National Deposit Friendly Society Limited

Annual Report & Financial Statements

2018

National friendly
150 years together

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Established 1868
Registered and incorporated Friendly Society no. 369F

Member of the Association of Financial Mutuals.

Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Chief Executive Officer: Jonathan Long
Secretary: Jonathan Long

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CHAIRMAN'S REVIEW

2018 has been a pivotal year for the Society as we have made significant progress in building the robust and sustainable new business stream required to achieve our long term strategy of:

"being a forward thinking and trusted mutual that meets the health, welfare and protection needs of our customers."

We are pleased to tell you that we issued just under 5,000 policies in the course of last year, which is significantly over our 4,200 target. This increase in sales has been driven primarily by our Over 50s guaranteed acceptance whole of life insurance policy which had outstanding sales performance in the last quarter of the year and this performance has continued into the first quarter of this year.

Supporting this are sales of our healthcare and savings and investment products which continue to be a reliable source of new policy growth and provide us with a more balanced book of business with a diversification of risk profile across product groups.

2018 has been a pivotal year for a number of other reasons, the growth in new business being only one. We have delivered a number of regulatory projects, including compliance with the General Data Protection Regulation ('GDPR'), greater accountability under the Senior Managers and Certification Regime and enhanced product governance and transparency of service through the Insurance Distribution Directive, as required by our regulators, the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA').

We have also launched, in early 2019, the final stage of our policy administration system, allowing us to administer all of our policies on one system. This provides us with an efficient and robust administration platform by which we can generate significant new business growth with little increase in cost. Furthermore, significant cost savings can now be generated with the launch of the final stage through decommissioning our legacy systems and reducing our server capacity.

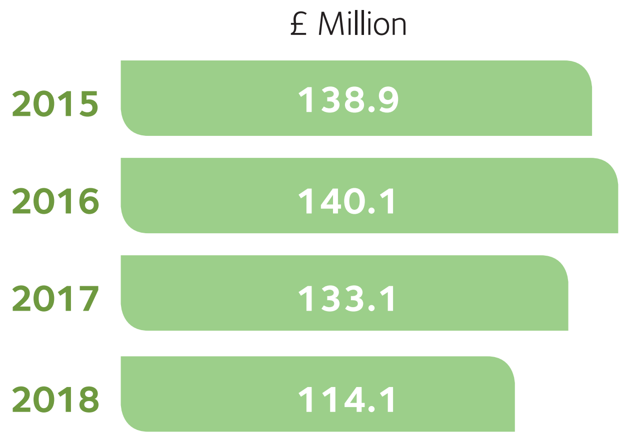
Looking ahead, we are seeking to embed our new products launched to date into a sustainable and growing income stream whilst also developing further new products to diversify our overall product proposition. 2019 and the years that follow will present an exciting, yet challenging, time for the Society as we further develop our offering to our existing members and prospective new members to best advantage.

Finally, I would like to thank our staff for all of their hard work, support and commitment in 2018 and also our members for their loyal support in using us to provide the financial support and protection that they require.

Tracy Morshead
Chairman
15 April 2019

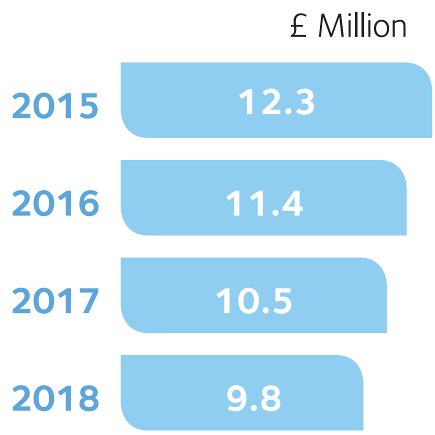
FINANCIAL HIGHLIGHTS

Total Assets



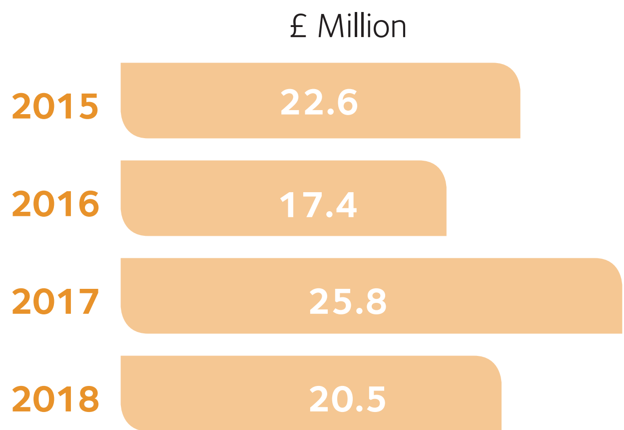
Premium Income

Earned premiums net of reinsurance



Own funds

Capital available to meet regulatory capital requirements



STRATEGIC REPORT

The Society's vision is:

"To be a forward thinking and trusted mutual that meets the health, welfare and protection needs of our customers"

Overall Strategy

The Society's aim as an organisation is to provide for its policyholders products and services that look after their health and welfare to give certainty and control over their wellbeing both now and in the future. This service will be delivered in a timely, personal and friendly manner using technology as appropriate.

The Society has three key objectives to achieve net growth in its customer base, whilst managing regulatory capital and acting in the best interests of the Society's policyholders in protecting and enhancing member value:

- Promoting customer retention, offering alternatives when products mature or reach trigger points such as price and benefit review.
- Expanding the current proposition with further new products and services.
- Establishing a presence in the later life care market in accordance with the long-term strategy.

The Society continues to develop its overall welfare and healthcare proposition. The Society's long-term proposition remains in the health and welfare market providing both insurance and investment products to help members to insure and / or save towards meeting their long term care needs.

The launch of the healthcare products in 2017 and 2018, available at different levels of cover provides insurance for a range of treatments and offers an alternative option to existing policyholders as well as providing affordable healthcare cover to new customers.

The 50 plus Guaranteed Life Assurance ('GLA') product, launched in mid-2018, provides a whole of life insurance with guaranteed acceptance for customers aged between 50 and 80 designed to pay out a sum on death of the life assured.

Business Performance

The Society's business plan and key performance indicators ('KPIs') for 2018 have focussed on continuing to develop and launch new products in line with its strategy, whilst maintaining a strong capital base and controlling costs in order to enhance Own Funds and ultimately, member value.

The main risk for the Society is that premiums and investment income are insufficient to pay the contractual benefits on a policy or the actual demographic experience and/or expenses of administering a group of policies is worse than that assumed in the calculation of future liabilities.

The following KPIs are used to measure ongoing success:

Own Funds

This is an economic Solvency II measure of the Society's net assets after liabilities and represents the long-term value to its members (Embedded Value), and allows the Board to establish the impact of management activity over the long term.

Solvency Coverage Requirements (SCR) ratio

This is a measure of how much surplus capital is available after the solvency capital requirements (a risk-based calculation, based on the actual risks on the balance sheet) that an insurer is required to hold.

Capital Management

The Society's capital position is assessed in accordance with the Solvency II regulations and the Society manages its business on this basis. This is a risk-based approach to the assessment of capital requirements whereby Technical Provisions are calculated as the sum of the best estimate liabilities plus a risk margin. The Society is required to hold sufficient own funds (assets less technical provisions) to meet the SCR, which represents the amount of risk capital required to withstand a set of events at the 1/200 confidence level which covers market, underwriting, counterparty and operational risks.

The Own Funds reduced from £25.8m in 2017 to £20.5m in 2018. The main drivers of this change were:

- A difference between actual and expected investment income. The majority of the investment loss was on the Society's equity portfolio, which fell by 12% over 2018. This was comparable to the fall in the FTSE 100 over 2018.
- Strategic expenses reduce the net assets as these expenses included further system development and strategic activities.
- The commission and acquisition expenses of writing new business were greater than the value created by the new business written in 2018. This is to be expected as the acquisition expenses relating to product development and marketing activities were incurred throughout 2018 whereas most of the new business was written in the last quarter as the investment in these activities was realised.

After allowing for the required SCR under Solvency II, the excess capital at 31 December 2018 reduced to £8.8m, from £13.6m at 31 December 2017.

The above result also takes account of a transitional measure for interest rates ('TMIR') approved by the regulator to enable the Society to smoothly transition to Solvency II. It allows the gradual move from using Solvency I discount rates to the prescribed Solvency II risk free rates set by the European Insurance and Pension Authority ("EIOPA") for existing policies over a period of 16 years, as these policies mature. Before taking account of the transitional measure, the excess assets position was £6.7m (2017: £10.8m).

STRATEGIC REPORT

New business

The Society has continued to consider widening its product offering in order to further protect and enhance the long-term interests of its policyholders through:

i. Writing profitable new business that strengthens embedded value for all policyholders;

ii. Providing an affordable option for new and existing policyholders to help fund their later life care needs;

iii. Reversing the decline in policy count and related income, as policies lapse, that has, to date, been addressed primarily by robust cost control; and

iv. Maximising the use of its existing expertise, resources and systems.

The Society's aim is to provide existing and new customers with products which address their welfare and care needs at every stage of life. Later Life Care (long-term care) is one of the key aims, and it is felt that the Society's best route into this market at this early stage is to develop and distribute products in partnership with major reinsurers.

We measure new sales by their annualised new business premium income ('API') and deposits to new savings and investment policies. In 2018, our new business API and investment deposits exceeded £1.8m, compared with £0.65m in 2017 representing an increase of over 175% from the prior year. Most of these sales were achieved in the last quarter of the year as our new products and investment in marketing activities came to fruition and therefore, we expect to report a further significant increase in API in 2019.

Cost Control

Administration costs are closely controlled and monitored against budgets and reported to both the Executive Committee and the Board. Writing new profitable business helps to reduce the per policy expenses. However, in the situation where lapses are higher or lower than expected, we are able to take management actions to address potential increases in per policy expenses.

Project Asterix, the development of a new policy administration system continued to progress well with the first phase of delivery being achieved in January 2017 and the second phase launched in October 2017. These first two phases provided a fully operational policy administration system and enabled the Society to migrate all of the Society's assurance policies onto the new system and decommission one of its legacy systems. The final stage of migrating the healthcare policies was completed in January 2019.

The implementation of the new system and decommissioning of legacy systems is expected to deliver efficiencies in providing the ability to write new business and at a higher volume without the need for additional administration staff or continued system development of legacy systems and in respect of IT server and maintenance cost savings.

Brexit

The Society is a UK based insurer providing regulated products to UK domiciled customers only. We are aware that a very small number of our members have, since taking out their policy, moved to a country within the EU and we will continue to meet the liabilities on these policies as they fall due.

As the UK considers to leave the EU, the Board will continue to consider how we may be impacted in the future and what, if any actions, we need to take. We are also proactively working with our partners in particular our reinsurers to understand any impacts on their business and the actions they are taking to address this.

Overall, we do not anticipate any material impact on our business and operations.

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Risk Management

Long term sustainability through capital management remains a priority for the Society and writing new contracts of insurance in sufficient volume is integral in achieving this.

The Board has identified key threats to business strategy and mitigation plans have been put in place to ensure that the Society can remain sustainable and continue to operate in the best interests of its policyholders. These risks are summarised in the table below.

Risk	Impact	Mitigating Activities
Solvency Risk The Society is unable to meet its solvency capital requirements	Regulatory intervention. Transfer of engagements or Run off.	Close monitoring of capital management at Board level both with and without the approved transitional measure. This includes scenario analysis and key sensitivities such as morbidity, lapse and expense assumptions. Quarterly roll-forward of Solvency Coverage allowing for updated market conditions, expense assumptions and change in the in-force book. Constant review of expenses including organisation restructuring to ensure right cost base.
Insurance Risk *Morbidity Risk* Morbidity (claims higher than expected) experience deteriorates over and above expectations.	Increased reserves results in reduced excess assets	Management of morbidity claims remains a key focus. Better claims data and more sophisticated valuation methodology is used whereby statistical analyses performed half yearly are used to predict ultimate claims costs. Any new business will be written on an insured / re-insured basis either mitigating or significantly reducing the morbidity risk of new policies. Continuous audit & monitoring of claims payments as well as audit review of outsourced claims administrator to confirm that paid claims are valid.
Lapse Risk Lapses are higher or lower than projected.	Lapses exceeding levels of new business result in higher per policy expenses. Lower than predicted lapses in some product lines could result in increased technical provisions.	Lapse rates are regularly monitored and reported so that sufficient reserves are held reflecting up to date lapse assumptions. Understanding the reasons for the lapses and considering whether action is needed.
Pension Scheme Risk Volatility of pension scheme valuation	Any change in valuation is reflected in the Society's UK GAAP and Solvency II balance sheets.	Review the investment strategy of the pension scheme with the objective of reducing volatility. However, any proposed changes to strategy would need to be approved through the pension trustees.

STRATEGIC REPORT

Risk Management (Continued)

Risk	Impact	Mitigating Activities
Interest Rate Risk Lower interest rates have an adverse impact on calculation of long-term liabilities.	Increased value of long term liabilities reduces SCR coverage.	Look to match as closely as possible assets against expected future liabilities. Use of transition measures to recognise the impact of low interest rates under the new Solvency II regime when compared with historic Solvency 1 position.
Expense Risk Inability to sell sufficient new policies to reverse the declining book and address the expense overrun.	Ongoing administration costs against continued decline in policies and income result in higher net cost to administer each policy Increasing per policy costs against declining book.	Expenses are closely monitored and organisational restructuring to ensure the right cost base. Writing new profitable contracts of insurance to reverse a trend of continued increase in per policy costs. Clear marketing strategy and development of profitable products that meet customer needs and demand against an effective and cost efficient distribution strategy. Close monitoring of ongoing expenses against sales volumes.
Operational Risk **Profitability of National Friendly Financial Solutions ('NFFS')** The Society's subsidiary does not generate a profit.	The subsidiary does not provide a positive financial contribution to the Society, resulting in an increase in expense reserves resulting from lower recharges.	NFFS has its own business plan with stretching targets to include: - Increase in performance and productivity - Reducing the dependency on one key lead provider - Acquisition of new client books
Governance Loss of key personnel and unable to recruit in qualified persons to fulfil key function roles including at Board level.	Loss of knowledge and expertise. Persons unwilling to take roles in highly regulated environment.	Performance against plan is closely monitored and action taken as appropriate to control cost. - Competitive remuneration structure with ongoing development opportunities - Established agreements in place with recruitment agencies should the need arise - Some functions may be outsourced - Use of specialist contractors as a short term solution

Viability Statement

The Directors confirm that they have a reasonable expectation that the Society is well placed to manage its business risks and will continue to meet its liabilities, as they fall due, for the foreseeable future; in particular financial projections for the next five years are incorporated into the Own Risk and Solvency Assessment ('ORSA'), and therefore, the Directors expect the Society to continue in operation over this period. The Directors' assessment has been made with reference to the Society's current position and prospects, the Society's strategy, the risk appetite and principal risks and how these are managed, as detailed above.

The strategy and associated principal risks underpin the Society's plans and scenario testing, which the Directors review at least annually and form an integral part of the ORSA process. The projections make certain assumptions about the level of new business, economic and demographic risks, insurance risks including morbidity, lapses and future expense assumptions. The projections are stress tested in robust downside scenarios including stresses for worsening morbidity, lapses and expenses over and above the assumptions. Under all of these stress tests, the projections demonstrate that the Society continues to meet all of its liabilities as they fall due. The Board recognises that such future assessments are subject to a level of uncertainty that increases with time and therefore, future outcomes cannot be guaranteed or predicted with absolute certainty.

Investment Performance

Our investments are held in a number of asset classes in particular fixed income, property and equities. These portfolios are managed by external property and fund managers whose performance is monitored on a regular basis by the Investment Committee.

Property

The commercial investment market continued to provide positive returns during 2018. Yields in the warehouse and office sectors remained stable during the period, but changes in sentiment within the retail sector resulted in an outward shift in yields and a reduction in capital values. Whilst the outcome of Brexit overshadowed the property market, quality commercial property in prime locations continued to be in good demand from private, overseas and institutional investors.

The keenest demand was for the warehouse sector which experienced strong rental and capital performance.

The Society's property portfolio fared well during 2018 providing a total return in excess of 9% - strongly outperforming the market average. The rental return from the portfolio was 5.75%. During 2018, the Society expanded the investment portfolio with the acquisition of office buildings in Manchester and Poole together with a mixed-use office and leisure property in Norwich.

Ongoing management initiatives should continue to drive total income forward during 2019. With the bulk of the portfolio being held in the office and warehouse sectors, exposure to the fragile retail market remains small.

Fixed Income

UK government bonds (Gilts) outperformed corporate bonds (Credit) over the review period amid a rise in market volatility. Gilts remained in a negative territory for most of the year but recovered losses in the final quarter as Prime Minister Theresa May delayed the vote on the Brexit deal in Parliament, even as the UK and the European Union ('EU') reached an in-principle Brexit agreement.

The portfolio posted negative returns over the period with credit positioning weighing on returns as the difference in yields between Gilts and Credit widened. The outlook for investment in the UK is more subdued than it has been, owing to persistent economic, political and Brexit-related uncertainty. It is believed that Gilt yields will remain within a narrow range as the Bank of England closely watches the progress on Brexit.

STRATEGIC REPORT

Investment Performance (continued)

Equity

The UK stock market fell over the 12-month review period, as lingering concerns about a possible slowdown in the global economy, Brexit-related uncertainties, normalisation of monetary policies by different central banks and the ongoing trade friction between the US and China led to a reduction in risk sentiment in financial markets.

The fund underperformed the index over the review period, largely due to the weak performance of financials holdings. In particular, positions in some banking stocks, such as Barclays and Lloyds Banking, held back gains against an uncertain macroeconomic backdrop.

Given the continued underperformance of the Equity fund over a number of recent years, the Board has made the decision to move from an actively managed portfolio to a 'tracker' in early 2019. The Board will continue to consider further diversification of the equities fund against market expectations and as Brexit related concerns are settled.

With-profits Review

Against a backdrop of continued low interest rates and general uncertainty in investment conditions, the Society has been able to maintain annual bonuses across its with-profits product range and to increase the rates of terminal bonus paid across most of its product range.

As pension contracts currently have a relatively high level of benefits (compared to premiums paid) additional annual bonuses were not awarded in 2018.

Maturity pay-outs for ten year endowment policies remained at a broadly similar level during 2018.

Investment returns for with-profits policies have not been immune to the general fall in investment markets over 2018. These returns will be taken into account when deciding on the 2018 annual bonus declarations. We would generally expect short-term investment fluctuations to be reflected in changes to terminal bonus rates rather than changes to annual bonuses, which are set having regard to the level of return available on fixed interest assets.

Our Members

Engaging with our members

Being a mutual friendly society it is very important for us to engage with our customers and we do this through our Annual General Meeting ('AGM') and Focus Group.

Our AGM

All our members are invited to attend our AGM giving us the valuable opportunity to meet our members and also giving the members an opportunity to meet the Board and Executive Committee of National Friendly.

In 2018, the AGM took place on 19th July at the Hallam Conference Centre, London. The Board and the Executive Committee are always present at the AGM, giving the membership the opportunity to ask the panel questions about the position of the Society, the events of the past year and where they would like to see the Society going in the future. Following the main presentation the members are also welcome to talk to the Board and the senior management team independently on a one-on-one basis if they so wish.

Our Focus Group

Our Member Focus Group currently consists of 23 members from across the Society and meets to discuss relevant issues and ideas going forward, usually twice a year. Our Focus Group members have a wide range of policies held with us and also have diversity in age, gender and national coverage.

We held one Focus Group meeting in February 2018 in London. The Chief Executive Officer presented on the Society's financial position and its performance against its objectives, together with details on progress on its strategy of customer retention and generating new business having launched Optimum Healthcare, an Assisted Living Insurance policy and a Guaranteed Life Assurance plan. The Focus Group members first engaged in discussion and provided feedback both throughout the course of the presentations and afterwards on a one-to-one basis.

150th Anniversary

2018 was a very special year for National Friendly, our 150th anniversary year. The society was formed in April 1868 by The Reverend Canon George Portal in order to help people prepare for contingencies. By setting aside a weekly amount, one could be assured of a useful sum of money to help in times of ill-health. This is still a core value held dear by the Society today; we believe in helping people to help themselves. Our current and planned products are designed to enable people to make provisions for life's uncertainties such as their health and finances.

National friendly 150 years together

Our anniversary in 2018 was a significant milestone that everyone can be proud of - our staff, members and partners, without whom it wouldn't have been possible. We held year-long celebrations from charity walks to competitions, to mark our official anniversary on 20th April 2018.

Treating Customers Fairly ('TCF')

We believe that treating customers fairly is an integral part of who we are. Our customers and their best interests are always at the forefront of our thinking which we firmly believe delivers fair customer outcomes at every step of the way.

To demonstrate our commitment to TCF we:

- Make sure that fair treatment of customers is central to the Society's culture and values.
- Design and market products that meet our customers' needs and perform as we have led them to expect.
- Provide customers with clear information and keep them appropriately informed before, during and after point of sale.
- Make sure that any advice that is given by National Friendly Financial Solutions is suitable and addresses the customer's needs.
- Use incentives for staff that reward behaviours that are consistent with the principles of TCF.
- Maintain service levels and processes that support customers who need to make a claim or complaint.
- Do not create barriers for customers to change product or switch provider.
- Have in place internal controls to monitor our achievement of the principles of TCF.

STRATEGIC REPORT

Corporate Social Responsibility ('CSR')

Our vision

Our CSR approach is a practical one; we look at ways in which we can make a fundamental difference to our people, the community and environment.

Our CSR committee meet regularly to discuss new initiatives and drive our strategic vision, which is to:

- Develop two-way community involvement with our business
- Improve the health, safety and wellbeing of our people
- Operate ethical employment practices
- Achieve high standards in the environmental management of our business

Community

We work with local charities to support our CSR strategic vision. We continue to work with Ablaze and in 2019 will be working with Southmead Hospital Charity as our chosen Charity of the Year.

Ablaze is a charity formed and supported by Bristol's business community to connect local firms with education and help improve the opportunities available to Bristol's young people. Their objective is to tackle the inequality of opportunity for young people in the West of England region. Since 2005, thousands of young people across the wider Bristol region have been supported by businesses and community volunteers delivering Ablaze programmes in schools.

Reading Buddies Programme

The Society has supported Ablaze since 2010 through its 'Reading Buddy Programme' as six of our staff members visit a local primary school during their lunch hour every week to read with the children. The Reading Buddy Programme is intended to increase the amount of reading out loud opportunities pupils have, inspire them to read more and encourage them to gain a love of books.

Queen Square Association

The Society is a member of the Queen Square Association, a registered charity, formed in June 1999 comprising interested residents and occupants of Queen Square, Bristol.

Its aims are to protect, maintain, repair, beautify, restore and advance the historical value of Queen Square for the benefit of its members and those visiting Bristol, and has the responsibility of raising funds along with the help of lottery funding.

The Association also recognises that an improved environment can be highly beneficial to the businesses situated on the Square, and we play an active role in building a positive relationship with our neighbours.

People

We pride ourselves on the quality of our staff and keeping them involved as we develop our strategy. We have a committed workforce who continues to deliver a high quality of service to our members and contribute to the achievement of our strategic objectives.

The Society recognises the importance of continuing development and supporting our staff to achieve their goals and every member of staff has agreed objectives and annual appraisals to assess performance against these objectives and demonstration of the Society's values.

The Society's values are:

- Customer driven
- Integrity
- Focused
- Innovative
- Agile
- Responsive

Environment

We recognise that, like any organisation, the activities we undertake will have an impact on the environment around us. We therefore continually seeking initiatives from our staff so that we operate on as much of a carbon neutral basis as is possible. Our strategy is therefore to:

- Reduce our energy consumption and increase energy efficiency through the appropriate use of office equipment, lighting and heating.
- Eliminate waste where practicable.
- Make use of recycled or recyclable material.
- Work with suppliers who adopt similar or higher environmental standards.

The printers we use are sourced from accredited Forest Stewardship Council ('FSC') printing companies, meaning that our choice of paper is produced from well-managed forests and/or recycled materials. They are Bristol based and less than three miles away from our office.

We use both digital and lithoprint technology to print our policy literature, enabling us to select the most economical way of printing. Two types of ink are used. Toner is used for digital printing and vegetable based ink is used for lithoprint.

We also send policy literature electronically. If you would prefer to receive your policy documentation via email, please contact our Customer Services team on 0333 014 6244 and they will update your records accordingly.

Our Foundation Fund

National Friendly's Foundation Fund provides strong support to our approach to CSR albeit under the direction of an independent Board, the Foundation Fund Committee.

The Foundation Fund has the general aim of making discretionary grants for the following purposes:

- To provide benevolent support to any member of the Society or their family at a time of need.
- For any activity or undertaking which promotes the engagement of the Society with its membership.
- To provide additional services or benefits to any or all of the Society's members/families.

The objectives of the Foundation Fund are in line with National Friendly's long standing aims of supporting its members at times of need. The aim is to award grants and disbursements that, regardless of relative value, are meaningful and make a significant difference to the recipients.

Members of the Society or employees can make applications by submitting a completed application form. Dispersals are reviewed and agreed by the Foundation Fund Committee.

Our Charity of the Year

Our staff choose a 'Charity of the Year' to raise funds for on an annual basis. Firstly, all staff are invited to nominate charities which they are passionate about. The CSR committee, against pre-agreed selection criteria, then reviews nominations to create a shortlist. All staff then vote from the shortlist for their preferred charity of the year and the charity with the most votes is selected.

Throughout 2018, the staff have been working hard to raise money for our nominated charity, the Cystic Fibrosis Trust. The Cystic Fibrosis Trust is the largest charity in the UK dedicated to transforming the lives of those with cystic fibrosis through investment into research, advising those with the condition and raising awareness throughout the country.

Cystic Fibrosis...

Staff are encouraged to take part in as many fundraising activities as possible throughout the year, ranging from themed bake sales, photography competitions and a host of sponsored sporting events.

Thanks to everybody's enthusiasm and commitment, staff were able to raise **£5,048**. Funds are matched by the Society's Foundation Fund, up to the amount of **£5,000**, which brought the total funds raised to **£10,048** and a cheque for this amount was presented to the Cystic Fibrosis Trust in January 2019.

STRATEGIC REPORT

Our Charity of the Year (continued)

Jessica Barnard, the Cystic Fibrosis Trust's community fundraiser for the West, said:

"The most exciting thing about working for the Cystic Fibrosis Trust for me is things like this, meeting incredible people. Because I'm not the interesting one; I just get to go and meet incredible people every single day. It's so humbling, all the things that they have done, it's so inspiring.

The thing that excites me constantly is how passionate our supporters are, we are so lucky in that. It is a life limiting condition, and everyone who is caring for someone with CF can see that, and so they're so passionate, so engaged, so that's exciting for me.

Working with National Friendly has honestly been amazing. You've all been so passionate and engaged, and there are so many different ways you've been fundraising or spreading awareness, it's just been wonderful to see."

Our charity of the year for 2019 is Southmead Hospital Charity Neonatal Intensive Care Unit ('NICU') fund. The neonatal unit has a specialist team who provide intensive care, high dependency care, special care and transitional care for hundreds of babies each year who are born prematurely or with medical conditions that mean they need extra support. The unit is one of the Regional Neonatal Intensive Care Units for the South Western Delivery Network.

The money raised by staff will help more patients in Bristol and the South West receive the very best possible care.

The Society's fundraising target for 2019 is £5,000, which will be matched by £1 for every £1 raised by the Foundation Fund, and staff are looking forward to taking part in a number of exciting events this year. As always, we are very grateful to our staff and their friends and families for all their efforts.

On behalf of the Board
Jonathan Long
Chief Executive Officer
15 April 2019

THE DIRECTORS' REPORT

Corporate Governance Review

The Board is of the view that good corporate governance is fundamental to the Society's operations. To comply with best practice in corporate governance it aims to adhere to the principles and provisions of the Code on Corporate Governance annotated by the Association of Financial Mutuals ("the Code").

Our policy is to observe the Code wherever appropriate to our size, status and objectives or to 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 in this report.

Role of the Board

The Board is the main decision making body for National Friendly and its subsidiary companies. It determines the strategic direction and has responsibility for the overall management of the Society's business affairs. The Board sets the Society's values and standards and has overall responsibility for establishing that obligations to members and other stakeholders are understood and met. The Board monitors and oversees the Society's operations with the purpose of maintaining competent management, sound planning, robust and prudent risk and capital management, an effective internal control environment, a culture of risk awareness and ethical behaviour, and compliance with statutory and regulatory obligations.

The Board meets a minimum of six times a year and more often if necessary. Additionally it meets at least once a year to undertake a detailed review of the Society's strategy.

The Board maintains a schedule of matters reserved for the Board's discussion and decision and it sets out its responsibilities and the structure of delegation of authority by the Board to management, as required by regulation and the Society's rules.

The Board has established sub committees, under its overall authority, to deal with certain functions in detail. Further details of the responsibilities and activities of these Committees are provided on pages 19-21. Each committee is chaired by a Non-Executive Director and all members are considered to have appropriate skills and expertise to undertake their role within the committees. The Terms of Reference of the Audit, Risk & Compliance, Investment, Nomination and Remuneration Committees are available on the Society's website and on request to the Secretary.

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 Audit Committee provided reasonable assurance that during 2018 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate system of internal control.

The Society maintains liability insurance for all officers throughout the year.

Chairman and Chief Executive

The role of the Chairman and Chief Executive are held by different people and are distinct and separate in their purpose.

The Non-Executive Chairman is responsible for leadership of the Board and ensuring that the Board acts effectively and has no involvement in the day to day business of the Society. The Chief Executive has overall responsibility for managing the Society and its subsidiaries and for implementing the strategies and policies agreed by the Board.

Board Balance and Independence

The Board consisted of four Non-Executive Directors and two Executive Directors throughout 2018.

The Board continues to review its own balance, completeness and appropriateness to meet the complexities of the business. The Board has and will continue to assess the balance of skills and where necessary will appoint individuals to meet the demands.

The Board has appointed Peter McIlwraith as Senior Independent Director ('SID'). The SID is available to members if they have concerns where contact through the Chairman or Chief Executive Officer has failed to resolve or for which such contact is inappropriate.

In the opinion of the Board, each Non-Executive Director, including the Chairman, is independent in character and judgement and free of any relationship or circumstances that could materially interfere with the exercise of their judgement.

THE DIRECTORS' REPORT

Appointments to the Board

The appointment and re-election of Directors is considered by the Nominations Committee (see page 20), which makes recommendations to the Board. The Society seeks to have broad experience and diversity on the Board. Furthermore, in respect of gender diversity, the inclusion of women on the Board is an important consideration during searches for new Board members. The focus is to increase Board diversity without compromising on the calibre of directors and therefore Board appointments are always made on merit as well as the skills, knowledge and experience of the Board as a whole.

All Directors are subject to election by members at the AGM following their appointment and re-election at least every three years. Any Non-Executive Director who has served the Society for longer than nine years is subject to annual re-election. In addition, all Directors are subject to approval from the Prudential Regulation Authority ('PRA') and / or the Financial Conduct Authority ('FCA') as an Approved Person under the Senior Managers & Certification Regime ('SM&CR'). The SM&CR provides a regulatory framework for the standards of fitness and propriety, conduct and accountability to be applied to individuals in positions of responsibility at insurers.

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.

Information and Professional Development

The Chairman has responsibility for overseeing that all Directors receive accurate, timely and clear information, which is fundamental to the effective function of the Board.

The Chairman ensures that, on appointment, all Directors receive a comprehensive induction programme. Non-Executive Directors update their skills, knowledge and familiarity with the Society through meetings with the Executive and employees and through attending external courses when relevant.

The Board has access to independent professional advice at the Society's expense where they consider it necessary to discharge their responsibilities. In addition, all Directors have access to the advice and services of the Secretary who is responsible for ensuring the Board procedures are complied with and advising the Board, through the Chairman, on governance matters.

Performance Evaluation

The Society considers the review of the Board's performance to be an essential part of good corporate governance. The evaluation considers the balance of skills, experience, independence and knowledge of the members of the Board, including its diversity, how the Board works together as a unit, and other factors relevant to its effectiveness.

A formal performance evaluation scheme is in place for Society staff including the Executive Directors. The Chairman undertakes a performance appraisal of the Chief Executive against agreed objectives.

Non-Executive remuneration is not performance related. However, an annual appraisal process is undertaken. Fees paid to Non-Executive Directors recognise the responsibilities of Non-Executive Directors and are designed to attract individuals with the necessary skills and expertise to fill the role.

Audit Committee

Members	Responsibilities
Peter McIlwraith (Chairman) **Mark Jackson** **Geoff Brown**	The Audit Committee meets at least four times a year at appropriate times in the financial reporting and audit cycle. 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 internal control and risk management processes. • The effectiveness of the internal and external audit functions and processes. • The recommendation to the Board in relation to the appointment, reappointment, remuneration and removal of the external auditors. • The objectivity and independence of the external auditor in respect of the provision of any non-audit services. • The arrangements by which staff within the Society may raise concerns, in confidence, about possible improprieties in matters of financial reporting or other matters. The Executive Directors and internal and external auditors attend meetings of the Committee as appropriate. The internal and external auditors may also meet separately with the Committee without the Executive Directors or any other members of staff present. Internal audits of the regulated business are conducted by Mazars LLP and reported to the Committee.

Investment Committee

Members	Responsibilities
Tracy Morshead (Chairman) **Geoff Brown** **Jonathan Long** **Peter McIlwraith** **Sandy Richards** (resigned 5 April 2019)	The Investment Committee meets as required but at least three times a year to review compliance with the terms of the Principles and Practices of Financial Management in relation to the investment strategy and review its continuing appropriateness in the light of changing circumstances with consideration to the needs of both with-profits and non with-profits policyholders. The Committee also has responsibility for: • Appointing the Society's Investment Fund Managers. • Determining the asset allocation and performance benchmarks. • Monitoring the performance of the Funds and of the Fund Managers.

THE DIRECTORS' REPORT

Nomination Committee

Members	Responsibilities
Peter McIlwraith (Chairman) **Geoff Brown** **Tracy Morshead**	The Nomination 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. Nominations for appointment to the Board are considered for approval by the full Board. Professional recruitment consultants can be and are consulted to ensure that non-executive vacancies on the Board are considered appropriately. Membership of the Committee may be altered as appropriate in particular to address circumstances where one of its members is being considered for re-appointment.

Remuneration Committee

Members	Responsibilities
Peter McIlwraith (Chairman) **Mark Jackson** **Tracy Morshead**	The Remuneration Committee meets at least twice a year to establish, implement and maintain a remuneration policy and practices in line with the Society's risk management strategy, risk profile, objectives and risk management practices. Further details on Directors' remuneration are set out in the Directors' Remuneration Report on pages 30-33.

Risk & Compliance Committee

Members	Responsibilities
Geoff Brown (Chairman) **Tracy Morshead** **Jonathan Long** **Sandy Richards** (resigned 5 April 2019)	The Risk Management Committee meets at least four times a year. The main function of the Committee is to assist the Board in its leadership and oversight of risk across the Society including the understanding and, where appropriate, optimisation of current and future risk strategy, overall risk appetite and tolerance, risk management framework including risk policies, process and controls, and the promotion of a risk awareness culture throughout the Society. The Committee has the additional responsibility of providing oversight of the Society's governance and regulatory compliance arrangements and their on-going effectiveness. The Chairman of the Committee meets the Head of Finance & Risk at least once a year, without management present, to discuss their remit and any issues arising from the risk and control assessments that have been carried out.

With-Profits Advisory Arrangement

Members	Responsibilities
Geoff Brown (Chairman) **Mark Jackson**	The With-Profits Actuary attends meetings of the Advisory Arrangement as appropriate. The With-Profits Advisory Arrangement meets as required and at least once a year to independently monitor and bring independent judgment on the extent to which procedures, systems and controls are adequate and effective to enable the Society to comply with the requirements of the FCA Handbook over the management and governance of with-profits business.

Executive Committee

The Executive Committee forms part of the Society's corporate governance structure. The Board is the main decision making body and the Executive Committee, whilst not a sub-committee of the Board, is charged (either individually or collectively) with running the Society's business within the delegated authority of the Board.

Attendance of Directors at Board and Committee meetings

	Board		Audit Committee		Remuneration Committee		Nominations Committee	
	Meetings attended	Meetings held	Meetings attended	Meetings held	Meetings attended	Meetings held	Meetings attended	Meetings held
Non-Executive								
Geoff Brown	7	7	6	6	3	*	1	1
Mark Jackson	6	7	5	6	3	3	1	*
Peter McIlwraith	7	7	6	6	3	3	1	1
Tracy Morshead	7	7	6	*	3	3	1	1
Executive								
Jonathan Long	7	7	6	*	3	*	-	-
Sandy Richards	7	7	6	*	-	-	-	-

* Attendance on an invitation basis.

THE DIRECTORS' REPORT

Attendance of Directors at Board and Committee meetings (continued)

	Investment Committee		Audit Committee		Remuneration Committee	
	Meetings attended	Meetings held	Meetings attended	Meetings held	Meetings attended	Meetings held
Non-Executive						
Geoff Brown	3	3	4	4	3	3
Mark Jackson	–	–	–	–	3	3
Peter McIlwraith	3	3	–	–	–	–
Tracy Morshead	3	3	4	4	–	–
Executive						
Jonathan Long	3	3	4	4	3	*
Sandy Richards	3	3	4	4	3	*

* Attendance on an invitation basis.

Statement of Compliance with the Annotated Corporate Governance Code

The Board considers that throughout 2018 the Society applied the relevant principles and voluntarily complied with the relevant provisions of the annotated Corporate Governance Code for Mutual Insurers issued by the Association of Financial Mutuals.

As required by the UK Corporate Governance Code – An Annotated Version for Mutual Insurers ('the Code'), the Board states that it considers the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and Society's performance and strategy.

The following are exceptions to our compliance with the Code for the stated reasons,

1. The Board notes the recommendation of the Code that Directors of larger organisations be subject to annual election by members. The Board considers, however, that the existing arrangements for re-election ensures proper accountability and underpins board effectiveness.

2. Peter McIlwraith, Tracy Morshead and Mark Jackson have served on the Board for more than nine years from the date of first election and therefore are subject to annual re-election after having considered their continued independence.

3. The Code recommends that an evaluation of the Board should be externally facilitated at least every three years. The last externally facilitated evaluation was completed in 2015 and therefore, it is recognised that this is now overdue. The Board plans to consider this alongside its own internal evaluation of the Board's effectiveness during 2019.

Annual General Meeting

The 2018 Annual General Meeting was held in London on 19th July and was attended by Members, Board Members, and Officers of the Society.
A number of resolutions were voted on including:

- The Board Report.
- The Directors' Remuneration Report.
- The Auditor's Report and the Annual Report and Financial Statements.
- To appoint Ernst & Young LLP as Auditors.
- Re-election of Peter McIlwraith, Tracy Morshead, Mark Jackson and Geoff Brown as Non-Executive Directors.
- Re-election of Jonathan Long and Sandy Richards as Executive Directors.

The response from members submitting their postal/ proxy forms was 12.5% of members eligible to vote electing to do so. The Society wishes to encourage more members to attend the AGM and arrangements are in place for the 2019 AGM to be held again in London.

THE DIRECTORS' REPORT

The Board

Tracy Morshead

(Chairman)

Tracy has held senior management positions with three major Building Societies, Birmingham Midshires, Principality, where he was Managing Director, and Nationwide, where he was Divisional Director. He is a Fellow of the Chartered Institute of Marketing and is a chartered marketer. Tracy is Managing Director of Morshead's Old Books Limited, Non-Executive Chairman of Mortgage Brain Holdings Limited, a leading financial services software company, and a Non-Executive Director of Newbury Building Society. Tracy joined the National Friendly Board in June 2009 as a Non-Executive Director and was appointed as Chairman of the Board effective from 1 April 2014.

Jonathan Long

(Chief Executive Officer)

Jonathan was appointed as a Director on 1 May 2007. After qualifying as a Chartered Accountant at Coopers & Lybrand, he went on to perform a variety of financial, strategic and business development roles at Prudential and Barclays before joining the Society in 2006. Jonathan was appointed Chief Executive in 2011.

Sandy Richards

(Executive Director)

Sandy was appointed as Secretary to the Society in March 2014 and as a Director on 1 September 2014, heading up our Finance, Risk, Compliance and HR functions. She has over 25 years' experience in the financial services sector in a variety of risk, finance and business development roles at Arval UK Limited (a subsidiary of BNP Paribas), the Higher Education Funding Council for England and at the Royal Bank of Scotland Plc, before joining the Society in 2012. Sandy is a qualified Fellow Chartered Certified Accountant.

Sandy resigned as a Director on 5 April 2019.

Peter McIlwraith

(Senior Independent Non-Executive Director)

Peter is a Chartered Accountant. He was a partner with PricewaterhouseCoopers (and prior to that Price Waterhouse) and was the Regional Chairman for the West and Wales and Senior Partner in Bristol from 1991 to 2001. Since then Peter has held a number of non-executive board positions in both the commercial and charitable sectors. Peter joined the National Friendly Board as a Non-Executive Director in April 2003.

Mark Jackson

(Non-Executive Director)

Mark is a former GP and successful business man. Mark was CEO of Helphire (now Redde PLC) which he founded and was co-founder and Chairman of Assura Group both of which he was instrumental in floating on the London Stock Exchange. Mark currently sits on a number of Boards including Medigold, Exemplar Health Care Limited and Astonbrook Care Holdings Limited. Mark joined the National Friendly Board as a Non-Executive Director in June 2009.

Geoff Brown

(Non-Executive Director)

Geoff is a qualified Actuary and had 44 years of experience in the financial services industry before retiring in late 2013. He spent most of his career in the health and care sector including 20 years with international healthcare company BUPA Limited, where he held a variety of roles and responsibilities – most recently as Chief Risk Officer of the BUPA Group and prior to this as Director of Compliance and Chief Actuary of the UK division. Geoff is also currently a Non-Executive Director of Medicover Forsakrings AB (publ.) and Chair of its Compliance and Risk Committee. Medicover is a Swedish insurer which provides healthcare insurance propositions for individuals and companies in Poland, Romania and Hungary. Geoff joined the National Friendly Board as a Non-Executive Director in June 2014.

THE DIRECTORS' REPORT

Business Objectives and Activities

The Society's objective is to provide our policyholders with products and services that look after their health and welfare to give certainty and control over their wellbeing both now and in the future. This will be delivered in a timely, personal and friendly manner using technology as appropriate.

The Board sets KPIs and targets, which it monitors on a regular basis throughout the year. These KPIs are reviewed in line with the Society's objectives and priorities. For 2018, the KPIs focussed on new product development and sales, capital management and cost control as set out in more detail within the Strategic Report.

The principal activities of the Society's subsidiaries are as follows:

- 425 Direct Limited (trading as National Friendly Financial Solutions) provides telephone based financial services: independent advice and a comparison non advised service;
- ND Member Services Limited: Owns the intellectual property rights to a policy administration system. It licences this software to National Friendly as well as marketing the system to other similar insurers.

Statement of Responsibilities of the Directors

The Board is required to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the Society as at the end of the financial year and of the results for that year. In preparing these financial statements the Board is required to:

- Select suitable accounting policies and then apply them consistently.
- Make judgements and estimates that are reasonable and prudent.
- State where applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.
- Prepare the statements on a going concern basis, unless it is inappropriate to assume that the Society will continue in business.
- Prepare the financial statements in accordance with the Friendly Societies (Accounts and Related Provisions) Regulations 1994 and in accordance with the applicable accounting standards in the United Kingdom.

In following the Friendly Societies (Accounts and Related Provisions) Regulations 1994, this includes the two updates to this regulation: the Friendly Societies (Accounts and Related Provisions) (Amendment) Regulations 2005; and the Friendly Societies (Accounts and Related Provisions) (Amendment) Regulations 2008.

The Directors confirm that the financial statements comply with the above.

The Directors are responsible for keeping appropriate accounting records which disclose with reasonable accuracy, at any time, the financial position of the Society and to enable it to ensure that the financial statements comply with the Friendly Societies Act 1992. They are also responsible for safeguarding the assets of the Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The maintenance and integrity of the National Deposit Friendly Society Limited and Group website is also the responsibility of the Directors.

Disclosure of Information to Auditors

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

Going Concern

The Society's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report for the year. The financial position of the Society, its cash flows, liquidity position and borrowing facilities have also been considered by the Board. The Society's policies and processes for managing capital are highlighted in Note 2 to the financial statements. The Society has adequate financial resources, supported by long-term relationships with its policyholders and suppliers. As a consequence, the Directors believe that the Society is well placed to manage its business risks in respect of liquidity and cash flows. After making enquiries, the Directors have a reasonable expectation that the Society has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Employees

The average number of Directors and staff employed by the Group and Society is disclosed in Note 9 on page 71.

The aggregate remuneration paid to Directors and staff employed by the Group during the year amounted to £3.0m million (2017: £2.8 million).

Communication with staff is undertaken through regular dialogue with staff, as groups, individually and through the organisation's intranet (with upward feedback positively encouraged). Open meetings are also conducted with the Chief Executive and other members of the Executive Committee. The Society is committed to the ongoing development of its staff.

Member Relations

The Board is committed to maintaining good communications with members. In order to fulfil this commitment, a Members' Focus Group and Research Community have been established. Engagement with the Focus Group has been positive and feedback valued. The Board also firmly believes in the principles of Treating Customers Fairly and adheres to these in its day to day operation.

Complaints Policy

The Society aims to deliver the highest possible level of service to members. If any member believes that the Society has failed in this aim they have recourse to the Society's Complaints Procedure.

The Society has a documented procedure for the handling and recording of complaints. The Board, through the Risk and Compliance Committee, regularly reviews the number and type of complaints received in order to monitor that complaints are properly dealt with and corrective action has been taken to prevent recurrence.

Charitable Donations

The Society made charitable donations of £5,000 (2017: £5,000). There were no political donations (2017: £nil).

Change of Secretary

Sandy Richards resigned as Secretary on 5 April 2019. On 5 April 2019 Jonathan Long was appointed as Secretary.

Re-appointment of Auditors

Following a tender process in late 2017 for the external audit, the Society appointed Ernst & Young LLP ('EY') as its new Independent Auditor to replace PricewaterhouseCoopers LLP. The appointment of EY as auditors was ratified at the Society's AGM in 2018. A resolution to re-appoint EY as auditors will be proposed at the forthcoming AGM.

Approved by order of the Board

Jonathan Long

Chief Executive Officer

15 April 2019

AUDIT COMMITTEE REPORT

The Audit Committee's role is to assist the Board in meeting its responsibilities for the integrity of the Society's financial reporting, including the effectiveness of the internal control and risk management systems, and for monitoring the effectiveness and objectivity of the internal and external auditors. The Committee considers that it has met its responsibilities and performed its duties with appropriate levels of care and expertise over the year.

All members of the Audit Committee are Non-Executive Directors. The external and internal auditors regularly attend Committee meetings. The Committee reviews and approves their audit plans, receives reports from the auditors and has a regular dialogue with them. It considers the systems of internal control, reviews recommendations from the auditors, management responses thereto and monitors follow up actions.

The Audit Committee and Risk and Compliance Committee work together effectively to cover all relevant issues and ensure that any pertinent areas of overlap are appropriately addressed.

Independent External Auditor

The Committee, during the year, assessed the effectiveness of the audit process including feedback from management and agreed with management's view that there had been appropriate focus and challenge on the primary areas of audit risk. The independence and objectivity of the external auditor was considered and concluded to be satisfactory.

The Committee reviewed the external audit arrangement in late 2017 undertaking a formal tender process and recommended to appoint EY as the Society's External Auditors with effect from 6 September 2017. A resolution proposing the appointment of EY as the Society's external auditor was put to the members at the 2018 AGM and approval gained.

The Committee continues to assess the independence, the objectivity of the external audit and the effectiveness of the audit process on an ongoing basis. The external auditor is required to rotate the audit partner responsible for the Society audit every five years.

The Society has policies in place, which aim to safeguard and support the independence and objectivity of the external independent auditors. One such policy requires the prior approval of the Committee for the engagement of the independent auditors for non-audit work. The external auditor (EY) did not undertake any non-audit assignments during 2018

Areas of particular focus

The Audit Committee considered the significant issues in relation to the preparation of the financial statements, and has addressed them as follows:

Significant Issue	How it was addressed
Assessment of morbidity assumptions and calculation of related liabilities	The Society has in place monthly procedures to analyse morbidity experience on Healthcare and Healthguard contracts. Sophisticated valuation methodology is used whereby statistical analyses are used to predict ultimate claims costs for each incurred month. This methodology provides an estimation of outstanding claims costs for previously notified claims and future costs of claims that will arise over the remaining lifetime of the contracts in force. It also provides a useful tool to monitor trends in experience. A quarterly review with the third party claims administrator includes analysis of claims experience and trends. The Society's internal auditors, reporting to the Audit Committee, provide further assurance on claims management for both in-house claims administration and the outsourced arrangement.
Assessment of assumptions relating to lapses and their resultant impact on liabilities	Lapse experience is monitored on a monthly basis throughout the year. Valuation assumptions are set with regard to the Society's own experience (given the uniqueness of the Healthcare business) taking into account trends in the actual versus expected experience. As much relevant data as possible is used to improve the reliability of any estimates of future experience. Allowance is made for significant non-recurring events which may trigger a short-term spike in lapses but which are unlikely to influence subsequent lapse experience.
Assessment of assumptions relating to expenses	Expenses are determined using per policy expenses equal to the level of expected administration costs in 5 years' time divided by the expected volume of business in force at that time. The new business assumption is based on the most recent sales projections. The Audit Committee is satisfied that, considering all material factors, the approach is reasonable and one that reflects its best estimate of future experience.
Adequate and Effective Control framework	The Society's Internal Auditors undertake financial, operational and strategic audits across the Society using a risk based approach. Internal audit services are provided by an outsourced partner and are fully independent from the operations of the Society. The Audit Committee agrees the planned internal audit work for the year and receives reports of findings for all reviews during the year and a report of progress. During 2018, internal audits were completed in areas including claims management, review on the implementation of new regulations including General Data Protection Regulations ('GDPR') and the SM&CR, reviews of the new sales processes and of key actuarial models including product profitability and solvency monitoring. Internal Audit provided an overall annual opinion of 'Substantial Assurance' on the Society's framework of risk management, governance and internal control.

Furthermore, it is the role of the Audit Committee and the Board to consider key assumptions in the preparation of the financial statements including the valuation of property and determination of pension deficit.

Peter McIlwraith
Chairman of the Audit Committee
15 April 2019

DIRECTORS' REMUNERATION REPORT

Introduction

The Society is committed to a framework which recognises and rewards contribution that individuals make. This Report of the Directors on remuneration explains how the Society applies the principles in the Annotated Code of Corporate Governance relating to remuneration.

The Remuneration Committee keeps itself informed of relevant developments and best practice and is authorised at its discretion to obtain advice from external advisers.

Remuneration Committee

Members	
Peter McIlwraith	- Committee Chairman
Mark Jackson	- Non Executive Director
Tracy Morshead	- Non Executive Director

The Remuneration Committee is appointed by the Board and all members of the Committee are Non-Executive Directors. The CEO and / or other relevant Executive Officers attend meetings as appropriate.

The Committee, within the terms of the Remuneration policy agreed by the Board, sets the level of remuneration for the Chief Executive and other Executive Directors. The Committee also sets the proposed level of fees for the Chairman, having taken advice from the Executive Directors. The Chairman takes no part in the setting of his own remuneration

Policy

The Society's approach to remuneration is an integral part of the Business strategy and the policy is designed to attract, retain and motivate competent, experienced and skilled staff. The policy is based on the following principles:

a. Reward and remuneration will be clear and up to date with the market so that individuals are motivated and the Society is able to attract and retain key talent.

b. Remuneration package will be competitive and recognise the relative remuneration in comparable market through benchmarking. The benchmarking may be undertaken by external advisers appointed by the Society.

c. Remuneration will be determined fairly and objectively across the Society.

d. Variable reward for the Directors and key function holders will be linked to strategic objectives as well as considering current and future risks.

e. Total remuneration will include a fixed base salary as well as a variable discretionary bonus and other financial and non-financial employee benefits.

f. The remuneration policy will be transparent and accessible to all staff across the Society.

Remuneration for Executive Directors consists of a fixed salary, variable incentive pay, pension and other benefits including company car allowance. All benefits (other than variable pay), including pension arrangements, are on the same terms as employees.

For each Executive Director, the Remuneration Committee determines an appropriate level of remuneration, taking account of the specific role and responsibilities. The Committee has access to external advisers, for guidance and benchmarking. Each year the Committee reviews the level of Directors' remuneration so that it continues to be competitive and provides proper and risk-based incentives to the Executive.

The Society requires that the Directors do not use personal hedging strategies or insurance that could be used to undermine the risk alignment effects embedded in their remuneration arrangements.

Remuneration for Non-Executive Directors comprises a basic fee plus a supplement for the Chairman of the Board also recognising his role as Non-Executive and Chairman of 425 Direct Limited and for the Senior Independent Non-Executive Director, both based primarily upon the time commitment required for the roles.

Summary

This report, together with the disclosures below, is provided to give members a full explanation of the policy and application of directors' remuneration. A resolution will be put to the Annual General Meeting inviting members to vote on the Directors' Remuneration Report. This vote is advisory and the Board will consider any action that may be required following the outcome of the vote.

Peter McIlwraith

Chairman of the Remuneration Committee

15 April 2019

Directors' emoluments

	Salaries & Fees £	Performance Related Pay £	Other Benefits[1] £	Total 2018 £	Total 2017 £
Chairman					
Tracy Morshead[2]	49,950	–	–	49,950	49,950
Executive Directors					
Jonathan Long[3]	161,570	31,526	29,225	222,321	219,537
Sandy Richards[3]	115,325	21,226	23,387	159,938	149,177
Non-Executive Directors					
Geoff Brown	29,940	–	–	29,940	29,205
Mark Jackson	29,940	–	–	29,940	29,205
Peter McIlwraith	40,250	–	–	40,250	39,270
TOTAL				**532,339**	**516,344**

[1] Other benefits include pension scheme contributions, car benefits and allowances, medical and other benefits in kind or equivalent monetary value.

[2] The Chairman also provides Non-Executive support and chairs the Board of National Friendly's subsidiary company, 425 Direct Limited.

[3] Performance related pay relates to 2017 but was awarded in 2018. Assessment of performance related pay for the Executive Directors for 2018 will be carried out in Q2 2019 following finalisation of the Annual Report and Accounts.

DIRECTORS' REMUNERATION REPORT

One of the Executive Directors is a member of the National Deposit Staff Superannuation Scheme. This is a defined benefit retirement plan that closed to future accrual on 31 May 2009.

Pension Entitlement - Defined benefit retirement plan

	Years of Service	Pension accrued during 2018 £	Accrued pension as at 31/12/2018 £	Accrued pension as at 31/12/2017 £	Closing value at 31/12/2028 £	Opening value at 31/12/2017 £	Pension input amount over 2018 £
Jonathan Long	12	123	5,049	4,926	100,981	101,474	-

At the AGM, members voted on the resolution to approve the 2017 Directors' Remuneration Report. The Group is committed to on-going shareholder dialogue and takes an active interest in voting outcomes. Where there are substantial votes against the resolutions in relation to Directors' remuneration, the reasons for any such vote will be sought, and any actions in response will be detailed in the next Directors' Remuneration Report.

The following table sets out the actual voting in respect of the approval of the 2017 Directors' Remuneration Report:

Number of votes cast for	Percentage of votes cast for	Number of votes cast against	Percentage of votes cast against	Total votes cast	Number of votes withheld
2808	94.64%	113	3.81%	2967	46

Executive Directors

Base Salaries

Base pay will normally be reviewed annually in January taking into consideration RPI and CPI as a guide in any cost of living uplift.

Pay reviews may take place at other times of the year to reflect a change in role and / or significant change in responsibilities. The Committee may consult with external advisors as appropriate for such pay reviews, who can undertake a job evaluation to provide a guide salary range relevant to the role. The evaluation considers the demands of the role and then applying factors derived from salary research data, takes account of the Society's size, sector and location.

Performance Related Pay

The Executive Directors are eligible for an annual Performance Related Pay currently representing up to a maximum of 30% of base salaries. All Executive Directors participate on the same basis and this comprises two elements: the first is assessed on a collective basis against identified corporate objectives and the second element is an individual performance related programme where the Executive Directors are assessed against personal goals and objectives.

LTIP

There is currently no Long Term Incentive Plan ('LTIP') scheme in operation. The Remuneration Committee may give consideration to the terms of such a scheme in the future, considering the Society's medium and long term objectives over an extended time horizon, whilst taking account of the Society's risk profile.

Retirement and Related Benefits

The Executive Directors are members of a defined contribution pension scheme which is available to all employees. The Society contributes up to a maximum of 12% of base salary per Director, dependent upon personal contribution levels.

Other Benefits

Executive Directors are entitled to private medical insurance, death in service benefit of four times basic salary and a company car or car cash allowance. Other benefits available to all staff are also available to Executive Directors such as salary sacrifice schemes for pension contributions, child care voucher scheme and the cycle to work initiatives and for season ticket loans.

Directors' Contract

The Executive Directors have service agreements which incorporate their terms and conditions of employment. Executive Directors are employed on contracts subject to no more than twelve months' notice in accordance with corporate governance best practice.

Non-Executive Directors

All Non-Executive Directors including the Chairman have letters of appointment which set out their duties and responsibilities. The appointment of Non-Executive Directors is usually for a period of three years and is subject to election and re-election at the Society's AGM. After nine years of service re-election becomes an annual process.

Fees are benchmarked against similar roles in comparable organisations. Fees are calculated on an annual rather than a daily basis. However, it is assumed that to fulfil the basic role of a Non-Executive Director, sufficient time and commitment is required each month for review work and attendance at regular Board meetings, the Society's AGM, Special General Meetings where appropriate, other ad hoc meetings with regulators and advisers as may be required and training courses.

Non-Executive Directors remuneration is not performance related nor pensionable and Non-Executive Directors do not participate in any incentive plans. However, a formal annual appraisal process is undertaken where the views of all Directors are taken into consideration and the outcome of this is ratified by the Board.

Fees for Non-Executive Directors are determined by the Executive Directors and subject to approval of the Board as a whole. They are designed to recognise the responsibilities of Non-Executive Directors and to attract individuals with the necessary skills and experience to contribute to the objectives of the Society.

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF NATIONAL DEPOSIT FRIENDLY SOCIETY LIMITED

Opinion

In our opinion:

- National Deposit Friendly Society Limited's Group and Society's financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Society's affairs as at 31 December 2018 and of the Group's and Society's income and expenditure for the year then ended;
- the Group and Society's financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Friendly Societies Act 1992.

We have audited the financial statements of National Deposit Friendly Society Limited which comprise:

Group	Society
Consolidated Income Statement for the year then ended	Income Statement for year then ended
Consolidated Statement of Comprehensive Income for the year then ended	Statement of Comprehensive Income for the year then ended
Consolidated Balance Sheet as at 31 December 2018	Balance Sheet as at 31 December 2018
Related notes 1 to 29 to the financial statements, including a summary of significant accounting policies	Related notes 1 to 29 to the financial statements including a summary of significant accounting policies

The financial reporting framework that has been applied in the preparation of the Group and Society financial statements is applicable law and United Kingdom Accounting Standards, including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" and FRS 103 "Insurance Contracts" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to principal risks, going concern and viability statement

The Society voluntarily complies with the provisions of the UK Corporate Governance Code- Annotated Version for Mutual Insurers dated September 2016 as issued by the Association of Financial Mutuals ('AFM') in the UK ('the Code'). As a result, we have nothing to report in respect of the following information in the annual report, in relation to which the ISAs (UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 9 to 10 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 9 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statements set out on pages 26 to 27 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; or
- the directors' explanation set out on page 11 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• Inappropriate actuarial demographic assumptions for morbidity, longevity and persistency • Inappropriate actuarial expense assumptions
Audit scope	• We performed an audit of the complete financial information of the Society and two components. • The components where we performed full audit procedures accounted for 100% of the Fund for Future Appropriations measure used to calculate materiality, 99% of Gross Premium and other income and 100% of Total assets.
Materiality	• Overall Group materiality of £633,000 which represents 3% of the Fund for Future Appropriations.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF NATIONAL DEPOSIT FRIENDLY SOCIETY LIMITED

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Inappropriate actuarial demographic assumptions for morbidity, longevity and persistency The assumptions underpinning the valuation of the long term business provision as at 31 December 2018 are disclosed in note 20 to the financial statements. The long–term nature of the liabilities the Society holds is inherently uncertain due to the dependency on a number of key assumptions, including morbidity, longevity and persistency and the risk resides around these assumptions being incorrect. Each of these assumptions presents different capital requirements across the Society's life and health business. In addition, these assumptions have different sensitivities, and for some assumptions small changes will have a material impact on the Group's reported result. Demographic assumptions are set based on internal and market experience, overlaid with the application of judgement in particular around expectations of future trends and external factors.	To obtain sufficient audit evidence to conclude on the appropriateness of actuarial assumptions, we engaged our actuarial specialists as part of our audit team and performed the following procedures: We obtained an understanding and tested the design and operating effectiveness of key controls over management's process for setting and updating actuarial assumptions. We tested that the policy records data used in the process for setting and updating demographic and expense assumptions was complete and accurate. We reviewed the results of management's experience analysis to assess whether these justified the adopted assumptions, checked that the assumptions used are consistent with the experience analysis and reviewed the judgements made (such as the weight put on recent years' experience), and explanations provided by management as to why experience had changed, to ensure they were reasonable. We concluded on whether the final assumptions were within a reasonable range based on our expert judgement, management's internal experience analysis and the results of assumptions used by peers as per our Hot Topics survey. We reviewed the disclosures have been made regarding the sensitivity of the valuation of the Long Term Business Provision to changes in the key actuarial assumptions.	We determined that the actuarial assumptions used by management in relation to morbidity, longevity and persistency are reasonable based on the analysis of experience to date, industry practice and the financial and regulatory requirements.

Risk (Continued)	Our response to the risk (Continued)	Key observations communicated to the Audit Committee (Continued)
Inappropriate actuarial expense assumptions The assumptions underpinning the valuation of the long term business provision as at 31 December 2018 are disclosed in note 20 to the financial statements. Whilst less significant than the demographic assumptions referred to as part of the key audit matter above, we consider expense assumptions to be a key part of the actuarial valuation and therefore an area of focus. Expense assumptions are set based on the anticipated costs associated with administering the business, including expenses inflation as well as the split between acquisition / maintenance and between different classes of business.	To obtain sufficient audit evidence to conclude on the appropriateness of actuarial assumptions, we engaged our actuarial specialists as part of our audit team and performed the following procedures: We obtained an understanding and tested the design and operating effectiveness of key controls over management's process and governance for setting expense assumptions. We compared the methodology and assumptions with market practice. We tested the split between maintenance and acquisition expenses and the allocation of expenses, between various product types and between new business and in–force business. We reviewed the disclosures have been made regarding the sensitivity of the valuation of the Long Term Business Provision to changes in the key actuarial assumptions.	We determined that the expense assumptions used by management are reasonable based on industry practice and the financial and regulatory requirements.

In the prior year, our auditor's report included the following two key audit matters (KAM's), which we do not consider to be KAM's for the current year due to the reasons outlined below:

- Inaccurate or incomplete data from policy administration systems (PAS) is used within MoNET actuarial model, including related data migrations to the new PAS (Odyssey) in the year – the risk relating to inaccurate or incomplete data from PAS's being used within MoNET whilst still relevant for the FY18 audit has been downgraded to an 'area of audit focus' only, due to our risk assessment this year. The risk relating to the migration of data to Odyssey is non-recurring in nature.
- Alignment of UK GAAP and Solvency II technical provisions – this is non-recurring in nature.

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF NATIONAL DEPOSIT FRIENDLY SOCIETY LIMITED

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the group and effectiveness of group-wide controls, changes in the business environment and other factors when assessing the level of work to be performed at each entity.

In assessing the risk of material misstatement to the Group financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements, we selected all three reporting components of the Group.

The audits of the three components were performed by the group audit team. These audits covered 100% of the Group's income statement and balance sheet accounts.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £633,000 (PY: £605,000), which is 3% of the Fund for Future Appropriations. We believe that the Fund for Future Appropriations provides us with the most appropriate basis for determining materiality as it reflects the underlying interests of the members of the Group.

We determined materiality for the Society to be £633,000 (PY: £605,000), which is 3% of the Fund for Future Appropriations.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group and Society's overall control environment, our judgement was that performance materiality was 50% of our planning materiality, namely £316,000 (PY: £302,000). We have set performance materiality at this percentage based on our assessment of the risk of misstatement.

Audit work of the components for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of Group performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £63,000 to £316,000.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £32,000 (PY: £30,000), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report set out on pages 3 to 33 other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

As a result of the directors' voluntary reporting on how they have applied the Code, we also have nothing to report in regard to our responsibility under ISAs (UK) to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- Fair, balanced and understandable set out on page 22 – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for members to assess the group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Audit committee reporting set out on pages 28-29 – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

Other voluntary reporting

In accordance with terms of engagement from the Society we review whether the Corporate Governance Statement reflects the Society's compliance with the Code and this includes us performing:

- an assessment based on inquiry of the directors, the supporting documentation prepared by or for the Directors and our knowledge obtained during the audit of the financial statements, of whether the Society's summary of the process the Board (and where applicable its committees) has adopted in reviewing the effectiveness of internal control appropriately reflects that process; and
- a review of the Society's disclosure of the processes it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and financial statements.

We have nothing to report in respect of this review based on the matters above.

Opinion on matters prescribed by the Friendly Societies Act 1992

The Group and Society complies with Friendly Societies Act 1992 and the regulations made under it. In our opinion the Report of the Board of Management has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it, and the information given in the Report of the Board of Management is consistent with the accounting records and consolidated financial statements for the financial year.

Opinions on other matters prescribed by the Friendly Societies Act 1992

In our opinion under the Friendly Societies Act 1992:

- satisfactory systems of control of the business and accounting records have been maintained by the Group and Society; and
- the Group and Society's financial statements are in agreement with the accounting records.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Group and the Society and its environment obtained in the course of the audit, we are required by the Friendly Societies Act 1992 to state in our report whether by exception the following:

- If we are of the opinion that proper accounting records have not been kept; or
- If we fail to obtain all the information and explanations and the access to documents which, to the best of our knowledge and belief, are necessary for the purposes of our audit.

We have no exceptions to report arising from this responsibility.

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF NATIONAL DEPOSIT FRIENDLY SOCIETY LIMITED

Responsibilities of directors

As explained more fully in the Statement of Responsibilities of the Directors set out on page 26, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our approach was as follows: objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit,

- in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management; and
- in respect to irregularities, considered to be non-compliance with laws and regulations, are to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements ('direct laws and regulations'), and perform other audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements. We are not responsible for preventing non-compliance with laws and regulations and our audit procedures cannot be expected to detect non-compliance with all laws and regulations.

Our approach was as follows:

- We obtained a general understanding of the legal and regulatory frameworks that are applicable to the Group and Society and determined that the direct laws and regulations, related to elements of company law and tax legislation, and the financial reporting framework. Our considerations of other laws and regulations that may have a material effect on the financial statements included permissions and supervisory requirements of the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA').
- We obtained a general understanding of how the Group and Society complies with these legal and regulatory frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also reviewed correspondence between the Group and Society and UK regulatory bodies; reviewed minutes of the Board and its Committees; and gained an understanding of the Group and Society's approach to governance, demonstrated by the Board's approval of the Group and Society's governance framework and the Board's review of the Group's risk management framework and internal control processes.
- For direct laws and regulations, we considered the extent of compliance with those laws and regulations

as part of our procedures on the related financial statement items.

- For both direct and other laws and regulations, our procedures involved: making enquiry of those charged with governance and senior management for their awareness of any non-compliance of laws or regulations, inquiring about the policies that have been established to prevent non-compliance with laws and regulations by officers and employees, inquiring about the Group and Society's methods of enforcing and monitoring compliance with such policies, inspecting significant correspondence with the FCA and PRA.
- The Group and Society operates in the insurance industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.
- We assessed the susceptibility of the Group and Society's financial statements to material misstatement, including how fraud might occur by considering the controls that the Group and Society has established to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. We also considered areas of significant judgement and complex transactions and the impact these have on the control environment. Where this risk was considered to be higher, we performed audit procedures to address each identified fraud risk including the procedures over the actuarial assumptions noted above. With regard to revenue recognition fraud risk we tied back all the gross premium income received to cash received during the year and additional procedures included testing manual journals. In addition we tested controls and reconciliations performed by the Customer Services and Finance Teams with regards to generation and collection of gross premium income via direct debit. We have also tested the monthly journal upload of investment income into the general ledger to address completeness and occurrence of revenue in conjunction with our journal entry testing. These procedures were designed to provide reasonable assurance that the financial statements were free from fraud or error

Other matters we are required to address

- We were appointed by the Society on 6 September 2017 to audit the financial statements for the year ending 31 December 2018 and subsequent financial periods.
- The period of total uninterrupted engagement is 2 years, covering the year ending 31 December 2018.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society and we remain independent of the Group and the Society in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee

Use of our report

This report is made solely to the Group and Society's members, as a body, in accordance with Section 73 of the Friendly Societies Act 1992. Our audit work has been undertaken so that we might state to the Group and 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 Group and Society and the Group and Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Andy Blackmore

(Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Bristol
17 April 2019

Notes:

1. The maintenance and integrity of the National Deposit Friendly Society Limited web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

INCOME STATEMENT

For the year ended 31 December 2018

		Group				Society			
	Note	2018		2017		2018		2017	
		£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Gross premiums written and payments to deposit	4	9,979		10,518		9,979		10,518	
Outward reinsurance premiums		(225)		(25)		(225)		(25)	
Earned premiums net of reinsurance			9,754		10,493		9,754		10,493
Investment income	5		6,534		6,785		6,534		6,785
Unrealised gains on investments	5		-		2,138		-		2,138
Other technical income	6		568		299		96		25
			16,856		**19,715**		**16,384**		**19,441**
Gross claims paid		17,876		18,530		17,876		18,530	
Reinsurers' share		(69)		-		(69)		-	
Net claims paid			17,807		18,530		17,807		18,530
Change in provision for claims			365		(722)		365		(722)
Change in long term funds Long term business provision			(13,295)		(10,591)		(13,295)		(10,591)
Investment contract liabilities			(6)		(10)		(6)		(10)
Provision for linked liabilities – insurance contracts	22		(154)		133		(154)		133
Provision for linked liabilities – investment contracts	22		(28)		49		(28)		49
Bonuses and rebates			(36)		(109)		(36)		(109)
Net operating expenses	7a								
Acquisition costs		3,041		1,323		2,786		949	
Administrative expenses		3,636		3,514		3,186		2,888	
			6,677		4,837		5,972		3,837
Other technical charges – project costs	7b		3,011		1,269		3,017		1,519
- other			46		82		47		82
Investment expenses	8		792		835		792		835
Unrealised losses on investments	5		7,909		-		7,909		-
Loss on investment in subsidiary	26		-		-		380		474
Tax attributable to long term business	11a		(11)		-		-		-
Transfer to/(from) the fund for future appropriations	27		(6,221)		5,412		(6,386)		5,414
			16,856		**19,715**		**16,384**		**19,441**
Balance after transfer to/(from) the fund for future appropriations			-		-		-		-

The information on pages 46 to 91 form an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	Note	Group		Society	
		2018 £'000	2017 £'000	2018 £'000	2017 £'000
Balance transferred from income statement		-	-	-	-
Actuarial gain/(loss) on pension scheme	21	152	1,058	152	1,058
Revaluation of occupied land and buildings		269	244	269	244
Total comprehensive income		**421**	**1,302**	**421**	**1,302**
Transfer to/(from) the fund for future appropriations	27	421	1,302	421	1,302
Total comprehensive income after transfer		-	-	-	-

The information on pages 46 to 91 form an integral part of these financial statements.

BALANCE SHEET

As at 31 December 2018

		Group				Society			
	Note	2018		2017		2018		2017	
ASSETS		£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Intangible assets	17		3,000		4,397		300		1,397
Investments									
Land and buildings	12	26,020		19,750		26,020		19,750	
Investment in subsidiaries	26	–		–		20		35	
Other financial investments	13	77,231		98,770		77,231		98,770	
			103,251		118,520		103,271		118,555
Assets held to cover linked liabilities	16		1,635		1,796		1,635		1,796
Reinsurers' share of technical provisions			101		118		101		118
Debtors – Loans and receivables									
Debtors arising from direct insurance operations	3	185		145		147		101	
Other debtors	3	752		1,190		760		1,486	
			937		1,335		907		1,587
Other assets									
Tangible assets	18	2,671		2,392		2,671		2,392	
Cash at bank and in hand	14	459		2,761		401		2,483	
Deferred tax asset	11c	11		–		–		–	
			3,141		5,153		3,072		4,875
Prepayments and accrued income – Loans and Receivables									
Accrued interest and rent		1,517		1,529		1,517		1,529	
Other prepayments and accrued income		554		230		3,244		3,213	
			2,071		1,759		4,761		4,742
			114,136		**133,078**		**114,047**		**133,070**

The information on pages 46 to 91 form an integral part of these financial statements.

As at 31 December 2018

		Group				Society			
	Note	2018		2017		2018		2017	
LIABILITIES		**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Fund for future appropriations	**27**		19,168		24,968		19,048		25,013
Technical provisions									
Long term business provision	**20**	88,134		101,445		88,134		101,445	
Investment contract liabilities		18		37		18		37	
Claims outstanding		2,214		1,849		2,214		1,849	
Provision for bonuses and rebates		120		156		120		156	
			90,486		103,487		90,486		103,487
Technical provision for linked liabilities – insurance contracts	**22**		1,036		1,190		1,036		1,190
Technical provision for linked liabilities – investment contracts	**22**		327		379		327		379
Derivatives	**28**		787		36		787		36
Creditors									
Arising out of direct insurance operations		49		49		49		49	
Other creditors including taxation and social security		350		380		307		340	
Accruals and deferred income		1,254		1,113		1,328		1,100	
			1,653		1,542		1,684		1,489
Net pension liability	**21**	679		1,476		679		1,476	
			679		1,476		679		1,476
			114,136		**133,078**		**114,047**		**133,070**

The information on pages 46 to 91 form an integral part of these financial statements.

These financial statements were approved by the Board on 15 April 2019.

Jonathan Long
Chief Executive Officer

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

1 Accounting policies

These accounting policies have been applied consistently in the preparation of the financial statements.

General information

The Society is a registered friendly society incorporated and domiciled in the United Kingdom. The address of its registered office is 11-12 Queen Square, Bristol. BS1 4NT

Statement of compliance

The Group and Society financial statements of National Deposit Friendly Society Limited have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" ("FRS 102"), Financial Reporting Standard 103, "Insurance Contracts" ("FRS 103") and the Friendly Societies Act 1992.

Basis of preparation

The financial statements have been prepared on a going concern basis, under the historical cost convention modified for fair value and in accordance with The Friendly Societies (Accounts and Related Provisions) Regulations 1994, and United Kingdom Generally Accepted Accounting Practice, specifically FRS 102 and FRS 103.

Basis of consolidation

The Group financial statements comprise the assets, liabilities and income and expenditure account transactions of the Society and its subsidiaries 425 Direct Limited and ND Member Services Limited. 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 statement.

Premiums

Premiums are accounted for when due for payment.

Insurance commission

Insurance commission represents the value of commission receivable, recognised on the effective commencement or renewal date of the policy. All commission received relates to insurance business transacted in the United Kingdom.

Reinsurance

The Society cedes reinsurance in the normal course of business. The cost of reinsurance is recognised in the income statement at the date of purchase. Premiums ceded and claims reimbursed are presented on a gross basis in the income statement and balance sheet as appropriate.

Reinsurance assets primarily include balances due from reinsurance companies for ceded insurance contract liabilities. Reinsurance assets are measured as the fair value of the technical provisions of the policies subject to the reinsurance treaty.

Realised and unrealised gains and losses

Realised investment gains and losses represent the difference between the sale proceeds and original cost. Unrealised investment gains and losses represent the net movement in the market value of investments during the year after allowing for realised gains and losses recognised in the income statement.

1 Accounting policies (continued)

Investment return

Investment return comprises the investment income and fair value gains and losses derived from assets held at fair value through profit and loss, rental income and fair value gains and losses derived from investment property and interest income derived from cash and cash equivalents.

Investment income derived from assets held at fair value through profit and loss includes dividends and interest income. Dividends are accounted for on the date the shares become quoted ex-dividend. UK dividends are shown excluding their irrecoverable associated tax credit. Interest income is recognised on the effective interest rate basis. Income from rents and securities is taken into account on an accruals basis. Bank interest is accrued in the period in which it arises.

Claims

Maturity claims and annuities are charged against income when due for payment. Surrenders are accounted for when paid or, if earlier, on the date when the policy ceases to be included within the calculation of the long term business provision. Death claims and all other claims including Healthcare are accounted for when notified.

Long term business provision

The long term business provision is determined by the Society's Board and is calculated on a Solvency II basis. It is calculated to comply with the PRA rulebook: Solvency II Firms Technical Provisions Instrument 2015.

Solvency II Provisions are defined as the sum of the Best Estimate of Liabilities and the Risk Margin. The best estimate and risk margin are calculated separately. The best estimate of liabilities is calculated on a policy by policy basis for all contracts accepted on risk at the valuation date using a cash flow approach and generally accepted actuarial practices. The calculations generate probability weighted cashflows for each monthly time period within a policy's contract boundary. The cash flows are discounted using the European Insurance and Occupational Pension Authority ("EIOPA") risk free yield curve and thus allow appropriately for the time value of money.

The total risk margin is calculated as the sum of the present values of the cost of capital rate applied to the Solvency Capital Requirement (SCR) of a reference undertaking, willing to take on the Society's insurance portfolio, in each future year until the obligations are extinguished and there is no remaining SCR.

The Technical Provisions and SCR reported in the Financial Statements do not take account of any transition measures approved by the PRA in respect of the transition from Solvency I to Solvency II.

Bonuses

Bonuses charged to the long term business technical account in a given year comprise new reversionary bonuses declared in respect of that year which are provided within the calculation of the long term business provision.

Claims outstanding

The outstanding claims reserve provides for all the estimated (based on actuarial calculations) Healthcare and Healthguard claims payable as at 31 December and represents the estimated ultimate cost of settling all claims which have occurred up to the balance sheet date.

Depreciation

Properties

No depreciation has been provided on investment properties in accordance with Section 16 "Investment Property" of FRS 102.

Intangible assets

Intangible assets represent the intellectual property rights for computer software. Intangible assets are held at cost less accumulated amortisation.

Computer Software is amortised on the straight line basis over its useful economic life, which is 10 years.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

1 Accounting policies (continued)

Tangible fixed assets and depreciation

Land and buildings

The owner occupied floors of 11-12 Queen Square, Bristol used by the Group and Society as a head office are held as land and buildings in tangible fixed assets in accordance with Section 17 "Property, Plant and Equipment" of FRS 102. The property is held at fair value at the balance sheet date with revaluation gains recognised through other comprehensive income.

Land and buildings are not depreciated as the opinion of the directors is that the depreciation is not material and the property is revalued annually on a fair value basis.

Other tangible fixed assets

Tangible fixed assets other than land and buildings are held at cost less accumulated depreciation.

Depreciation has been provided at the following rates calculated to write off each asset over its estimated useful life:

Computer equipment is depreciated at 25% per annum on a straight line basis;

Office equipment is depreciated at 12.5% per annum on a straight line basis.

Motor vehicles are depreciated at 33.33% per annum on a straight line basis.

Acquisition costs

Acquisition costs represent commission payable and other related expense of acquiring insurance policies written during the financial year.

Operating leases

The Group leases office machinery and equipment under contracts of operating leases. The leases are cancellable. The lease expenses are accounted for as an operating expense as incurred.

Project costs

Project costs comprise expenditure on business process improvements which are intended to deliver future financial benefits to the Group through reducing operating costs and/or creating operational efficiencies.

Projects costs are charged to the income statement with the exception of major projects where the outcome is assessed to be reasonably certain as regards viability and feasibility. These costs are capitalised if they meet the criteria laid out in Section 17 "Property, Plant and Equipment" or Section 18 "Intangible Assets other than Goodwill" of FRS 102. Amortisation is charged once the economic benefits of the project start to be realised.

Pension costs

The Society operates a defined benefit pension scheme. This scheme closed to new entrants and future accrual on 31 May 2009. A pension asset or liability is calculated as the recoverable amount of the scheme's assets less the present value of the scheme's liabilities in accordance with the principles set out in the Section 28 "Employee Benefits" of FRS 102. The Society is currently making contributions to the scheme at the level agreed with the trustees with the objective of having sufficient assets to meet its liabilities.

The pension cost for the scheme is analysed between current service cost, past service cost and net return on pension scheme. Current service cost is the actuarially calculated present value of the benefits earned by the active employees in each year. Past service costs relating to employee service in prior years arising in the current year as a result of the introduction of, or improvement to, retirement benefits, are recognised in the profit and loss account on a straight-line basis over the year in which the increase in benefits vest.

The actuarial gains and losses which arise from a valuation and from updating the latest actuarial valuation to reflect conditions at the balance sheet date are taken to the statement of comprehensive income for the year to the extent they are attributable to members. The attributable deferred taxation is shown separately in the statement of comprehensive income.

Payments made to the defined contribution scheme for current employees are charged as an expense as they fall due.

1 Accounting policies (continued)

Taxation

Deferred tax is provided using the full provision method. Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date. It is calculated at rates expected to be applicable when the asset or liability crystallises on a non-discounted basis. Deferred tax assets are recognised only to the extent that there will be sufficient foreseeable future taxable profits from which the future reversal of timing differences can be deducted.

Investment in subsidiaries

Investments in subsidiary companies are held at fair value. The change in fair value through the year is recognised through "gain or loss on investment in subsidiary" in the income statement.

Fund for future appropriations

The fund for future appropriations incorporates amounts which have yet to be allocated to participating policyholders. Any surplus or deficit arising in the technical account is transferred to or from the fund on an annual basis. Surpluses are allocated by the directors to participating policyholders by way of bonuses. Any unallocated surplus is carried forward in the fund for future appropriations.

Contract classification

The Society classifies its products for accounting purposes as insurance, investment or investment with discretionary participation features. Insurance contracts are those contracts that transfer significant insurance risk. Contracts that do not transfer significant insurance risk are investment contracts.

A discretionary participation feature is a contractual right held by a policyholder to receive additional payments as a supplement to guaranteed benefits:

- that are likely to be a significant proportion of the total contractual payments; and
- whose amount or timing is contractually at the discretion of the issuer and that are contractually based on:
  - the performance of a specified pool of contracts, or a specified type of contract, or
  - realised and/or unrealised investment returns on a specified type of contract, or
  - the profit or loss of the company that issues the contracts.

Such contracts are more commonly known as "with-profits" or as "participating contracts".

Insurance contracts and participating investment contracts

The insurance and participating investment contract liabilities are determined annually in accordance with regulatory requirements.

The participating liabilities include an assessment of any future options and guarantees included in this business and are measured on a fair value basis.

The estimation techniques and assumptions are periodically reviewed, with any changes in estimates reflected in the income statement as they occur.

The long term business provision is calculated by the Society's Chief Actuary, having due regard to the actuarial principles laid down in the Life Framework Directive, and is approved by the Board.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

1 Accounting policies (continued)

Investment contracts

Investment contracts are those contracts that transfer financial risk with no significant insurance risk. These contracts are accounted for using deposit accounting. Premiums and claims are not recognised in the income statement in respect of these policies. The investment gain or loss on these policies is shown through the movement in the investment contract liabilities on the income statement and measured on a fair value basis.

Financial assets

The Society classifies its financial assets as fair value through the profit and loss or as loans and receivables. Assets held at fair value through the profit and loss are measured at fair value based on the active market price with gains and losses recognised in the Income Statement, whilst loans and receivables are held at amortised cost. This is in line with International Accounting Standard 39 "Financial Instruments" as allowed under Section 11 "Basic Financial Instruments" in FRS102. Financial assets are derecognised when the rights to receive future cash flows from the investments have expired or have been transferred and the Society has transferred substantially all risks and rewards of ownership. All financial assets are held at fair value through profit and loss other than mortgages, debtors arising from insurance operations, other debtors and accrued interest and rent which are held at amortised cost.

Investments

Listed securities are shown in the financial statements at bid price. Properties are shown in the financial statements at fair value.

Mortgages and loans are valued at amortised cost which is not materially different from the fair value of its future cash flows.

Derivatives

The Society holds some forward contracts for foreign currency exchange. The Society also holds some gilt future contracts to better match the duration of the fixed interest portfolio to its liabilities. Depending on whether the contract is in a favourable or adverse position they are classified as financial assets or financial liabilities respectively and are classified as fair value through the profit and loss. They are initially recognised and are subsequently re-measured at their fair value. Changes in fair value are recognised through unrealised or realised gains and losses on the income statement.

All derivatives are carried as assets when fair value is positive and as liabilities when the fair value is negative.

Foreign currencies

Some fixed interest investments are held in foreign currencies. The assets are held on the balance sheet in sterling using the year-end exchange rate, whilst the book cost is calculated using the exchange rate on the day of purchase. Any gains or losses on the exchange rates are recognised through unrealised or realised gains and losses in the income statement.

Cash flow statement

The Society, being a mutual life assurance company, is exempt from the requirement under Section 7 "Statement of Cash Flows" of FRS102 to produce a cash flow statement.

1 Accounting policies (continued)

Key estimates and judgements

a. Classification of contracts

A key issue for the Society under FRS103 is that a distinction is made between insurance contracts, investment contracts and investment contracts with discretionary participation features. The Society issues contracts that transfer insurance risk, financial risk or both. Insurance contracts are those contracts that transfer significant insurance risk. Such contracts may also transfer financial risk.

Investment contracts are those that transfer financial risk with no significant insurance risk.

For each product type within the Society's portfolio, Management has reviewed the level of benefits under the contract to determine the appropriate contract classification. All with-profits contracts have been classified as participating contracts as these contracts entitle the holder to receive, as a supplement, guaranteed benefits, additional benefits or bonuses that are likely to be a significant portion of the total contractual benefits whose amount or timing is contractually at the discretion of the Society.

As a result of this review, three products, temporary annuities, CABF Unit-linked Whole of Life Flexiplan and CABF Unit Linked Whole Life Bond, have been classified as Investment Contracts.

b. Technical Provisions - Valuation of investment and long-term insurance contracts

Technical provisions are calculated using policy data held on the Society's administration systems and assumptions set using internal and external data as inputs to actuarial valuation models. The assessment of the appropriate value of the technical provisions requires the Society to make significant judgements when determining the underlying assumptions. The principal economic assumption is the inflation rate for future expenses, while the principal non-economic assumption is longevity. The non-economic assumptions are based on the Society's own experience and projection of expenses. The valuation interest rates used to discount projected cash flows are a duration-specific risk-free yield curve specified by EIPOA (the European Insurance and Occupational Pensions Authority) under Solvency II regulations. Due to the long-term nature of these obligations, the estimates are subject to significant uncertainty. Further details on specific assumptions are provided in note 20 to these Financial Statements.

c. Valuation of Investment Properties

The Society owns a portfolio of Investment Properties which are held for long-term rental yield and capital growth. This portfolio is valued on a fair value basis on an annual basis by Society appointed Chartered Surveyors. The valuations have been prepared in accordance with the Royal Institution of Chartered Surveyors' Valuation – Professional Standards effective from 6th January 2014. In preparing these valuations, data and information available concerning rental yields, lease terms, voids and floor areas and enquiries within local market places have been used as contributing factors to each individual property's valuation. The most significant inputs into this valuations are the rental income and yield assumptions. Further information is provided in note 12.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

1 Accounting policies (continued)

Key estimates and judgements (continued)

d. Valuation of Financial Assets

The Society holds a number of financial assets such as equities, fixed income securities, derivatives, cash, mortgages and debtors. The Society has no financial assets held for trading, all investment are classified and valued at fair value. Equities, fixed income securities and derivatives are measured at market prices, or prices consistent with market ratings should no price be available. Mortgages and debtors are measured at amortised cost which is not materially different from the valuation of its future cash flows. Any unrealised or realised gains or losses are recognised in the Income Statement. Further detail are provided in note 13.

e. Defined Benefit Pension Schemes

In determining the pension cost and the defined benefit obligation of the Society's defined benefit pension schemes, a number of assumptions are used. These assumptions include an appropriate discount rate, the level of salary escalation, price inflation and mortality rates. Further details are contained in note 21.

f. Valuation of Investment in Subsidiaries

Investment subsidiaries are held at fair value. The change in fair value through the year is recognised through the income statement. Judgement is required in assessing the fair value of the subsidiary companies which are not considered to be materially different from the net asset values in the respective subsidiary accounts.

g. Valuation of Intangible Assets

The Society holds intangible assets at cost less accumulated amortisation. The value of these assets are reviewed annually and impaired through the income statement if the carrying value is greater than the fair value of the expected future cashflows.

2 Capital management

The capital requirement for the Society is determined by the Solvency II regime. This is a risk-based approach to the assessment of capital requirements whereby Technical Provisions are calculated as the sum of the best estimate liabilities plus a risk margin. The Solvency Capital Requirement ("SCR") is the additional capital the Society is required to hold to withstand a set of adverse events (covering market, underwriting, counterparty and operational risks) with a 99.5% level of confidence. The Society aims to manage its capital to ensure that there is an appropriate level of surplus over the SCR. This is monitored formally through the Board on a bi-annual basis and more regularly by the Actuarial Function.

The Society calculates its SCR in accordance with EIOPA's standard formula. The liabilities are discounted using risk free discount rates prescribed by EIOPA. These rates do not necessarily reflect the rates earned on the financial assets held by the Society. The Society complied with the prudential requirements regarding capital and technical provisions throughout 2018.

The Society maintains a single long term business fund. The available capital for the fund is represented by the fund for future appropriations which represents the difference between the assets and liabilities of the Society and Group. For Solvency II regulatory purposes certain assets are deemed inadmissible for meeting the capital requirements. At the balance sheet date £0.3m (2017: £1.4m) of assets could not be included for regulatory capital purposes.

In addition, for statutory purposes under FRS 102 / 103, the Society calculates its FRS 102 / 103 liabilities on the same basis as Solvency II, with the exception that the Society has adopted a Transitional Measure on the riskfree Interest Rate (TMIR) for its regulatory reporting to the PRA under Solvency II. The TMIR applies only to policies in force prior to the Solvency II regime and is released over a 16 year period.

The Capital Statement below outlines the Society's Capital available for regulatory requirements. This is the Solvency II Own Funds. The impact of the TMIR is shown.

Capital Statement

	Society	
	2018 **£'000**	**2017** **£'000**
Fund for future appropriations	**19,048**	**25,013**
Regulatory valuation adjustment	(300)	(1,397)
Transitional measures adjustment	1,706	2,156
Capital available to meet regulatory capital requirements	**20,454**	**25,772**

A reconciliation of the movements in the capital available to meet capital requirements at the start and end of the year is set out overleaf:

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 Capital management (continued)

	Society
	2018 **£'000**
Available capital at the start of the year	**25,772**
Model and methodology changes	(1,267)
Assumption changes	775
Actual versus expected* investment income and gains	(2,030)
Actual versus expected* inflows	593
Actual versus expected* outflows	(1,279)
Actual versus expected in force data at end 2018	(485)
New business**	(1,216)
Change in Additional Expense Reserve (AER)***	(825)
Change in the Risk Margin (other than due to new business)	1,711
Impact of Staff Superannuation Fund****	24
Change in creditors	(947)
Other adjustments	79
Change in TMIR	(451)
Available capital at the end of the year	**20,454**

Other than for actual investment income, the actual versus expected are only in respect of business in force at 31/12/2017.

New business is covered separately.

** New business is the total of premiums, claims, commission, acquisition expenses, the change in the BEL and the change in the Risk Margin due to new business.

*** Relating to 2019 cash-flows onwards. 2018 cash-flows are picked up in the expected outflows line.

**** Impact of Staff Superannuation Fund reflects the change in the assets, the change in the liabilities and the contributions the Society has made over 2018.

2 Capital management (continued)

The main reasons for the change in available capital are:

- Model and methodology changes have reduced the available capital by £1.3m. The majority of this impact is due to changes in the calculation of the Risk Margin.
- The Society's assets yielded an investment loss over 2018 of £1.5m. Expected investment returns (at the risk-free rate) over 2018 on assets held to back the liabilities were £0.5m. This has resulted in an actual versus expected impact of investment returns of -£2.0m.
- Actual outflows were higher than expected by £1.3m. A key driver of this is £1.9m of strategic expenses over 2018. Strategic expenses are not allowed for in the calculation of the Best Estimate Liabilities and hence the actual has an adverse impact on the available capital.
- New business written over 2018 has reduced the available capital by £1.2m.
- The Additional Expense Reserve (AER) has reduced by £0.3m. However, some of the 2017 AER related to expected expenses during 2018 and so are included in the actual versus expected outflows in the table. The change in the AER relating only to expenses from 2019 onwards, reduces Own Funds by £0.8m. This is because the 2018 AER is in respect of expense over-runs to 2023, as opposed to 2022 as for the 2017 AER.
- The change in the Risk Margin (other than due to model changes and new business) has increased available capital by £1.7m. The biggest driver of the change is due to the increased management actions assumed in the calculation of the health business SCR stresses.
- Creditors have increased by £0.9m, reducing the available capital.

Options and guarantees

The Society has some With Profit retirement annuity contracts that have valuable Guaranteed Annuity Rates attached to them in a low interest rate environment. In addition, there are some guarantees on mortgage endowments and With Profit bonds, although these are not material.

The net cost of guarantees is particularly sensitive to market risk and to longevity risk.

Assumptions used in the valuation of the Technical Provisions

The assumptions used in the valuation of the Technical Provisions, including those used to value options and guarantees, are determined by conducting an analysis of the Society's past experience and overlaying this with expert judgement.

Capital resource sensitivities

The Society's capital position is sensitive to changes in economic conditions and demographic assumptions, due to both changes in the value of the assets and the value of the liabilities. The main sensitivities arise from:

Market risk:

The Society is exposed to reductions in the value of its assets.

The risk is reduced by matching fixed interest assets to the expected profile of the liabilities so that the assets and liabilities move in the same way under a fixed interest market stress scenario.

For With Profit business, the risk to available capital is further reduced by the fact that asset shares will reduce in a market risk scenario. This reduces exposure under the equity and property stresses in particular.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

2 Capital management (continued)

Lapse risk:

The Society is exposed to the risk that lapses are higher or lower than expected. Whether this increases or reduces available capital varies by product. The highest impact Standard Formula lapse risk is the risk of a mass lapse scenario.

In the event of an adverse lapse scenario, management actions can be taken on some legacy Health contracts to increase the available capital. These are premium increases, increases to "own share" percentages (the proportion of claims that are paid by the members deposit account) and reductions in "premium surplus" (a discretionary proportion of each premium that is paid into the member's deposit account).

New Health contracts have annually reviewable premiums to reduce exposure to underwriting risks.

Longevity risk:

The Society is exposed to the risk that mortality rates reduce, particularly on annuity business. This risk could be mitigated through reinsurance, but is not currently.

Morbidity risk:

The Society is exposed to the risk that there are more morbidity claims than expected, or that they are of higher value.

The management actions as described under the lapse risk section can equally be applied in an morbidity risk scenario to increase the available capital.

Expense risk:

The Society is exposed to the risk that expenses are higher than expected. This could materialise by lower than expected volumes of new business meaning the per policy expenses are increased. The Society has achieved its sales targets over 2018.

The management actions as described under the lapse risk section can equally be applied in an expense risk scenario to increase the available capital.

In addition, an expense stress in relation to With Profit business can be charged to asset shares, further reducing the impact.

Mortality risk:

The Society is exposed to the risk that mortality is increased. The risk has increased over 2018 with the introduction of the Guaranteed Life Assurance product. The Society's exposure to mortality risk is expected to increase as we continue to sell this product.

2 Capital management (continued)

The following table shows the sensitivity of the Society's available capital to changes in assumptions. The assumption changes shown are those as per the Solvency II standard formula. The sensitivities do not allow for the TMIR adjustment.

	Society
	Impact £'000
Property risk * *Decrease in property values of 25%*	**(7,173)**
Interest rate risk * *Increase in risk free yield curve as specified by EIOPA (+1%)* *Decrease in risk free yield curve as specified by EIOPA (c.-0.4%**)*	**(7,109)** **2,945**
Equity risk * *Decrease in equity values of 32.9%*	**(4,793)**
Credit spread risk * *Decrease in corporate bond values of 11.0%*	**(4,128)**
Lapse risk *** *Increase in lapse rates of 50%* *Decrease in lapse rates of 50%* *Mass lapse of 40%*	**(362)** **(1,068)** **(1,855)**
Longevity risk *Decrease in mortality rates of 20%*	**(1,806)**
Expense risk *Increase in per policy expenses of 10% and expense inflation of 1% p.a.*	**(1,585)**
Morbidity risk *Increase in morbidity rates of 5% and claim inflation of 1% p.a.*	**(1,041)**
Mortality risk *Increase in mortality rates of 15%*	**(602)**

* The market risk sensitivities show the impact on the assets only and do not allow for changes in the liabilities.

** For a 10 year term which is the approximate average duration of the Society's liabilities

*** Article 142 of the Solvency II Delegated Act requires that the lapse stresses are applied only to lines of business where the stress would result in a decrease in Own Funds. As such, all of the lapse stresses reduce the available capital.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

3 Risk management

The key risks that the Society and Group are exposed to and the way the Society and Group manage them is set out as follows:

Insurance risk

Insurance risk is the risk that arises from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. Long term insurance risk arises from morbidity, persistency, mortality and expense variances. Systems are in place to measure, monitor and mitigate exposure to all these risks.

The valuation assumptions have been recommended by the Chief Actuary and approved by the Board. See note 20 for details of assumptions used in the calculation of the long term business provision.

Financial risk

The Society is exposed to a range of financial risks through its financial assets, financial liabilities, reinsurance assets and insurance liabilities. The most important components of this financial risk are market risk (including interest rate risk, exchange rate risk and equity price risk), credit risk and liquidity risk. The Society also faces financial risks in respect of property valuations, concentration of investments and counter-party exposures.

Each of the exposures to risk are analysed regularly to assess their likely impact and probability.

i. Market risk

Market risk is the risk that as a result of market movements the Society may be exposed to fluctuations in the value of its assets, the amount of its liabilities, or the income from its assets. Sources of general market risk include movements in interest rates, equities, exchange rates and real estate prices.

The Society has a low appetite for market risks and this is reflected in its investment strategy. The investment strategy is kept under regular review as part of the capital management plan.

a. Interest rate risk

Changes in interest rates impact the value of the Society's assets and liabilities. The risk to Own Funds from changes in interest rates is reduced by close matching of assets to liabilities.

b. Exchange rate risk

The Society has a number of fixed interest investments in foreign currencies which present an exchange rate risk that is mitigated by holding Forward Contracts for foreign exchange as a natural hedge against the exchange rate risk. The Society's holdings shown by currencies are listed opposite:

3 Risk management (continued)

Market Value Equities	Group & Society 2018 £'000	Group & Society 2017 £'000
UK pound	12,453	14,591
Euro	195	342
Swiss franc	247	-
	12,895	**14,933**

Market Value Fixed Interest	Group & Society 2018 £'000	Group & Society 2017 £'000
UK pound	50,763	70,073
Australian dollar	234	252
Euro	567	591
USA dollar	10,068	10,564
	61,632	**81,480**

Exchange rate risk is hedged so a small change in the exchange rate will lead to a negligible change in the value of assets. All liabilities are denominated in sterling so a change in exchange rate will have no effect on the value of liabilities.

c. Equity price risk

Holdings in equities are by their nature subject to market movement. In order to mitigate this risk the Society employs an external investment portfolio manager and the Investment Committee regularly review the level of equities notionally allocated to with profit life business to ensure the level of risk remains appropriate.

ii. Credit risk

Credit risk is the risk of loss incurred whenever a counterparty fails to perform its contractual obligations including failure to perform them in a timely manner.

The Society has a low appetite for credit risk on cash and cash is spread over a number of high rated banks with the maximum limit on the exposure to any one financial institution.

The terms of the investment funds require an appropriate spread of holdings within specified parameters, with the majority of assets being 'A' rated bonds or higher. There are also limits on the maximum exposure to any single counterparty and on the level of exposure to lower rated bonds.

This results in a relatively modest exposure to lower rated and possibly more risky assets within the investment funds. However, the Society considers regular reviews from the fund manager so that the risk within the funds remains appropriate relative to the Society's appetite for credit risk.

The Society currently has a low level of exposure to re-assurer security which will decline as the portfolio matures. Therefore, there are no specific actions envisaged to manage the risks in this section.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

3 Risk management (continued)

The assets bearing credit risk are summarised and analysed by credit rating below:	Group	
	2018 £'000	2017 £'000
Derivative financial instruments	118	386
Listed fixed interest securities	61,632	81,480
Loans and receivables (Note 14)	2,570	2,993
Deposits with credit institutions	2,470	1,842
Cash at bank and in hand	459	2,761
	67,249	**89,462**
AAA	4,628	4,837
AA	24,732	41,827
A	24,448	28,436
BBB	7,844	8,653
Below BBB	-	-
Not rated	5,597	5,709
	67,249	**89,462**

The assets bearing credit risk are summarised and analysed by credit rating below:	Society	
	2018 £'000	2017 £'000
Derivative financial instruments	118	386
Listed fixed interest securities	61,632	81,480
Loans and receivables (Note 14)	2,540	3,245
Deposits with credit institutions	2,470	1,842
Cash at bank and in hand	401	2,483
	67,161	**89,436**
AAA	4,628	4,837
AA	24,675	41,549
A	24,448	28,436
BBB	7,844	8,653
Below BBB	-	-
Not rated	5,566	5,961
	67,161	**89,436**

3 Risk management (continued)

No credit limits were exceeded during the year. No financial assets are past due or impaired at the reporting date and management expects no significant losses from non-performance by these counterparties.

iii. Liquidity risk

Liquidity risk is the risk that the Society, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost. For example, liquidity risk can arise from mismatching between expected asset and liability cash flows or from the inability to sell assets quickly.

The Society has a low appetite for liquidity risk and the risk is controlled by primarily investing in liquid assets.

The Society also holds some gilt futures to manage the duration of the fixed interest portfolio. This strategy is intended to be maintained and the Society will also continue to monitor its emerging cash flow requirements.

Financial assets held over five years are long-term assets aiming to match the duration of liabilities. It is not possible to invest in fixed income investments with no maturity date. However the Society carries out regular checks so that assets and liabilities are well matched by duration.

	Group				
	No maturity date	Within 1 year	1 - 5 years	Over 5 years	Total
Financial and insurance liabilities at 31/12/18	£'000	£'000	£'000	£'000	£'000
Fund for future appropriation	19,168	–	–	–	**19,168**
Long term business provision	–	9,034	4,396	74,704	**88,134**
Investment contract liabilities	–	5	13	-	**18**
Claims outstanding	–	2,214	–	–	**2,214**
Provision for bonuses and rebates	–	65	33	22	**120**
Technical provision for linked liabilities – insurance contracts	–	1,036	–	–	**1,036**
Technical provision for linked liabilities – investment contracts	–	327	-	-	**327**
Derivatives	–	787	-	-	**787**
Defined benefit pension liability	–	-	-	679	**679**
Creditors arising out of direct insurance operations	–	49	-	-	**49**
Other creditors including taxation and social security	–	350	-	-	**350**
Accruals and deferred income	–	1,254	-	-	**1,254**
Total financial and insurance liabilities	**19,168**	**15,121**	**4,442**	**75,405**	**114,136**

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

3 Risk management (continued)

	Group				
	No maturity date	Within 1 year	1 - 5 years	Over 5 years	Total
Financial and insurance liabilities at 31/12/17	£'000	£'000	£'000	£'000	£'000
Fund for future appropriation	24,968	-	-	-	**24,968**
Long term business provision	–	6,355	10,698	84,392	**101,445**
Investment contract liabilities	–	6	31	-	**37**
Claims outstanding	-	1,849	-	-	**1,849**
Provision for bonuses and rebates	-	42	77	37	**156**
Technical provision for linked liabilities – insurance contracts	-	1,190	-	-	**1,190**
Technical provision for linked liabilities – investment contracts	-	379	-	-	**379**
Derivatives	-	36	-	-	**36**
Defined benefit pension liability	-	-	-	1,476	**1,476**
Creditors arising out of direct insurance operations	-	49	-	-	**49**
Other creditors including taxation and social security	-	380	-	-	**380**
Accruals and deferred income	-	1,113	-	-	**1,113**
Total financial and insurance liabilities	**24,968**	**11,399**	**10,806**	**85,905**	**133,078**

3 Risk management (continued)

Financial assets at 31/12/18	Group				
	No maturity date £'000	Within 1 year £'000	1 - 5 years £'000	Over 5 years £'000	Total £'000
Equity investments	12,895	–	–	–	**12,895**
Fixed interest securities	–	1,895	6,813	52,924	**61,632**
Derivatives	–	118	–	–	**118**
Deposits with credit institutions	–	2,470	–	–	**2,470**
Mortgages	95	5	13	3	**116**
Assets held to cover linked liabilities	1,635	–	–	–	**1,635**
Debtors arising from direct insurance operations	–	185	–	–	**185**
Other debtors	–	752	–	–	**752**
Cash at bank and in hand	459	–	–	–	**459**
Accrued interest and rent	–	1,517	–	–	**1,517**
Total financial assets	**15,084**	**6,942**	**6,826**	**52,927**	**81,779**

Financial assets at 31/12/17	Group				
	No maturity date £'000	Within 1 year £'000	1 - 5 years £'000	Over 5 years £'000	Total £'000
Equity investments	14,933	–	–	–	**14,933**
Fixed interest securities	–	3,967	6,259	71,254	**81,480**
Derivatives	–	386	–	–	**386**
Deposits with credit institutions	–	1,842	–	–	**1,842**
Mortgages	107	5	13	4	**129**
Assets held to cover linked liabilities	1,796	–	–	–	**1,796**
Debtors arising from direct insurance operations	–	145	–	–	**145**
Other debtors	–	1,190	–	–	**1,190**
Cash at bank and in hand	2,761	–	–	–	**2,761**
Accrued interest and rent	–	1,529	–	–	**1,529**
Total financial assets	**19,597**	**9,064**	**6,272**	**71,258**	**106,191**

NOTES TO THE FINANCIAL STATEMENTS

3 Risk management (continued)

	Society				
	No maturity date	Within 1 year	1 - 5 years	Over 5 years	Total
Financial and insurance liabilities at 31/12/18	£'000	£'000	£'000	£'000	£'000
Fund for future appropriation	19,048	-	-	-	**19,048**
Long term business provision	-	9,034	4,396	74,704	**88,134**
Investment contract liabilities	-	5	13	-	**18**
Claims outstanding	-	2,214	-	-	**2,214**
Provision for bonuses and rebates	-	65	33	22	**120**
Technical provision for linked liabilities – insurance contracts	-	1,036	-	-	**1,036**
Technical provision for linked liabilities – investment contracts	-	327	-	-	**327**
Derivatives	-	787	-	-	**787**
Defined benefit pension liability	-	-	-	679	**679**
Creditors arising out of direct insurance operations	-	49	-	-	**49**
Other creditors including taxation and social security	-	307	-	-	**307**
Accruals and deferred income	-	1,328	-	-	**1,328**
Total financial and insurance liabilities	**19,048**	**15,152**	**4,442**	**75,405**	**114,047**

	Society				
	No maturity date	Within 1 year	1 - 5 years	Over 5 years	Total
Financial and insurance liabilities at 31/12/17	£'000	£'000	£'000	£'000	£'000
Fund for future appropriation	25,013	-	-	-	**25,013**
Long term business provision	-	6,355	10,698	84,392	**101,445**
Investment contract liabilities	-	6	31	-	**37**
Claims outstanding	-	1,849	-	-	**1,849**
Provision for bonuses and rebates	-	42	77	37	**156**
Technical provision for linked liabilities – insurance contracts	-	1,190	-	-	**1,190**
Technical provision for linked liabilities – investment contracts	-	379	-	-	**379**
Derivatives	-	36	-	-	**36**
Defined benefit pension liability	-	-	-	1,476	**1,476**
Creditors arising out of direct insurance operations	-	49	-	-	**49**
Other creditors including taxation and social security	-	340	-	-	**340**
Accruals and deferred income	-	1,100	-	-	**1,100**
Total financial and insurance liabilities	**25,013**	**11,346**	**10,806**	**85,905**	**133,070**

3 Risk management (continued)

	Society				
	No maturity date	Within 1 year	1 - 5 years	Over 5 years	Total
Financial and insurance liabilities at 31/12/18	£'000	£'000	£'000	£'000	£'000
Equity investments	12,895	–	–	–	**12,895**
Fixed interest securities	–	1,895	6,813	52,924	**61,632**
Derivatives	–	118	–	–	**118**
Deposits with credit institutions	–	2,470	–	–	**2,470**
Mortgages	95	5	13	3	**116**
Assets held to cover linked liabilities	1,635	–	–	–	**1,635**
Debtors arising from direct insurance operations	–	147	–	–	**147**
Other debtors	–	760	–	–	**760**
Cash at bank and in hand	401	–	–	–	**401**
Accrued interest and rent	–	1,517	–	–	**1,517**
Total financial assets	**15,026**	**6,912**	**6,826**	**52,927**	**81,691**

	Society				
	No maturity date	Within 1 year	1 - 5 years	Over 5 years	Total
Financial assets at 31/12/17	£'000	£'000	£'000	£'000	£'000
Equity investments	14,933				**14,933**
Fixed interest securities	–	3,967	6,259	71,254	**81,480**
Derivatives	–	386	–	–	**386**
Deposits with credit institutions	–	1,842	–	–	**1,842**
Mortgages	107	5	13	4	**129**
Assets held to cover linked liabilities	1,796	–	–	–	**1,796**
Debtors arising from direct insurance operations	–	101	–	–	**101**
Other debtors	–	1,486	–	–	**1,486**
Cash at bank and in hand	2,483	–	–	–	**2,483**
Accrued interest and rent	–	1,529	–	–	**1,529**
Total financial assets	**19,319**	**9,316**	**6,272**	**71,258**	**106,165**

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

3 Risk management (continued)

iv. Fair value estimation

The principal financial assets held at 31 December 2018, analysed by their fair value hierarchies are:

	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Assets 2018 Financial assets at fair value through the profit and loss				
- Equity investments	12,895	–	–	12,895
- Fixed interest securities	18,488	43,144	–	61,632
- Derivatives	113	5	–	118
- Assets held to cover linked liabilities	–	1,635	–	1,635
Total assets	**31,496**	**44,784**	**-**	**76,280**

The principal financial assets held at 31 December 2017, analysed by their fair value hierarchies were:

	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Assets 2017 Financial assets at fair value through the profit and loss				
- Equity investments	14,933	–	–	14,933
- Fixed interest securities	33,034	48,446	–	81,480
- Derivatives	–	386	–	386
- Assets held to cover linked liabilities	–	1,796	–	1,796
Total assets	**47,967**	**50,628**	**-**	**98,595**

3 Risk management (continued)

The principal financial liabilities held at 31 December 2018, analysed by their fair value hierarchies are:

	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Liabilities 2018 Financial liabilities at fair value through the profit and loss				
– Investment contract liabilities	–	18	–	18
– Investment contracts on linked liability fund	–	327	–	327
– Derivatives	432	355	–	787
Total liabilities	**432**	**700**	**-**	**1,132**

The principal financial liabilities held at 31 December 2017, analysed by their fair value hierarchies are:

	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Liabilities 2017 Financial liabilities at fair value through the profit and loss				
– Investment contract liabilities	–	37	–	37
– Investment contracts on linked liability fund	–	379	–	379
– Derivatives	–	36	–	36
Total liabilities	**-**	**452**	**-**	**452**

NOTES TO THE FINANCIAL STATEMENTS

3 Risk management (continued)

iv. Fair value estimation (continued)

The principal financial assets held at 31 December 2018, analysed by their fair value hierarchies are:

Level 1 Valued using unadjusted quoted price in active markets for identical financial instruments.

Level 2 Valued using techniques based significantly on observed market data.

Level 3 Valued using techniques incorporating information other than observable market data.

The Society engages investment fund managers to monitor the valuation of assets in markets that become less liquid. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured. When it is determined that there is no active market for the instrument being measured fair value is established using a valuation technique.

4 Gross premiums written and payments to deposit

Gross premiums written and payments to deposit	Group & Society 2018 £'000	Group & Society 2017 £'000
Assurance	2,147	2,395
Bonds and other single premiums	213	373
Healthcare policies	7,217	7,345
Payments to deposit	370	370
Unit linked	32	35
	9,979	**10,518**

The gross premiums written and payments to deposit above include gross new business premiums as detailed below:

Gross new premiums written	Group & Society 2018 £'000	Group & Society 2017 £'000
Assurance	945	117
Bonds and other single premiums	196	373
Healthcare policies	661	159
	1,802	**649**

The Society only transacts long term business within the United Kingdom.

5 Investment income

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Income from land and buildings	**1,571**	**1,717**	**1,571**	**1,717**
Fixed interest stocks	2,712	3,005	2,712	3,005
Ordinary shares	469	424	469	424
Income from investments at fair value through profit and loss	**3,181**	**3,429**	**3,181**	**3,429**
Bank interest	16	13	16	13
Mortgages	4	4	4	4
Income from other investments	**20**	**17**	**20**	**17**
Income from investments	**4,772**	**5,163**	**4,772**	**5,163**
Net gains/(losses) on realisation of land and buildings	665	(612)	665	(612)
Net gains on realisation of listed investments at fair value through profit and loss	1,097	2,234	1,097	2,234
Net gains on realisation of investments	**1,762**	**1,622**	**1,762**	**1,622**
Investment income	**6,534**	**6,785**	**6,534**	**6,785**
Net unrealised gains/(losses) on investments				
– Land and buildings	(373)	2,545	(373)	2,545
– Listed investments at fair value through profit and loss	(7,400)	(640)	(7,400)	(640)
– Assets held to cover linked liabilities at fair value through profit and loss	(136)	233	(136)	233
	(7,909)	**2,138**	**(7,909)**	**2,138**
Total investment return	**(1,375)**	**8,923**	**(1,375)**	**8,923**

There is no interest expense in respect of financial liabilities not at fair value through profit and loss.

6 Other technical income

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Insurance commission	313	276	2	2
Other income	255	23	94	23
	568	**299**	**96**	**25**

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

7 Net operating expenses

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
a) Included in operating expenses are:				
Fees payable to the Society's auditor:				
Audit of the Society's annual accounts:	149	167	149	167
Non-recurring audit fees in respect of the prior year	33	–	33	–
Fees payable to the Society's auditor and its associates for other services:				
- Audit of the accounts of subsidiaries	9	9	–	–
- Audit-related assurance services	–	10	–	10
Taxation compliance services	–	–	–	–
Other non-audit services	–	–	–	–
Fees payable to internal auditors in respect of:				
Internal audit	45	22	45	22
Actuarial fees	66	169	66	169
Depreciation of tangible assets	58	57	58	51
(b) Other technical charges – project costs:				
Capital management	671	819	671	819
Distribution	18	9	–	9
Systems and processing	2,000	101	2,000	351
Risk management	322	340	346	340
Total project costs	**3,011**	**1,269**	**3,017**	**1,519**

8 Investment expenses

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Investment management expenses	353	281	353	281
Investment property direct costs	439	554	439	554
	792	**835**	**792**	**835**

9 Staff costs

	Group		Society	
	2018	2017	2018	2017
Average monthly number of employees:				
Administration	38	38	38	38
Distribution	18	13	13	6
	56	**51**	**51**	**44**

The average full-time equivalent is 54 (2017: 45) for the Group and 49 (2017: 39) for the Society. Excludes Non- Executive Directors of 4 (2017: 4).

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
Wages and salaries (inc commission)	2,563	2,368	2,356	2,130
Social security costs	267	246	247	224
Pension costs	169	187	154	168
	2,999	**2,801**	**2,757**	**2,522**

This includes Executive Directors' emoluments totalling £382,259 (2017: £368,714). Details of Directors' remuneration are set out on page 31.

10 Directors' emoluments

	Group & Society	
	2018 £'000	2017 £'000
Aggregate emoluments	532	516

Retirement benefits are accruing to one Executive Director as at 31 December 2018 (2017: one) under a defined benefit scheme. The aggregate amount of pension contribution made by the Society to a defined contribution scheme was £13,838 (2017: £31,651).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

10 Directors' emoluments (continued)

Highest paid Director	Group & Society 2018 £'000	Group & Society 2017 £'000
Total emoluments and amounts receivable under long-term incentive schemes	222	201
Defined benefit scheme: Pension accrued during the year	-	1
Defined contribution scheme: Contributions made by the Society	-	19

11 Taxation

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
(a) Tax attributable to long term business Tax (credited)/charged in the long term business technical account comprises:				
Current tax				
UK corporation tax	-	-	-	-
Prior year adjustments	-	-	-	-
Total current tax	-	-	-	-
Deferred tax				
Origination and reversal of timing differences	(11)	-	-	-
Total deferred tax	**(11)**	-	-	-
Total tax charged/(credited) in the long term business technical account	**(11)**	-	-	-

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
(b) Factors that may affect future tax charges The deferred tax assets which have not been recognised due to the uncertainty of their recoverability in the foreseeable future comprise:				
Realised and unrealised capital losses	264	217	264	217
Expenses deductible in future years	666	174	666	174
Trade losses	775	695	-	-
Short term timing differences	4	5	-	-
Deferred tax asset not recognised	**1,709**	**1,091**	**930**	**391**

11 Taxation (continued)

These deferred tax assets may be realised, and therefore reduce future tax payable, when net gains chargeable to corporation tax are realised or when there is sufficient taxable income with which to offset carried forward expenses and/or losses. This will therefore depend substantially upon future movements in the stock market and on future taxable income which cannot be predicted with certainty. There are unused gross capital losses of £1,613,642.

Expenses deductible in the Society in future periods are primarily driven by excess management expenses carried forward of £1,582,931, along with expenses for which tax relief is spread over 7 years of £1,613,674. Future pension contributions and fixed asset timing differences make up a further £133,106 of future tax deductions. Trade losses not recognised are made up of £4,618,069 of trading losses incurred in subsidiaries.

	Group		Society	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000
(c) Balance sheet The deferred tax balance included within other assets comprises: Unrelieved expenses carried forward				
Realised capital losses	70	122	59	122
Unrealised capital gains	(59)	(122)	(122)	(122)
Deferred tax on Pension Scheme surplus	–	–	–	–
Undiscounted deferred tax asset balance	**11**	–	–	–
d) Reconciliation of deferred taxation balances				
Opening deferred tax asset	–	–	–	–
(Charge)/credit to income statement	11	–	–	–
Credit/(charge) to statement of comprehensive income	–	–	–	–
	11	–	–	–

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

12 Investments Land and Buildings

	Group		Society	
	2018 £'000 Cost	2018 £'000 Valuation	2018 £'000 Cost	2017 £'000 Valuation
Freehold investment properties				
At 1 January	9,731	11,795	9,731	11,795
Additions	7,824	7,824	7,824	7,824
Disposals	(1,181)	(1,900)	(1,181)	(1,900)
Net gains on revaluation	–	366	–	366
At 31 December	**16,374**	**18,085**	**16,374**	**18,085**
Long leasehold properties				
At 1 January	8,016	7,900	8,016	7,900
Disposals	–	–	–	–
Net gains on revaluation	–	(25)	–	(25)
At 31 December	**8,016**	**7,875**	**8,016**	**7,875**
Freehold ground rents				
At 1 January	4	55	4	55
Disposals	–	–	–	–
Net gains on revaluation	–	5	–	5
At 31 December	**4**	**60**	**4**	**60**
Freehold and long leasehold investment properties: At 1 January	17,751	19,750	17,751	19,750
Freehold and long leasehold investment properties: At 31 December	**24,394**	**26,020**	**24,394**	**26,020**

The Society's properties are included at Fair Value. The Properties are valued by Mellersh and Harding LLP as at 31st December 2018 in accordance with the requirements of the Royal Institution of Chartered Surveyors' Valuation – Professional Standards effective from 6th January 2014.

Under the fair value measurement hierarchy, investment properties are classed as level 3 as they are valued using techniques incorporating information other than observable data.

13 Other financial investments

	Group & Society			
	2018 £'000 Cost	2018 £'000 Valuation	2017 £'000 Cost	2017 £'000 Valuation
Fixed interest securities	57,037	61,632	72,946	81,480
Listed shares	14,019	12,895	13,611	14,933
Derivatives	–	118	–	386
Deposits with credit institutions	2,470	2,470	1,842	1,842
Mortgages	116	116	129	129
	73,642	**77,231**	**88,528**	**98,770**

Of the listed fixed interest securities £24,704,160 (2017: £25,507,667) relates to overseas fixed interest securities, with the remainder relating to UK fixed interest securities.

Of the listed shares £3,006,877 (2017: £1,401,590) relates to overseas investments, with the remainder relating to UK investments.

Derivatives consist of: forward contracts for foreign currency exchange to mitigate the risk of a change in foreign currency exchange rates; and futures to manage the duration of the fixed interest portfolio. The gain in the value of these contracts has been recognised through the income statement. The contracts will mature in 2019.

Included within deposits with credit institutions is £794,585 (2017: £425,610) which relates to cash in a cash margin account which enables the Society to enter into the forward contracts. This amount is held with the clearing house for the life of the contracts and is refunded if market movements mean that the contract is favourable and used to pay for the liability if it is adverse.

The Directors have the opinion that the carrying value of the investments is supported by their net underlying assets.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

14 Financial assets

	Group			
	2018 £'000 Cost	2018 £'000 Valuation	2017 £'000 Cost	2017 £'000 Valuation
Financial assets at fair value through profit and loss				
Designated upon initial recognition	74,993	79,209	92,168	103,198
	74,993	**79,209**	**92,168**	**103,198**
Loans and receivables	2,570	2,570	2,993	2,993
Total financial assets	**77,563**	**81,779**	**95,161**	**106,191**
Included in the balance sheet as:				
Listed fixed interest securities	57,037	61,632	72,946	81,480
Listed shares	14,019	12,895	13,611	14,933
Derivatives	–	118	–	386
Deposits with credit institutions	2,470	2,470	1,842	1,842
Mortgages	116	116	129	129
Other financial investments (Note 13)	**73,642**	**77,231**	**88,528**	**98,770**
Assets held to cover linked liabilities (Note 16)	1,008	1,635	1,008	1,796
Debtors arising from direct insurance operations	185	185	145	145
Other debtors	752	752	1,190	1,190
Cash at bank and in hand	459	459	2,761	2,761
Accrued interest and rent	1,517	1,517	1,529	1,529
Total financial assets	**77,563**	**81,779**	**95,161**	**106,191**

For the year ended 31 December 2018

14 Financial assets (continued)

	Society			
	2018 £'000 Cost	2018 £'000 Valuation	2017 £'000 Cost	2017 £'000 Valuation
Financial assets at fair value through profit and loss				
Designated upon initial recognition	74,935	79,151	91,890	102,920
	74,935	**79,151**	**91,890**	**102,920**
Loans and receivables	2,540	2,540	3,245	3,245
Total financial assets	**77,475**	**81,691**	**95,135**	**106,165**
Included in the balance sheet as:				
Listed fixed interest securities	57,037	61,632	72,946	81,480
Listed shares	14,019	12,895	13,611	14,933
Derivatives	–	118	–	386
Deposits with credit institutions	2,470	2,470	1,842	1,842
Mortgages	116	116	129	129
Other financial investments (Note 13)	**73,642**	**77,231**	**88,528**	**98,770**
Assets held to cover linked liabilities (Note 16)	1,008	1,635	1,008	1,796
Debtors arising from direct insurance operations	147	147	101	101
Other debtors	760	760	1,486	1,486
Cash at bank and in hand	401	401	2,483	2,483
Accrued interest and rent	1,517	1,517	1,529	1,529
Total financial assets	**77,475**	**81,691**	**95,135**	**106,165**

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

15 Financial Liabilities

	Group			
	2018 £'000 Cost	2018 £'000 Valuation	2017 £'000 Cost	2017 £'000 Valuation
Financial liabilities at fair value through profit and loss				
Designated upon initial recognition	–	787	–	36
Other financial liabilities at amortised cost	1,998	1,998	1,958	1,958
Total financial liabilities	**1,998**	**2,785**	**1,958**	**1,994**
Included in the balance sheet as:				
Derivatives	–	787	–	36
Investment contract liabilities	18	18	37	37
Investment contract liabilities on linked liability fund	327	327	379	379
Arising out of direct insurance operations	49	49	49	49
Other creditors including taxation and social security	350	350	380	380
Accruals and deferred income	1,254	1,254	1,113	1,113
Total financial liabilities	**1,998**	**2,785**	**1,958**	**1,994**

	Society			
	2018 £'000 Cost	2018 £'000 Valuation	2017 £'000 Cost	2017 £'000 Valuation
Financial liabilities at fair value through profit and loss				
Designated upon initial recognition	–	787	–	36
Other financial liabilities at amortised cost	2,029	2,029	1,905	1,905
Total financial liabilities	**2,029**	**2,816**	**1,905**	**1,941**
Included in the balance sheet as:				
Derivatives	–	787	–	36
Investment contract liabilities	18	18	37	37
Investment contract liabilities on linked liability fund	327	327	379	379
Arising out of direct insurance operations	49	49	49	49
Other creditors including taxation and social security	307	307	340	340
Accruals and deferred income	1,328	1,328	1,100	1,100
Total financial liabilities	**2,029**	**2,816**	**1,905**	**1,941**

15 Financial Liabilities (continued)

Derivatives consist of forward contracts for foreign currency exchange to mitigate the risk of a change in foreign currency exchange rates. The loss in the value of these contracts has been recognised through the income statement forming a natural hedge. Other financial liabilities are carried in the balance sheet at amortised cost. Their fair values are not materially different from the values shown above.

16 Assets held to cover linked liabilities

	Group & Society			
	2018 £'000 Cost	2018 £'000 Valuation	2017 £'000 Cost	2017 £'000 Valuation
Assets held to cover unit linked insurance contracts	764	1,244	764	1,362
Assets held to cover unit linked investment contracts	244	391	244	434
	1,008	**1,635**	**1,008**	**1,796**

Included within assets held to cover linked liabilities is £272,100 (2017: £227,504) representing units not yet purchased by policyholders.

An analysis of total financial assets, including assets held to cover linked liabilities is provided in Note 14 'Financial assets'.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

17 Intangible assets

	Group		
At 31 December 2017	**Software under Construction £'000**	**Computer Software £'000**	**Total £'000**
Cost/Valuation	1,397	3,250	**4,647**
Accumulated depreciation and impairment	–	(250)	**(250)**
Net book amount	**1,397**	**3,000**	**4,397**
Year ended 31 December 2018			
Opening net book value	1,397	3,000	**4,397**
Amortisation	–	(300)	**(300)**
Impairment	(1,097)	–	**(1,097)**
Closing net book amount	**300**	**2,700**	**3,000**
At 31 December 2018			
Cost/Valuation	1,397	3,250	**4,647**
Accumulated depreciation and impairment	(1,097)	(550)	**(1,647)**
Net book amount	**300**	**2,700**	**3,000**

	Society	
At 31 December 2017	**Software under Construction £'000**	**Total £'000**
Cost/Valuation	1,397	**1,397**
Accumulated depreciation and impairment	–	**-**
Net book amount	**1,397**	**1,397**
Year ended 31 December 2018		
Opening net book value	1,397	**1,397**
Amortisation	-	**-**
Impairment	(1,097)	**(1,097)**
Closing net book amount	**300**	**300**
At 31 December 2018		
Cost/Valuation	1,397	**1,397**
Accumulated depreciation and impairment	(1,097)	**(1,097)**
Net book amount	**300**	**300**

An impairment was recognised in the year due to a reduction in expected cash flows from third party licence sales of the Policy Administration System.

18 Tangible assets

	Group				
At 31 December 2017	Land & Buildings £'000	Computer Equipment £'000	Office Equipment £'000	Motor Vehicle £'000	Total £'000
Cost/Valuation	2,230	513	165	58	**2,966**
Accumulated depreciation and impairment	–	(488)	(74)	(12)	**(574)**
Net book amount	**2,230**	**25**	**91**	**46**	**2,392**
Year ended 31 December 2018					
Opening net book value	2,230	25	91	46	**2,392**
Additions	–	5	5	75	**85**
Disposals – cost	–	(24)	–	(34)	**(58)**
Disposals – accumulated depreciation	–	24	–	17	**41**
Depreciation	–	(13)	(18)	(27)	(58)
Revaluation	269	–	–	–	**269**
Closing net book amount	**2,499**	**17**	**78**	**77**	**2,671**
At 31 December 2018					
Cost/Valuation	2,499	494	170	99	**3,262**
Accumulated depreciation and impairment	–	(477)	(92)	(22)	**(591)**
Net book amount	**2,499**	**17**	**78**	**77**	**2,671**

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

18 Tangible assets (continued)

	Society				
At 31 December 2017	**Land & Buildings £'000**	**Computer Equipment £'000**	**Office Equipment £'000**	**Motor Vehicle £'000**	**Total £'000**
Cost/Valuation	2,230	489	165	58	**2,942**
Accumulated depreciation and impairment	-	(464)	(74)	(12)	**(550)**
Net book amount	**2,230**	**25**	**91**	**46**	**2,392**
Year ended 31 December 2018					
Opening net book value	2,230	25	91	46	**2,392**
Additions	-	5	5	75	**85**
Disposals – cost	-	–	-	(34)	**(34)**
Disposals – accumulated depreciation	-	-	-	17	**17**
Depreciation	–	(13)	(18)	(27)	(58)
Revaluation	269	-	-	-	**269**
Closing net book amount	**2,499**	**17**	**78**	**77**	**2,671**
At 31 December 2018					
Cost/Valuation	2,499	494	170	99	**3,262**
Accumulated depreciation and impairment	-	(477)	(92)	(22)	**(591)**
Net book amount	**2,499**	**17**	**78**	**77**	**2,671**

The net book value of land and buildings consists of the proportion of 11-12 Queen Square, Bristol utilised by the Society and Group as a head office, which is valued on a Fair Value basis.

The valuation was performed by Mellersh and Harding LLP as at 31st December 2018 in accordance with the requirements of the Royal Institution of Chartered Surveyors' Valuation - Professional Standards effective from 6th January 2014. Under the amortised cost model the land and buildings have a cost of £1,538,000 (2017: £1,538,000), a useful life of 100 years and a net book value of £1,461,000 (2017: £1,476,000).

Under the fair value measurement hierarchy, tangible fixed assets are classed as level 3 as they are valued using techniques incorporating information other than observable data.

19 Capital commitments

Amounts authorised and contracted for at 31 December 2018 are £nil (2017: £nil).

20 Long term business provision

The long term business provision has been calculated on the basis of the following principal assumptions:

Rates of interest	Solvency II Best Estimate Assumptions
All contracts	Based on prescribed Solvency II rates

Rates of mortality	Solvency II Best Estimate Assumptions
Health contracts	Ranges from 69.0% to 78.2% (2017: 77.6% to 92.0%) of the AMN00 and AFN00 ultimate tables for assured lives depending on the contract.
Life contracts	Ranges from 29.7% to 320% (2017: 29.7% to 126%) of the AMN00, AFN00 and AMS00 ultimate table for assured lives depending on the contract.
Pension and Annuity contracts	Ranges from 51.2% to 113.4% (2017: 61.7% to 121.3%) of the PNMA00 and PNFA00 mortality tables, and for annuities CMI 2017 for the future mortality improvements subject to a minimum improvement of 1.125% per annum.

Rates of morbidity	Solvency II Best Estimate Assumptions
Health contracts	Morbidity assumptions are based upon the Society's actual experience.

Rates of lapses	Solvency II Best Estimate Assumptions
All contracts	Lapse assumptions are based upon the Society's actual experience.

Expenses	Solvency II Best Estimate Assumptions
Death Benefits Only (DBO) contracts	£3.02 (2017: £2.95) per annum
Non-DBO Old Deposit contracts	£47.29 (2017: £71.03) per annum
Health contracts excluding Optimum combined	£73.19 (2017: £71.03) per annum
Optimum combined contracts	£47.92 (2017: £71.03) per annum
Income Protection contracts	£51.78 (2017: £71.03) per annum
All life assurance and pension policies	£31.53 (2017: £47.35) per annum
Per policy Expense Inflation	2.5% (2017: 2.3%) per annum
Tax relief on per policy expenses for taxable business	20%
Offset for with profits life assurance policies	The value of expenses detailed in the terms and conditions for that particular policy

Expenses are determined using per policy expenses equal to the level of expected administration costs in 5 years' time divided by the expected volume of business in force at that time.

The new business assumption is based on the most recent sales projections.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2018

21 Pensions
National Deposit Staff Superannuation Fund

Nature of the Fund

The NDFS Staff Superannuation Fund operated by the Society is a funded defined benefit arrangement which provides retirement benefits based on final pensionable salary.

The Fund is closed to the future accrual of benefits with effect from 31 May 2009. All remaining active members were treated as having left Pensionable Service with effect from that date. These members receive increases in deferment equal to the higher of the increase in their pensionable salary and statutory deferred revaluation while they remain in employment with the Society.

The most recent actuarial valuation of the Fund indicated that the Fund had a deficit. The Society and the Trustees of the Fund have put in place a Schedule of Contributions and a Recovery Plan which detail the contributions that will be made to fund this deficit, which are monthly payments of £15,925 over the period from April 2015 to March 2018, £25,000 from April 2018 to March 2019, £30,000 from April 2019 to March 2020, £35,000 from April 2020 to March 2021 and £40,000 from April 2021 to November 2022 inclusive. Along with one-off contributions of £500,000 in April 2018 and £250,000 in April 2019 and April 2021.

The most recent formal actuarial valuation of the Fund was carried out as at 31 December 2016. The calculations for the FRS102 disclosures have been carried out by running full actuarial calculations as at 31 December 2018.

Funding Policy

Following the cessation of accrual of benefits with effect from 31 May 2009, regular contributions to the Fund are no longer required. However, additional contributions are still made to cover any shortfalls that arise following each valuation. The funding method employed to calculate the value of previously accrued benefits is the Projected Unit Method. The Trustees determine the level of contributions payable to the Fund following agreement from the Society and advice of the Fund's Actuary.

Fund Amendments

There have been no amendments to the Fund during the year and no special events have occurred.

Employee benefit obligations for National Deposit Friendly Society Limited in respect of the National Deposit Friendly Society Staff Superannuation Fund

	Group & Society	
The amounts recognised in the balance sheet are as follows:	**2018 £'000**	**2017 £'000**
Fair value of fund assets	18,985	19,662
Present value of funded obligations	(19,664)	(21,138)
Net (under) / overfunding in Fund	**(679)**	**(1,476)**
Liability recognised on the balance sheet	(679)	(1,476)
Net Defined Benefit Liability	**(679)**	**(1,476)**

21 Pensions (continued)

Employee benefit obligations for National Deposit Friendly Society Limited in respect of the National Deposit Friendly Society Staff Superannuation Fund (continued)

The amounts recognised in income statement are as follows:

	Group & Society	
	2018 £'000	2017 £'000
Net Interest expense	27	64
Expense recognised in the Income Statement	**27**	**64**

	Group & Society	
	2018 £'000	2017 £'000
Interest on obligation	516	556
Interest on assets	(489)	(492)
Net Interest expense	**27**	**64**

The amounts recognised as Remeasurements in the Statement of Comprehensive Income are as follows:

	Group & Society	
	2018 £'000	2017 £'000
Return on assets (not included in interest)	(884)	707
Actuarial (Losses)/Gains on obligation	1,036	351
Total Remeasurements recognised in Other Comprehensive Income	**152**	**1,058**
Cumulative amount of Remeasurements recognised in Other Comprehensive Income	**(1,736)**	**(1,888)**
Actual return on Fund assets	**(395)**	**1,199**

NOTES TO THE FINANCIAL STATEMENTS

21 Pensions (continued)

Employee benefit obligations for National Deposit Friendly Society Limited in respect of the National Deposit Friendly Society Staff Superannuation Fund (continued)

The following other costs are included in the relevant sections of the accounts.

	Group & Society	
	2018 £'000	2017 £'000
Administration expenses paid from Fund	101	92
Other Items	**101**	**92**

The Society contributed £772,775 to the Fund over the year from 1 January 2018 to 31 December 2018 (2017: £191,100). No contributions were paid by members of the Fund over the period.

The Society expects to contribute £595,000 to the Fund over the year from 1 January 2019 to 31 December 2019. No contributions are expected by members of the Fund over the next year.

Changes in the present value of the Fund's Defined Benefit Obligation are as follows:

	Group & Society	
	2018 £'000	2017 £'000
Opening defined benefit obligation	21,138	21,856
Benefits paid	(954)	(923)
Interest on obligation	516	556
Experience gains	164	(71)
Losses/(gains) from changes in assumptions	(1,200)	(280)
Closing defined benefit obligation	**19,664**	**21,138**

The weighted average duration of the liabilities of the Fund was 15 years as at 31 December 2018 (2017: 15 years).

21 Pensions (continued)

Employee benefit obligations for National Deposit Friendly Society Limited in respect of the National Deposit Friendly Society Staff Superannuation Fund (continued)

Changes in the fair value of the Fund assets are as follows:

	Group & Society	
	2018 £'000	2017 £'000
Opening fair value of fund assets	19,662	19,287
Interest on assets	489	492
Return on assets (not included in interest)	(884)	707
Contributions by employer	773	191
Benefits paid	(954)	(923)
Administration expenses	(101)	(92)
Closing fair value of fund assets	**18,985**	**19,662**

The major categories of fund assets as a percentage of the total are as follows:	%	%
Equities	**24**	34
Gilts	**15**	11
Corporate bonds	**26**	27
Property	**20**	18
Cash	**15**	10

All of the Fund's assets are classed as level 2 under the fair value hierarchy, as they are valued using techniques based on observed market data. The Fund holds no financial instruments issued by the Company (other than incidentally through investment in pooled funds), nor does it hold any property or other assets used by the Company.

Principal actuarial assumptions at the balance sheet date (expressed as weighted averages (where applicable)).

	Group & Society	
	2018 %pa	2017 %pa
Discount rate at 31 December	2.7	2.5
Discount rate at 1 January	2.5	2.6
Inflation (Retail Price Index)	2.0	3.2
Rate of increase in pensionable salaries	2.8	3.5
Rate of increase in deferred pensions	2.0	2.2
Rate of increase in pensions in payment – service pre 06/04/2005	2.8	3.1
Rate of increase in pensions in payment – service post 06/04/2005	2.2	2.2

NOTES TO THE FINANCIAL STATEMENTS

21 Pensions (continued)

Mortality assumptions

The mortality assumptions are based on standard mortality tables, which allow for future mortality improvements. The assumptions are that a member aged 65 will live on average until age 87 if they are male (2017: 87) and until age 89 if female (2017: 89).

For a member currently aged 50 the assumptions are that if they attain age 65 they will live on average until age 88 if they are male (2017: 88) and until age 91 if female (2017: 90).

Defined contribution scheme

The contributions to the defined contribution scheme made by the Society in the year amounted to £153,594 (2017: £168,472), and contributions made by the Group amounted to £168,668 (2017: £186,804).

22 Technical provisions for linked liabilities

	Group & Society					
	Insurance contracts		Investment contracts		Total	
	2018 £'000	2017 £'000	2018 £'000	2017 £'000	2018 £'000	2017 £'000
At 1 January	1,190	1,057	379	352	1,569	1,409
Payments made to policy holders of investment contracts	-	-	(24)	(22)	(24)	(22)
Change in technical provision as shown in the income statement	(154)	133	(28)	49	(182)	182
At 31 December	**1,036**	**1,190**	**327**	**379**	**1,363**	**1,569**

All movements in unit-linked insurance contracts including premium receipts and claims payments, are recorded in the Income Statement.

23 Assets attributable to the long term business fund

All assets shown on the Balance Sheet on page 44 are attributable to the long term business fund.

24 Operating lease commitments

The Society leases various motor vehicles and office equipmzent under cancellable operating lease agreements. The lease terms are for up to five years, with penalty for early cancellation.

	Group & Society	
Total future minimum lease payments: plant & machinery	2018 £'000	2017 £'000
Within one year	26	–
Between one and five years	–	26
After five years	–	–
Total	**26**	**26**

25 Related party transactions

425 Direct Limited was charged £449,458 (2017: £372,803) by the Society in respect of service charges.

The Society paid 425 Direct Limited commission of £145,639 (2017: £40,669) for the sale of National Friendly products. The Society paid 425 Direct Limited £24,000 following its appointment to provide an advice service to the members of the National Deposit Society Staff Superannuation Fund as part of an Incentive Exercise.

Contributions of £772,775 (2017: £191,100) were made to the National Deposit Friendly Society Staff Superannuation Fund, of which Jonathan Long is a Trustee, as agreed with the trustees with the objective of having sufficient assets to meet its liabilities.

During the year the Society paid ND Member Services Limited £300,000 (2017: £250,000) in licence fees for the policy administration system.

As at 31 December 2018, 425 Direct Limited owed £8,387 to the Society (2017: £21,204 owed by Society) and ND Member Services Limited was owed by the Society a net amount of £110,114 (2017: £296,344 owed to the Society).

Key management personnel

All directors and certain senior employees who have authority and responsibility for planning, directing and controlling the activities of the Group are considered to be key management personnel. Total key management personnel compensation is £382,259 (2017: £368,714). Director's remuneration is disclosed in the directors' remuneration report on page 31.

In addition the directors of the Society may from time to time purchase insurance or investment products marketed by the Society in the ordinary course of business on the same terms as those prevailing at the time for comparable transactions with other persons. In 2018 and 2017, other transactions with the Society's directors' were not deemed to be significant both by virtue of their size and in context with the directors' financial position. All of these transactions are on normal commercial terms.

NOTES TO THE FINANCIAL STATEMENTS

26 Subsidiary undertakings

The Society has two wholly owned subsidiary companies incorporated in the United Kingdom: 425 Direct Limited and ND Member Services Limited.

During the year additional capital of £365,000 (2017: £480,000) was provided to 425 Direct Limited. 425 Direct Limited operates a call centre giving financial advice. 425 Direct Limited is held by the Society at a fair value of £20,000 (2017: £35,000) after an impairment charge of £380,000 (2017: £474,000).

ND Member Services Limited licences a policy administration system to its customers and is held by the Society at a fair value of £1 (2017: £1) which represents the net realisable value of its assets.

The results of all subsidiaries for the year ended 31 December 2018 have been consolidated into the Group financial statements.

	Group & Society	
	2018 £'000	2017 £'000
Fair value of investment in subsidiaries at 1 January	35	29
Additional share capital provided in the year	365	480
Unrealised loss in value of subsidiaries	(380)	(474)
Fair value of investment in subsidiaries at 31 December	**20**	**35**

27 Fund for Future Appropriations

		Group		Society	
	Note	2018 £'000	2018 £'000	2018 £'000	2017 £'000
As at 1 January		24,968	18,254	25,013	18,297
Transfer to/(from) the fund for future appropriations from income statement		(6,221)	5,412	(6,386)	5,414
Transfer to/(from) the fund for future appropriations from statement of comprehensive income		421	1,302	421	1,302
As at 31 December		**19,168**	**24,968**	**19,048**	**25,013**

The Fund for Future Appropriations represents the estimated surplus in the funds that has not been allocated to policyholders and is available to meet regulatory and other solvency requirements.

28 Derivatives

Included within assets are forward currency contracts with a fair value of £5,000 (2017: £287,000) and a fair value within liabilities of £355,000 (2017: £2,000). The nominal contract value of these contracts is £11,532,000 (2017: £12,032,000). These are used to manage the exchange rate risk arising from investments in non-sterling denominated bonds. Cash flows under these contracts are dependent on exchange rates at the dates on which the contracts mature. Movements in fair value arise due to variations in exchange rate and are reflected in the income statement. Fair value losses included in the income statement for 2018 in relation to the forward currency contracts amounted to £635,000 (2017: gains of £287,000).

Bond future contracts with a fair value of £113,000 (2017: £99,000) are held within assets and a fair value of £432,000 (2017: £34,000) within liabilities. The nominal contract value of these contracts is £21,655,000 (2017: £20,211,000). These are used to manage the duration of the fixed interest portfolio. Fair value losses for the year of £384,000 (2017: gains of £65,000) are included in the income statement in respect of bond future contracts.

The liability position of the forward currency contracts at 31 December 2018 has primarily been driven by the decrease in value of sterling against the US dollar by $0.04 in November and December 2018, the US dollar investments have increased in value, but the derivative contracts held to protect against this risk have decreased into a liability position.

The liability position of the Bond futures at 31 December 2018 has primarily been driven by the decrease in US treasury gilt yield of 0.3% in December 2018. Whilst this increases the value of the US dollar bonds, the derivative contracts held to protect against this risk have decreased into a liability position.

	Group & Society		
Derivatives held at 31 December 2018	Contract value £'000	Fair value assets £'000	Fair value liabilities £'000
Forward currency contracts	11,532	5	355
Bond futures	21,655	113	432
Total derivatives	**33,187**	**118**	**787**

	Group & Society		
Derivatives held at 31 December 2017	Contract value £'000	Fair value assets £'000	Fair value liabilities £'000
Forward currency contracts	12,032	**287**	**2**
Bond futures	20,211	**99**	**34**
Total derivatives	**32,243**	**386**	**36**

29 Events after the end of the reporting period

On 5th April 2019 the Society's subsidiary 425 Direct Limited acquired a customer book for £558,000.

For further information or to request a copy in Braille, large print or audio please call us on:

0333 014 6244 Calls from UK landlines and mobiles cost no more than a call to an 01 or 02 number and will count towards any inclusive minutes.

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