National Deposit Friendly Society Limited

Annual Report & Financial Statements 2016

Contents

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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.
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Chairman's Review

2016 has been an eventful year for National Friendly with a combination of factors giving rise to some unique challenges. Nevertheless we have continued to pursue our overall strategic objective of being a forward thinking and trusted mutual that meets the health, welfare and protection needs of our customers.

We re-opened to new business in the spring with our new healthcare product, Your Health Fund, and followed this up with the launch of two savings products, a Tax Exempt Savings Plan and a With Profits Bond. The healthcare product is aimed at both existing members and new customers and, following market feedback, we have recently made some product refinements to better meet customers' needs. The two savings products are aimed primarily at our existing members that have maturing savings policies, allowing them to continue saving with us by re-investing the proceeds or by taking out a new regular premium plan. These have been well received by our membership.

The new regulatory regime, Solvency II, came into force on 1st January 2016 and we are now reporting our quarterly results to our regulator under this basis. In respect of our Annual Report and Financial Statements for this year we have continued determining and reporting our reserves under the prior basis, Solvency I, as we are permitted to do so and this is more cost effective than reporting both this year and the comparative numbers for last year on a Solvency II basis. However, we intend to report Solvency II figures only from 2017 year end onwards.

Market conditions were difficult in 2016 with a severe fall in interest rates that had a positive impact on our fixed income assets due to an increase in valuation but also resulted in a lower discount rate increasing the present value of our long term liabilities. Furthermore, there was also an impact on the balance sheet value of our (now closed) staff defined benefit pension scheme which moved from an overall net surplus at the prior year to a deficit at the end of 2016.

Overall, our capital position has reduced over the course of 2016 primarily due to the fall in interest rates. In determining our reserves under Solvency I, and as reported in our Financial Statements, our Fund for Future Appropriation has fallen from £12.5m to £7.9m. Under Solvency II our net assets reduced from £21.6m to £17.4m and our free assets fell from £6.5m to £2.7m after taking account of our Solvency Capital Requirement.

The Solvency II regime is more sensitive to interest rate movements than Solvency I. However it recognises that there may be some anomalies such as this in moving over to the new requirements and so it has introduced a set of transitional measures to better manage this. We have therefore applied to use the Transitional Measure for Interest Rates which, if approved, will result in our free assets being similar to that at the start of the year. Our business planning and forecasting demonstrates that, by writing new business, our capital position will strengthen going forwards and so this is our focus for 2017 and future years.

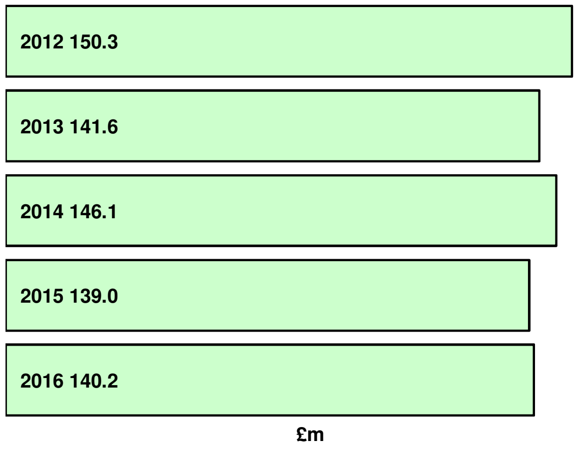
Finally I would like to take this opportunity to thank all of our staff for their continued hard work and commitment in 2016 and wish them every success in 2017 and beyond.

Tracy Morshead
Chairman
19 May 2017

Financial Highlights

Total Assets

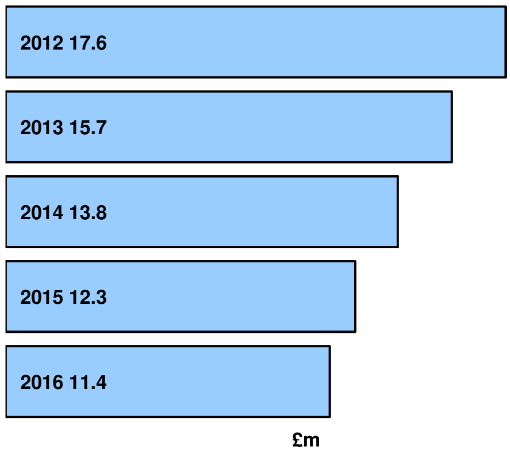
Our asset base has increased during the year due to the increased return on the financial investments held by the Society.



Annual Premiums Earned & Premium Income

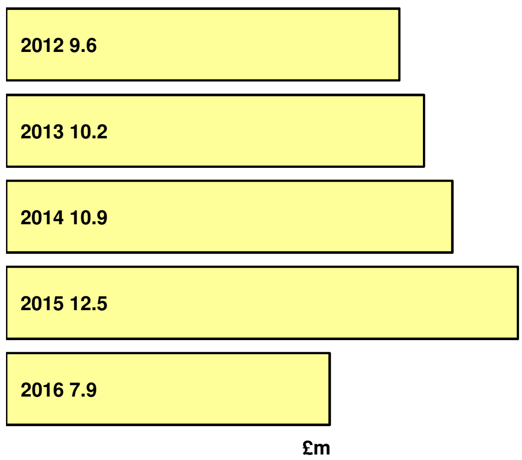
Calculated using 10% of Single Premium Business.

Premium income has reduced due to policy maturities and lapses.



Fund for future Appropriations

The Fund for Future Appropriations has decreased through a combination of the pension scheme deficit and increase in per policy expense reserves due to the declining book.



Strategic Report

Overall Strategy

The Society's vision is:

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

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 re-opened to writing new business in early 2016 with 'Your Health Fund,' a deposit-based healthcare product, offering access to private diagnosis and out-patient treatments with the option of adding access to private hospital in-patient treatments. This was followed later in the year by the relaunch of the updated Tax Exempt Savings Plan (TESP) providing an opportunity for maturing TESP policyholders to continue saving in a similar with-profits policy. Also, by the end of the year a single lump sum premium With Profits Bond had been developed that was launched early in 2017 to allow policyholders with maturing policies a place to re-invest their funds.

The Society continued work on an innovative policy for later life care needs and we are currently working with a major reinsurer in designing, market testing and pricing a new product.

Our strategy has three key objectives all aimed to achieve net growth in our customer base, whilst continuing to strengthen our underlying capital position and act in the best interests of our policyholders:

- Expand our healthcare proposition with further new products and services.
- Establish a presence in the later life care market in accordance with our long term strategy.
- Promote customer retention, offering alternative choices when products mature or reach trigger points such as price and benefit review.

Business Performance

The solvency position of the Society is continually monitored and the level of liquid assets managed to make sure that sufficient liquid funds are held to cover liabilities and claims as they fall due.

As at 1 January 2016 the new Solvency II regulatory capital regime became effective. 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 Solvency Capital Requirement ("SCR"). The SCR 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 Society assesses its capital position in accordance with the new Solvency II regulations and manages its business on this basis. However, the reserves within the Financial Statements are still reported on the old Solvency I reporting basis taking advantage of the allowed transition to the new regime with the intention to align the Financial Statement reserves to Solvency II for the 2017 year end reporting.

Strategic Report (continued)

Business Performance (continued)

Under Solvency II, the excess capital after the SCR at 31 December 2016 was £2.7m, a reduction from £6.5m as at 31 December 2015. The reduction in capital position over 2016 was a result of number of factors including:

- A significant fall in the risk free rates used to set the discount rates to establish the current value of future liabilities had a significant adverse impact on the value of liabilities, solvency capital requirement and risk margin.
- The fall in interest rates also had an adverse impact on the staff pension scheme which was in surplus at the end of 2015 but was in deficit at the end of 2016.
- An increase in per policy expense reserves as broadly the same level of administration costs are spread over a smaller policy book as existing policies mature and lapse.

There were a number of positive factors that helped to offset some of the above downsides:

- The sale of the software asset that has been developed to its subsidiary ND Member Services Limited ("NDMS"), This will enable NDMS to licence back the use of the software to the Society as well as provide the opportunity to market it to similar insurers for policy administration.
- Based on experience to date, there was a reduction in provision for medical claim inflation.
- The fall in interest rates, referred to above, resulted in an increase in the value of our fixed income assets (being predominantly government and corporate bonds).

Business Objectives

The Society's business plan for 2016 focussed on continuing to deliver our capital management plan, opening to new business and controlling costs.

The key objective remains for the Society to continue to write new contracts of insurance through products that meet the needs of existing and new policyholders. This will help reverse the increasing per policy cost of administration relative to the reducing number of policies and will help to achieve the target level of free assets set out in our risk appetite.

Capital Management

In 2016, interest rates fell sharply to unprecedented low levels, creating a harsh business environment. Although this fall in interest rates increased the market value of the Society's fixed income assets, it did result in a fall in the risk free rates used to discount our long term liabilities. Although the Society made changes in 2012 to largely match its assets and liabilities, the exceptional fall in interest rates identified that due to the nature and type of existing business and assets, these could not be fully matched, particularly against the prescribed methodology for assessing capital under Solvency II, the new regulatory regime which uses interest rates set by the European Insurance and Occupational Pension Authority ("EIOPA") that do not necessarily move in line with UK interest rates that determine the value of our fixed income assets.

The Board's view is that the previous Solvency I regime which was based on actual assets and yields obtainable continues to provide a credible basis of valuation and therefore, it has applied to the regulator, the Prudential Regulation Authority ("PRA"), for approval to smooth the transition from using the Solvency I discount rates to the Solvency II prescribed risk free rates for the existing policies over a 16 year period, as these policies mature. Transitional measures such as this are permitted as part of a smooth implementation of the new regulatory regime. If approved, this will provide enhanced capital headroom for the Society to pursue its strategy.

Strategic Report (continued)

Business Objectives (continued)

We have continued to monitor and manage morbidity carefully and continue to explore opportunities to mitigate further the exposure to morbidity risk on the existing healthcare book although this is much reduced from prior years due to policy lapses.

We have further strengthened our governance, capital and reporting requirements so that we are fully compliant with the requirements of Solvency II and the new Senior Insurance Managers Regime.

Re-opening to new business

The Society continued to develop its overall health, welfare and protection proposition and launched Your Health Fund, being a deposit based healthcare product, as it returned to writing new business in early 2016. Our long term proposition remains in the long term care 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 Your Health Fund, available at different levels of cover and providing insurance for a range of treatments, offers an alternative option to the Society's existing policyholders as well as providing affordable healthcare cover to new customers. Furthermore, in launching this product the Society is supported by a major reinsurer whereby we have an agreement in place on financial terms that will help to protect the Society from adverse claims experience thereby protecting the current surplus.

The Society also re-opened its with-profits investment business, firstly with the relaunch of the Tax Exempt Savings Plan ("TESP") and, secondly with a With-Profits Bond early in 2017, both helping to mitigate the outflow of funds and reduction in policy count as the current investment policies mature. These products were developed in response to feedback from our members, through both the Focus Group and at the Annual General Meeting, indicating their desire to continue to save with the Society upon the maturity of their existing policies.

As well as developing the new TESP product, we have progressed in designing and developing a later life care product again in partnership with a major re-insurer. The objective of the product will be to provide the policyholder cover primarily to assist in continuing to live in their own homes for as long as possible as later life care needs emerge, funding a variety of needs such as the cost of external carers, mobility aids, minor home alternations (and the like). There will also be access to assisted living and care advice. The product will be an excellent fit and the first step in the Society progressing its later life and welfare strategy.

Cost Control

The Society is aware of the need to address future cost issues as the declining policy book provides progressively lower income to cover its cost base. Overall costs have been maintained within budgets that continue to be tightly controlled.

The development of our new policy administration system has continued to progress well with the first phase delivered in December 2016. This first phase provides a fully operational policy administration system and has enabled us to migrate a number of policy books onto the new system allowing us to decommission one of our legacy administration systems. The final completion is planned by end-2017 and after this the remainder of policies will be migrated over and administered on the new system. The implementation of the new system and decommissioning of legacy systems will deliver medium to long term savings through improved efficiencies and the removal of manual processes as well as providing additional IT security and meeting enhanced data requirements. The new system should also provide the Society with a flexible platform to enable more effective development, launch, issue and subsequent administration of new products.

Strategic Report (continued)

Business Objectives (continued)

425 Financial Solutions

We continued to seek opportunities to deliver value through profitability of our intermediary subsidiary, 425 Direct Limited ("425"), to a level where it is able to cover its costs and contribute towards the Society's expense recharges.

At the start of the year, we restructured the business in order to capitalise on our strengths within 425 with a renewed focus on:

- Seeking and developing new opportunities by working in partnership with our main lead partner, Phoenix.
- Establishing a National Friendly new business stream, particularly in the distribution and conversion of the newly launched TESP and With Profit Bond policies.
- Developing a later life care advice proposition to dove-tail into National Friendly's strategy.

Sales levels for 425 were disappointing for the year due to a combination of a fall in leads from Phoenix, primarily as the pension freedom changes introduced in 2015 have now become the established norm with no pent-up back demand, and a later than planned launch of the TESP and With-Profits Bond by the Society. That said, the cost base of 425 now reflects current and anticipated demand and provides a platform for sustainable profitable growth that continues to be our priority aim.

Strategic Report (continued)

Risk Management

The Board seeks to undertake a structured approach for the effective management of risks to support its strategic and business objectives. It considers that the key risks to the achievement of the Society's objectives, their impact and any mitigating action that can be taken are as follows:

Risk	Impact	Mitigating Activities
Solvency Risk The Society is unable to meet its solvency capital requirements	Regulatory intervention. Transfer of engagements or Run off.	Approval of transitional measures will provide capital headroom for the Society to pursue its strategy and objectives in the interests of its policyholders. Close monitoring of the capital management at Board level with quarterly reporting of the Solvency II position. This includes scenario analysis and key sensitives such as morbidity, lapse and expense assumptions. Implementation of monthly roll-forward of Solvency Coverage allowing for updated market conditions, expense assumptions and change in 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 continues to deteriorate over and above expectations either holding back capital restoration or reducing free capital.	Worsening morbidity results in increased reserves slowing capital restoration.	Management of morbidity claims remains a key focus. Better claims data and more sophisticated valuation methodology is used whereby statistical analyses performed monthly 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. Audit & monitoring of claims administrator to confirm that paid claims are valid.
➢ **Market Risk** Lower interest rates results and a fall in risk free rates used to discount long term liabilities.	Increased value of long term liabilities reduce SCR coverage.	Objective to match as closely as possible assets against technical provisions. Use of derivatives to better match long term cash inflows and outflows. Application for transition measures to recognise the impact of low interest rates under the new Solvency II regime when compared with historic Solvency 1 position. Review investment strategy to achieve the best outcomes from a Solvency II perspective whilst achieving the right return for policyholders. Actions include disinvestment of surplus property, move holdings from lower rated bonds to higher rated investments, divest securitised assets.

Strategic Report (continued)

Risk Management (continued)

Risk	Impact	Mitigating Activities
Expense Risk Per policy costs continue to increase against a declining policy book.	Ongoing administration costs against continued decline in policies and income resulting in higher net cost to administer each policy.	Expenses are closely monitored and organisational restructuring to ensure the right cost base. Re-opening to new business and writing new contracts of insurance in sufficient volumes will mitigate and, over time, reverse this trend of continued increase in per policy costs.
Inability to sell sufficient new policies to reverse the declining book and address the expense overrun.	Increasing per policy costs against declining book. Lower than projected capital restoration and if sufficient volumes are not achieved could present a worse scenario than run off.	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 **System development** Failure of the project to deliver quality results, on time and within cost estimated.	Continuing with existing system with manual workarounds poses control risks and it is costly to maintain and develop.	Delivery of the project in a phased approach including: - Strict cost control. - Regular monitoring of progress against deliverables.
Profitability of 425 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.	425 has its own business plan with stretching targets to include: - Increase in performance and productivity - Distributing National Friendly business - Identifying new lead providers to reduce the dependency on one (to become two) key lead providers Performance against plan is closely monitored and action taken as appropriate to control costs.
Pension Scheme Risk Volatility of pension scheme valuation	Any change in valuation is reflected in the SCR calculation.	Review the investment strategy of the pension scheme with the objective of reducing volatility, possibly also consider hedging strategies. However, any proposed changes to strategy would need to be approved through the pension trustees.

Strategic Report (continued)

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 interest, property and equities. These portfolios are managed by external fund managers whose performance is monitored on a regular basis by the Investment Committee.

Fixed Income

Fixed income markets posted strong returns over the year, as weak growth and low inflation data encouraged global central banks to remain in monetary easing mode. 2016 was dominated by surprising political outcomes, mainly the UK voting to exit the European Union (EU) and Donald Trump winning the US Presidential election, which resulted in heightened market volatility. Core government bond yields edged lower as the European Central Bank (ECB) announced a new set of easing measures which exceeded expectations. The ECB also extended its bond buying to the end of 2017, while reducing the monthly bond purchases to 60 billion euros from 80 billion euros starting in April. The Bank of England (BoE) also lowered its key interest rate and announced the purchase of corporate bonds, in order to prevent the UK economy from going into a recession following the surprise vote to leave the EU. These measures resulted in core government bond yields hitting historic lows, including German 10 year yields falling to negative territory. More recently, however, core government bond yields backed up somewhat driven by sentiment from across the Atlantic that the new Trump administration will initiate a large fiscal stimulus plan that will spur growth at the expense of higher inflation. Furthermore, at the December meeting the Federal Reserve raised interest rates by 0.25% and also signalled a faster pace of rate hikes in 2017. Despite the elevated volatility and political surprises the overall risk sentiment remained positive leading to credit spreads tightening and corporate bonds outperforming government bonds. The spread tightening was also helped by the rise in oil prices, after touching sub-30 levels in January, which helped a rebound in risky assets with high yield bonds outperforming investment grade bonds. Against this backdrop, the portfolio generated positive returns of 13.4% benefitting from its credit as well as interest rate risk exposure.

Strategic Report (continued)

Property

The commercial property market has continued to provide positive returns during 2016. The growth in capital values began to slow during Quarters 1 and 2, notwithstanding that some sectors have shown limited rental growth. The “Brexit” decision in June resulted in a sharp downward correction in capital values although Quarters 3 and 4 reclaimed some of this lost value.

The Society’s property portfolio performed well during 2016 recording a total return of 11%, including a strong rental return of 6.5% over the period. This has the potential to increase to 7.5 % following the completion of future rent reviews and lease renewals in the portfolio.

Highlights for the year include a successful rent review settlement on Eastcheap, London EC3, where a 65% rental increase was agreed. 20,000 sq. ft. of offices in Sunderland were successfully let on a new 10 year lease and the sale in Quarter 4 of the Society’s largest warehouse in Hoddesdon achieved receipts of 16% above valuation.

Continuing asset management initiatives in 2017 should further strengthen the rental return from the portfolio.

Equities

The UK stock market rose strongly over the 12-month period. The Bank of England’s decision to cut interest rates, for the first time in seven years, to 0.25% in August, and further expand its stimulus efforts in view of the weakening economic outlook, supported a strong rally in equities. Stocks had fallen sharply in the immediate aftermath of the Brexit referendum held in June, when the UK voted to leave the European Union. Contrary to expectations, the UK economy continued to show resilience, which helped to ease concerns over the economic implications of the Brexit vote. A sharp fall in sterling post the Brexit vote also supported stock prices. At a sector level, the resources, technology and industrials sectors led the gainers, while telecommunications and consumer services stocks were among the weakest performers. Against this backdrop, the Society’s UK portfolio delivered a positive return of 7.7%, versus the FTSE All Share return of 16.8%. During the year the stocks selected were in the industrial sector (e.g. Wolsey and CRH) which added value to the returns of the portfolio, but this was largely offset by some stocks in the resources sector (such as Glencore) where Fidelity were underweight in relation to the benchmark index (FTSE All Share).

With-profits Review

The 2016 bonus declaration resulted in positive annual bonuses for endowment and whole life contracts, as well as with profits bonds and ISAs. In accordance with the Principles and Practices of Financial Management (PPFM), annual bonuses should be sustainable taking into account the level of return available on fixed interest securities. Therefore, the rates of bonus credited were reduced as prospective returns on fixed interest securities reduced.

As pension contracts currently have a relatively high level of benefits (compared to premiums paid) additional annual bonuses were not awarded in 2016.

Terminal bonus rates were also increased for most categories of policy, reflecting the satisfactory investment returns for with-profits policies in 2015. Maturity pay-outs for ten year endowment policies remained at a broadly similar level during 2016.

Investment returns for with-profits policies have again been positive in 2016. These returns will be taken into account when deciding on the 2017 annual bonus declarations.

Strategic Report (continued)

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 Groups.

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 2016 this took place on 26th 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 Groups

Our Focus Group currently consists of 25 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 polices held with us and also have diversity in age, gender and national coverage.

We held one Focus Group meeting in 2016, held at the Hilton London Paddington Hotel in April. The Chief Executive Officer presented on the Society's financial position and its performance against its objectives, together with details on re-opening to new business and the launch of its new product, "Your Health Fund", and to discuss the Society's future product propositions. 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.

Strategic Report (continued)

Treating Customers Fairly

We recognise that the Financial Conduct Authority's initiative of Treating Customers Fairly ("TCF") is of fundamental importance in driving up standards in the financial services sector and in line with our long-standing principles. We fully support its aims.

The Society and 425 are committed both to achieving the outcomes expected by the FCA and to improving the customer journey for our customers. Our focus has been on:

Delivering our strategy and giving our customers confidence that they are dealing with a firm where fair treatment is central to the corporate culture.	This has been achieved by: • Recruiting and employing skilled and dedicated staff who share our company values and take pride in providing high standards of service and customer care; • Evaluation of TCF best practice via dashboards and management information, our intranet, working parties, staff and customer engagement forums, and projects.
Providing products and services that are marketed and sold in the retail market, which are designed to meet the needs of identified consumer groups and are targeted accordingly.	We have undertaken: • Research and analysis of products and services that could potentially benefit existing and new customers of the Society; • A customer engagement exercise into the needs of our current and potential future customers; • Design, development, and launch of new products, distribution methods and customer communications which encompass our customer feedback, research and experience; • Regular reviews of the performance of our legacy products and service proposition, ensuring they keep pace with good practice in the industry and continue to meet the ongoing needs of our customers; • Collection and evaluation of customer feedback across the Society.
Providing customers with clear information, keeping them appropriately informed before, during and after the point of sale.	We have achieved this by: • Providing relevant information and guidance to customers at the point of claim and during policy administration; • Maintaining product literature that clearly sets out the features, benefits, limitations and risks, in a fair and balanced way; • Taking account of evolving industry and regulatory themes and adapting these into our communications; • Monitoring the quality of our verbal and written communications via our customer service teams, publications, and third party partnerships.

Strategic Report (continued)

Treating Customers Fairly (continued)

Ensuring that our customers do not face unreasonable post-sale barriers.	We make sure: • Our customer services and claims helplines are sufficiently staffed at all times and calls are answered within rigorous service standards; • Our claims service provides consistently high standards of service and care so that customers can rely on us at time of need; • We promptly turn around customer transactions and correspondence, without undue delay, whether by email or post; • Our services are designed to be straightforward, accessible and convenient to use; • Any feedback and complaints we receive are impartially assessed, responded to fairly and promptly, and are used to inform and improve our service to customers.
Providing suitable advice to our customers which is suitable and takes account of their circumstances.	We have accomplished this through: • Maintaining rigorous standards of training, competence and conduct across the Society; • Overseeing the quality of advice provided by 425 advisers to ensure that recommendations are in the best interests of customers; • Upholding robust standards controlling the provision of information and guidance to customers by non-advisory functions in the Society; • Assurance by independent internal and external assessors that standards of quality are being met; • Performance management targets and remuneration for staff which incentivise and reward best practice.
Providing customers with products that perform as we have led them to expect, and a service of an acceptable standard and as we have led them to expect.	We commit to: • Effective governance of the Society's operations through sound planning and management; • Investing prudently in line with our investment strategy; • Protecting the interests of our policyholders and potential future policyholders; • Compliant, transparent, and timely financial reporting and communications in line with industry standards.

Strategic Report (continued)

Corporate Social Responsibility ("CSR")

Our approach to CSR is a practical one; aimed at areas where we can fundamentally make a difference.

Delivering to our membership relies not only on our service delivery capabilities but delivering our services as good corporate citizens.

Our CSR objectives remain to:

- Support and build relationships with our local community.
- Improve the impact we have on the environment.
- Improve the health, wellbeing and safety of our people.

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.

Applications can be made by members of the Society or employees by submitting a completed application form. Dispersals will be reviewed and agreed by the Foundation Fund Committee, with input and advice from a Foundation Fund sub-committee if required.

Our Charity of the Year

Our employees choose a 'Charity of the Year' to raise funds for on an annual basis. Firstly all staff are invited to nominate charities about which they are passionate. Nominations are then reviewed by the CSR committee against a pre-agreed selection criteria and a shortlist is created. All staff are then invited to vote from the shortlist for their preferred charity of the year and the charity that receives the most votes is selected.

The CSR committee then creates and manages a fund raising calendar for the year encouraging as many people to take part in as many fundraising activities as possible.

In 2016, staff voted to support Penny Brohn UK as its Charity of the Year with over £4,500, being raised through a variety of events, such as a head shave by Claire Bisp, a member of our Customer Services team, bake sales, sweepstakes, together with other sponsored events.

Funds raised are matched £1 for every £1 raised (up to a maximum of £5,000) by the Society's Foundation Fund.

A fundraising cheque for a total of £10,000 was presented to Penny Brohn UK in February 2017.

Strategic Report (continued)

Our Charity of the Year (continued)

On presentation of the fundraising cheque, Jamie Bramhall, Corporate Account Manager at Penny Brohn, said,

> "We would like to thank everyone at National Friendly for your continued belief in, and support for, our holistic approach to helping people live well with the impact of cancer. Your support is transformational in enabling us to keep pace with the increasing demand for our services. We are extremely thankful for such a significant contribution, without which we simply would not be able to help so many.
>
> From the moment that the team chose to support us with an epic 45 mile charity walk around Bristol we knew it was going to be an energetic partnership. This commitment was more than matched when Claire Bisp bravely stepped forward for her head shave – raising interest, funds and importantly awareness of cancer. It was a pleasure to work with National Friendly and we cannot thank you enough.
>
> With your support we have been able to bring improved health and enrichment to more people affected by cancer than ever before."

For 2017, members of staff have voted St Mungo's as their Charity of the Year. St Mungo's is a homelessness charity and housing association, providing bed and support to more than 2,600 people a night who are either homeless or at risk, and works to end homelessness and rebuild lives.

The charity currently works across London and the south of England including Bristol, Reading, Milton Keynes, Oxfordshire and Sussex. It also manages major homelessness sector projects such as Streetlink and the Combined Homelessness and Information Network (CHAIN), supporting men and women through projects including:

- Emergency, hostel and supportive housing projects.
- Advice services.
- Specialist physical and mental health services.
- Skills and work services.

The Society's fundraising target for 2017 is £5,000, 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.

Our 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.

Strategic Report (continued)

Equality and Diversity

National Friendly is committed to preventing any kind of discrimination and encouraging diversity amongst its employees.

The Society's commitment is:

- To create an environment in which individual differences and the contributions of all our staff are recognised and valued.
- Every employee is entitled to a working environment that promotes dignity and respect to all. No form of intimidation, bullying or harassment is tolerated.
- Training, development and progression opportunities are available to all staff.
- Equality in the workplace is good management practice and makes sound business sense.
- We will review all our employment practices and procedures to ensure fairness.
- Breaches of our Equality and Diversity policy are regarded as misconduct and could lead to disciplinary proceedings.
- The Equality and Diversity policy is fully supported by senior management and the Board.

National Friendly Group Diversity as at 31 December 2016

Level	Total	Male		Female	
Board (NEDs and Executive Director)	6	5	83%	1	17%
Heads of Functions	1	0	0%	1	100%
Managers	14	8	57%	6	43%
Other staff	35	13	37%	22	63%
TOTAL	**56**	**26**	**46%**	**30**	**54%**

On behalf of the Board
Jonathan Long
Chief Executive Officer
19 May 2017

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 22 – 24. 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 2016 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.

The Directors' Report (continued)

Board Balance and Independence

The Board consisted of four Non-Executive Directors and two Executive Directors throughout 2016.

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.

Appointments to the Board

The appointment and re-election of Directors is considered by the Nominations Committee (see page 23), 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 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 Insurance Managers Regime (SIMR). The SIMR 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.

The Directors' Report (continued)

Performance Evaluation (continued)

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

<u>Members</u>
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 an independent external firm that reports to the Committee.

Investment Committee

<u>Members</u>
Tracy Morshead (Chairman)
Geoff Brown
Jonathan Long
Peter McIlwraith
Sandy Richards

The Investment Committee meets as required but at least four 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:

The Directors' Report (continued)

Investment Committee (continued)

- 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.

Nomination Committee

Members
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
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 32 – 36.

Risk & Compliance Committee

Members
Geoff Brown (Chairman)
Tracy Morshead
Jonathan Long
Sandy Richards

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.

The Directors' Report (continued)

With-Profits Advisory Arrangement

Members
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	9	9	5	5	-	-	2	2
Mark Jackson	9	9	5	5	2	2	2	2
Peter McIlwraith	9	9	5	5	2	2	2	2
Tracy Morshead	9	9	5	*	2	2	2	2
Executive								
Jonathan Long	9	9	5	*	2	*	-	-
Sandy Richards	9	9	5	*	-	-	-	-

	Investment Committee		**Risk & Compliance Committee**		**With Profit Advisory Arrangement**	
	Meetings attended	Meetings held	Meetings attended	Meetings held	Meetings attended	Meetings held
Non-Executive						
Geoff Brown	4	4	4	4	5	5
Mark Jackson	-	-	-	-	5	5
Peter McIlwraith	4	4	-	-	5	*
Tracy Morshead	4	4	4	4	3	*
Executive						
Jonathan Long	4	4	4	4	5	*
Sandy Richards	4	4	4	4	5	*

* Attendance on an invitation basis.

The Directors' Report (continued)

Statement of Compliance with the Annotated Corporate Governance Code

The Board considers that throughout 2016 the Society applied the relevant principles and complied with the relevant provisions of the annotated Corporate Governance Code for Mutual Insurers ('the Code') 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 has served on the Board for more than nine years from the date of first election and therefore is subject to annual re-election after having given consideration to his continued independence.

Annual General Meeting

The 2016 Annual General Meeting was held in London 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.
- Reappointment of PricewaterhouseCoopers LLP as Auditors.
- Re-election of Tracy Morshead, Peter McIlwraith, and Mark Jackson as Non-Executive Directors.
- Re-election of Jonathan Long as Executive Director.

The response from members submitting their postal/proxy forms was just under 12% 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 2017 AGM to be held again in London.

The Directors' Report (continued)

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, a Non-Executive Director of Assurant Group Limited, a 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.

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. Peter was also a Non-Executive Director of Bristol Water Plc from November 2001 until May 2016. 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 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 Keycare Limited, 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.) 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.

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.

The Directors' Report (continued)

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 Key Performance Indicators (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 2016 the KPIs were focused on capital management and, in particular, the implementation of Solvency II requirements, re-opening to new business, continued development of our policy administration system and the profitability of 425.

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

- 425 Direct Limited (trading as 425 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.

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 who held office at the date of approval of this Director's 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.

The Directors' Report (continued)

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 64.

The aggregate remuneration paid to Directors and staff employed by the Group during the year amounted to £2.7 million (2015: £2.6 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. Our approach to treating customers fairly is set out on pages 15 - 16.

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 (2015: £6,250). There were no political donations (2015: £nil).

Re-appointment of Auditors

PricewaterhouseCoopers LLP were re-appointed as the Society's Independent Auditors at the Annual General Meeting on 26th July 2016. A resolution to re-appoint PricewaterhouseCoopers LLP as Auditors will be proposed at the forthcoming Annual General Meeting. The Society intends to review the external audit arrangement in 2017 with a view to undertaking a formal tender process with the appointment or re-appointment of the external auditor ahead of the 2017 year-end.

Approved by order of the Board
Sandy Richards, Secretary
19 May 2017

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.

A resolution proposing the reappointment of PricewaterhouseCoopers as the Society's external auditor was put to the members at the 2016 AGM and approval gained.

PricewaterhouseCoopers has been the Society's external auditor for over thirty years. However, the Society has in this period, regularly reviewed and tendered this arrangement. The last time this was undertaken by an informal tender process in 2011.

The Committee considers the reappointment of the external auditor, including the rotation of the audit partner, every year and also assesses their 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 ten years. The current lead audit partner will be required to rotate following the 2016 year-end audit.

In determining that it was to retain the services of PwC as external auditors in 2016, the Committee took into account the considerable amount of change as a result of the introduction of the Solvency II regime and the heavy workload falling on our staff flowing therefrom. The Committee intends to review the external audit arrangement in 2017 with a view to undertaking a formal tender process with the appointment or re-appointment of the external auditor ahead of the 2017 year-end.

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 auditors undertook a number of non-audit assignments during 2016 and in the opinion of the Audit Committee, these were considered to be consistent with the professional and ethical standards expected of the external auditors. The cost of this work for the year ended 31 December 2016 totalled £66,000, of which £57,600 related to a review of the Solvency II methodology and £8,400 related to support in respect of defining securitized assets.

Internal Audit

Mazars LLP provided internal audit services to the Society until 31 December 2016. The Audit Committee is planning to review the arrangement and undertake a tender process to appoint or re-appoint a suitable provider of internal audit services from 1st July 2017.

Audit Committee Report (continued)

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 the intercompany debtor in the Society arising from a sale of software	During the year the Society sold its policy administration system to its subsidiary, NDMS, resulting in the recognition of an intercompany debtor which is expected to be repaid over a number of years. NDMS will licence the software to the Society as well as to other similar insurance companies, which will generate funds to repay the debt to the Society. In this respect, the Society has put in place a contractual agreement for it to licence the software from NDMS Limited. In assessing the appropriateness of the debtor the Directors have made a number of judgments in relation to the timing of future repayments and the appropriate discount rate to use to reflect the risks related to the expected cashflows. The Directors have prepared a business plan and forecast for NDMS including the fair value assessment of the debt.

Audit Committee Report (continued)

Areas of particular focus (continued)

Significant Issue	How it was addressed
Allocation of costs relating to policy guarantees	The PPFM allows the cost of guarantees to be deducted from surplus in the event that the inherited estate is below the minimum target level. At 2014 year end, the Society adopted the recommendations made by the With-Profits Actuary, including: • that the approach would be applied from 1 January 2014 onwards. • the cost of guarantees each year will be charged to all with-profits policies by means of a reduction in the investment return credited to asset shares and therefore the proportional impact should be limited. • the cost will not be applied prior to being incurred, and • if the Society improves its financial position such that when the inherited estate surplus increases to over 10% of liabilities, then the adjustment in future years should be reduced or removed. The Board has reviewed the methodology used for the calculation of the cost of guarantees in the financial statements and that the approach adopted in 2014 remains appropriate for the 2016 year end and also to determine that the approach is fair to all policyholders.
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 2016, internal audits were completed in areas including claims management, premium processing, finance operations and IT cyber security. Internal Audit provided an overall annual opinion that the Society has a satisfactory framework of risk management, governance and internal control.

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

Peter McIlwraith
Chairman of the Audit Committee
19 May 2017

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

<u>Members</u>

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.

Directors' Remuneration Report (continued)

Policy (continued)

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 Chair of 425 Direct Limited and for the Senior Independent Director 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
19 May 2017

Directors' Remuneration Report (continued)

Directors' emoluments	Salaries & Fees £	Performance Related Pay £	Other Benefits[1] £	Total 2016 £	Total 2015 £
Chairman					
Tracy Morshead[2]	49,950	-	-	49,950	48,960
Executive Directors					
Jonathan Long[3 4]	154,530	30,300	30,616	215,446	211,638
Sandy Richards[4 5]	104,040	20,400	21,978	146,418	143,720
Non-Executive Directors					
Geoff Brown	28,625	-	-	28,625	28,050
Mark Jackson	28,625	-	-	28,625	28,050
Peter McIlwraith	38,500	-	-	38,500	37,740
Total				**507,564**	**498,158**

[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] Part payment of performance related pay deferred for 2010, 2011 and 2012 was made in March 2015. This pay was declared in the Directors' Remuneration Report for those years and therefore not included above. The balance was paid in February 2016 by way of an additional pension contribution.

[4] Performance related pay relates to 2015 but was awarded in 2016. Assessment of performance related pay for the Executive Directors for 2016 will be carried out in Q2 2017 following finalisation of the Annual Report and Accounts.

[5] Performance related pay for 2015 was paid by way of an additional pension contribution.

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 2015 £	Accrued pension as at 31/12/2016 £	Accrued pension as at 31/12/2015 £	Closing value at 31/12/2016 £	Opening value at 31/12/2015 £	Pension input amount over 2016 £
Jonathan Long	10	95	4,829	4,734	96,581	94,687	1,894

At the AGM, members voted on the resolution to approve the 2015 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 2015 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
3108	**93.39%**	**155**	**4.65%**	**3328**	**65**

Directors' Remuneration Report (continued)

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
The Executive Directors may participate in a Long Term Incentive Plan ("LTIP") that is linked to achievement of strategic objectives over an extended time period, designed to enhance overall performance.

There is currently no LTIP scheme in operation. The Remuneration Committee will give consideration to the terms of such a scheme now that the Society has re-opened to new business. The scheme will consider the Society's medium and long term objectives over an extended time horizon, taking account of the Society's risk profile and including an adjustment for future risks.

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.

Directors' Remuneration Report (continued)

Non-Executive Directors (continued)

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 auditors' report to the members of National Deposit Friendly Society Limited

Report on the financial statements

Our opinion

In our opinion, National Deposit Friendly Society Limited's group financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and the Society's affairs as at 31 December 2016 and of the Group's and the Society's income and expenditure for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Friendly Societies Act 1992.

What we have audited

The Group's financial statements included within the Annual Report & Financial Statements 2016 (the "Annual Report") comprise:

- the Group and Society Balance Sheet as at 31 December 2016;
- the Group and Society Income Statement, Statement of Comprehensive Income and Statement of Movements in Funds for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

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

Our audit approach

Context

National Deposit Friendly Society Limited is a group writing and broking insurance business. There have been no significant events or changes in the business that have resulted in changes to the basis for our assessment of materiality, audit scope or areas of focus.

Overview

Overall Group materiality: £198,000 which represents 2.5% of the fund for future appropriations.

The Group financial statements are a consolidation of three entities which were subject to an audit of their financial information.

Valuation of long-term business provision – morbidity, lapse and expense assumptions.

Fair value of intercompany debt in the Society balance sheet

Segregation of duties

The scope of our audit and our areas of focus

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)").

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

The risk of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, identified as an "area of focus" in the table below. We have also set out how we tailored our audit to address this specific area in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

Area of focus	*How our audit addressed the area of focus*
Valuation of long-term business provision The Society's financial statements include liabilities for the estimated cost of settling benefits and claims associated with long term products, including healthcare products, written by the Society. The long-term nature of the liabilities means that calculating their value is inherently uncertain because it involves making assumptions about future circumstances or events. In particular, in valuing the long-term business provision, the Society needs to take into account a range of demographic factors about its policyholders, including health-related factors. It also needs to make estimates of the likelihood that a policy will be retained year to year, the likely level of future per-policy expenses and future expenses related to guarantees. This is therefore an area of significant focus in our audit. In particular, we focused on the following assumptions and methodologies, to which the valuation of the provision is most sensitive, because small changes in them can result in material changes in the valuation:	*Valuation of long-term business provision* Our work to address the valuation of the long-term business provision included the following procedures: • testing completeness of data inputs feeding into the actuarial model by tracing a sample of policies per the policy administration system to the data feeding into the actuarial model and vice versa. • comparing the methodology, models and assumptions used against recognised actuarial practices and by applying our industry knowledge and experience. No exceptions were noted when performing these procedures. Further testing was also conducted on specific assumptions and methodologies, including our areas of focus, as set out below.
a) *Morbidity assumptions* *See note 1 to the financial statements for the Directors' disclosures of the related accounting policies, judgements and estimates, the Audit Committee Report areas of particular focus and note 20 for detailed long-term business provision disclosures.* The morbidity assumptions are used to estimate the number of policyholders that will develop a disease, disability, or enter into poor health, triggering a claim to the Society. Judgements around these estimates are complex and highly subjective. We focused specifically on: • the morbidity assumptions in relation to Healthcare and Old Deposit products, because morbidity experience on these products has historically been volatile; and • the claim inflation assumption for Healthcare business, for which the methodology used to derive the assumption was changed since the prior year. The Directors have estimated the rate of morbidity with reference to industry morbidity tables and the historic experience data of the Society.	*a) Morbidity assumptions* We considered the appropriateness of the morbidity and claim inflation assumptions used by the Directors in the calculation of the long-term business provision. Our work included: • comparing the assumptions to the Society's historical claims experience. In assessing the differences we considered the historical trends in the Society's experience along with future morbidity expectations and found them to be supportable; • assessing the appropriateness of morbidity prudence margins by considering the volatility of the underlying book and testing the historical precision of the Directors' estimates around expected claims; and • testing the reliability and completeness of the experience data used by the Directors by agreeing it to source systems and, for a sample of items, agreeing it to independent supporting evidence such as invoices for claims amounts held by the Society's third party policy administrator. We consider that the experience data used by the Directors was fit for this purpose and we did not identify any matters that caused us to question its reliability.
(b) Lapse assumptions *See note 1 to the financial statements for the Directors' disclosures of the related accounting policies, judgements and estimates, the Audit Committee Report areas of*	*(b) Lapse assumptions* We tested the methodology used to derive the lapse assumptions used by the Directors in the calculation of the

Area of focus	*How our audit addressed the area of focus*
particular focus and note 20 for detailed long-term business provision disclosures. The lapse assumptions are used to estimate the number of policyholders that will terminate their policies in any particular year. We focused on lapse assumptions for Healthcare and Old Deposit products in particular, because the lapse experience on these products has historically been volatile given they have been impacted by changes to the policy terms and premium review timing relating to Own-Share and top-up benefits in recent years. The Directors have estimated the lapse assumptions using the historic experience data of the Society.	long-term business provision. Our work included: • assessing the appropriateness of the experience data used to derive the assumptions and comparing the assumptions to trends in the underlying data on both a long-term and short-term basis. We found the assumptions to be supportable given the experience data. We assessed the changes made to the best estimate and prudent margin assumptions and found these to be appropriate. We also assessed the appropriateness of lapses which follow a different behavioural profile due to certain one-off events such as lapses caused by expiry of top-up cover on policies. We determined that the Directors had reflected these one-off events appropriately in the assumptions. • agreeing the experience data used by the Directors to the Society's books and records to check that a complete and accurate data set was used, finding no material differences.
(c) Expense assumptions *See note 1 to the financial statements for the Directors' disclosures of the related accounting policies, judgements and estimates and note 2 for the financial impact of the changes in these assumptions.* The expense assumptions are used to estimate the level of expenses per policy for the remaining period in the future for which each policy is expected to be in force (i.e. not to have lapsed). The Directors make these assumptions using expenses incurred during the current financial year, excluding those expenses that are considered one-off in nature and adjusting for any known future expenses that the Society is committed to. We focused on this area because it requires complex and subjective judgements to be made by the Directors about future events, both internal and external to the business, such as the allocation of expenses to the Society's subsidiary 425 Direct Limited which is currently loss making. This impacts the expenses allocated within the Society itself. If too little expense were allocated per policy, the long-term business provision would be understated.	*(c) Expense assumptions* We assessed the appropriateness of the methodology used by the Directors to derive the expense assumptions by comparing the expenses used in the per policy expense assumptions to the actual level of expenditure incurred during the year. We evaluated differences by; • challenging the classification of excluded one-off expenses and agreeing a sample of these to the Society's underlying records and supporting documentation; • assessing whether the proposed management actions, that have an impact of the expected future level of expenses, were enforceable by agreeing that the actions were consistent with board plans and forecasts. • we found the differences to be supportable. Through the procedures performed, we considered that the Directors' expense assumptions were appropriate.
Fair value of intercompany debtor in the Society arising from a sale of software *See note 1 to the financial statements for the Directors' disclosures of the related accounting policies and the Audit Committee Report areas of particular focus. The intercompany debtor of £2.2m is included within Other debtors in the Society's balance sheet.* During the year the Society sold its policy administration system to its subsidiary, NDMS, resulting in the recognition of an intercompany debtor which is expected to be repaid over a number of years. It is expected that NDMS will generate funds to repay the	Our work to address this area of focus included: • obtaining a copy of NDMS's business forecast and comparing the cashflows included in that forecast with those included in the fair value assessment of the debt. We found that the forecast supported the expected debt repayments. • assessing the appropriateness of those forecast cashflows by comparing them to the contractual agreement in place for the Society to licence the software from NDMS. We found the cashflows to be supportable. • assessing the appropriateness of the discount rate applied given the contractual nature of the cashflows

Area of focus	*How our audit addressed the area of focus*
debt through the licencing of the software, including to the Society. In assessing the fair value of the debtor the Directors have made a number of judgments in relation to the timing of future repayments and the appropriate discount rate to use to reflect the risks related to the expected cashflows. In addition, the transaction has given rise to a capital contribution being recognised by the Society to NDMS to reflect the beneficial impact of the deferred payment terms to NDMS.	and our assessment of the Society's ability to meet these future debt repayments as they fall due. We found this rate to be appropriate. • We considered the appropriateness of the recognition of the capital contribution in the Society's cost of investment in NDMS and found it to be in accordance with FRS 102.
Segregation of duties Due to the small size of the Society's management team, small number of executive Directors and a high level of manual processing, there are inherent limits in the Society's ability to enforce segregation of duties. The non-executive Directors provide independent challenge over the significant judgements (such as the assumptions included as areas of focus above). However, given the nature of their role, they are not involved in the day to day running of the Society and therefore the scope of their challenge is limited to the more significant matters. As such, we focussed on this area of management override of controls because we consider there to be a heightened risk of material misstatement due to management override of controls or undetected error. In addition, ISAs (UK & Ireland) require that we focus our work on the risk of management override of controls.	We addressed this area of focus through performing substantive testing throughout our audit rather than seeking to rely on controls. We considered whether there was evidence of bias by management in the significant accounting estimates and judgements relevant to the financial statements, in particular in the valuation of the long-term business provision discussed above. We determined that the estimates and judgements applied were appropriate. In addition, we performed a test to identify significant or unusual journal transactions which we agreed to supporting documentation and found them to be valid and agreed 96% of premiums to cash received during the year.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group is based in one location and has one finance function, with the Group financial statements consisting of a consolidation of three entities; the National Deposit Friendly Society (the "Society"), 425 Direct Limited ("425") and ND Member Services Limited ("NDMS").

We performed an audit of the complete financial information for the Society, 425 and NDMS, which gave us the evidence we needed for our opinion on the Group financial statements as a whole.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall group materiality	£205,000 (2015: £219,000).
How we determined it	2.5% of the Fund for future appropriations
Rationale for benchmark applied	We believe the fund for future appropriations represents the most appropriate benchmark as it best reflects the underlying interests of the members.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £10,250 (2015: £10,950) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the Directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements. We have nothing material to add or draw attention to.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. The going concern basis presumes that the Group and Society have adequate resources to remain in operation, and that the Directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Director's use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and Society's ability to continue as a going concern.

The Directors have requested that we review the statement on going concern, set out on page 28, as if the Society were a premium listed company. We have nothing to report having performed our review.

Other required reporting

Consistency of other information

Friendly Societies Act 1992 opinion

In our opinion the Director's Report for the financial year for which the financial statements are prepared is consistent with the financial statements and has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it.

ISAs (UK & Ireland) reporting

The Directors comply with the UK Corporate Governance Code – An Annotated version for Mutual Insurers ("the Code"). Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:	
information in the Annual Report is: materially inconsistent with the information in the audited financial statements; or apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Society acquired in the course of performing our audit; or otherwise misleading.	We have no exceptions to report arising from this responsibility.
the statement given by the Directors on page 25, in accordance with provision C.1.1 of the Code, that they consider 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 position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Society acquired in the course of performing our audit.	We have no exceptions to report arising from this responsibility.
the section of the Annual Report on page 29 to 31, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report arising from this responsibility.

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

As a result of the Directors' voluntary reporting on how they have applied the Code, under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to:	
the Director's confirmation on page 12 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the Group and Society, including those that would threaten its business model, future performance, solvency or liquidity.	We have nothing material to add or to draw attention to.
the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.	We have nothing material to add or to draw attention to.

the Director's explanation on page 12 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Group and Society, 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 Group and Society 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.	We have nothing material to add or to draw attention to.
The Association of Financial Mutuals has specified that we review the Director's statement that they have carried out a robust assessment of the principal risks facing the Society. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Director's process supporting their statement; checking that the statement is in alignment with the relevant provisions of the Code; and considering whether the statement is consistent with the knowledge acquired by us in the course of performing our audit. We have nothing to report having performed our review.	

Propriety of accounting records and information and explanations received

Under the Friendly Societies Act 1992 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- proper accounting records have not been kept by the Group or Society, or
- the financial statements are not in agreement with the accounting records.

We have no exceptions to report arising from this responsibility.

Other voluntary reporting

Matter on which we have agreed to report by exception

Corporate governance statement

In accordance with our instructions from the Society we review the parts of the Corporate Governance Statement relating to the Society's compliance with ten further provisions of the Code specified for auditor review by the Association of Financial Mutuals. We have nothing to report having performed our review.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Director's Responsibilities Statement, the Directors are responsible for the preparation of the Group and Society's financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the Group and Society financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 73 of the Friendly Societies Act 1992 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group and Society's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the Director's judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Joanne Leeson (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol

19 May 2017

(a) The maintenance and integrity of the National Deposit Friendly Society Limited website 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 website.

(b) 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 2016

	Note	Group				Society			
		2016		2015		2016		2015	
		£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Gross premiums written and payments to deposit	4	11,354		12,280		11,354		12,280	
Outward reinsurance premiums		(17)		(19)		(17)		(19)	
Earned premiums net of reinsurance			11,337		12,261		11,337		12,261
Investment income	5		9,613		7,054		9,613		7,054
Unrealised gains on investments	5		6,373		-		6,373		-
Other technical income	6		414		630		27		31
			27,737		**19,945**		**27,350**		**19,346**
Gross claims paid		18,805		19,416		18,805		19,416	
Reinsurers' share		(41)		-		(41)		-	
Net claims paid			18,764		19,416		18,764		19,416
Change in provision for claims			(131)		(1,672)		(131)		(1,672)
Change in long term funds									
Long term business provision			3,613		(6,580)		3,613		(6,580)
Investment contract liabilities			(7)		(9)		(7)		(9)
Provision for linked liabilities	22		(109)		(121)		(109)		(121)
Investment contract on linked liability	22		34		26		34		26
Bonuses and rebates			(330)		(40)		(330)		(40)
Net operating expenses	7a								
Acquisition costs		1,293		924		779		-	
Administrative expenses		3,275		3,436		2,853		2,984	
			4,568		4,360		3,632		2,984
Other technical charges – project costs	7b		1,535		1,795		1,535		1,785
- other			(13)		14		(33)		1
Investment expenses	8		961		1,212		961		1,212
Unrealised losses on investments	5		-		1,013		-		982
Loss on investment in subsidiary	26		-		-		569		799
Tax attributable to long term business	11a		22		(22)		22		(22)
Transfer to/(from) the fund for future appropriations			(1,170)		553		(1,170)		585
			27,737		**19,945**		**27,350**		**19,346**
Sub-total – balance on technical account – long term business			**-**		**-**		**-**		**-**

The information on pages 48 to 77 form an integral part of these financial statements.

Balance Sheet

As at 31 December 2016

		Group				Society			
	Note	2016		2015		2016		2015	
ASSETS		£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Intangible assets	17		3,157		2,145		657		2,145
Investments									
Land and buildings	12	21,074		23,620		21,074		23,920	
Investment in subsidiaries	26	-		-		316		34	
Other financial investments	13	104,488		103,094		104,488		103,094	
			125,562		126,714		125,878		127,048
Assets held to cover linked liabilities	16		1,701		2,227		1,701		2,227
Reinsurers' share of technical provisions	3		202		217		202		217
Debtors – Loans and receivables									
Debtors arising from direct insurance operations	3	130		182		95		127	
Other debtors	3	1,168		871		3,424		867	
			1,298		1,053		3,519		994
Other assets									
Tangible assets	18	2,178		2,146		2,172		1,831	
Cash at bank and in hand	14	4,333		1,523		4,322		1,513	
Net pension asset	21	-		987		-		987	
			6,511		4,656		6,494		4,331
Prepayments and accrued income – Loans and Receivables									
Accrued interest and rent		1,617		1,823		1,617		1,823	
Other prepayments and accrued income		161		154		140		130	
			1,778		1,977		1,757		1,953
			140,209		**138,989**		**140,208**		**138,915**

The information on pages 48 to 77 form an integral part of these financial statements.

Balance Sheet - continued

As at 31 December 2016

		Group				Society			
	Note	2016		2015		2016		2015	
LIABILITIES		£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Fund for future appropriations			7,893		12,526		7,936		12,568
Technical provisions									
Long term business provision	20	122,433		118,835		122,433		118,835	
Investment contract liabilities		66		106		66		106	
Claims outstanding		2,582		2,713		2,582		2,713	
Provision for bonuses and rebates		302		632		302		632	
			125,383		122,286		125,383		122,286
Technical provision for linked liabilities	22		1,057		1,166		1,057		1,166
Investment contract liabilities on linked liability fund	22		352		362		352		362
Provision for other risks and charges									
Derivatives	27		149		585		149		585
Creditors									
Arising out of direct insurance operations		49		49		49		49	
Other creditors including taxation and social security		1,031		310		996		261	
Accruals and deferred income		1,726		1,705		1,717		1,638	
			2,806		2,064		2,762		1,948
Net pension liability	21	2,569		-		2,569		-	
			2,569		-		2,569		-
			140,209		**138,989**		**140,208**		**138,915**

The information on pages 48 to 77 form an integral part of these financial statements.

These financial statements were approved by the Board on 19 May 2017.

Jonathan Long
Chief Executive Officer

Sandy Richards
Secretary

Statement of Comprehensive Income

For the year ended 31 December 2016

	Note	Group		Society	
		2016 £'000	2015 £'000	2016 £'000	2015 £'000
(Deficit)/surplus for the financial year		(1,170)	553	(1,170)	585
Actuarial (loss)/gain on pension scheme	21	(3,720)	938	(3,720)	938
Movement in deferred tax on pension scheme		22	(22)	22	(22)
Revaluation of occupied land and buildings		256	182	256	150
Other comprehensive income		(21)	(7)	(20)	(7)
Total comprehensive income		**(4,633)**	**1,644**	**(4,632)**	**1,644**

The information on pages 48 to 78 form an integral part of these financial statements.

Statement of Movements in Funds

For the year ended 31 December 2016

	Note	Group		Society	
		2016 £'000	2015 £'000	2016 £'000	2015 £'000
As at 1 January Fund for future appropriations		12,526	10,882	12,568	10,924
(Deficit)/surplus for the financial year		(1,170)	553	(1,170)	585
Actuarial (loss)/gain on defined benefit pension scheme	21	(3,720)	938	(3,720)	938
Movement in deferred tax on pension scheme		22	(22)	22	(22)
Revaluation of occupied land and buildings		256	182	256	150
Other comprehensive income		(21)	(7)	(20)	(7)
Total comprehensive income		(4,633)	1,644	(4,632)	1,644
As at 31 December Fund for future appropriations		**7,893**	**12,526**	**7,936**	**12,568**

The information on pages 48 to 77 form part of these financial statements.

Notes to the Financial Statements

For the year ended 31 December 2016

(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.
No activities carried on during the year by the Society or any of its subsidiaries are believed to have been carried on outside the powers of the Society or its subsidiaries.

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

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.

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.

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 technical account.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(1) Accounting policies (continued)

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 statutory solvency basis to comply with former reporting requirements under the Prudential Sourcebook for Insurers. The calculation uses a net premium method for with-profit policies and as such includes explicit provision for annual reversionary bonuses declared prior to the valuation date. Implicit provision is made for future bonuses by using a valuation rate of interest lower than the expected return on the assets.

For conventional non-profit business, a gross premium valuation method is used, which brings into account the full premiums receivable under contracts written by the Society, estimated renewal and maintenance costs and contractually guaranteed benefits.

The calculation of the long term business provision for unit linked policies is based on the fund valuation at the valuation date.

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.
• terminal bonuses paid out to policyholders on maturity which are included within claims paid.

Claims outstanding
The outstanding claims reserve provides for all the estimated (based on actuarial calculations) Healthcare and Healthguard claims payable as at 31 December. Claims outstanding represent the ultimate cost of settling all claims which have occurred up to the balance sheet date, together with the provision for claims incurred but not yet reported.

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 depreciated over the useful economic life of the software.

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 valuation at the balance sheet date.

Tangible fixed assets 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:
Land and building 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.
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.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(1) Accounting policies (continued)

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 merger and acquisition activity, when undertaken, and 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. 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 34 “Specialised Activities - Retirement Benefit Plans” 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.

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.

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 fair value.
Investments in subsidiary companies are held at cost less any provisions for diminution in value. In accordance with Section 27 “Impairment of assets” of FRS 102; the carrying value of the subsidiary undertaking is compared to its recoverable amount.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(1) Accounting policies (continued)

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 of 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 Head of Actuarial Function, having due regard to the actuarial principles laid down in the Life Framework Directive, and is approved by the Board.

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. Such assets are measured at fair value based on the active market price with gains and losses recognised in the Income Statement. 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. The intercompany debtors are held at fair value, based on a discounted cashflow valuation. The discount rate is 3%.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

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. 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.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(2) Capital management

Solvency II Capital Requirements
As at 1 January 2016 the new Solvency II regulatory capital regime became effective. 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 Solvency Capital Requirement ("SCR"). These assets comprise cash and other assets, fixed interest sovereign and corporate debt in addition to property and equity assets. The SCR 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 Society aims to manage its funds such that there is an appropriate margin of own funds over the SCR at all times. This is monitored formally through the Board on a quarterly basis and more regularly through review of key market and demographic assumptions.

In previous years the Society managed its capital on the Solvency I basis. The key differences between the Solvency I methodology and assumptions and those used in Solvency II are as follows:

- The Solvency II best estimate of liabilities is calculated using best estimate assumptions which do not include margins for adverse deviation in each assumption as under Solvency I;
- The best estimate Solvency II cash flows are valued on a market consistent basis using UK specific risk free discount rates prescribed by the European Insurance and Occupational Pensions Authority (EIOPA) whereas the Financial Statement technical provisions are based on cash flows discounted at the higher risk adjusted yield of the assets notionally matched to each liability group;
- Where the best estimate of liabilities for a group of similar contracts is negative, this has been allowed in the Solvency II technical provisions. Any such amounts are held at a minimum value of zero under Solvency I;
- An additional risk margin is required under the Solvency II regulations. This represents the cost of capital that another insurance undertaking would require to take on the Society's insurance liabilities using the 6% EIOPA cost of capital rate.

The Society has complied with the new Solvency II regulations since 1 January 2016 and assesses its capital position in accordance with these regulations and manages its business on this basis. The table below shows the position as at 31 December 2016.

Solvency II Balance Sheet	Society
	2016
	£m
Assets	**139.2**
Best Estimate Liabilities	112.6
Other Liabilities	5.5
Risk Margin	3.7
Total Liabilities	**121.8**
Own Funds	17.4
Solvency Capital Requirement	14.7
Excess Assets	**2.7**

Under the Solvency II regime, 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. During 2016, there was a significant fall in the underlying risk free rates which have had a significant adverse impact on the value of liabilities, solvency capital requirement and risk margin.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(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 Head of Actuarial Function and approved by the Board. See note 19 for details of assumptions used in the calculation of the long term business provision. The impact on the policy reserves of sensitivities to key valuation assumptions are as follows:

Assumption	Increase in policy reserves
Increase in morbidity by 10%	£2.3 million
Decrease in mortality by 10%	£1.2 million
Reduction in lapses by 25%	£1.4 million
Increase in expense inflation by 1%	£3.2 million
Increase in claim inflation by 1%	£0.5 million
Reduction in yields by 1%	£7.3 million
Increase in expense amounts by 10%	£2.2 million

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. The overall level of risk is then compiled into a detailed report taking into account the correlation of individual risks to arrive at a required level of capital as part of the Society's Own Risk and Solvency Assessment ("ORSA") process. The Board is responsible for reviewing the risks faced by the Society and approving the required level of capital to be held against each risk element. The Society does not use hedge accounting.

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.

In view of the relatively low level of free assets, 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 and capital restoration plan.

a. **Interest rate risk**

Due to the nature of its products, the long term business fund may be impacted by interest rate movements. The Society has closely matched specific assets to non-profit pension liabilities in order to benefit from improved valuation assumptions and to reduce interest rate risk by matching the duration of fixed interest investments to the expected cash flow requirements. This asset and liability matching cannot be exact due to the uncertainties involved but nevertheless this activity has reduced the amount of resilience capital that is required than otherwise would have been the case. The matching of assets to liabilities is reviewed regularly and adjustments made to the portfolio allocation if required.

A 100bps or 1% change in the interest rate would lead to a change of £9.3m (2015: £9.7m) in the total holding of fixed interest assets.
The new market value is calculated by applying the change in rate to each asset individually in proportion to its duration. The value of liabilities is calculated using the revised interest rate in the usual way.

A 1% fall in yields leads to an increase of £7.3m (2015: £6.0m) in the value of liabilities. This does not allow for any change from asset shares due to market movements in asset values.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(3) Risk management (continued)
(i) Market risk (continued)
(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 below:

	Group & Society	
Market Value	**2016 £'000**	**2015 £'000**
Equities		
UK pound	15,169	14,132
Euro	308	71
Swiss franc	162	417
USA dollar	377	253
	16,016	**14,873**

	Group & Society	
Market Value	**2016 £'000**	**2015 £'000**
Fixed Interest		
UK pound	65,330	71,640
Australian dollar	259	223
Euro	662	1,121
USA dollar	15,489	11,377
	81,740	**84,361**

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.

b. **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. The Society does not invest in equities out of assets held for with profit pension policies.

A 10% change in the market value of equities would lead to a change of £1.8m (2015: £1.7m) in the total holding of equities.

A 10% change in equity values would lead to a change of £1.5m (2015: £1.6m) in the value of the liabilities matched by equity.

ii. Credit risk

Credit risk is the risk of loss incurred whenever a firm is exposed to loss if 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 (continued)

For the year ended 31 December 2016

(3) Risk management (continued)
(ii) Credit risk (continued)

The assets bearing credit risk are summarised and analysed by credit rating below:	Group 2016 £'000	Group 2015 £'000
Derivative financial instruments	654	44
Listed fixed interest securities	81,740	84,361
Loans and receivables	3,075	3,041
Deposits with credit institutions	5,918	3,651
Cash at bank and in hand	4,333	1,523
	95,720	**92,620**
AAA	4,844	7,092
AA	39,598	36,592
A	36,274	25,157
BBB	9,326	15,822
Below BBB	-	2,016
Not rated	5,678	5,941
	95,720	**92,620**

The assets bearing credit risk are summarised and analysed by credit rating below:	Society 2016 £'000	Society 2015 £'000
Derivative financial instruments	654	44
Listed fixed interest securities	81,740	84,361
Loans and receivables (Note 14)	5,296	2,982
Deposits with credit institutions	5,918	3,651
Cash at bank and in hand	4,322	1,513
	97,930	**92,551**
AAA	4,844	7,092
AA	39,586	36,582
A	36,274	25,157
BBB	9,326	15,822
Below BBB	-	2,016
Not rated	7,900	5,882
	97,930	**92,551**

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.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(3) Risk management (continued)

iii. Liquidity risk (continued)

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				
Financial and insurance liabilities at 31/12/16	**No maturity date £'000**	**Within 1 year £'000**	**1 - 5 years £'000**	**Over 5 years £'000**	**Total £'000**
Fund for future appropriation	7,893	-	-	-	**7,893**
Long term business provision	-	7,256	14,978	100,199	**122,433**
Investment contract liabilities	-	8	50	8	**66**
Claims outstanding	-	2,582	-	-	**2,582**
Provision for bonuses and rebates	-	60	146	96	**302**
Technical provision for linked liabilities	-	1,057	-	-	**1,057**
Investment contracts on linked liability fund	-	352	-	-	**352**
Derivatives	-	149	-	-	**149**
Defined benefit pension liability	-	-	-	2,569	**2,569**
Creditors arising out of direct insurance operations	-	49	-	-	**49**
Other creditors including taxation and social security	-	1,031	-	-	**1,031**
Accruals and deferred income	-	1,726	-	-	**1,726**
Total financial and insurance liabilities	**7,893**	**14,270**	**15,174**	**102,872**	**140,209**

	Society				
Financial and insurance liabilities at 31/12/16	**No maturity date £'000**	**Within 1 year £'000**	**1 - 5 years £'000**	**Over 5 years £'000**	**Total £'000**
Fund for future appropriation	7,936	-	-	-	**7,936**
Long term business provision	-	7,256	14,978	100,199	**122,433**
Investment contract liabilities	-	8	50	8	**66**
Claims outstanding	-	2,582	-	-	**2,582**
Provision for bonuses and rebates	-	60	146	96	**302**
Technical provision for linked liabilities	-	1,057	-	-	**1,057**
Investment contracts on linked liability fund	-	352	-	-	**352**
Derivatives	-	149	-	-	**149**
Defined benefit pension liability	-	-	-	2,569	**2,569**
Creditors arising out of direct insurance operations	-	49	-	-	**49**
Other creditors including taxation and social security	-	996	-	-	**996**
Accruals and deferred income	-	1,717	-	-	**1,717**
Total financial and insurance liabilities	**7,936**	**14,226**	**15,174**	**102,872**	**140,208**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(3) Risk management (continued)

iii. Liquidity risk (continued)

	Group				
Financial assets at 31/12/16	**No maturity date £'000**	**Within 1 year £'000**	**1 - 5 years £'000**	**Over 5 years £'000**	**Total £'000**
Equity investments	16,016	-	-	-	**16,016**
Fixed interest securities	-	512	8,588	72,640	**81,740**
Derivatives	-	654	-	-	**654**
Deposits with credit institutions	-	5,918	-	-	**5,918**
Mortgages	134	5	17	4	**160**
Assets held to cover linked liabilities	1,701	-	-	-	**1,701**
Debtors arising from direct insurance operations	-	130	-	-	**130**
Other debtors	-	1,168	-	-	**1,168**
Cash at bank and in hand	4,333	-	-	-	**4,333**
Accrued interest and rent	-	1,617	-	-	**1,617**
Total financial assets	**22,184**	**10,004**	**8,605**	**72,644**	**113,437**

	Society				
Financial assets at 31/12/16	**No maturity date £'000**	**Within 1 year £'000**	**1 - 5 years £'000**	**Over 5 years £'000**	**Total £'000**
Equity investments	16,016	-	-	-	**16,016**
Fixed interest securities	-	512	8,588	72,640	**81,740**
Derivatives	-	654	-	-	**654**
Deposits with credit institutions	-	5,918	-	-	**5,918**
Mortgages	134	5	17	4	**160**
Assets held to cover linked liabilities	1,701	-	-	-	**1,701**
Debtors arising from direct insurance operations	-	95	-	-	**95**
Other debtors	-	1,418	1,344	662	**3,424**
Cash at bank and in hand	4,322	-	-	-	**4,322**
Accrued interest and rent	-	1,617	-	-	**1,617**
Total financial assets	**22,173**	**10,219**	**9,949**	**73,306**	**115,647**

	Group				
Financial and insurance liabilities at 31/12/15	**No maturity date £'000**	**Within 1 year £'000**	**1 - 5 years £'000**	**Over 5 years £'000**	**Total £'000**
Fund for future appropriation	12,526	-	-	-	**12,526**
Long term business provision	-	5,553	18,672	94,610	**118,835**
Investment contract liabilities	-	15	74	17	**106**
Claims outstanding	-	2,713	-	-	**2,713**
Provision for bonuses and rebates	-	81	299	252	**632**
Technical provision for linked liabilities	-	1,166	-	-	**1,166**
Investment contracts on linked liability fund	-	362	-	-	**362**
Derivatives	-	585	-	-	**585**
Creditors arising out of direct insurance operations	-	49	-	-	**49**
Other creditors including taxation and social security	-	310	-	-	**310**
Accruals and deferred income	-	1,705	-	-	**1,705**
Total financial and insurance liabilities	**12,526**	**12,539**	**19,045**	**94,879**	**138,989**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(3) Risk management (continued)
(iii) Liquidity risk (continued)

	Society				
Financial and insurance liabilities at 31/12/15	**No maturity date £'000**	**Within 1 year £'000**	**1 - 5 years £'000**	**Over 5 years £'000**	**Total £'000**
Fund for future appropriation	12,568	-	-	-	**12,568**
Long term business provision	-	5,553	18,672	94,610	**118,835**
Investment contract liabilities	-	15	74	17	**106**
Claims outstanding	-	2,713	-	-	**2,713**
Provision for bonuses and rebates	-	81	299	252	**632**
Technical provision for linked liabilities	-	1,166	-	-	**1,166**
Investment contracts on linked liability fund	-	362	-	-	**362**
Derivatives	-	585	-	-	**585**
Creditors arising out of direct insurance operations	-	49	-	-	**49**
Other creditors including taxation and social security	-	261	-	-	**261**
Accruals and deferred income	-	1,638	-	-	**1,638**
Total financial and insurance liabilities	**12,568**	**12,423**	**19,045**	**94,879**	**138,915**

	Group				
Financial assets at 31/12/15	**No maturity date £'000**	**Within 1 year £'000**	**1 - 5 years £'000**	**Over 5 years £'000**	**Total £'000**
Equity investments	14,873	-	-	-	**14,873**
Fixed interest securities	-	1,073	7,049	76,239	**84,361**
Derivatives	-	44	-	-	**44**
Deposits with credit institutions	-	3,651	-	-	**3,651**
Mortgages	133	5	20	7	**165**
Assets held to cover linked liabilities	2,227	-	-	-	**2,227**
Debtors arising from direct insurance operations	-	182	-	-	**182**
Other debtors	-	871	-	-	**871**
Cash at bank and in hand	1,523	-	-	-	**1,523**
Accrued interest and rent	-	1,823	-	-	**1,823**
Total financial assets	**18,756**	**7,649**	**7,069**	**76,246**	**109,720**

	Society				
Financial assets at 31/12/15	**No maturity date £'000**	**Within 1 year £'000**	**1 - 5 years £'000**	**Over 5 years £'000**	**Total £'000**
Equity investments	14,873	-	-	-	**14,873**
Fixed interest securities	-	1,073	7,049	76,239	**84,361**
Derivatives	-	44	-	-	**44**
Deposits with credit institutions	-	3,651	-	-	**3,651**
Mortgages	133	5	20	7	**165**
Assets held to cover linked liabilities	2,227	-	-	-	**2,227**
Debtors arising from direct insurance operations	-	127	-	-	**127**
Other debtors	-	867	-	-	**867**
Cash at bank and in hand	1,513	-	-	-	**1,513**
Accrued interest and rent	-	1,823	-	-	**1,823**
Total financial assets	**18,746**	**7,590**	**7,069**	**76,246**	**109,651**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(3) Risk management (continued)

iv. Fair value estimation

The principal financial assets held at 31 December 2016, analysed by their fair value hierarchies are:

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Assets 2016				
Financial assets at fair value through the profit and loss				
- Equity investments	16,016	-	-	16,016
- Fixed interest investments	33,127	48,613	-	81,740
- Financial Instruments	-	654	-	654
- Assets held to cover linked liabilities	-	1,701	-	1,701
Total assets	**49,143**	**50,968**	**-**	**100,111**

The principal financial assets held at 31 December 2015, analysed by their fair value hierarchies were:

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Assets 2015				
Financial assets at fair value through the profit and loss				
- Equity investments	14,873	-	-	14,873
- Fixed interest investments	25,090	59,271	-	84,361
- Financial Instruments	-	44	-	44
- Assets held to cover linked liabilities	-	2,227	-	2,227
Total assets	**39,963**	**61,542**	**-**	**101,505**

The principal financial liabilities held at 31 December 2016, analysed by their fair value hierarchies are:

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Liabilities 2016				
Financial liabilities at fair value through the profit and loss				
- Investment contract liabilities	-	66	-	66
- Investment contracts on linked liability fund	-	352	-	352
- Financial Instruments	-	149	-	149
Total liabilities	**-**	**567**	**-**	**567**

The principal financial liabilities held at 31 December 2015, analysed by their fair value hierarchies are:

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Liabilities 2015				
Financial liabilities at fair value through the profit and loss				
- Investment contract liabilities	-	106	-	106
- Investment contracts on linked liability fund	-	362	-	362
- Financial Instruments	-	585	-	585
Total liabilities	**-**	**1,053**	**-**	**1,053**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(3) Risk management (continued)

iv. Fair value estimation (continued)

The basis for determining the fair value hierarchy is as follows:

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	**Group & Society**	
	2016 £'000	**2015 £'000**
Assurance	3,022	3,183
Healthcare, Healthguard and Your Health Fund	7,844	8,673
Payments to deposit	448	375
Unit linked	40	49
	11,354	**12,280**

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

Gross new premiums written	**Group & Society**	
	2016 £'000	**2015 £'000**
Healthcare, Healthguard and Your Health Fund	34	24
Assurance	6	-
	40	**24**

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

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(5) Investment income	**Group**		**Society**	
	2016 £'000	**2015 £'000**	**2016 £'000**	**2015 £'000**
Income from other financial investments:				
Loans and receivables interest income	26	24	26	24
Total interest income on financial assets not at fair value through profit and loss	**26**	**24**	**26**	**24**
Income from financial investments at fair value through profit and loss:				
Fixed interest stocks	3,470	3,796	3,470	3,796
Ordinary shares	504	466	504	466
Mortgages and ground rents	6	5	6	5
Income from financial assets at fair value through profit and loss	**3,980**	**4,267**	**3,980**	**4,267**
Income from land and buildings	2,242	2,092	2,242	2,092
Net gains on realisation of investments	3,365	671	3,365	671
	9,613	**7,054**	**9,613**	**7,054**
Net unrealised gains/(losses) on investments				
- Investments	6,445	(1,213)	6,445	(1,182)
- Assets held to cover linked liabilities	(72)	200	(72)	200
	6,373	**(1,013)**	**6,373**	**(982)**
Total investment return	**15,986**	**6,041**	**15,986**	**6,072**

Net gains/(losses) on investments	**Group**		**Society**	
	2016 £'000	**2015 £'000**	**2016 £'000**	**2015 £'000**
Included in the total investment return are net realised gains on financial assets at fair value through profit and loss				
Designated upon initial recognition	3,553	1,871	3,553	1,871
Included in the total investment return are net unrealised gains/(losses) on financial assets at fair value through profit and loss				
Designated upon initial recognition	4,580	3,913	4,580	3,913
Total net realised and unrealised gains/(losses) included in investment return	**8,133**	**5,784**	**8,133**	**5,784**

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

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(6) Other technical income	Group		Society	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Insurance commission	388	602	1	3
Other income	26	28	26	28
	414	**630**	**27**	**31**

(7) Net operating expenses	Group		Society	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000
(a) Included in operating expenses are:				
Fees payable to external auditors:				
Audit of the Group and Society financial statements	254	186	254	186
Taxation compliance services	-	-	-	-
Other non-audit services	66	36	66	36
Fees payable to internal auditors in respect of:				
Internal audit	39	30	39	30
Actuarial fees	175	107	175	107
Depreciation of tangible assets	248	86	240	78
(b) Other technical charges – project costs:				
Capital management	714	610	714	610
Distribution	104	652	104	642
Systems and processing	316	398	316	398
Risk management	401	135	401	135
Total project costs	**1,535**	**1,795**	**1,535**	**1,785**

(8) Investment expenses	Group		Society	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Investment management expenses	435	581	435	581
Investment property direct costs	526	631	526	631
	961	**1,212**	**961**	**1,212**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(9) Staff costs	**Group**		**Society**	
	2016	**2015**	**2016**	**2015**
Average monthly number of employees:				
Administration	39	39	39	39
Distribution	12	19	3	4
	51	**58**	**42**	**43**

The average full-time equivalent is 50 (2015: 51) for the Group and 39 (2015: 40) for the Society. Excludes Non-Executive Directors of 4 (2015: 4).

	Group		**Society**	
	2016 £'000	**2015 £'000**	**2016 £'000**	**2015 £'000**
Wages and salaries (inc commission)	2,241	2,218	1,929	1,784
Social security costs	223	226	192	185
Pension costs	198	162	175	132
	2,662	**2,606**	**2,296**	**2,101**

This includes Executive Directors' emoluments totalling £361,834 (2015: £355,358). Details of Directors' remuneration are set out on page 34.

(10) Directors' emoluments	**Group & Society**	
	2016 £'000	**2015 £'000**
Aggregate emoluments	508	498

Retirement benefits are accruing to one Executive Director as at 31 December 2016 (2015: one) under a defined benefit scheme. The aggregate amount of pension contribution made by the Society to a defined contribution scheme was £31,028 (2015: £30,420).

Highest paid Director	**Group & Society**	
	2016 £'000	**2015 £'000**
Total emoluments and amounts receivable under long-term incentive schemes	197	193
Defined benefit scheme: Pension accrued during the year	2	1
Defined contribution scheme: Contributions made by the Society	19	18

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(11) Taxation	**Group & Society**	
	2016	**2015**
	£'000	**£'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	22	(22)
Total deferred tax	**22**	**(22)**
Total tax charged/(credited) in the long term business technical account	**22**	**(22)**

	Group & Society	
(b) Factors that may affect future tax charges	**2016**	**2015**
The deferred tax assets which have not been recognised due to the uncertainty of their recoverability in the foreseeable future comprise:	**£'000**	**£'000**
Realised and unrealised capital losses	195	287
Expenses deductible in future years	223	226
Undiscounted deferred tax asset balance	**418**	**513**

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.

	Group & Society	
	2016	**2015**
(c) Balance sheet	**£'000**	**£'000**
The deferred tax balance included within other assets comprises:		
Unrelieved expenses carried forward	-	22
Realised capital gains/(losses)	155	104
Accelerated capital allowances	(155)	(104)
Deferred tax on Pension Scheme surplus	-	(22)
Undiscounted deferred tax asset balance	**-**	**-**
(d) Reconciliation of deferred taxation balances		
Opening deferred tax asset	-	-
(Charge)/credit to operating profit	(22)	22
Credit/(charge) to statement of comprehensive income	22	(22)
	-	**-**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(12) Investments Land and buildings	Group 2016 £'000 Cost	 2016 £'000 Valuation	Society 2016 £'000 Cost	 2016 £'000 Valuation
Freehold investment properties				
At 1 January (restated)	13,351	12,395	13,618	12,695
Disposals	-	-	(267)	(300)
Net gains on revaluation	-	944	-	944
At 31 December	**13,351**	**13,339**	**13,351**	**13,339**
Long leasehold properties				
At 1 January (restated)	11,832	11,150	11,832	11,150
Disposals	(3,816)	(3,375)	(3,816)	(3,375)
Net loss on revaluation	-	(125)	-	(125)
At 31 December	**8,016**	**7,650**	**8,016**	**7,650**
Freehold ground rents				
At 1 January	9	75	9	75
Disposals	-	-	-	-
Net gains on revaluation	-	10	-	10
At 31 December	**9**	**85**	**9**	**85**
Freehold and long leasehold investment properties: At 31 December	**21,376**	**21,074**	**21,376**	**21,074**

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

(13) Other financial investments	Group & Society 2016 £'000 Cost	 2016 £'000 Valuation	 2015 £'000 Cost	 2015 £'000 Valuation
Listed fixed interest securities	73,262	81,740	80,871	84,361
Listed shares	14,402	16,016	12,358	14,873
Derivatives	-	654	-	44
Deposits with credit institutions	5,918	5,918	3,651	3,651
Mortgages	160	160	165	165
	93,742	**104,488**	**97,045**	**103,094**

Of the listed fixed interest securities £26,238,740 (2015: £30,795,417) relates to overseas fixed interest securities, with the remainder relating to UK fixed interest securities.

Of the listed shares £1,866,447 (2015: £1,264,329) 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; futures to manage the duration of the fixed interest portfolio; and interest rate swaps to match specific assets to non-profit pension liabilities. The gain in the value of these contracts has been recognised through the income statement. The contracts will mature in 2017.

Included within deposits with credit institutions is £306,191 (2015: £554,949) 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 (continued)

For the year ended 31 December 2016

(14) Financial assets	**Group**			
	2016 £'000 Cost	**2016 £'000 Valuation**	**2015 £'000 Cost**	**2015 £'000 Valuation**
Financial assets at fair value through profit and loss				
Designated upon initial recognition	99,030	110,362	99,937	106,679
	99,030	**110,362**	**99,937**	**106,679**
Loans and receivables	3,075	3,075	3,041	3,041
Total financial assets	**102,105**	**113,437**	**102,978**	**109,720**
Included in the balance sheet as:				
Listed fixed interest securities	73,262	81,740	80,871	84,361
Listed shares	14,402	16,016	12,358	14,873
Derivatives	-	654	-	44
Deposits with credit institutions	5,918	5,918	3,651	3,651
Mortgages	160	160	165	165
Other financial investments (Note 13)	**93,742**	**104,488**	**97,045**	**103,094**
Assets held to cover linked liabilities (Note 16)	1,115	1,701	1,534	2,227
Debtors arising from direct insurance operations	130	130	182	182
Other debtors	1,168	1,168	871	871
Cash at bank and in hand	4,333	4,333	1,523	1,523
Accrued interest and rent	1,617	1,617	1,823	1,823
Total financial assets	**102,105**	**113,437**	**102,978**	**109,720**

	Society			
	2016 £'000 Cost	**2016 £'000 Valuation**	**2015 £'000 Cost**	**2015 £'000 Valuation**
Financial assets at fair value through profit and loss				
Designated upon initial recognition	99,019	110,351	99,927	106,669
	99,019	**110,351**	**99,927**	**106,669**
Loans and receivables	5,296	5,296	2,982	2,982
Total financial assets	**104,315**	**115,647**	**102,909**	**109,651**
Included in the balance sheet as:				
Listed fixed interest securities	73,262	81,740	80,871	84,361
Listed shares	14,402	16,016	12,358	14,873
Derivatives	-	654	-	44
Deposits with credit institutions	5,918	5,918	3,651	3,651
Mortgages	160	160	165	165
Other financial investments (Note 13)	**93,742**	**104,488**	**97,045**	**103,094**
Assets held to cover linked liabilities (Note 16)	1,115	1,701	1,534	2,227
Debtors arising from direct insurance operations	95	95	127	127
Other debtors	3,424	3,424	867	867
Cash at bank and in hand	4,322	4,322	1,513	1,513
Accrued interest and rent	1,617	1,617	1,823	1,823
Total financial assets	**104,315**	**115,647**	**102,909**	**109,651**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(15) Financial Liabilities	Group			
	2016 £'000 Cost	**2016 £'000 Valuation**	**2015 £'000 Cost**	**2015 £'000 Valuation**
Financial liabilities at fair value through profit and loss				
Designated upon initial recognition	-	149	-	585
Other financial liabilities at amortised cost	3,224	3,224	2,532	2,532
Total financial liabilities	**3,224**	**3,373**	**2,532**	**3,117**
Included in the balance sheet as:				
Derivatives	-	149	-	585
Investment contract liabilities	66	66	106	106
Investment contract liabilities on linked liability fund	352	352	362	362
Arising out of direct insurance operations	49	49	49	49
Other creditors including taxation and social security	1,031	1,031	310	310
Accruals and deferred income	1,726	1,726	1,705	1,705
Total financial liabilities	**3,224**	**3,373**	**2,532**	**3,117**

	Society			
	2016 £'000 Cost	**2016 £'000 Valuation**	**2015 £'000 Cost**	**2015 £'000 Valuation**
Financial liabilities at fair value through profit and loss				
Designated upon initial recognition	-	149	-	585
Other financial liabilities at amortised cost	3,180	3,180	2,416	2,416
Total financial liabilities	**3,180**	**3,329**	**2,416**	**3,001**
Included in the balance sheet as:				
Derivatives	-	149	-	585
Investment contract liabilities	66	66	106	106
Investment contract liabilities on linked liability fund	352	352	362	362
Arising out of direct insurance operations	49	49	49	49
Other creditors including taxation and social security	996	996	261	261
Accruals and deferred income	1,717	1,717	1,638	1,638
Total financial liabilities	**3,180**	**3,329**	**2,416**	**3,001**

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.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(16) Assets held to cover linked liabilities

	Group & Society			
	2016 £'000 Cost	2016 £'000 Valuation	2015 £'000 Cost	2015 £'000 Valuation
Assets held to cover unit linked insurance contracts	836	1,276	1,171	1,700
Assets held to cover unit linked investment contracts	279	425	363	527
	1,115	**1,701**	**1,534**	**2,227**

Included within assets held to cover linked liabilities is £291,502 (2015: £699,113) 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'.

(17) Intangible assets

	Group		
At 31 December 2015	Software under Construction £'000	Computer Software £'000	Total £'000
Cost/Valuation	2,145	-	**2,145**
Accumulated depreciation and impairment	-	-	-
Net book amount	**2,145**	-	**2,145**
Year ended 31 December 2016			
Opening net book value	2,145	-	**2,145**
Additions	1,012	-	**1,012**
Reclassification	(2,500)	**2,500**	-
Depreciation	-	-	-
Revaluation	-	-	-
Closing net book amount	**657**	**2,500**	**3,157**
At 31 December 2016			
Cost/Valuation	657	**2,500**	**3,157**
Accumulated depreciation and impairment	-	-	-
Net book amount	**657**	**2,500**	**3,157**

	Society	
At 31 December 2015	Software under Construction £'000	Total £'000
Cost/Valuation	2,145	**2,145**
Accumulated depreciation and impairment	-	-
Net book amount	**2,145**	**2,145**
Year ended 31 December 2016		
Opening net book value	2,145	**2,145**
Additions	1,012	**1,012**
Disposals	(2,500)	**(2,500)**
Depreciation	-	-
Revaluation	-	-
Closing net book amount	**657**	**657**
At 31 December 2016		
Cost/Valuation	657	**657**
Accumulated depreciation and impairment	-	-
Net book amount	**657**	**657**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(18) Tangible assets

	Group				
At 31 December 2015	**Land & Buildings £'000**	**Computer Equipment £'000**	**Office Equipment £'000**	**Motor Vehicle £'000**	**Total £'000**
Cost/Valuation	1,731	494	164	-	**2,389**
Accumulated depreciation and impairment	-	(208)	(35)	-	**(243)**
Net book amount	**1,731**	**286**	**129**	**-**	**2,146**
Year ended 31 December 2016					
Opening net book value	1,731	286	129	-	**2,146**
Additions	-	1	1	22	**24**
Reclassification	-	-	-	-	**-**
Depreciation	-	(223)	(20)	(5)	**(248)**
Revaluation	256	-	-	-	**256**
Closing net book amount	**1,987**	**64**	**110**	**17**	**2,178**
At 31 December 2016					
Cost/Valuation	1,987	495	165	22	**2,669**
Accumulated depreciation and impairment	-	(431)	(55)	(5)	**(491)**
Net book amount	**1,987**	**64**	**110**	**17**	**2,178**

	Society				
At 31 December 2015	**Land & Buildings £'000**	**Computer Equipment £'000**	**Office Equipment £'000**	**Motor Vehicle £'000**	**Total £'000**
Cost/Valuation	1,430	470	164	-	**2,064**
Accumulated depreciation and impairment	-	(198)	(35)	-	**(233)**
Net book amount	**1,430**	**272**	**129**	**-**	**1,831**
Year ended 31 December 2016					
Opening net book value	1,430	272	129	-	**1,831**
Additions	301	1	1	22	**325**
Disposals	-	-	-	-	**-**
Depreciation	-	(215)	(20)	(5)	**(240)**
Revaluation	256	-	-	-	**256**
Closing net book amount	**1,987**	**58**	**110**	**17**	**2,172**
At 31 December 2016					
Cost/Valuation	1,987	471	165	22	**2,645**
Accumulated depreciation and impairment	-	(413)	(55)	(5)	**(473)**
Net book amount	**1,987**	**58**	**110**	**17**	**2,172**

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 in accordance with the requirements of the Royal Institution of Chartered Surveyors' Valuation - Professional Standards effective from 6th January 2014.

(19) Capital commitments

Amounts authorised and contracted for at 31 December 2016 £299,000 (2015: £240,000).

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(20) Long term business provision

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

Rates of interest	2016 valuation assumptions	2015 valuation assumptions
Old deposit contracts	1.51% per annum.	2.15% per annum.
Healthcare and Healthguard contracts	1.71% per annum.	2.35% per annum.
Other PHI contracts	1.29% per annum	2.27% per annum
With profits life assurance policies	1.69% per annum for tax exempt policies and 1.35% per annum for taxable policies.	2.48% per annum for tax exempt policies and 1.98% per annum for taxable policies.
With profits bonds and investment ISAs	Not applicable since the basic reserve is equal to current death benefits.	Not applicable since the basic reserve is equal to current death benefits.
With profits personal pensions and retirement annuities	2.45% per annum before vesting and -0.85% per annum after vesting (for retirement annuities).	3.48% per annum before vesting and 0.00% per annum after vesting (for retirement annuities).
Other non-profit business	1.29% per annum for tax exempt policies, 1.03% for taxable policies and 0.00% for short term non-profit bonds.	2.27% per annum for tax exempt policies, 1.82% for taxable policies and 0.65% for short term non-profit bonds.

Rates of mortality	2016 valuation assumptions	2015 valuation assumptions
DBO contracts	33% of the AMN00 and 39% of the AFN00 ultimate table for assured lives (assumed to be transferred to suspense at age 100).	33% of the AMN00 and 39% of the AFN00 ultimate table for assured lives (assumed to be transferred to suspense at age 100).
Deposit (non-DBO) contracts	83% of the AMN00 and 95% of the AFN00 ultimate table for assured lives.	86% of the AMN00 and 97% of the AFN00 ultimate table for assured lives.
Healthcare contracts	83% of the AMN00 and 95% of the AFN00 ultimate table for assured lives.	86% of the AMN00 and 97% of the AFN00 ultimate table for assured lives.
PHI deferred sickness claims in payment	Nil.	Nil.
Other PHI contracts	70% of the AMN00 ultimate table for assured lives.	70% of the AMN00 ultimate table for assured lives.
Critical illness policies	Table provided by reinsurer combining mortality and sickness rates.	Table provided by reinsurer combining mortality and sickness rates.
50+ life plan policies	139% of the AMN00 ultimate table for non-smokers or 139% of the AMS00 ultimate table for smokers.	144% of the AMN00 ultimate table for non-smokers or 144% of the AMS00 ultimate table for smokers.
Other life assurance policies	74% of the AMN00 ultimate table for assured lives of 92% of the AMS00 ultimate table for smokers.	77% of the AMN00 ultimate table for assured lives of 96% of the AMS00 ultimate table for smokers.

Rates of morbidity	2016 valuation assumptions	2015 valuation assumptions
Healthcare & Healthguard contracts	Morbidity assumptions are based upon the Society's actual experience plus a margin for prudence.	Morbidity assumptions are based upon the Society's actual experience plus a margin for prudence.

Lapses	2016 valuation assumptions	2015 valuation assumptions
All policies	Lapse assumptions are based upon the Society's actual experience less a margin for prudence.	Lapse assumptions are based upon the Society's actual experience less a margin for prudence.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(20) Long term business provision (continued)

Expenses	2016 valuation assumptions	2015 valuation assumptions
DBO contracts	£3.17 per annum	£3.08 per annum
Deposit (non-DBO) contracts and PHI contracts	£108.12 per annum	£93.22 per annum
Life and pensions	£72.08 per annum	£62.15 per annum

Full details of the method and assumptions used in calculating the long term business provision are given in the Society's Solvency and Financial Condition Report.

(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 February 2023 inclusive.

The most recent formal actuarial valuation of the Fund was carried out as at 31 December 2013. The calculations for the FRS102 disclosures have been carried out by running full actuarial calculations as at 31 December 2016.

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

The amounts recognised in the balance sheet are as follows:

	Group & Society	
	2016 £’000	**2015 £’000**
Fair value of fund assets	19,287	19,369
Present value of funded obligations	(21,856)	(18,382)
Net (under) / overfunding in Fund	**(2,569)**	**987**
Asset/(liability) recognised on the balance sheet		-
Net Defined Benefit (Liability) / Asset	**(2,569)**	**987**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(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	
	2016 £'000	**2015 £'000**
Net Interest of Net Defined Benefit Liability	(41)	(2)
Expense recognised in the Income Statement	**(41)**	**(2)**

	Group & Society	
	2016 £'000	**2015 £'000**
Interest on obligation	663	682
Interest on assets	(704)	(684)
Net Interest on Defined Benefit Liability	**(41)**	**(2)**

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

	Group & Society	
	2016 £'000	**2015 £'000**
Return on assets (not included in interest)	35	(366)
Actuarial (Losses)/Gains on obligation	(3,755)	1,305
Total Remeasurements recognised in Other Comprehensive Income	**(3,720)**	**939**
Cumulative amount of Remeasurements recognised in Other Comprehensive Income	**(2,945)**	**775**
Actual return on Fund assets	**707**	**350**

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

	Group & Society	
	2016 £'000	**2015 £'000**
Administration expenses paid from Fund	68	102
Other Items	**68**	**102**

The Society contributed £191,100 to the Fund over the year from 1 January 2016 to 31 December 2016. No contributions were paid by members of the Fund over the period.

The Society expects to contribute £191,100 to the Fund over the year from 1 January 2017 to 31 December 2017. No contributions are expected by members of the Fund over the next year.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

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

	Group & Society	
	2016 £'000	**2015 £'000**
Opening defined benefit obligation	18,382	19,989
Benefits paid	(944)	(984)
Interest on obligation	663	682
Experience gains	(55)	(560)
Losses/(gains) from changes in assumptions	3,810	(745)
Closing defined benefit obligation	**21,856**	**18,382**

The weighted average duration of the liabilities of the Fund was 14 years as at 31 December 2016.

Changes in the fair value of the Fund assets are as follows:	Group & Society	
	2016 £'000	**2015 £'000**
Opening fair value of fund assets	19,369	19,946
Interest on assets	704	684
Return on assets (not included in interest)	35	(366)
Contributions by employer	191	191
Benefits paid	(944)	(984)
Administration expenses	(68)	(102)
Closing fair value of fund assets	**19,287**	**19,369**

The major categories of fund assets as a percentage of the total are as follows::	%	%
Equities	29	27
Gilts	13	9
Corporate bonds	33	35
Index linked bonds	-	-
Property	17	17
Cash	8	12

All of the Fund's assets have a quoted market price in an active market. 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	
	2016 %pa	**2015 %pa**
Discount rate at 31 December	2.6	3.7
Discount rate at 1 January	3.7	3.5
Inflation (Retail Price Index)	3.3	2.8
Rate of increase in pensionable salaries	3.6	3.1
Rate of increase in deferred pensions	2.3	1.8
Rate of increase in pensions in payment – service pre 06/04/2005	3.2	2.7
Rate of increase in pensions in payment – service post 06/04/2005	2.1	2.0

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(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 and until age 88 if female.

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 and until age 91 if female.

Defined contribution scheme
The contributions to the defined contribution scheme in the year amounts to £175,807 (2015: £132,033).

(22) Technical provisions for linked liabilities

	Group & Society					
	Insurance contracts		Investment contracts		Total	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000	2016 £'000	2015 £'000
At 1 January	1,166	1,287	362	379	1,528	1,666
Payments made to policy holders of investment contracts	-	-	(44)	(43)	(44)	(43)
Change in technical provision as shown in the income statement	(109)	(121)	34	26	(75)	(95)
At 31 December	**1,057**	**1,166**	**352**	**362**	**1,409**	**1,528**

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 45 are attributable to the long term business fund.

(24) Operating lease commitments
The Society leases various motor vehicles and office equipment under cancellable operating lease agreements. The lease terms are for up to five years, with penalty for early cancellation.

	Group & Society	
	2016	2015
Total future minimum lease payments: plant & machinery	£'000	£'000
Within one year	-	-
Between one and five years	26	26
After five years	-	-
Total	**26**	**26**

(25) Related party transactions
425 Direct Limited was charged £422,186 (2015: £450,796) by the Society in respect of service charges.

Contributions of £191,100 (2015: £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.

On 29 December 2016 ND Member Services Limited acquired for £2,500,000 the Intellectual Property of the policy administration system which the Society had developed through Project Asterix. The Society will licence this software from ND Member Services Limited over ten years.

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(25) Related party transactions (continued)
As at 31 December 2016, 425 Direct Limited was owed £31,361 by the Society (2015: £46,915) and ND Member Services Limited owed the Society a net amount of £2,542,844 (2015: £42,844). This loan will be repaid to the Society over nine years, the present value of the repayment cash flows in £2,256,493, which is the value recognised in the financial statements. The difference of £286,351 is recognised as a capital contribution to ND Member Services Limited.

(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 £565,000 (2015: £820,000) 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 £30,000 (2015: £34,000) after an impairment charge of £569,000 (2015: £799,000).

ND Member Services Limited licences a policy administration system to its customers and is held by the Society at a value of £286,000 at 31 December 2016 (2015: £1) which represents the net realisable value of its assets.

The results of all subsidiaries for the year ended 31 December 2016 have been consolidated into the Group financial statements.

(27) Derivatives
Included within assets are forward currency contracts with a fair value of £50,000 (2015: £11,000) and a fair value within liabilities of £64,000 (2015: £338,000). The nominal contract value of these contracts is £13,496,000 (2015: £12,976,000). 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 2016 in relation to the forward currency contracts amounted to £14,000 (2015: £328,000).

Bond future contracts with a fair value of £424,000 (2015: £33,000) are held within assets and a fair value of £85,000 (2015: £91,000) within liabilities. The nominal contract value of these contracts is £27,982,000 (2015: £20,990,000) was also held to manage the duration of the fixed interest portfolio. Fair value gains for the year of £339,000 (2015: loss of £57,000) are included in the income statement in respect of bond future contracts.

Interest rate swaps are included within assets with a fair value of £180,000 (2015: liabilities £156,000); the notional value of these contracts was £2,000,000. Due to the nature of its products, the long term business fund may be impacted by interest rate movements. The Society has closely matched specific assets to non-profit pension liabilities in order to benefit from improved valuation assumptions and to reduce interest rate risk by matching the duration of fixed interest investments to the expected cash flow requirements. This asset and liability matching cannot be exact due to the uncertainties involved but nevertheless this activity has continued to reduce the amount of resilience capital that is required. The matching of assets to liabilities is reviewed regularly and adjustments made to the portfolio allocation if required. Positions may be taken via interest rate swaps of varying duration in order to enhance matching to the underlying liabilities. Fair value gains included in the income statement in relation to the interest rate swap contracts amounted to £180,000 (2015: loss of £156,000).

	Group & Society		
Derivatives held at 31 December 2016	**Contract value £'000**	**Fair value assets £'000**	**Fair value liabilities £'000**
Forward currency contracts	13,496	50	64
Bond futures	27,982	424	85
Interest rate swaps	2,000	180	-
Total derivatives	**43,478**	**654**	**149**

Notes to the Financial Statements (continued)

For the year ended 31 December 2016

(27) Derivatives (continued)

Derivatives held at 31 December 2015	**Group & Society**		
	Contract value £'000	**Fair value assets £'000**	**Fair value liabilities £'000**
Forward currency contracts	12,976	11	338
Bond futures	20,990	33	91
Interest rate swaps	2,000	-	156
Total derivatives	**35,966**	**44**	**585**