular contributions	4,369	1,422
Single contributions	27,627	17,214
Total contributions	**31,996**	18,636

Contributions relate to business conducted in **engage** Mutual Funds Limited, a regulated subsidiary of the Society. This business is classed as retail investment business, as such the contributions received are not included in the income and expenditure accounts. The income and expenditure from this subsidiary is included in the Non-Technical Account.

3. investment income

Society and Group	2006 £'000	2005 £'000
Income from listed investments	10,974	3,429
Income from other investments	10,125	14,283
Realised gains/(losses) on investments	14,613	19,333
Total investment income	**35,712**	37,045
Unrealised gains on investments	**10,166**	28,841
Net investment return	**45,878**	65,886

4. claims incurred

Society and Group	2006 £'000	2005 £'000
Gross claims paid	79,778	70,329
Change in provision or claims outstanding at year end	(1,523)	2,597
Gross claims incurred	**78,255**	72,926

5. net operating expenses

a. Technical account	Group 2006 £'000	Group 2005 £'000	Society 2006 £'000	Society 2005 £'000
Acquisition costs	10,790	13,084	10,790	13,084
Change in deferred acquisition costs	859	1,512	859	1,512
Administrative expenses	4,333	6,036	4,333	6,036
Reinsurance commissions and profit participation	(4,422)	(4,255)	(4,422)	(4,255)
Total net operating expenses	**11,560**	16,377	**11,560**	16,377
Commissions paid	**1,041**	291	**1,041**	291

b. Non-technical account	Group 2006 £'000	Group 2005 £'000	Society 2006 £'000	Society 2005 £'000
Net operating expenses	**4,244**	2,649	-	-

Expenses incurred in the subsidiary companies were previously included in "Other Technical Charges" in the Group income and expenditure account – Long-Term Business – Technical Account. These expenses are now included in Net Operating Expenses in the Non-Technical Account.

5. net operating expenses (continued)

Also included in net operating expenses are amounts paid to the Society's Auditor and its associates as illustrated below, exclusive of value added tax.

	2006	2005
	£'000	£'000
Fees payable to the Society's Auditor for the audit of the Society's annual accounts	**79**	71
Fees payable to the Society's Auditor for other services:		
Audit of the Society's subsidiaries, pursuant to legislation	27	21
Other services pursuant to legislation	11	22
Tax services	11	24
Other services	18	21
Total	**146**	160

The audit fees incurred in the subsidiaries are included in the income and expenditure – Non-Technical Account.

notes to the accounts

at 31 December 2006

6. staff costs

The total staff costs for the Group were comprised as follows:

	2006	2005
	£'000	£'000
Wages and salaries	5,147	5,161
Social security costs	534	535
Other pension costs	684	(264)
Total staff costs	**6,365**	5,432

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

	2006	2005
	No.	No.
Administration	122	145
Management	29	24
Marketing	21	23
Total number of staff	**172**	192

All staff are employed and remunerated by **engage** Mutual Administration Limited, which administers the Society's policies. As such no staff are employed directly by the Society.

7. directors' emoluments

Directors' emoluments are shown as part of the Report of the Directors on Remuneration on pages 26 to 28.

8. debtors

	Group	Group	**Society**	Society
	2006	2005	**2006**	2005
	£'000	£'000	**£'000**	£'000
Other debtors	572	530	333	452
Amounts owed from group undertakings	-	-	6,715	6,752
Balance at 31 December	**572**	530	**7,048**	7,204

9. fund for future appropriations

	Group 2006 £'000	Group 2005 £'000	**Society 2006 £'000**	Society 2005 £'000
Balance at 1 January	**49,416**	44,862	**55,812**	47,913
Transfer to income and expenditure account - Long-Term Business - Technical Account	2,180	4,554	5,021	7,899
Balance at 31 December	**51,596**	49,416	**60,833**	55,812

The Fund for Future Appropriations (FFA) excluding the pension asset as required by FRS 17 is:

	Group 2006 £'000	Group 2005 £'000	**Society 2006 £'000**	Society 2005 £'000
FFA at 31 December	51,596	49,416	60,833	55,812
Less FRS 17 pension asset	(1,549)	(546)	-	-
FFA excluding pension asset at 31 December	**50,047**	48,870	**60,833**	55,812

10. investments

a. Property

Society and Group	**Current value**		**Historical cost**	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Land and buildings				
Property occupied by the Society	5,550	5,550	8,147	8,147
Property in Kew Gardens	750	750	625	625
Balance at 31 December	**6,300**	6,300	**8,772**	8,772

Land and buildings are freehold. The Society's Head Office was valued on an 'open market with vacant possession' basis as at 22 September 2004, by independent valuers Eddisons Commercial - RICS, Chartered Surveyors, Leeds in accordance with the Royal Institution of Chartered Surveyors' Appraisal and Valuation Manual.

The property in Kew Gardens was valued on an 'open market value' basis as at 31 December 2005, by independent valuers Drivers Jonas - RICS, Chartered Surveyors, London in accordance with the Statement of Asset Valuation Practice and Guidance Notes published by the Royal Institution of Chartered Surveyors.

10. investments (continued)

b. Subsidiaries

The Society owns 100% of the ordinary share capital of the following subsidiaries:

Name of Subsidiary Undertaking	Nature of Business
engage Mutual Funds Limited (formerly Homeowners Investment Fund Managers Limited)	Authorised Corporate Director (ACD) of an OEIC
engage Mutual Administration Limited (formerly Homeowners Financial Administration Limited)	Third party administrator
engage Mutual Services Limited (formerly UK Friendly Insurance Services Limited)	Insurance and non-regulated financial product intermediary
Homeowners Membership Services Limited	Dormant company

All four companies are registered in England and Wales.

The investment in the subsidiaries can be analysed as follows:

Society	Shares in subsidiary undertakings £'000
Cost at 1 January 2006	2,550
Additions	7,300
Write off	-
Cost at 31 December 2006	**9,850**
Provision at 1 January 2006	(2,550)
Write down	-
Provision at 31 December 2006	**(2,550)**
Carrying value at 31 December 2006	**7,300**

The carrying value of the Society's subsidiaries was £nil at 31 December 2005.

c. Financial investments

Society and Group	Current value		Historical cost	
	2006	2005	**2006**	2005
	£'000	£'000	**£'000**	£'000
Other financial investments:				
Shares, other variable yield securities and unit trusts:				
UK	37,380	37,249	25,826	34,344
Overseas	-	-	-	-
Debt securities and other fixed income securities	**70,113**	75,854	**72,157**	74,680
Mortgage loans	**131**	134	**131**	134
Deposits with credit institutions	**15,074**	21,115	**15,074**	21,115
Accrued income and receivables	**5**	7	**5**	7
Total	**122,703**	134,359	**113,193**	130,280

notes to the accounts

at 31 December 2006

11. assets held to cover linked liabilities

Society and Group	Current value		Historical cost	
	2006	2005	**2006**	2005
	£'000	£'000	**£'000**	£'000
Assets held to cover linked liabilities	**447,618**	456,561	**397,017**	421,480
These assets are analysed as follows:				
Shares, other variable yield securities and unit trusts	201,243	198,176	158,798	171,915
Debt securities and other fixed income securities	53,026	58,367	44,870	49,547
Deposits with credit institutions	193,275	199,944	193,275	199,944
Accrued income and receivables	74	74	74	74
Total	**447,618**	456,561	**397,017**	421,480

12. tangible assets

Group	Computer equipment £'000	Office equipment £'000	Total £'000
Cost:			
At 1 January 2006	858	640	1,498
Additions	106	39	145
Disposals	-	-	-
At 31 December 2006	**964**	**679**	**1,643**
Depreciation:			
At 1 January 2006	448	245	693
Provided in the year	232	126	358
On disposals	-	-	-
At 31 December 2006	**680**	**371**	**1,051**
Net book value:			
At 31 December 2006	**284**	**308**	**592**
At 31 December 2005	410	395	805

The charge for depreciation for the Group in the year ended 31 December 2005 was £261,000

13. other technical income

Other Technical Income in the Society is in relation to rental charged to its subsidiary **engage** Mutual Administration Limited, for the use of Gardner House.

14. technical provisions

Society and Group	Long-Term Business Provision (LTBP) £'000	Reinsurer's share of LTBP £'000	Provision for outstanding claims £'000	Technical provision for linked liabilities £'000
At 1 January 2006	**98,126**	**(4,604)**	**6,768**	**456,561**
Change in other technical provisions	-	-	-	(8,943)
Movement in provision for outstanding claims	-	-	(1,523)	-
Transfer to Technical Account	(6,574)	(4,128)	-	-
Balance at 31 December 2006	**91,552**	**(8,732)**	**5,245**	**447,618**

Uncertainties and estimation techniques

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

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

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

Process for determining assumptions

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

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

The principle level assumption underlying the calculation of the Long-Term Business Provision is:

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

The Long-Term Business Provision has been calculated on the basis of the following principal interest assumptions for 2006:

Class of business	Interest
Linked assurance tax exempt/taxable	3.5% gross / 2.8% net
Life annuities in payment	2.8%
Term assurance/whole of life	2.8%
With profits tax exempt/taxable	3.0% gross / 2.5% net

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

14. technical provisions (continued)

With profits bonuses

The Long-Term Business Provision includes £769,000 (2005: £831,000) for reversionary bonuses to be declared. The cost of these bonuses is included in "Change in long-term business provision" in the income and expenditure account – Long-Term Business – Technical Account. The cost of terminal bonuses on with profits policies is included in "Gross claims incurred" in the income and expenditure account – Long-Term Business – Technical Account.

15. capital position statement & management of insurance risk

Available capital resources as at 31 December 2006:	Non-profits £'000	With profits £'000	Society Total £'000
Fund for future appropriations	**29,821**	**31,012**	**60,833**
Adjustments in respect of subsidiary undertakings	(10,390)	-	(10,390)
Adjustment to assets onto regulatory basis	(4)	(71)	(75)
Adjustment to liabilities onto regulatory basis	(5,500)	(257)	(5,757)
Total available capital resources	**13,927**	**30,684**	**44,611**
Capital requirements	(2,703)	(3,423)	(6,126)
Excess capital over regulatory requirements	**11,224**	**27,261**	**38,485**

Available capital resources as at 31 December 2005:	Non-profits £'000	With profits £'000	Society Total £'000
Fund for future appropriations	**26,930**	**28,882**	**55,812**
Adjustments in respect of subsidiary undertakings	(6,616)	-	(6,616)
Adjustment to assets onto regulatory basis	(613)	(179)	(792)
Adjustment to liabilities onto regulatory basis	(5,094)	-	(5,094)
Total available capital resources	**14,607**	**28,703**	**43,310**
Capital requirements	(2,852)	(3,864)	(6,716)
Excess capital over regulatory requirements	**11,755**	**24,839**	**36,594**

15. capital position statement & management of insurance risk (continued)

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

Technical provisions	2006 £'000	2005 £'000
Unit-linked		
Unit insurance contracts	447,181	456,561
Non unit insurance contracts	1,629	2,621
Non participating insurance contracts	8,823	6,488
Participating insurance contracts	78,126	89,369
Total technical provisions	**534,759**	555,039

The Society and its regulated subsidiaries maintain sufficient capital, consistent with the Group's risk profile. Further information about the risk appetite and risk management framework can be found in the Corporate Governance Report on pages 20 to 25.

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

In reporting financial strength, capital resources and solvency is measured following the regulations prescribed by the Financial Services Authority (FSA). These regulatory capital tests are based upon solvency capital and a series of prudent assumptions in respect of the type of business written. New guidance on the basis for calculating valuation liabilities was published by the FSA in December in Policy Statement 06/14. We will apply this guidance to our valuation basis in 2007 when we expect it will improve our reported capital position.

Homeowners Friendly Society is a mutual organisation and there are no shareholders. As at 31 December 2006 the available capital resources were made up by the Fund for Future Appropriations (FFA). The FFA is the surplus accumulated that has not yet been allocated to policies. It forms the working capital of the Group and is available to meet risk and capital requirements, as well as any uncertain additional liabilities that may arise in the future.

Capital management objectives

The Group's objectives in managing capital are that:

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

Details of how the capital objectives are managed are included in the Chief Executive's Business Review and the Corporate Governance sections.

15. capital position statement & management of insurance risk (continued)

Funding of subsidiary undertakings

engage Mutual Funds Limited (eMFL) is a wholly owned subsidiary of Homeowners Friendly Society Limited and is a company regulated by the FSA. eMFL is required to hold sufficient capital to meet regulatory capital requirements in its own right. eMFL along with **engage** Mutual Services Limited is funded by share capital issued to the Society.

engage Mutual Administration Limited is funded by an inter-company loan for ongoing financing purposes.

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

Restrictions on available capital resources

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

The Society's total available capital resources are £44.6m (2005: £43.3m) of which £30.7m (2005: £28.7m) is held in the With Profits Fund and £13.9m (2005: £14.6m) is held in the Non-Profits Fund.

The available capital resources held in the With Profits Fund are normally only available to meet the capital requirements or be allocated to policyholders of the fund. There are no restrictions on the available capital held in the Non-Profits Fund.

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

Value of financial guarantees and options

As Homeowners Friendly Society Limited has a with profits fund with liabilities less than £500m it is not within the FSA realistic reporting regime. The realistic reporting regime requires life insurers to measure liabilities on a market consistent basis which values options and guarantees at fair value.

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

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

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

15. capital position statement & management of insurance risk (continued)

Capital resource sensitivities

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

The most significant sensitivities arise from the following five risks:

a) Market risk in relation to unit-linked business and OEIC 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.

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

c) Expense risk in relation to the costs of running the business, which would arise if there was an increase in expense inflation and/or the cost base of the Group.

d) Persistency risk in relation to whole of life assurance and Child Trust Fund business, which would deprive the Group of the future income that this business is planned to provide.

e) Mortality risk in relation to whole of life business, which would arise if mortality of the lives assured was heavier than that assumed, possibly due to an epidemic or catastrophe.

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

Analysis of movement

The table below shows how the capital resources have changed during 2006:

	Non-Profits £'000	With Profits £'000	Total £'000
Opening capital resources at 1 January 2006	**11,755**	**24,839**	**36,594**
Investment returns	1,125	6,411	7,536
Life assurance/new business costs	(9,131)	-	(9,131)
Reinsurance commissions on new business	4,406	-	4,406
Subsidiary new business costs	(4,595)	-	(4,595)
Other	7,664	(3,989)	3,675
Closing capital resources at 31 December 2006	**11,224**	**27,261**	**38,485**

16. creditors arising out of insurance operations

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

17. other creditors including taxation and social security

	Group 2006 £'000	Group 2005 £'000	**Society 2006 £'000**	Society 2005 £'000
Other taxes and social security costs	205	165	61	13
Other creditors	1,211	2,653	527	1,190
Total	**1,416**	2,818	**588**	1,203

18. pension commitments

The Group operates a defined contribution stakeholder pension scheme for all employees joining the group after 29 March 2001, total employer contributions under this scheme were £223,000 (2005: £209,000).

The Group operates a defined benefit pension scheme for its employees, the Scheme was closed to new entrants on 29 March 2001. On 1 September 2004 the UKCSBS scheme was merged with the Homeowners pension scheme to form a single combined pension scheme.

The assets of the defined benefit scheme are held separate from those of the Group in an independently administered fund and are stated at their market value at 31 December 2006.

A full actuarial funding valuation is performed every three years, the last valuation being 1 January 2005, by the Scheme Actuary, and is updated annually to calculate the present value of scheme liabilities on the basis prescribed in FRS 17. The assumptions used to calculate the present value of the scheme liabilities have been recommended by the Scheme Actuary, and approved by the Directors, in line with the requirements of FRS 17. Some assumptions will differ between the FRS 17 accounting valuation and the triennial funding valuation. The scheme is closed to new entrants. This means that, under the Projected Unit Method, the service cost will increase as the remaining members reach retirement.

FRS 17 prescribes the basis under which a pension asset is recognised in the balance sheet; on this basis a pension contribution holiday can be taken to recover the pension asset. However, under the triennial funding valuation employers contributions will continue at the rate recommended by the Scheme Actuary which is expected to seek a 100% funding ratio.

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

	2006 % per annum	2005 % per annum	2004 % per annum
Long-term salary progression	**4.60**	4.40	4.40
Rate of increase in pension payments guaranteed	**3.10**	2.80	2.70
Discretionary rate of increase in pensions payment	**-**	-	1.35
Rate of price inflation and deferred pension revaluation	**3.10**	2.90	2.90
Discount rate	**5.10**	4.70	5.30

18. pension commitments (continued)

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

	Long-term rate of return expected at 31 December			Value at 31 December		
	2006	2005	2004	**2006**	2005	2004
	%	%	%	**£'000**	£'000	£'000
Equities	**7.50 pa**	7.10 pa	7.50 pa	**10,760**	9,768	8,118
Bonds	**4.50 pa**	4.10 pa	4.50 pa	**4,208**	3,767	3,390
Other	**5.00 pa**	4.50 pa	4.90 pa	**310**	333	454
Total market value of scheme assets				**15,278**	13,868	11,962
Present value of scheme liabilities				(13,729)	(13,322)	(11,549)
Surplus in scheme				**1,549**	546	413

The Group has a deferred tax asset as presented in note 24, as such the pension asset has been stated before any deferred tax liability.

18. pension commitments (continued)

a. Movement in surplus/(deficit) during the year

	2006 £'000	2005 £'000
Surplus in scheme at 1 January	**546**	413
Current service cost	(384)	(327)
Contributions	388	229
Past service (cost) / credit	(77)	800
Pension finance income	235	169
Actuarial profit / (loss)	841	(738)
Surplus in scheme at 31 December	**1,549**	546

b. Analysis of net return on pension scheme under FRS 17

	2006 £'000	2005 £'000
Expected return on pension scheme assets	862	782
Interest on pension scheme liabilities	(627)	(613)
Net return	**235**	**169**

The amounts above are included in Pension Finance Income in the Group Non-Technical Account on page 33.

c. Analysis of income and expenditure account charge under FRS 17

	2006 £'000	2005 £'000
Current service cost	384	327
Past service cost / (credit)	77	(800)
Total charge / (credit)	**461**	**(473)**

The amounts above are included in Net operating expenses in the Group Non-Technical Account on page 33.

d. Analysis of actuarial gains and losses

	2006 £'000	2005 £'000
Actual return less expected return on pension scheme assets	612	1,178
Experience gains and losses arising on the scheme liabilities	(92)	(446)
Changes in assumptions underlying the present value of the scheme liabilities	321	(1,470)
Total actuarial profit/(loss)	**841**	**(738)**

The amounts above are included in Actuarial gains/(losses) on pension scheme in the Group Non-Technical Account on page 33.

18. pension commitments (continued)

e. History of experience gains and losses

	2006	2005	2004	*2003
Difference between the expected and actual return on scheme assets (£'000)	**612**	1,178	340	624
Percentage of scheme assets (%)	**4.0**	8.5	2.8	6.0
Experience (losses) / gains on scheme liabilities (£'000)	**(92)**	(446)	234	(26)
Percentage of present value of scheme liabilities (%)	**0.7**	3.4	2.0	0.2
Total amount recognised in the Non-Technical Account (£'000)	**841**	(738)	(45)	(203)
Percentage of present value of scheme liabilities (%)	**6.1**	5.5	0.4	1.9

* 2003 figures have been restated to provide a combined figure for the UKCSBS and HFS pension schemes for comparative purposes.

19. operating leases

Group	**2006 £'000**	2005 £'000
Operating leases which expire:		
within one year	8	10
between two and five years	79	37
Total	**87**	47

20. taxation

	Group 2006 £'000	Group 2005 £'000	**Society 2006 £'000**	Society 2005 £'000
Corporation tax at 20% and 22% (Society), at 30% (Group Subsidiaries)	2	-	2	-
Adjustment to corporation tax and income tax payable and recoverable relating to prior year	-	278	-	278
Tax credits recoverable on dividends	-	-	-	-
Total	**2**	278	**2**	278

21. commitments

There was no capital expenditure contracted but not provided for in the financial statements (2005: £nil).

22. statement of information relating to the actuarial function holder

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

- Mr T M Batten was not a member of the Society at any time during 2006;
- no other member of his family was a member of the Society during 2006;
- Mr T M Batten is a member of the Homeowners Friendly Society Pension Scheme;
- the aggregate rate of the remuneration and benefits (excluding pension contributions) of Mr T M Batten for 2006 amounted to £83,551.22.

23. related party transactions

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

During 2006, no members of the Board of Directors of Homeowners Friendly Society Limited and its key management had material transactions with any of the Group's related parties.

24. deferred taxation

In accordance with Financial Reporting Standard 19 'Deferred Taxation' (FRS 19) the Group is required to disclose any deferred tax that has not been provided for in the balance sheet. The Group has an unprovided deferred tax asset of £8.4m (2005: £8.0m) and the Society has £5.1m (2005: £5.4m).

25. post balance sheet events

A contract to provide reinsurance arrangements with Munich Reinsurance Company United Kingdom Life Branch was signed on 28 February 2007.

any questions

call free on 0800 028 1045*

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