National friendly

Annual Report & Financial Statements 2017

ADVISORS

Bankers
HSBC,
62 George White Street,
Cabot Circus, Bristol, BS1 3BA

Chief Actuary
Christopher Critchlow, OAC plc,
141-142 Fenchurch Street, London,
EC3M 6BL

Custodians
Northern Trust,
50 Bank Street, Canary Wharf,
London, E14 5NT

Independent Auditors
Ernst & Young LLP,
The Paragon, 32 Counterslip,
Bristol, BS1 6BX

Internal Auditors
Mazars LLP,
James Tudor House, 90 Victoria St,
Bristol, BS1 6DP

Investment Managers
(Equity and Fixed Income Fund)
Fidelity Investment Limited,
25 Cannon Street,
London, EC4M 5TA

(Unit Linked Fund)
Church House Investments,
York House, 6 Coldharbour,
Sherbourne, Dorset, DT9 4JW

Solicitors
DAC Beachcroft LLP,
100 Fetter Lane, London, EC4A 1BN

Hogan Lovells,
Atlantic House, Holborn Viaduct,
London, EC1A 2FG

Keystone Law,
Audley House, 13 Palace Street,
London, SW1E 5HX

Thrings LLP,
The Paragon, Counterslip, Bristol, BS1 6BX

Property Manager
Mellersh and Harding LLP,
Kingsbury House, 15-17 King Street,
London, SW1Y 6QU

With-Profits Actuary
Ian Morris, BWCI Limited,
Albert House, South Esplanade, St Peter Port,
Guernsey, GY1 1AW

CONTACT DETAILS

Head Office

11-12 Queen Square, Bristol BS1 4NT

Telephone 0117 244 6062

enquiries@nationalfriendly.co.uk
www.nationalfriendly.co.uk

Established 1868
Registered and incorporated Friendly Society no. 369F

Member of the Association of Financial Mutuals.

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

Chief Executive Officer: Jonathan Long
Secretary: Sandy Richards

INVESTORS IN PEOPLE | Bronze

CONTENTS

CHAIRMAN'S REVIEW

2017 has been a very important year for the Society. Our capital position has strengthened significantly over the course of the year and we have achieved two key milestones in firmly establishing a sustainable and growing stream of new policy sales and delivered the first two phases of our new policy administration system development.

In terms of our capital position our excess assets have increased to £13.6m from the £2.7m reported last year. This is partly attributed to our regulator, the Prudential Regulation Authority, approving the use of transitional measures (for interest rates) in order to soften the impact of the move from the old, Solvency I, regulatory regime to the new Solvency II one. We have also made a change in methodology for determining our expense reserving now that we have developed a sustainable stream of new (profitable) business, which has had a positive impact on our future per policy expenses.

In September 2017 we launched our new healthcare product, Optimum Healthcare following broker and consumer feedback on our previous offering, Your Health Fund. This has provided us with a growing new business stream over the months since launch and will be enhanced by the launch of a single broker specific healthcare product coming this summer.

To further strengthen our new business streams 2018 has seen the launch of our new guaranteed acceptance whole of life insurance policy for which sales are now being generated. Our savings and investment products, being the Tax Exempt Savings Plan and With-Profits Bond, are also generating a steady stream of sales primarily from our existing membership base.

Furthermore, I am pleased to announce that our policy administration system development project has delivered two, out of three, key phases during the course of 2017. Now all of our assurance business with-profits policies, bonds and ISAs are being administered on the new system and Healthcare policies will migrate onto the new system later this year as part of the final stage of the new system implementation. This will enable us to make significant cost savings, in particular in respect of IT infrastructure, and also to grow the policy book without having to recruit further staff due to the administration efficiencies delivered by the new system.

Looking forwards, the Board remains alert to the risks and challenges that we face in achieving our strategy and objectives. Our key challenge is the launch of suitable products that meet customers' needs whilst providing the Society with sufficient volume in order to build the policy book in line with our expectations.

Finally, I would like to thank all of our staff for their hard work and commitment during the course of 2017 and wish them every success for 2018.

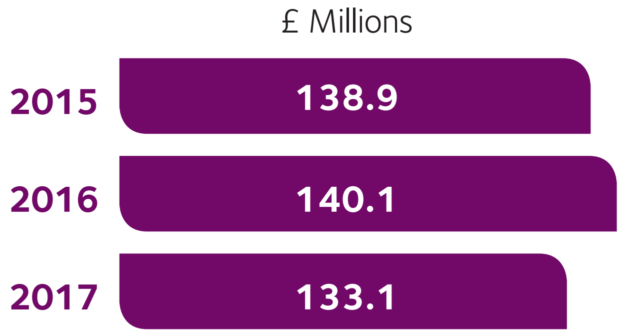
Tracy Morshead

Chairman

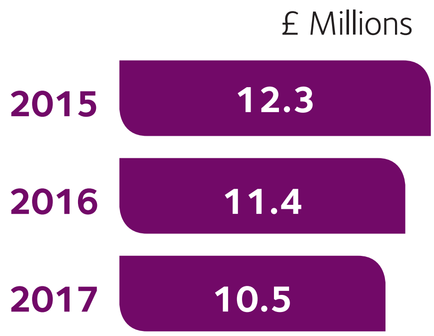
27 April 2018

FINANCIAL HIGHLIGHTS

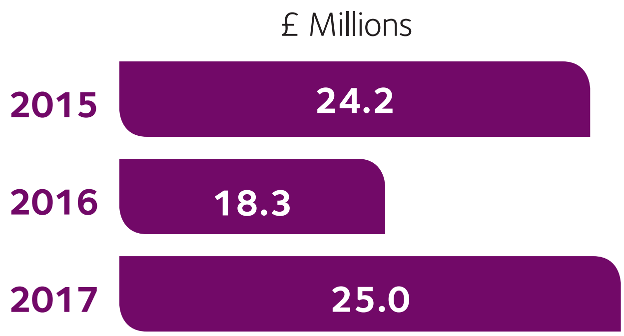
Total Assets



Premium Income



Funds for Future Appropriations



STRATEGIC REPORT

The Society's vision is:

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

Overall Strategy

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

The 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.

The Society has three key objectives to achieve net growth in its customer base, whilst continuing to strengthen its underlying capital position and act in the best interests of the Society's policyholders with the ultimate aim of protecting and enhancing member value:

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

The Society's proposition remains in the long-term health and welfare market providing both insurance and investment products to help members to insure and / or save towards meeting their long-term care needs. During 2017, the Society reviewed and refined its healthcare product following feedback from customers and intermediaries. Relaunched as Optimum healthcare, the policy is available at different levels of cover providing insurance for a range of treatments and offers an alternative option to existing healthcare policyholders as well as providing affordable healthcare cover to new customers.

The Society also progressed and launched a pilot of its first later life care product (Assisted Living Insurance). The objective of the product primarily being to provide the policyholder cover to assist in continuing to live in their own homes for as long as possible as later life care needs emerge, including access to assisted living and care advice.

The relaunch of legacy products such as the Tax Exempt Savings Plan ("TESP") in 2016 and With-Profits Bond in early 2017 helped to maximise the use of the Society's existing resources, in particular to reduce fixed cost issues arising from the requirement to administer a policy book that is reducing in overall size due to maturities and lapses.

Business Performance

The Society assesses its capital position in accordance with the Solvency II regulations and manages its business on this basis. This is a risk-based approach to the assessment of capital requirements whereby Technical Provisions are calculated as the sum of the best estimate liabilities plus a risk margin. The Society is required to hold sufficient own funds (assets less technical provisions) to meet the 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.

Financial Reporting Standard 103 (Insurance Contracts) was amended in May 2016 to reflect the implementation from 1 January 2016 of the Solvency II Directive. This revised standard permits the Society to change its accounting policy for insurance contracts if the change makes the financial statements more relevant to the economic decision-making needs of the users and no less reliable, by recognising and measuring technical provisions in a manner more consistent with the Solvency II Directive. The Society has therefore, decided to change its accounting policy for insurance contracts from a Solvency I basis to a Solvency II basis and the prior year results have been restated accordingly as required by the relevant financial reporting standards.

Under Solvency II, the excess capital after the SCR at 31 December 2017 was £13.6m, an increase from £2.7m at 31 December 2016. The main reasons for the improvement were:

- A reduction in reserves due to a change in methodology on determining future expenses recognising that the Society is now writing new business;
- Change in the methodology to calculate investment expenses and expense inflation to better reflect our liabilities in this respect;
- A reduction in the deficit generated from the Staff Superannuation Fund ("SSF") due to an increase in interest rates compared to the prior year and improvements in mortality experience.

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

Business Objectives

The Society's business plan for 2017 focussed on continuing to deliver our capital management plan, developing and launching new products in line with our strategy and controlling costs.

Capital Management

In 2016 and into 2017, interest rates fell sharply to unprecedented low levels, creating a harsh business environment. This fall in interest rates increased the market value of the Society's fixed income assets, but it did result in a fall in the risk free rates used to discount long-term liabilities. Although the Society largely matches 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. Under this regime the interest rates set by EIOPA do not necessarily move in line with UK interest rates that determine the value of the Society's 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. Therefore, it applied to the regulator, the Prudential Regulation Authority ("PRA"), for approval to continue to use the Solvency I discount rates for the existing policies and gradually transition over a 16 year period as these policies mature. The PRA provided approval of the Transitional Measure on risk free Interest Rates ('TMIR') on 20 June 2017, which has enhanced the capital headroom for the Society.

We continue to monitor and manage morbidity carefully and continue to explore opportunities to mitigate further the exposure to morbidity risk on the existing healthcare book. This is much reduced from prior years due to a reduction in unprofitable healthcare policies as well as positive actions taken by the Society on policy terms and premium reviews where appropriate whilst meeting 'Treating Customers Fairly' principles.

New Business

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

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

During 2017, the Society also progressed and launched a pilot of its first later life care product (Assisted Living Insurance). The prime objective of this product is to provide the policyholder cover to assist in continuing to live in their own homes for as long as possible as later life care needs emerge, including access to assisted living and care advice.

STRATEGIC REPORT

Part of the Society's objective is to identify opportunities for new products that will enable it to grow its business in line with its strategy. Successful development and launch of the planned products provides three key benefits for the Society:

- Every policy taken out, whether from a new or existing customer, will see the Society's per policy administration cost reduce which will benefit the entire membership by strengthening member value and increasing solvency coverage.
- It maximises the use of existing expertise, resources and systems.
- It provides a further step into developing a presence in the over 50s market and the next step in the later life market for the future benefit of our policyholders.

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.

Project Asterix, the development of a new policy administration system continued to progress well with the first phase of delivery being achieved in January 2017 and the second phase launched in October 2017. The first phase provided a fully operational policy administration system and enabled the Society to migrate a number of policy books and decommission one of its legacy systems. The second phase migrated all of the Society's assurance policies onto the new system. The final stage will migrate the healthcare policies onto the system, enabling further decommissioning of legacy systems so that all policies will be administered on one system. Final completion is planned by late Summer 2018.

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

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.	Close monitoring of capital management at Board level both with and without the approved transitional measure. This includes scenario analysis and key sensitivities such as morbidity, lapse and expense assumptions. Quarterly roll-forward of Solvency Coverage allowing for updated market conditions, expense assumptions and change in 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.	Increased reserves results in reduced excess assets	Management of morbidity claims remains a key focus. Better claims data and more sophisticated valuation methodology is used whereby statistical analyses performed monthly are used to predict ultimate claims costs. Any new business will be written on an insured / re-insured basis significantly reducing the morbidity risk of new policies. Continuous audit & monitoring of claims payments as well as audit review of outsourced claims administrator to confirm that paid claims are valid.
Lapse Risk Lapses are higher or lower than projected.	Lapses exceeding levels of new business result in higher per policy expenses. Lower than predicted lapses in some product lines could result in increased technical provisions.	Lapse rates are regularly monitored and reported so that sufficient reserves are held reflecting up to date lapse assumptions.

Risk	Impact	Mitigating Activities
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. However, any proposed changes to strategy would need to be approved by the Scheme Trustee.
Interest rate risk Lower interest rates results have an adverse impact on calculation of long term liabilities.	Increased value of long term liabilities reduce SCR coverage.	Look to match as closely as possible assets against technical provisions. Use of transition measures to recognise the impact of low interest rates under the new Solvency II regime when compared with historic Solvency 1 position. 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.
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. Writing new contracts of insurance will help 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.	Clear marketing strategy and development of profitable products that meet customer needs and demand against an effective and cost efficient distribution strategy. Close monitoring of ongoing expenses against sales volumes
Operational Risk **Profitability of 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 • Reducing the dependency on one key lead provider Performance against plan is closely monitored and action taken as appropriate to control costs
Governance Loss of key personnel and unable to recruit in qualified persons to fulfil key function roles including at Board level.	Loss of knowledge and expertise Persons unwilling to take roles in highly regulated environment	• Competitive remuneration structure with ongoing development opportunities • Established agreements in place with recruitment agencies should the need arise • Some functions may be outsourced • Use of specialist contractors as a short term solution

STRATEGIC REPORT

Viability Statement

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

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

Investment Performance

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

Fixed Income

Synchronised global growth, accommodative central banks, low volatility and a benign inflation backdrop drove markets higher in 2017. Despite the US Federal Reserve (Fed) raising rates three times, the European Central Bank (ECB) signalling less need for accommodative policy and the Bank of England (BoE) raising its base rate for the first time in a decade, the bond yields remained anchored and yield curves flattened significantly. Credit markets recorded another year of strong performance as demand for yield drove credit spreads tighter. Sterling credit underperformed its European and US counterparts, reflecting the Brexit premium. European credit outperformed the US, benefitting from the positive technical backdrop provided by the ECB's CSPP programme. Even the geo-political risks such as the French elections and North Korea tensions, failed to cause any significant re-pricing in risk assets. Against this backdrop, the portfolio generated positive returns of 4.8%.

Credit selection across a mix of sectors such as financials, technology & communications and utilities were the key contributors. At the issuer level, holdings in HSBC, Microsoft, America Movil and EDF were among the top contributors. Favourable positioning across the sterling yield curve also enhanced returns as the curve flattened.

Property

The commercial investment market continued to provide healthy returns during 2017 with most sectors recording yield compression over the period. Prime property has been in greater demand as investors seek out secure income returns. Whilst the retail sector continues to be challenging, corporate activity in the office and warehouse/distribution sectors held up relatively well as the Brexit process moved forward. South East warehousing provided the highest capital returns with the sector seeing a noticeable tightening of yields.

The Society's property portfolio performed well during 2017 recording total returns of 12% including a strong rental return of 6.5%. Following successful asset management initiatives, property sales during the year yielded total contract receipts of 21% above the previous year's valuation having sold four properties at a total value of £4.96m. This included one property, although exchanged in 2017, completed in January 2018.

Further asset management and the identification of new opportunities in 2018 should continue to strengthen the income return and the quality of the property investment portfolio.

Equity

The UK stock market rose over the 12-month period, driven by gains in the resources and technology sectors. Investor sentiment remained positive despite concerns around rising inflation and a lacklustre economic outlook, as UK equities rallied in line with strong global markets. Investors were also optimistic about a transitional deal on "Brexit" following the completion of the first round of

STRATEGIC REPORT

negotiations. At a sector level, mining stocks were among the major gainers as global growth remained strong and given signs of a potential re-acceleration. In addition, expectations of strong Chinese demand supported metal prices. Conversely, health care and utilities stocks underperformed the broader market against the backdrop of a slightly risk-on environment where investors moved to riskier higher yielding investments.

The portfolio generated positive returns but underperformed the index over the twelve months review period. UK equities rose on the back of the global economic recovery, led by cyclical sectors, despite the lacklustre economic outlook.

Several of our key holdings made a contribution to returns, but these gains were offset by weakness in selected positions which fell owing to stock specific reasons. Notably, shares in BT Group held back gains as it issued a profit warning and cautioned against the increasing costs of an Italian accounting scandal. There were also some concerns around a regulatory review of the company's pension deficit funding plan. Nevertheless, we retained the trimmed position as its long-term earnings outlook remains positive and its shares are very attractively valued relative to peers. The position in Shire also underperformed on concerns around increased competition in its haemophilia franchise. However, it remains a key holding given its attractive valuation and strong drugs pipeline. Satellite operator Inmarsat also declined after it highlighted the challenging market conditions. However, the company maintained its full-year revenue guidance. On a positive note, the position in International Consolidated Airlines was the top contributor to returns as it benefited from a strong set of results. The holding in Glencore also performed well as mining stocks benefited from strong metal prices, mainly driven by robust global growth and expectations for strong Chinese demand. Among consumer stocks, shares in fashion brand Jimmy Choo rose as its German owners put the company up for sale. Other notable gainers in the sector included Cairn Homes and Bovis Homes.

The 2017 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 2017.

Terminal bonus rates were also increased for most categories of policy, reflecting the satisfactory investment returns for with-profits policies in 2016. Maturity pay-outs for ten year endowment policies remained at a broadly similar level during 2017.

Investment returns for with-profits policies have again been positive in 2017. These returns will be taken into account when deciding on the 2018 annual bonus declarations.

Our Members

Engaging with our members

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

Our AGM

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

In 2017 this took place on 18th July at the Hallam Conference Centre, London. The Board and the Executive Committee are always present at the AGM, giving the membership the opportunity to ask the panel questions about the position of the Society, the events of the past year and where they would like to see the Society going in the future. Following the main presentation the members are also welcome to talk to the Board and the senior management team independently on a one-on-one basis if they so wish.

Our Focus Group

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

We held one Focus Group meeting in 2017, held at the Raddison Blu Edwardian Bloomsbury Hotel, London in February. The Chief Executive Officer presented on the Society's financial position and its performance against its objectives, together with details on progress having relaunched the Tax Exempt savings plan and With Profit Bond as a means of customer retention and its proposal to launch other new and innovative products that meet the needs of both existing and new customers. The Focus Group members first engaged in discussion and provided feedback both throughout the course of the presentations and afterwards on a one-to-one basis.

150th Anniversary

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

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

National friendly
150 years together

STRATEGIC REPORT

Treating Customers Fairly

There are six key TCF outcomes for customers that our regulator, the Financial Conduct Authority, sets out for our guidance. At National Friendly we aim to achieve these six outcomes in everything we do, putting our customers firmly and squarely at the heart of our business. Below are just some of the TCF achievements we are proud of having made happen during 2017:

Delivering our strategy and giving our customers confidence that they are dealing with a firm where the fair treatment is central to our corporate culture.	**This has been achieved by:** • Having the right mix of expertise, experience and knowledge within the management Board to run the business prudently and intelligently. In doing so we have continued to build on our foundations for the success of the Society and our members' benefit; • Recruiting, training and coaching skilled and dedicated staff who share our company values and take pride in providing high standards of service and customer care; • Evaluating our TCF best practice via dashboards and management information, our intranet, working parties, staff and customer engagement forums, and projects; • Setting performance targets and remuneration for staff that incentivise and reward best TCF practice; • Appointing a Non-executive Director, as a whistleblowing champion.
Providing products and services that we have designed to meet the needs of identified consumer groups, then targeting those consumer groups through our marketing and sales activities.	**We have undertaken:** • The appointment of a new Commercial Development Manager and Head of Sales & Marketing with particular responsibility for distribution, including the research and analysis of products and services that could potentially benefit existing and new customers of the Society; • The design and launch of new products: our With-Profits Bond, Assisted Living Insurance and Optimum, have all been developed with our customers' needs as our focus; • Adaptions to our distribution methods and customer communications embracing our customers' and brokers' feedback, alongside our own research and experience; • Collection and evaluation of customer feedback across the Society, from surveys, telephone calls and emails, and complaints.
Providing our customers with clear information, keeping them appropriately informed before, during and after the point of sale.	**We have achieved this by:** • Giving our customers accurate, clear and useful information and guidance when they contacted us by whichever means suit them; • Writing our product documents in a straightforward and accessible way so that our customers can easily find the information they need about the product features and benefits, and be fully informed about any limitations and risks; • Continually updating the way we communicate with our customers as the world evolves, using technology to make efficiencies where appropriate, whilst also keeping other communication channels alive and well; • Monitoring feedback from customers about the communications we sent them so that we can measure how well we achieve this outcome.

Treating Customers Fairly (continued)

Ensuring that our customers do not face unreasonable post-sale barriers.	**We made sure:** • We staffed our customer services and claims helplines sufficiently at all times. 89% of nearly 15,900 calls received were answered within our target service standard of 20 seconds; • We provided consistently high standards of service to our customers, at point of claims, especially at times of vulnerability, so they could rely on us in a time of need. We checked this by monitoring our claims closely throughout the year; • We responded promptly to customer enquiries and transaction requests by telephone, email and post. 89% of claims-related enquiries were actioned within 5 working days; • We impartially assessed our customer feedback and complaints and we responded fairly and promptly. We used our experience to inform and further improve our service to customers.
Providing advice to our customers which is suitable and takes account of their circumstances.	**National Friendly does not provide financial advice services but works closely with a number of carefully selected firms who do.** **In line with this we have:** • Maintained rigorous standards of training, competence and conduct across the Society to make sure our non-advisory customer-facing staff did not inadvertently provide any form of regulated advice; • Overseen the quality of advice provided by advisers in our subsidiary firm 425 Financial Solutions, to ensure that recommendations were suitable and in the best interests of customers; • Monitored the sales volumes and sales quality indicators of intermediary firms who advised on our products; This monitoring ensures we continue to work only with reputable advisory firms.
Providing our customers with products that perform as we have led them to expect; also providing our customers with services which are of an acceptable standard and in line with what we have led them to expect.	**Continuing the long tradition of the Society we :** • Governed the Society's operations efficiently through sound planning ahead and management; • Invested the Society's assets in line with our investment strategy, protecting the interests of our policyholders and potential future policyholders; • Carried out a gap analysis of our legacy products and the service we provide for our long-standing customers to identify any areas where those products and service might no longer be meeting these customers' needs, then prioritised where we needed to take action; • Advocated for the needs and rights of members under 16 to be given due protection and updated our Rule Book so that their needs and rights are treated consistently with their policy terms and conditions; • Provided regular and timely reports to policyholders on our with-profits performance and their policy values.

STRATEGIC REPORT

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.

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

Our Charity of the Year

Our 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. The CSR committee, against pre-agreed selection criteria, then reviews nominations to create a shortlist. All staff then vote from the shortlist for their preferred charity of the year and the charity with the most votes is selected.

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 2017, staff voted to support St Mungo's as its Charity of the Year with £6,650 being raised through a variety of events, such as the Bristol 10k, bake sales, sweepstakes, and Katie Ross, Business Analyst undertaking the Tough Mudder, Bristol Half Marathon and the Cardiff Marathon.

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 £11,650 was presented to St Mungo's in January 2018.

St Mungo's
Ending homelessness
Rebuilding lives

On presentation of the fundraising cheque, Kathryn Lacy, Regional Fundraising Manager at St Mungo's, said,

> Thank you so much from everyone at St Mungo's for choosing us as your charity of the year. You have been an incredible partner with us and have made a significant impact to the lives of hundreds of homeless and vulnerable people in Bristol.
>
> Through raising £11,650 you will have directly helped to ensure that over 685 beds are provided at our emergency night shelter for rough sleepers – this equates to funding our night shelter for over one whole month. You have helped to provide a safe and comfortable space for people with nowhere else to go, whilst we work on longer term housing and support solutions. We cannot do this work without you – Thank you.
>
> I am pleased to have supported you in a variety of fundraising and volunteering initiatives. You got quizzical, baked cakes, ran, trekked and got your hands dirty with gardening projects – thank you for all of the effort you put in last year. As homelessness is such a high priority in the city, your awareness and fund raising went a long way to being part of the solution.
>
> Without donations from companies like yours, we would not be able to provide a wide range of service for vulnerable and homeless people, or reach our ambitions to grow the number of people we can support. This partnership has directly helped homeless people to be safer off the streets of Bristol and will help to support many peoples long-term recovery for years to come.
>
> Once again, thank you from everyone at St Mungo's.

For 2018, members of staff have voted Cystic Fibrosis as their Charity of the Year. Cystic Fibrosis ("CF") is a genetic condition affecting more than 10,400 people in the UK. This is a condition, which someone is born with, although many people carry the faulty gene which causes it.

The Money raised by our staff will help fund research, improve standards of care and support people with CF and their families in dealing with this condition.

The Society's fundraising target for 2018 is £5,000 which will be matched by £1 for every £1 raised by the Foundation Fund, and staff are looking forward to taking part in a number of exciting events this year. As always, we are very grateful to our staff and their friends and families for all their efforts.

Cystic Fibrosis Trust

STRATEGIC REPORT

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.

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.

On behalf of the Board
Jonathan Long
Chief Executive Officer
27 April 2018

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 2017 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate system of internal control.

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

Chairman and Chief Executive

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

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

Board Balance and Independence

The Board consisted of four Non-Executive Directors and two Executive Directors throughout 2017.

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.

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.

THE DIRECTORS' REPORT

Audit Committee

Members	Responsibilities
Peter McIlwraith (Chairman) Mark Jackson Geoff Brown	The Audit Committee meets at least four times a year at appropriate times in the financial reporting and audit cycle. The main function of the Committee is to assist the Board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of: • The integrity of the financial statements and reviewing significant financial reporting judgements contained in them. • The effectiveness of internal control and risk management processes. • The effectiveness of the internal and external audit functions and processes. • The recommendation to the Board in relation to the appointment, reappointment, remuneration and removal of the external auditors. • The objectivity and independence of the external auditor in respect of the provision of any non-audit services. • The arrangements by which staff within the Society may raise concerns, in confidence, about possible improprieties in matters of financial reporting or other matters.

The Executive Directors and internal and external auditors attend meetings of the Committee as appropriate. The internal and external auditors may also meet separately with the Committee without the Executive Directors or any other members of staff present.

Internal audits of the regulated business are conducted by Mazars LLP that reports to the Committee.

Investment Committee

Members	Responsibilities
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: • 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	Responsibilities
Peter McIlwraith (Chairman) Geoff Brown Tracy Morshead	The Nomination Committee meets as appropriate to review the structure, size and composition of the Board and to make recommendations to the Board with regard to any adjustments that are deemed necessary. Nominations for appointment to the Board are considered for approval by the full Board. Professional recruitment consultants can be and are consulted to ensure that non-executive vacancies on the Board are considered appropriately. Membership of the Committee may be altered as appropriate in particular to address circumstances where one of its members is being considered for re-appointment.

Remuneration Committee

Members	Responsibilities
Peter McIlwraith (Chairman) Mark Jackson Tracy Morshead	The Remuneration Committee meets at least twice a year to establish, implement and maintain a remuneration policy and practices in line with the Society's risk management strategy, risk profile, objectives and risk management practices. Further details on Directors' remuneration are set out in the Directors' Remuneration Report on pages 32-34.

Risk & Compliance Committee

Members	Responsibilities
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

With-Profits Advisory Arrangement

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

Executive Committee

Responsibilities
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	8	8	6	6	2	*	1	1
Mark Jackson	8	8	6	6	2	2	1	1
Peter McIlwraith	8	8	6	6	2	2	1	1
Tracy Morshead	8	8	6	*	2	2	1	1
Executive								
Jonathan Long	8	8	6	*	2	*	–	–
Sandy Richards	8	8	6	*	–	–	–	–

* Attendance on an invitation basis.

	Investment Committee		Risk & Compliance Committee		With-Profits Advisory Arrangement	
	Meetings attended	Meetings held	Meetings attended	Meetings held	Meetings attended	Meetings held
Non-Executive						
Geoff Brown	5	5	4	4	3	3
Mark Jackson	2	*	–	–	2	3
Peter McIlwraith	5	5	–	–	–	–
Tracy Morshead	5	5	4	4	–	–
Executive						
Jonathan Long	5	5	4	4	3	*
Sandy Richards	5	5	4	4	3	*

* Attendance on an invitation basis.

Statement of Compliance with the Annotated Corporate Governance Code

The Board considers that throughout 2017 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 considered his continued independence.
3. Tracy Morshead and Mark Jackson will have served on the Board for nine year in 2018 from the date of their first election and therefore, both will also be subject to annual election at the 2018 AGM and thereafter, after having considered their continued independence.

Annual General Meeting

The 2017 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 Peter McIlwraith and Geoff Brown as Non-Executive Directors.
- Re-election of Jonathan Long as Executive Director.

The response from members submitting their postal/proxy forms was just under 11% 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 2018 AGM to be held again in London.

THE DIRECTORS' REPORT

The Board

Tracy Morshead
(Chairman)

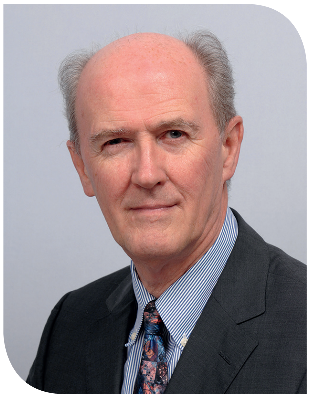
Tracy has held senior management positions with three major Building Societies, Birmingham Midshires, Principality, where he was Managing Director, and Nationwide, where he was Divisional Director. He is a Fellow of the Chartered Institute of Marketing and is a chartered marketer. Tracy is Managing Director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

Jonathan Long
(Chief Executive Officer)

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

Sandy Richards
(Executive Director)

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



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 was co-founder and Chairman of Assura Group both of which he was instrumental in floating on the London Stock Exchange. Mark currently sits on a number of Boards including Medigold, Exemplar Health Care Limited and Astonbrook Care Holdings Limited. Mark joined the National Friendly Board as a Non-Executive Director in June 2009.

Geoff Brown

(Non-Executive Director)

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

THE DIRECTORS' REPORT

Business Objectives and Activities

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

The Board sets 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 2017, the KPIs were focused on new product development and sales, capital management and cost control.

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

Going Concern

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

Employees

The average number of Directors and staff employed by the Group and Society is disclosed in Note 9 on page 69.

The aggregate remuneration paid to Directors and staff employed by the Group during the year amounted to £2.8 million (2016: £2.65 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 14-15.

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 (2016: £5,000). There were no political donations (2016: £nil).

Re-appointment of Auditors

PricewaterhouseCoopers LLP ("PwC") were re-appointed as the Society's Independent Auditors at the Annual General Meeting on 18th July 2017. Following a recent tender process for the external audit and after careful consideration the Society decided to appoint Ernst & Young LLP ("EY") as its new Independent Auditor to replace PricewaterhouseCoopers LLP. PwC has formally resigned with no matters to report. The appointment of EY as auditors will be ratified at the Society's next AGM in 2018.

Approved by order of the Board

Sandy Richards

Secretary

27 April 2018

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 PwC as the Society's external auditor was put to the members at the 2017 AGM and approval gained.

The Committee considers the reappointment of the external auditor, including the rotation of the audit partner, every year and 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 five years.

The Committee reviewed the external audit arrangement in 2017 undertaking a formal tender process and recommended to appoint EY as the Society's External Auditors with effect from 6 September 2017. The appointment of EY as auditors will be ratified at the Society's next AGM.

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 (EY) did not undertake any non-audit assignments during 2017.

Internal Audit

The Audit Committee reviewed the internal audit function and undertook a tender process to appoint or re-appoint a suitable provider of internal audit services in 2017. Mazars LLP were re-appointed as the Society's internal auditors with effect from 1 September 2017.

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	Significant Issue
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. In order to reflect increasing uncertainty in the longer term lapse rate assumptions, a greater margin for adverse deviation over the best estimate has been adopted at longer durations.
Adoption of Solvency II basis of reporting Technical Provisions within the 2017 Financial Statements	For this year-end, the Society has aligned the valuation of the long-term business provision reported in the financial statements with the technical provisions reported under Solvency II. The Society has assessed whether to treat the change in basis as a 'change in accounting policy' or a 'change in accounting estimate'. It was concluded that the alignment is a 'change in accounting policy' and therefore, the Society has restated its prior year figures within the financial statements as acceptable under the relevant financial reporting standards.
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 2017, internal audits were completed in areas including claims management, review on the progress with General Data Protection Regulations (GDPR) and reviews following migration of data onto the new policy administration system. 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 and the Board 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

27 April 2018

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.

Members

Peter McIlwraith	– Committee Chairman
Mark Jackson	– Non Executive Director
Tracy Morshead	– Non Executive Director

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

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

Policy

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

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

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

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

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

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

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

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

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

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

Remuneration for Non-Executive Directors comprises a basic fee plus a supplement for the Chairman of the Board also recognising his role as Non-Executive and Chairman of 425 Direct Limited and for the Senior Independent 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

27 April 2018

Directors' Emoluments

	Salaries & Fees £	Performance Related Pay £	Other Benefits[1] £	Total 2017 £	Total 2016 £
Chairman					
Tracy Morshead[2]	49,950	-	-	49,950	49,950
Executive Directors					
Jonathan Long[3]	157,630	30,906	31,001	219,537	215,446
Sandy Richards[3]	106,130	20,808	22,239	149,177	146,418
Non-Executive Directors					
Geoff Brown	29,205	-	-	29,205	28,625
Mark Jackson	29,205	-	-	29,205	28,625
Peter McIlwraith	39,270	-	-	39,270	38,500
Total				516,344	507,564

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

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

[3] Performance related pay relates to 2016 but was awarded in 2017. Assessment of performance related pay for the Executive Directors for 2017 will be carried out in Q2 2018 following finalisation of the Annual Report and Accounts.

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 2017 £	Accrued pension as at 31/12/2017 £	Accrued pension as at 31/12/2016 £	Closing value at 31/12/2017 £	Opening value at 31/12/2016 £	Pension input amount over 2017 £
Jonathan Long	11	97	4,926	4,829	98,519	97,547	972

At the AGM, members voted on the resolution to approve the 2016 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 2016 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
2626	93.19%	131	4.65%	2818	61

DIRECTORS' REMUNERATION REPORT

Executive Directors

Base Salaries

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

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

Performance Related Pay

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

LTIP

There is currently no Long Term Incentive Plan ("LTIP") scheme in operation. The Remuneration Committee 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.

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

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NATIONAL DEPOSIT FRIENDLY SOCIETY LIMITED

Opinion

In our opinion:

- National Deposit Friendly Society Limited's Group and Society's financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Society's affairs as at 31 December 2017 and of the Group's and Society's income and expenditure for the year then ended;
- the Group and Society's financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Friendly Societies Act 1992.

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

Group	Society
Consolidated Income Statement for the year then ended	Income Statement for year then ended
Consolidated Statement of Comprehensive Income for the year then ended	Statement of Comprehensive Income for the year then ended
Consolidated Balance Sheet as at 31 December 2017	Balance Sheet as at 31 December 2017
Related notes 1 to 29 to the financial statements, including a summary of significant accounting policies	Related notes 1 to 29 to the financial statements including a summary of significant accounting policies

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

INDEPENDENT AUDITOR'S REPORT

Basis for opinion

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

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

Use of our report

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

Conclusions relating to principal risks, going concern and viability statement

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

- the disclosures in the annual report set out on pages 9 to 10 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 9 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 28 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; or
- the directors' explanation set out on page 11 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• Inappropriate actuarial demographic assumptions for morbidity, longevity and persistency • Inappropriate actuarial expense assumptions • Inaccurate or incomplete data from policy administration systems (PAS) is used within the MoNET actuarial model, including related data migrations to the new PAS (Odyssey) in the year • Alignment of UK GAAP and Solvency II technical provisions
Audit scope	• We performed an audit of the complete financial information of the Society and two components. • The components where we performed full audit procedures accounted for 100% of the Fund for Future Appropriations measure used to calculate materiality, 100% of Gross Premium and other income and 100% of Total assets.
Materiality	• Overall Group materiality of £605,000 which represents 3% of the Fund for Future Appropriations.

Key audit matters

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

INDEPENDENT AUDITOR'S REPORT

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Inappropriate actuarial demographic assumptions for morbidity, longevity and persistency The valuation of the long term business provision as at 31 December 2017 is £101.4m (2016: £112.0m) as disclosed in note 20 to the financial statements. The long–term nature of the liabilities the Society holds is inherently uncertain due to the dependency on a number of key assumptions, including morbidity, longevity and persistency and the risk resides around these assumptions being incorrect. Each of these assumptions presents different capital requirements across the Society's life and health business. In addition, these assumptions have different sensitivities, and for some assumptions small changes will have a material impact on the Group's reported result. Demographic assumptions are set based on internal and external experience, overlaid with the application of judgement in particular around future trends and external factors.	We performed procedures to ensure that the appropriate data was feeding into the demographic assumptions process accurately and completely. We reviewed the backing spreadsheets to ensure data was being analysed correctly and no hardcoded assumptions/ adjustments existed. We reviewed judgements made by management and explanations provided by management as to why experience had changed, to ensure they were reasonable. We concluded on whether the final assumptions were within a reasonable range based on our expert judgement, management's internal experience analysis and the results of assumptions used by peers as per EY's annual market benchmarking survey. We ensured the actuarial assumptions used were in line with financial and regulatory requirements.	We determined that the actuarial assumptions used by management in relation to morbidity, longevity and persistency are reasonable based on the analysis of experience to date, industry practice and the financial and regulatory requirements.
Inappropriate actuarial expense assumptions The valuation of the long term business provision as at 31 December 2017 is £101.4m (2016: £112.0m) as disclosed in note 20 to the financial statements. Whilst less significant than the demographic assumptions referred to as part of the key audit matter above, we consider expense assumptions to be a key part of the actuarial valuation and therefore	We performed walkthroughs in order to understand the process and tested key controls over management's process and governance for setting expense assumptions. We reviewed the expenses methodology and questioned management over the allowance for expected new business. We concluded on whether the final assumptions were within a	We determined that the expense assumptions used by management are reasonable based on industry practice and the financial and regulatory requirements.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
an area of focus. Expense assumptions are set based on the anticipated costs associated with administering the business, including expenses inflation as well as the split between acquisition / maintenance and between different classes of business.	reasonable range based on our expert judgement, management's internal experience analysis and the results of assumptions used by peers as per EY's annual market benchmarking survey.	
Inaccurate or incomplete data from policy administration systems (PAS) is used within MoNET actuarial model, including related data migrations to the new PAS (Odyssey) in the year The effectiveness of the valuation process for calculating the long term business provision is contingent on the accuracy and completeness of the data extraction and conversion process used in the actuarial model (MoNET) and also the accuracy of the data migrations from the PAMS and M2000 policy administration systems (PAS) to the new Odyssey PAS during the year.	We reviewed the work performed by management around the data migration processes from PAMS and M2000 to Odyssey (including the controls and substantive testing performed by management) to ensure the migration was accurate and complete, as well as performing our own testing. We tested the key controls over management's data collection, extraction and validation processes from underlying policy administration systems to ensure the completeness of policy data within the MoNET actuarial model.	We are satisfied with the accuracy of the data migrations to Odyssey during the year and have determined based on our audit work that the policy holder data used for the actuarial model inputs are materially complete and accurate.
Alignment of UK GAAP and Solvency II technical provisions For the year ended 31 December 2017, management have aligned the valuation of the long term business provision reported in the financial statements with the technical provisions reported under Solvency II. This alignment has resulted in a change in accounting policy and a restatement of the prior year figures within the financial statements. The restatement is disclosed in Note 29 of the financial statements. The risk relates to the alignment and the resulting restatement not being correctly accounted for or disclosed.	We discussed with management their proposed accounting treatment, including whether to treat the change in basis as a 'change in accounting policy' as opposed to a 'change in accounting estimate'. We reviewed management's prior year accounting policy to assess whether a 'change in accounting policy' was required. We researched FRS 102 and FRS 103 to confirm whether the proposed change in accounting policy was acceptable. We reviewed the revised accounting policy in the FY17 financial statements, as well as the prior year restatement and related disclosure in Note 29 of the financial statements.	We concur with management's conclusion that the alignment of the valuation of the long term business provision in the financial statements with the technical provisions reported under Solvency II is a 'change in accounting policy' as opposed to a 'change in accounting estimate'. We are also satisfied that this change is acceptable under FRS 102 and FRS 103. We are satisfied with the revised accounting policy in the FY17 financial statements, as well as the accounting for the prior year restatement and related disclosure in Note 29 of the financial statements.

INDEPENDENT AUDITOR'S REPORT

An overview of the scope of our audit

Tailoring the scope

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

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

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

Our application of materiality

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

Materiality

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

We determined materiality for the Group to be £605,000, which is 3% of the Fund for Future Appropriations. We believe that the Fund for Future Appropriations provides us with the most appropriate basis for determining materiality as it reflects the underlying interests of the members of the Group. In their prior year audit, PwC adopted a materiality of £205,000 based on 2.5% of the Fund for Future Appropriations.

We determined materiality for the Society to be £605,000, which is 3% of the Fund for Future Appropriations. In their prior year audit, PwC adopted a materiality of £205,000 based on 2.5% of the Fund for Future Appropriations.

Performance materiality

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

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

Audit work of the components for the purpose of obtaining audit coverage over significant financial statement accounts is undertaken based on a percentage of Group performance materiality. The performance materiality set for each component is based on the relative scale and risk of the component to the Group as a whole and our assessment of the risk of misstatement at that component. In the current year, the range of performance materiality allocated to components was £60,000 to £302,000.

Reporting threshold

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

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

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

Other information

The other information comprises the information included in the annual report set out on pages 3 to 34 other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

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

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

We have nothing to report in this regard.

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

- Fair, balanced and understandable set out on page 25 – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for members to assess the group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Audit committee reporting set out on pages 30-31 – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

Other voluntary reporting

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

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

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

Opinion on matters prescribed by the Friendly Societies Act 1992

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

Opinions on other matters prescribed by the Friendly Societies Act 1992

In our opinion under the Friendly Societies Act 1992:

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

Matters on which we are required to report by exception

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

If we are of the opinion that proper accounting records have not been kept; or

If we fail to obtain all the information and explanations and the access to documents which, to the best of our knowledge and belief, are necessary for the purposes of our audit.

We have no exceptions to report arising from this responsibility.

INDEPENDENT AUDITOR'S REPORT

Responsibilities of directors

As explained more fully in the Statement of Responsibilities of the Directors set out on page 28, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

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

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

The objectives of our audit,

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

Our approach was as follows:

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

for their awareness of any non-compliance of laws or regulations, inquiring about the policies that have been established to prevent non-compliance with laws and regulations by officers and employees, inquiring about the Group and Society's methods of enforcing and monitoring compliance with such policies, inspecting significant correspondence with the FCA and PRA.

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

Other matters we are required to address

- We were appointed by the Society on 6 September 2017 to audit the financial statements for the year ending 31 December 2017 and subsequent financial periods.
- The period of total uninterrupted engagement is 1 year, covering the year ending 31 December 2017.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society and we remain independent of the Group and the Society in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee

Andy Blackmore

(Senior Statutory Auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor

Bristol

27 April 2018

Notes:

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

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

CHAIRMAN'S REVIEW
FINANCIAL HIGHLIGHTS
STRATEGIC REPORT
THE DIRECTORS' REPORT
AUDIT COMMITTEE REPORT
DIRECTORS' REMUNERATION REPORT
INDEPENDENT AUDITORS' REPORT
INCOME STATEMENT
BALANCE SHEET
STATEMENT OF COMPREHENSIVE INCOME
NOTES TO THE FINANCIAL STATEMENTS

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2017

		Group				Society			
		2017		Restated 2016		2017		Restated 2016*	
	Note	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Gross premiums written and payments to deposit	4	10,518		11,354		10,518		11,354	
Outward reinsurance premiums		(25)		(17)		(25)		(17)	
Earned premiums net of reinsurance			10,493		11,337		10,493		11,337
Investment income	5		6,785		9,613		6,785		9,613
Unrealised gains on investments	5		2,138		6,373		2,138		6,373
Other technical income	6		299		414		25		27
			19,715		**27,737**		**19,441**		**27,350**
Gross claims paid		18,530		18,805		18,530		18,805	
Reinsurers' share		–		(41)		–		(41)	
Net claims paid			18,530		18,764		18,530		18,764
Change in provision for claims			(722)		(142)		(722)		(142)
Change in long term funds Long term business provision			(10,591)		4,614		(10,591)		4,614
Investment contract liabilities			(10)		(7)		(10)		(7)
Provision for linked liabilities – Insurance contracts	22		133		(109)		133		(109)
Provision for linked liabilities – Investment contracts	22		49		34		49		34
Bonuses and rebates			(109)		(37)		(109)		(37)
Net operating expenses Acquisition costs	7a	1,323		1,293		949		779	
Administrative expenses		3,514		3,275		2,888		2,853	
			4,837		4,568		3,837		3,632
Other technical charges – project costs	7b		1,269		1,535		1,519		1,535
other			69		(13)		69		(33)
Investment expenses	8		835		961		835		961
Loss on investment in subsidiary	26		–		–		474		569
Tax attributable to long term business	11a		–		22		–		22
Transfer to/(from) the fund for future appropriations			5,425		(2,453)		5,427		(2,453)
			19,715		**27,737**		**19,441**		**27,350**
Balance after transfer to/(from) the fund for future appropriations			–		–		–		–

The information on pages 48 to 93 form an integral part of these financial statements.
* For details of the restatements refer to note 29

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2017

		Group		Society	
		2017	Restated 2016	2017	Restated 2016*
	Note	£'000	£'000	£'000	£'000
Balance transferred from income statement		-	-	-	-
Actuarial gain/(loss) on pension scheme		1,058	(3,720)	1,058	(3,720)
Movement in deferred tax on pension scheme		-	22	-	22
Revaluation of occupied land and buildings		244	256	244	256
Other comprehensive income		(13)	(20)	(13)	(19)
Total comprehensive income		**1,289**	**(3,462)**	**1,289**	**(3,461)**
Transfer to/(from) the fund for future appropriations		1,289	(3,462)	1,289	(3,461)
Total comprehensive income after transfer		-	-	-	-

The information on pages 48 to 93 form an integral part of these financial statements.
* For details of the restatements refer to note 29

BALANCE SHEET

AS AT 31 DECEMBER 2017

Assets		Group				Society			
		2017		Restated 2016		2017		Restated 2016*	
	Note	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Intangible assets	17		4,397		3,157		1,397		657
Investments									
Land and buildings	12	19,750		21,074		19,750		21,074	
Investment in subsidiaries	26	–		–		35		316	
Other financial investments	13	98,770		104,488		98,770		104,488	
			118,520		125,562		118,555		125,878
Assets held to cover linked liabilities	16		1,796		1,701		1,796		1,701
Reinsurers' share of technical provisions			118		129		118		129
Debtors – Loans and receivables									
Debtors arising from direct insurance operations	3	145		130		101		95	
Other debtors	3	1,190		1,168		1,486		3,424	
			1,335		1,298		1,587		3,519
Other assets									
Tangible assets	18	2,392		2,178		2,392		2,172	
Cash at bank and in hand	14	2,761		4,333		2,483		4,322	
			5,153		6,511		4,875		6,494
Prepayments and accrued income – Loans and Receivables									
Accrued interest and rent		1,529		1,617		1,529		1,617	
Other prepayments and accrued income		230		161		3,213		140	
			1,759		1,778		4,742		1,757
			133,078		**140,136**		**133,070**		**140,135**

The information on pages 48 to 93 form an integral part of these financial statements.
* For details of the restatements refer to note 29

BALANCE SHEET

AS AT 31 DECEMBER 2017

Liabilities		**Group**				**Society**			
		2017		**Restated 2016**		**2017**		**Restated 2016 ***	
	Note	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Fund for future appropriations	27		24,968		18,254		25,013		18,297
Technical provisions									
Long term business provision	20	101,445		112,047		101,445		112,047	
Investment contract liabilities		37		66		37		66	
Claims outstanding		1,849		2,571		1,849		2,571	
Provision for bonuses and rebates		156		265		156		265	
			103,487		114,949		103,487		114,949
Technical provision for linked liabilities – insurance contracts	22		1,190		1,057		1,190		1,057
Technical provision for linked liabilities – investment contracts	22		379		352		379		352
Provision for other risks and charges									
Derivatives	28		36		149		36		149
Creditors									
Arising out of direct insurance operations		49		49		49		49	
Other creditors including taxation and social security		380		1,031		340		996	
Accruals and deferred income		1,113		1,726		1,100		1,717	
			1,542		2,806		1,489		2,762
Net pension liability	21	1,476		2,569		1,476		2,569	
			1,476		2,569		1,476		2,569
			133,078		**140,136**		**133,070**		**140,135**

The information on pages 48 to 93 form an integral part of these financial statements.
These financial statements were approved by the Board on 27 April 2018.
* For details of the restatements refer to note 29

Jonathan Long
Chief Executive Officer

Sandy Richards
Secretary

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(1) Accounting policies

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

General information

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

Statement of compliance

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

Basis of preparation

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

As permitted by the Amendments to FRS 103 Insurance Contracts Solvency II, the Society has changed its accounting policy to recognise and measure technical provisions on long term insurance contracts on a best estimate basis. This means that the value of technical provisions disclosed in these financial statements are aligned with the Society's other regulatory financial reporting.

The prior year financial statements have been restated for material adjustments resulting from adopting this accounting policy change this year. The new accounting policy for technical provisions is shown in the long-term business provision on page 49. The prior year restatement is shown in Note 29 on pages 89 to 93 and more information on the new technical provisions is shown in Note 20 on pages 80 to 81.

Basis of consolidation

The Group financial statements comprise the assets, liabilities and income and expenditure account transactions of the Society and its subsidiaries 425 Direct Limited and ND Member Services Limited. The net results are included in the fund for future appropriations for the Group. The activities of the Society and Group are accounted for in the income statement.

Premiums

Premiums are accounted for when due for payment.

Insurance commission

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

Reinsurance

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

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

Realised and unrealised gains and losses

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

(1) Accounting policies (continued)

Investment return

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

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

Claims

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

Long term business provision

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

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

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

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

Bonuses

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

Claims outstanding

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

Depreciation

Properties

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

Intangible assets

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(1) Accounting policies (continued)

Tangible fixed assets and depreciation

Land and buildings

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

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

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

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

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

Acquisition costs

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

Operating leases

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

Project costs

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

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

Pension costs

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

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

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

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

(1) Accounting policies (continued)

Taxation

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

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.

Investment in subsidiaries

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.

Fund for future appropriations

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

Contract classification

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

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

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

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

Insurance contracts and participating investment contracts

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(1) Accounting policies (continued)

Investment contracts

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

Financial assets

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

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.

Key estimates and judgements

a) Classification of contracts

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

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

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

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

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

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

c) Valuation of Investment Properties

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

d) Valuation of Financial Assets

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

e) Defined Benefit Pension Schemes

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(2) Capital management

Solvency II Capital Requirements

The capital requirement for the Society is determined by the Solvency II regime. This is a risk-based approach to the assessment of capital requirements whereby Technical Provisions are calculated as the sum of the best estimate liabilities plus a risk margin. The 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.

The Society assesses its capital position in accordance with the Solvency II regulations and manages its business on this basis. The table below shows the position as at 31 December 2017.

Solvency II Balance Sheet	Society 2017 £m	Society 2016 £m
Assets	**131.7**	**139.2**
Best Estimate Liabilities	102.4	112.6
Other Liabilities	3.0	5.5
Risk Margin	2.7	3.7
Total Liabilities	**108.1**	**121.8**
Own Funds	23.6	17.4
Solvency Capital Requirement	12.8	14.7
Excess Assets	**10.8**	**2.7**

Under the Solvency II regime the Society is not able to recognise the intangible assets held on the same basis as under FRS 102. This is reflected in the valuation difference of £1.4m (2016: £0.9m) between the Balance Sheet assets and the assets report on a Solvency II basis. The Society calculates its FRS 102 liabilities on the same basis as Solvency II, with the exception that the Society has adopted the transitional measure for interest rates for its regulatory reporting to the PRA under Solvency II. The liabilities are discounted using risk free discount rates prescribed by EIOPA. These rates do not necessarily reflect the rates earned on the financial assets held by the Society.

Under Solvency II the Technical Provisions are reported as a Best Estimate of the Liabilities plus a Risk Margin. These are represented in the Balance Sheet under FRS 102, as the Long Term Business Provision, the Provision for Bonuses, the Outstanding Claims Reserve, the Technical Provision for linked liabilities and the Investment Contract liabilities. The reduction in liabilities from 2016 to 2017 has been driven by more policies exiting due to maturity, death, surrender than being replaced by new policies.

During 2017, the PRA approved the Society's application to use a Transitional Measure on the risk-free Interest Rate ("TMIR") in order to smooth the transition from using Solvency I discount rates to the Solvency II prescribed risk free rates for existing policies over a 16 year period and as these policies mature. The table below shows the position after taking account of the approved transitional measure:

Solvency II Balance Sheet	Society 2017 £m
Assets	**131.7**
Best Estimate Liabilities	100.2
Other Liabilities	3.0
Risk Margin	2.7
Total Liabilities	**105.9**
Own Funds	25.8
Solvency Capital Requirement	12.2
Excess Assets	**13.6**

Capital resource sensitivities

The preparation of the Society's capital position requires the Board to make complex judgements on information and financial data that may change in future years. Although the estimates are based on best knowledge of current facts as at the reported date, taking into account matters that have arisen following the year-end but before the financial statements are finalised, the actual outcome may differ from those estimates.

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

- The market risk in relation to the with-profit business, which would arise if adverse changes in the value of the underlying property assets supporting this business could not be reflected in payments to policyholders because of the effect of guarantees and options.
- The market risk in relation to the with-profit business, which would arise where a widening of the credit spread would result in a reduction in the value of the corporate bonds underlying this business and which could not be reflected in payments to policyholders.
- An improvement in the future longevity experience has a significant impact on best estimate of annuities in payment.
- An increase in expense inflation would significantly affect the value of liabilities, especially for Healthcare products.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(3) Risk management

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

Insurance risk

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

The valuation assumptions have been recommended by the Chief Actuary and approved by the Board. See note 20 for details of assumptions used in the calculation of the long term business provision. The impact on the policy reserves of sensitivities to key valuation assumptions are as follows:

Assumption	Increase in policy reserves
Increase in morbidity by 5% plus 1% increase in claim inflation	£1.5m
Increase in mortality by 15%	£0.1m
Mass lapse stress (based on 40% of negative reserves)	£1.3m
Increase in expenses by 10% and increase in expense inflation by 1%	£3.0m
Reduction in interest rates by 1%	£8.3m

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.

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

a. Interest rate risk

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 1% fall in interest rates would lead to a change of £9.7m (2016: £9.4m) 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 interest rates leads to an increase of £8.3m (2016: £9.1m) in the value of liabilities. This does not allow for any change from asset shares due to market movements in asset values.

(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	
	2017	2016
Market Value – Equities	£'000	£'000
UK pound	14,591	15,169
Euro	342	308
Swiss franc	–	162
USA dollar	–	377
	14,933	**16,016**

	Group & Society	
	2017	2016
Market Value – Fixed Interest	£'000	£'000
UK pound	70,073	65,330
Australian dollar	252	259
Euro	591	662
USA dollar	10,564	15,489
	81,480	**81,740**

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

c. Equity price risk

Holdings in equities are by their nature subject to market movement. In order to mitigate this risk the Society employs an external investment portfolio manager and the Investment Committee regularly review the level of equities notionally allocated to with profit life business to ensure the level of risk remains appropriate. The Society does not invest in equities out of assets held for with profit pension policies.

Based on the Solvency II prescribed equity stress, a 38.5% decrease in the market value of equities would lead to a change of -£6.5m in the total holding of equities.

A 38.5% decrease in equity values would lead to a change of -£4.5m in the value of the liabilities matched by equities.

Based on the Solvency II prescribed equity stress for the previous year end, a 31.3% decrease in the market value of equities would lead to a change of -£6.2m in the total holding of equities and -£3.9m in the value of liabilities matched by equities.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(3) Risk management (continued)

ii. Credit risk

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

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

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

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

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

The assets bearing credit risk are summarised and analysed by credit rating below:

	Group	
	2017 £'000	2016 £'000
Derivative financial instruments	386	654
Listed fixed interest securities	81,480	81,740
Loans and receivables	2,993	3,075
Deposits with credit institutions	1,842	5,918
Cash at bank and in hand	2,761	4,333
	89,462	**95,720**
AAA	4,837	4,844
AA	41,827	39,598
A	28,436	36,274
BBB	8,653	9,326
Below BBB	-	-
Not rated	5,709	5,678
	89,462	**95,720**

(3) Risk management (continued)

(ii) Credit risk (continued)

The assets bearing credit risk are summarised and analysed by credit rating below:

	Society	
	2017 £'000	2016 £'000
Derivative financial instruments	386	654
Listed fixed interest securities	81,480	81,740
Loans and receivables (Note 14)	3,245	5,296
Deposits with credit institutions	1,842	5,918
Cash at bank and in hand	2,483	4,322
	89,436	**97,930**
AAA	4,837	4,844
AA	41,549	39,586
A	28,436	36,274
BBB	8,653	9,326
Below BBB	-	-
Not rated	5,961	7,900
	89,436	**97,930**

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

iii. Liquidity risk

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(3) Risk management (continued)

(iii) Liquidity risk (continued)

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

	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	18,254	-	-	-	**18,254**
Long-term business provision	-	7,061	13,847	91,139	**112,047**
Investment contract liabilities	-	9	50	7	**66**
Claims outstanding	-	2,571	-	-	**2,571**
Provision for bonuses and rebates	-	60	136	69	**265**
Technical provision for linked liabilities – insurance contracts	-	1,057	-	-	**1,057**
Technical provision for linked liabilities – investment contracts	-	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	**18,254**	**14,065**	**14,033**	**93,784**	**140,136**

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

Financial assets at 31/12/16	Group				
	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**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(3) Risk management (continued)

(iii) Liquidity risk (continued)

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

	Society				
	No maturity date	Within 1 year	1 – 5 years	Over 5 years	Total
Financial and insurance liabilities at 31/12/16	£'000	£'000	£'000	£'000	£'000
Fund for future appropriation	18,297	-	-	-	**18,297**
Long term business provision	-	7,061	13,847	91,139	**112,047**
Investment contract liabilities	-	9	50	7	**66**
Claims outstanding	-	2,571	-	-	**2,571**
Provision for bonuses and rebates	-	60	136	69	**265**
Technical provision for linked liabilities – insurance contracts	-	1,057	-	-	**1,057**
Technical provision for linked liabilities – investment contracts	-	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	**18,297**	**14,021**	**14,033**	**93,784**	**140,135**

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

Financial assets at 31/12/16	Society				
	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**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(3) Risk management (continued)

(iv) Fair value estimation

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

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

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

	Level 1	Level 2	Level 3	Total
Assests 2016	**£'000**	**£'000**	**£'000**	**£'000**
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
- Derivatives	-	654	-	654
- Assets held to cover linked liabilities	-	1,701	-	1,701
Total assets	**49,143**	**50,968**	**-**	**100,111**

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

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

(3) Risk management (continued)

(iv) Fair value estimation (continued)

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

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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(4) Gross premiums written and payments to deposit

	Group & Society	
	2017 £'000	2016 £'000
Assurance	2,395	3,022
Bonds and other single premiums	373	–
Healthcare policies	7,345	7,844
Payments to deposit	370	448
Unit linked	35	40
	10,518	**11,354**

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

	Group & Society	
	2017 £'000	2016 £'000
Assurance	117	6
Bonds and other single premiums	373	–
Healthcare policies	159	34
	649	**40**

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

(5) Investment income

	Group		Society	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Income from land and buildings	**1,717**	**2,242**	**1,717**	**2,242**
Fixed interest stocks	3,005	3,470	3,005	3,470
Ordinary shares	424	504	424	504
Income from investments at fair value through profit and loss	**3,429**	**3,974**	**3,429**	**3,974**
Bank interest	13	26	13	26
Mortgages	4	6	4	6
Income from other investments	**17**	**32**	**17**	**32**
Income from investments	**5,163**	**6,248**	**5,163**	**6,248**
Net losses on realisation of land and buildings	(612)	(188)	(612)	(188)
Net gains on realisation of listed investments at fair value through profit and loss	2,234	3,553	2,234	3,553
Net gains on realisation of investments	**1,622**	**3,365**	**1,622**	**3,365**
Investment income	**6,785**	**9,613**	**6,785**	**9,613**
Net unrealised gains/(losses) on investments				
– Land and buildings	2,545	1,793	2,545	1,793
– Listed investments at fair value through profit and loss	(640)	4,652	(640)	4,652
– Assets held to cover linked liabilities at fair value through profit and loss	233	(72)	233	(72)
	2,138	**6,373**	**2,138**	**6,373**
Total investment return	**8,923**	**15,986**	**8,923**	**15,986**

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

CHAIRMAN'S REVIEW
FINANCIAL HIGHLIGHTS
STRATEGIC REPORT
THE DIRECTORS' REPORT
AUDIT COMMITTEE REPORT
DIRECTORS' REMUNERATION REPORT
INDEPENDENT AUDITORS' REPORT
INCOME STATEMENT
BALANCE SHEET
STATEMENT OF COMPREHENSIVE INCOME
NOTES TO THE FINANCIAL STATEMENTS

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(6) Other technical income

	Group		Society	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Insurance commission	276	388	2	1
Other income	23	26	23	26
	299	**414**	**25**	**27**

(7) Net operating expenses

	Group		Society	
(a) Included in operating expenses are:	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Fees payable to external auditors:				
Audit of the Group and Society financial statements	223	254	223	254
Taxation compliance services	–	–	–	–
Other non-audit services	–	66	–	66
Fees payable to internal auditors in respect of:				
Internal audit	22	39	22	39
Actuarial fees	169	175	169	175
Depreciation of tangible assets	57	50	51	48
(b) Other technical charges – project costs:				
Capital management	819	714	819	714
Distribution	9	104	9	104
Systems and processing	101	316	351	316
Risk management	340	401	340	401
Total project costs	**1,269**	**1,535**	**1,519**	**1,535**

The 2017 audit fees relate to Ernst & Young LLP whereas the 2016 audit fees relate to PricewaterhouseCoopers LLP.

(8) Investment income

	Group		Society	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Investment management expenses	281	435	281	435
Investment property direct costs	554	526	554	526
	835	**961**	**835**	**961**

(9) Staff costs

	Group		Society	
	2017	2016	2017	2016
Average monthly number of employees:				
Administration	38	39	38	39
Distribution	13	12	6	3
	51	**51**	**44**	**42**

The average full-time equivalent is 45 (2016: 50) for the Group and 39 (2016: 39) for the Society.
Excludes Non-Executive Directors of 4 (2016: 4).

	Group		Society	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Wages and salaries (inc commission)	2,368	2,241	2,130	1,929
Social security costs	246	223	224	192
Pension costs	187	198	168	175
	2,801	**2,662**	**2,522**	**2,296**

This includes Executive Directors' emoluments totalling £368,714 (2016: £361,834).
Details of Directors' remuneration are set out on page 33.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(10) Directors' emoluments

	Group & Society	
	2017 £'000	2016 £'000
Aggregate emoluments	516	508

Retirement benefits are accruing to one Executive Director as at 31 December 2017 (2016: one) under a defined benefit scheme. The aggregate amount of pension contribution made by the Society to a defined contribution scheme was £31,651 (2016: £31,028).

Highest paid Director	Group & Society	
	2017 £'000	2016 £'000
Total emoluments and amounts receivable under long-term incentive schemes	201	197
Defined benefit scheme:		
Pension accrued during the year	1	2
Defined contribution scheme:		
Contributions made by the Society	19	19

(11) Taxation

(a) Tax attributable to long term business	Group & Society	
Tax charged/(credited) in the long-term business technical account comprises:	2017 £'000	2016 £'000
Current tax		
UK corporation tax	-	-
Prior year adjustments	-	-
Total current tax	**-**	**-**
Deferred tax		
Origination and reversal of timing differences	-	22
Total deferred tax	**-**	22
Total tax charged/(credited) in the long-term business technical account	**-**	**22**

(11) Investment income (continued)

(b) Factors that may affect future tax charges	**Group**		**Society**	
The deferred tax assets which have not been recognised due to the uncertainty of their recoverability in the foreseeable future comprise:	**2017 £'000**	**2016 £'000**	**2017 £'000**	**2016 £'000**
Realised and unrealised capital losses	217	195	217	195
Expenses deductible in future years	174	223	174	223
Trade losses	695	615	-	-
Short term timing differences	5	5	-	-
Deferred tax asset not recognised	**1,091**	**1,038**	**391**	**418**

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.

(c) Balance sheet	**Group**		**Society**	
The deferred tax balance included within other assets comprises:	**2017 £'000**	**2016 £'000**	**2017 £'000**	**2016 £'000**
Unrelieved expenses carried forward	-	-	-	-
Realised capital losses	122	155	122	155
Unrealised capital gains	(122)	(155)	(122)	(155)
Deferred tax on Pension Scheme surplus	-	-	-	-
Undiscounted deferred tax asset balance	**-**	**-**	**-**	**-**

(d) Reconciliation of deferred taxation balances	**Group**		**Society**	
	2017 £'000	**2016 £'000**	**2017 £'000**	**2016 £'000**
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

FOR THE YEAR ENDED 31 DECEMBER 2017

(12) Investments Land and buildings

	Group		Society	
Land and buildings	2017 £'000 Cost	2017 £'000 Valuation	2017 £'000 Cost	2017 £'000 Valuation
Freehold investment properties				
At 1 January	13,351	13,339	13,351	13,339
Disposals	(3,620)	(2,280)	(3,620)	(2,280)
Net gains on revaluation	–	736	–	736
At 31 December	**9,731**	**11,795**	**9,731**	**11,795**
Long leasehold properties				
At 1 January	8,016	7,650	8,016	7,650
Disposals	–	–	–	–
Net gains on revaluation	–	250	–	250
At 31 December	**8,016**	**7,900**	**8,016**	**7,900**
Freehold ground rents				
At 1 January	9	85	9	85
Disposals	(5)	(30)	(5)	(30)
Net gains on revaluation	–	–	–	–
At 31 December	**4**	**55**	**4**	**55**
Freehold and long leasehold investment properties: At 31 December	**17,751**	**19,750**	**17,751**	**19,750**

The Society's properties are included at Fair Value. The Properties are valued by Mellersh and Harding LLP as at 31st December 2017 in accordance with the requirements of the Royal Institution of Chartered Surveyors' Valuation – Professional Standards effective from 6th January 2014.

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

(13) Other financial investments

	Group & Society			
	2017 £'000 Cost	2017 £'000 Valuation	2016 £'000 Cost	2016 £'000 Valuation
Fixed interest securities	72,946	81,480	73,262	81,740
Listed shares	13,611	14,933	14,402	16,016
Derivatives	–	386	–	654
Deposits with credit institutions	1,842	1,842	5,918	5,918
Mortgages	129	129	160	160
	88,528	**98,770**	**93,742**	**104,488**

Of the listed fixed interest securities £25,507,667 (2016: £26,238,740) relates to overseas fixed interest securities, with the remainder relating to UK fixed interest securities.

Of the listed shares £1,401,590 (2016: £1,866,447) 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 2018.

Included within deposits with credit institutions is £425,610 (2016: £306,191) which relates to cash in a cash margin account which enables the Society to enter into the forward contracts. This amount is held with the clearing house for the life of the contracts and is refunded if market movements mean that the contract is favourable and used to pay for the liability if it is adverse.

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(14) Financial assets

	Group			
	2017	2017	2016	2016
Financial assets at fair value through profit and loss	£'000 Cost	£'000 Valuation	£'000 Cost	£'000 Valuation
Designated upon initial recognition	92,168	103,198	99,030	110,362
	92,168	**103,198**	**99,030**	**110,362**
Loans and receivables	2,993	2,993	3,075	3,075
Total financial assets	**95,161**	**106,191**	**102,105**	**113,437**
Included in the balance sheet as:				
Listed fixed interest securities	72,946	81,480	73,262	81,740
Listed shares	13,611	14,933	14,402	16,016
Derivatives	–	386	–	654
Deposits with credit institutions	1,842	1,842	5,918	5,918
Mortgages	129	129	160	160
Other financial investments (Note 13)	**88,528**	**98,770**	**93,742**	**104,488**
Assets held to cover linked liabilities (Note 16)	1,008	1,796	1,115	1,701
Debtors arising from direct insurance operations	145	145	130	130
Other debtors	1,190	1,190	1,168	1,168
Cash at bank and in hand	2,761	2,761	4,333	4,333
Accrued interest and rent	1,529	1,529	1,617	1,617
Total financial assets	**95,161**	**106,191**	**102,105**	**113,437**

(14) Financial assets (continued)

	Society			
	2017 £'000 Cost	2017 £'000 Valuation	2016 £'000 Cost	2016 £'000 Valuation
Financial assets at fair value through profit and loss				
Designated upon initial recognition	91,890	102,920	99,019	110,351
	91,890	**102,920**	**99,019**	**110,351**
Loans and receivables	3,245	3,245	5,296	5,296
Total financial assets	**95,135**	**106,165**	**104,315**	**115,647**

Included in the balance sheet as:

	2017 £'000 Cost	2017 £'000 Valuation	2016 £'000 Cost	2016 £'000 Valuation
Listed fixed interest securities	72,946	81,480	73,262	81,740
Listed shares	13,611	14,933	14,402	16,016
Derivatives	–	386	–	654
Deposits with credit institutions	1,842	1,842	5,918	5,918
Mortgages	129	129	160	160
Other financial investments (Note 13)	**88,528**	**98,770**	**93,742**	**104,488**
Assets held to cover linked liabilities (Note 16)	1,008	1,796	1,115	1,701
Debtors arising from direct insurance operations	101	101	95	95
Other debtors	1,486	1,486	3,424	3,424
Cash at bank and in hand	2,483	2,483	4,322	4,322
Accrued interest and rent	1,529	1,529	1,617	1,617
Total financial assets	95,135	106,165	104,315	115,647

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(15) Financial liabilities

	Group			
Financial liabilities at fair value through profit and loss	2017 £'000 Cost	2017 £'000 Valuation	2016 £'000 Cost	2016 £'000 Valuation
Designated upon initial recognition	–	36	–	149
Other financial liabilities at amortised cost	1,958	1,958	3,224	3,224
Total financial liabilities	**1,958**	**1,994**	**3,224**	**3,373**

Included in the balance sheet as:

Derivatives	–	36	–	149
Investment contract liabilities	37	37	66	66
Investment contract liabilities on linked liability fund	379	379	352	352
Arising out of direct insurance operations	49	49	49	49
Other creditors including taxation and social security	380	380	1,031	1,031
Accruals and deferred income	1,113	1,113	1,726	1,726
Total financial liabilities	**1,958**	**1,994**	**3,224**	**3,373**

	Society			
Financial liabilities at fair value through profit and loss	2017 £'000 Cost	2017 £'000 Valuation	2016 £'000 Cost	2016 £'000 Valuation
Designated upon initial recognition	–	36	–	149
Other financial liabilities at amortised cost	1,905	1,905	3,180	3,180
Total financial liabilities	**1,905**	**1,941**	**3,180**	**3,329**

Included in the balance sheet as:

Derivatives	–	36	–	149
Investment contract liabilities	37	37	66	66
Investment contract liabilities on linked liability fund	379	379	352	352
Arising out of direct insurance operations	49	49	49	49
Other creditors including taxation and social security	340	340	996	996
Accruals and deferred income	1,100	1,100	1,717	1,717
Total financial liabilities	**1,905**	**1,941**	**3,180**	**3,329**

(15) Financial liabilities (continued)

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

(16) Assets held to cover linked liabilities

	Group & Society			
	2017 £'000 Cost	2017 £'000 Valuation	2016 £'000 Cost	2016 £'000 Valuation
Assets held to cover unit linked insurance contracts	764	1,362	836	1,276
Assets held to cover unit linked investment contracts	244	434	279	425
	1,008	**1,796**	**1,115**	**1,701**

Included within assets held to cover linked liabilities is £227,504 (2016: £291,502) representing units not yet purchased by policyholders.

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(17) Intangible assets

	Group		
At 31 December 2016	**Software under Construction £'000**	**Computer Software £'000**	**Total £'000**
Cost/Valuation	657	2,500	**3,157**
Accumulated depreciation and impairment	–	–	**-**
Net book amount	**657**	**2,500**	**3,157**
Year ended 31 December 2017			
Opening net book value	657	2,500	**3,157**
Additions	1,490	–	**1,490**
Disposals	(750)	750	**-**
Amortisation	–	(250)	**(250)**
Revaluation	–	–	**-**
Closing net book amount	**1,397**	**3,000**	**4,397**
At 31 December 2017			
Cost/Valuation	1,397	**3,250**	**4,647**
Accumulated depreciation and impairment	–	**(250)**	**(250)**
Net book amount	**1,397**	**3,000**	**4,397**

	Society	
At 31 December 2016	**Software under Construction £'000**	**Total £'000**
Cost/Valuation	657	**657**
Accumulated depreciation and impairment	–	**-**
Net book amount	**657**	**657**
Year ended 31 December 2017		
Opening net book value	657	**657**
Additions	1,490	**1,490**
Disposals	(750)	**(750)**
Amortisation	–	**-**
Revaluation	–	**-**
Closing net book amount	**1,397**	**1,397**
At 31 December 2017		
Cost/Valuation	1,397	**1,397**
Accumulated depreciation and impairment	–	**-**
Net book amount	**1,397**	**1,397**

(18) Tangible assets

	Group				
At 31 December 2016	**Land & Buildings £'000**	**Computer Equipment £'000**	**Office Equipment £'000**	**Motor Vehicle £'000**	**Total £'000**
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**
Year ended 31 December 2017					
Opening net book value	1,987	64	110	17	**2,178**
Additions	–	18	–	58	**76**
Disposals	–	–	–	(14)	**(14)**
Depreciation	–	(57)	(19)	(15)	**(91)**
Revaluation	243	–	–	–	**243**
Closing net book amount	**2,230**	**25**	**91**	**46**	**2,392**
At 31 December 2017					
Cost/Valuation	2,230	513	165	58	**2,966**
Accumulated depreciation and impairment	–	(488)	(74)	(12)	**(574)**
Net book amount	**2,230**	**25**	**91**	**46**	**2,392**

	Society				
At 31 December 2016	**Land & Buildings £'000**	**Computer Equipment £'000**	**Office Equipment £'000**	**Motor Vehicle £'000**	**Total £'000**
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**
Year ended 31 December 2017					
Opening net book value	1,987	58	110	17	**2,172**
Additions	–	18	–	58	**76**
Disposals	–	–	–	(14)	**(14)**
Depreciation	–	(51)	(19)	(15)	**(85)**
Revaluation	243	-	–	–	**243**
Closing net book amount	**2,230**	**25**	**91**	**46**	**2,392**
At 31 December 2017					
Cost/Valuation	2,230	489	165	58	**2,942**
Accumulated depreciation and impairment	–	(464)	(74)	(12)	**(550)**
Net book amount	**2,230**	**25**	**91**	**46**	**2,392**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(18) Tangible assets (continued)

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

The valuation was performed by Mellersh and Harding LLP as at 31st December 2017 in accordance with the requirements of the Royal Institution of Chartered Surveyors' Valuation - Professional Standards effective from 6th January 2014. Under the amortised cost model the land and buildings have a cost of £1,538,000 (2016: £1,538,000), a useful life of 100 years and a net book value of £1,476,000 (2016: £1,492,000).

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

(19) Capital commitments

Amounts authorised and contracted for at 31 December 2017 are £nil (2016: £299,000).

(20) Long term business provision

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

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

Rates of mortality	Solvency II Best Estimate Assumptions
DBO contracts	29.7% (2016: 26.3%) of AMN00 and 35.1% (2016: 31.1%) of the AFN00 ultimate table for assured lives (and assumed to be transferred to suspense at age 100).
Deposit (non-DBO) contracts	81.2% (2016: 92.7%) of the AMN00 and 92.0% (2016: 105.0%) of the AFN00 ultimate table for assured lives
Healthcare contracts	81.2% (2016: 92.7%) of the AMN00 and 92.0% (2016: 105.0%) of the AFN00 ultimate table for assured lives
Healthguard contracts	81.2% (2016: 92.7%) of the AMN00 and 92.0% (2016: 105.0%) of the AFN00 ultimate table for assured lives
PHI deferred sickness claims in payment	Nil
Other PHI contracts	77.6% (2016: 77.6%) of the AMN00 ultimate table for assured lives
Critical illness policies	Table provided by reinsurer combining mortality and sickness rates
50+ life plan policies	126.0% (2016: 126.0%) of the AMN00 ultimate table for non-smokers or 126.0% (2016: 126.0%) of the AMS00 ultimate table for smokers
Other life assurance policies	67.2% (2016: 67.2%) of the AMN00 ultimate table for assured lives or 84.0% (2016: 84.0%) of the AMS00 ultimate table for smokers

(20) Long term business provision (continued)

Rates of mortality	Solvency II Best Estimate Assumptions
Annuities in Payment (including CFPS annuities)	121.3% (2016: 121.3%) of the PNMA00 and PNFA00 mortality tables for pensioners with an average of the medium and long cohort adjustments from the year 2000, subject to a minimum improvement of 1.125% per annum
Annuities in Deferment (retirement annuity contracts)	Post Retirement age: 121.3% (2016: 121.3%) of the PNMA00 and PNFA00 mortality tables for pensioners with an average of the medium and long cohort adjustments from the year 2000, subject to a minimum improvement of 1.125% per annum. Pre Retirement age: 61.7% (2016: 61.7%) of the PNMA00 and PNFA00 mortality tables for pensioners with an average of the medium and long cohort adjustments from the year 2000, subject to a minimum improvement of 1.125% per annum
Other contracts	Nil

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

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

Expenses	Solvency II Best Estimate Assumptions
Deposit contracts covered for death benefits only	£2.95 (2016: £2.89) per annum
All other deposit and PHI contracts	£71.03 (2016: £97.88) per annum
All life assurance and pension policies	£47.35 (2016: £65.25) per annum
Per policy Expense Inflation	2.3% (2016: 2.9%) per annum
Tax relief on per policy expenses for taxable business	20%
Offset for with profits life assurance policies	The value of expenses detailed in the terms and conditions for that particular policy

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.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(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 2017.

Funding Policy

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

Fund Amendments

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

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

	Group & Society	
The amounts recognised in the balance sheet are as follows:	**2017 £'000**	**2016 £'000**
Fair value of fund assets	19,662	19,287
Present value of funded obligations	(21,138)	(21,856)
Net (under)/overfunding in Fund	**(1,476)**	**(2,569)**
Liability recognised on the balance sheet	(1,476)	(2,569)
Net Defined Benefit Liability	**(1,476)**	**(2,569)**

(21) Pensions (continued)

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

	Group & Society	
	2017 £'000	2016 £'000
Net Interest expense	64	(41)
Expense recognised in the Income Statement	**64**	**(41)**

	Group & Society	
	2017 £'000	2016 £'000
Interest on obligation	556	663
Interest on assets	(492)	(704)
Net interest expense	**64**	**(41)**

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

	Group & Society	
	2017 £'000	2016 £'000
Return on assets (not included in interest)	707	35
Actuarial (Losses)/Gains on obligation	351	(3,755)
Total remeasurements recognised in other comprehensive income	**1,058**	**(3,720)**
Cumulative amount of remeasurements recognised in other comprehensive income	**(1,888)**	**(2,945)**
Actual return on fund assets	**1,199**	**707**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(21) Pensions (continued)

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

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

	Group & Society	
	2017 £'000	2016 £'000
Administration expenses paid from Fund	92	68
Other Items	**92**	**68**

The Society contributed £191,100 to the Fund over the year from 1 January 2017 to 31 December 2017. 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 2018 to 31 December 2018. No contributions are expected by members of the Fund over the next year.

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

	Group & Society	
	2017 £'000	2016 £'000
Opening defined benefit obligation	21,856	18,382
Benefits paid	(923)	(944)
Interest on obligation	556	663
Experience gains	(71)	(55)
Losses/(gains) from changes in assumptions	(280)	3,810
Closing defined benefit obligation	**21,138**	**21,856**

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

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

	Group & Society	
	2017 £'000	2016 £'000
Opening fair value of fund assets	19,287	19,369
Interest on assets	492	704
Return on assets (not included in interest)	707	35
Contributions by employer	191	191
Benefits paid	(923)	(944)
Administration expenses	(92)	(68)
Closing fair value of fund assets	**19,662**	**19,287**

(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 major categories of fund assets as a percentage of the total are as follows:

	%	%
Equities	34	29
Gilts	11	13
Corporate bonds	27	33
Property	18	17
Cash	10	8

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

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

	Group & Society	
	2017	2016
	%pa	%pa
Discount rate at 31 December	2.5	2.6
Discount rate at 1 January	2.6	3.7
Inflation (Retail Price Index)	3.2	3.3
Rate of increase in pensionable salaries	3.5	3.6
Rate of increase in deferred pensions	2.2	2.3
Rate of increase in pensions in payment – service pre 06/04/2005	3.1	3.2
Rate of increase in pensions in payment – service post 06/04/2005	2.2	2.1

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 89 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 90 if female.

Defined contribution scheme

The contributions to the defined contribution scheme made by the Society in the year amounted to £168,472 (2016: £175,807), and contributions made by the Group amounted to £186,804 (2016: £197,893).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(22) Technical provisions for linked liabilities

	Group & Society					
	Insurance contracts		Investment contracts		Total	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000	2017 £'000	2016 £'000
At 1 January	1,057	1,166	352	362	1,409	1,528
Payments made to policyholders of investment contracts	–	–	(22)	(44)	(22)	(44)
Change in technical provision as shown in the income statement	133	(109)	49	34	182	(75)
At 31 December	**1,190**	**1,057**	**379**	**352**	**1,569**	**1,409**

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 46 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	
Total future minimum lease payments: plant & machinery	2017 £'000	2016 £'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 £372,803 (2016: £422,186) by the Society in respect of service charges.

Contributions of £191,100 (2016: £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 28 December 2017 ND Member Services Limited acquired £750,000 of the Intellectual Property of Phase 2a of the policy administration system which the Society had developed through Project Asterix. The Society will re-licence this software from ND Member Services Limited over ten years.

As at 31 December 2017, 425 Direct Limited was owed £21,204 by the Society (2016: £31,361) and ND Member Services Limited owed the Society a net amount of £296,344 (2016: £2,542,844). This loan was repaid in 2018.

Key management personnel

All directors and certain senior employees who have authority and responsibility for planning, directing and controlling the activities of the Group are considered to be key management personnel. Total key management personnel compensation is £368,714 (2016: £361,834). Director's remuneration is disclosed in the directors' remuneration report on page 33.

In addition the directors of the Society may from time to time purchase insurance or investment products marketed by the Society in the ordinary course of business on the same terms as those prevailing at the time for comparable transactions with other persons. In 2017 and 2016, other transactions with the Society's directors' were not deemed to be significant both by virtue of their size and in context with the directors' financial position. All of these transactions are on normal commercial terms.

(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 £480,000 (2016: £565,000) 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 £35,000 (2016: £30,000) after an impairment charge of £474,000 (2016: £569,000).

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

The results of all subsidiaries for the year ended 31 December 2017 have been consolidated into the Group financial statements.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(27) Fund for Future Appropriations

	Group		Society	
	2017 £'000	Restated 2016 £'000	2017 £'000	Restated 2016* £'000
As at 1 January	18,254	12,526	18,297	12,568
Restatement (note 29)	–	11,643	–	11,643
Fund for future appropriations as at 1 January (restated)	18,254	24,169	18,297	24,211
Transfer to/(from) the fund for future appropriations from income statement	5,425	(2,453)	5,427	(2,453)
Transfer to/(from) the fund for future appropriations from statement of comprehensive income	1,289	(3,462)	1,289	(3,461)
At 1 January (restated)	**24,968**	**18,254**	**25,013**	**18,297**

The Fund for Future Appropriations represents the estimated surplus in the funds that has not been allocated and is available to meet regulatory and other solvency requirements.
*For details of the restatements refer to note 29.

(28) Derivatives

Included within assets are forward currency contracts with a fair value of £287,000 (2016: £50,000) and a fair value within liabilities of £2,000 (2016: £64,000). The nominal contract value of these contracts is £12,032,000 (2016: £13,496,000). 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 gains included in the income statement for 2017 in relation to the forward currency contracts amounted to £287,000 (2016: loss of £14,000).

Bond future contracts with a fair value of £99,000 (2016: £424,000) are held within assets and a fair value of £34,000 (2016: £85,000) within liabilities. The nominal contract value of these contracts is £20,211,000 (2016: £27,982,000) was also held to manage the duration of the fixed interest portfolio. Fair value gains for the year of £65,000 (2016: £339,000) are included in the income statement in respect of bond future contracts.

There are no interest rate swaps held at the year-end (2016: £180,000 were held within assets with a notional value £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 had matched 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 reduced the amount of resilience capital required in 2016. 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.

(28) Derivatives (continued)

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

Derivatives held at 31 December 2016	Group & Society		
	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**

(29) Prior year restatement

Financial Reporting Standard 103 (Insurance Contracts) was amended in May 2016 to reflect the implementation from 1 January 2016 of the Solvency II Directive. This revised standard permits the Society to change its accounting policy for insurance contracts if the change makes the financial statements more relevant to the economic decision-making needs of the users and no less reliable, by recognising and measuring technical provisions in a manner more consistent with the Solvency II Directive. The Society has therefore decided to change its accounting policy for insurance contracts from a Solvency 1 basis to a Solvency II basis. The Board consider that this change results in a more relevant and reliable reflection of the financial performance and capital position of the Society, as the Board's decision making is based on the Society's Solvency II capital position. A further benefit is that all of the Society's financial reporting is on a consistent basis.

Under the revised accounting policy liabilities have reduced as a result of the change from a prudent basis to a best estimate basis. Technical provisions have also reduced due to the risk margin under Solvency II being lower than the prudence margins under Solvency I and the use of a different expense methodology on a Solvency II going concern basis. For further details of the calculation methodology see Note 20. The adjustments to technical provisions resulting from the change in accounting policy are matched by an equal and opposite change in the Fund for Future Appropriations. Under UKGAAP, the Society is not required to present three balance sheets for the purposes of prior year restatements but we have included the 2015 balance sheet position below to outline the impact of the restatement. Details of the changes and the restatement of comparatives for the periods ended 31 December 2015 and 2016 are shown below.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(29) Prior year restatement (continued)

Balance Sheet		Group		
		As previously reported 2015	Adjustment	As restated 2015
Assets		£'000	£'000	£'000
Reinsurance Asset	1	217	(83)	134
Total Assets		**138,989**	**(83)**	**138,906**
Fund for future appropriations	1,2	12,526	11,643	24,169
Long term business provision	2	118,835	(11,396)	107,439
Investment contract liabilities	2	106	-	106
Claims outstanding	2	2,713	-	2,713
Provision for bonuses	2	632	(330)	302
		122,286	(11,726)	110,560
Total liabilities		**138,989**	**(83)**	**138,906**

[1] Recalculation of reinsurers' share of technical provisions on a Solvency II basis.
[2] Recalculation of technical provisions on a Solvency II basis.

Balance Sheet		Group		
		As previously reported 2016	Adjustment	As restated 2016
Assets		£'000	£'000	£'000
Reinsurance Asset	1	202	(73)	129
Total Assets		**140,209**	**(73)**	**140,136**
Liabilities				
Fund for future appropriations	1,2	7,893	10,361	18,254
Long term business provision	2	122,433	(10,386)	112,047
Investment contract liabilities	2	66	-	66
Claims outstanding	2	2,582	(11)	2,571
Provision for bonuses	2	302	(37)	265
		125,383	(10,434)	114,949
Total liabilities		**140,209**	**(73)**	**140,136**

[1] Recalculation of reinsurers' share of technical provisions on a Solvency II basis.
[2] Recalculation of technical provisions on a Solvency II basis.

(29) Prior year restatement (continued)

		Society		
		As previously reported 2015	Adjustment	As restated 2015
Assets		£'000	£'000	£'000
Reinsurance Asset	1	217	(83)	134
Total Assets		**138,915**	**(83)**	**138,832**
Liabilities				
Fund for future appropriations	1,2	12,568	11,643	24,211
Long term business provision	2	118,835	(11,396)	107,439
Investment contract liabilities	2	106	–	106
Claims outstanding	2	2,713	–	2,713
Provision for bonuses	2	632	(330)	302
		122,286	(11,726)	110,694
Total liabilities		**138,915**	**(83)**	**138,832**

[1] Recalculation of reinsurers' share of technical provisions on a Solvency II basis.
[2] Recalculation of technical provisions on a Solvency II basis.

		Society		
		As previously reported 2016	Adjustment	As restated 2016
Assets		£'000	£'000	£'000
Reinsurance Asset	1	202	(73)	129
Total Assets		**140,208**	**(73)**	**140,135**
Liabilities				
Fund for future appropriations	1,2	7,936	10,361	18,297
Long term business provision	2	122,433	(10,386)	112,047
Investment contract liabilities	2	66	–	66
Claims outstanding	2	2,582	(11)	2,571
Provision for bonuses	2	302	(37)	265
		125,383	(10,434)	114,949
Total liabilities		**140,208**	**(73)**	**140,135**

[1] Recalculation of reinsurers' share of technical provisions on a Solvency II basis.
[2] Recalculation of technical provisions on a Solvency II basis.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

(29) Prior year restatement (continued)

Income Statement		Group		
		As previously reported 2016	Adjustment	As restated 2016
		£'000	£'000	£'000
Long term business provision	1,2	3,613	1,001	4,614
Change in provision for claims	2	(131)	(11)	(142)
Bonuses and rebates	2	(330)	293	(37)
		3,152	1,283	4,435
Transfer from fund for future appropriation	1,2,3	**(1,170)**	**(1,283)**	**(2,453)**

[1]Recalculation of reinsurers' share of technical provisions on a Solvency II basis.

[2]Recalculation of technical provisions on a Solvency II basis.

[3]Please note that the movement between the FFA in the 2015 and 2016 restated balance sheets is (£5,915k) as per the Statement of Movements in Funds below. The figure of (£2,453k) above is the income statement element only of the movement in FFA as the restatement only impacts the income statement.

		Society		
		As previously reported 2016	Adjustment	As restated 2016
		£'000	£'000	£'000
Long term business provision	1,2	3,613	1,001	4,614
Change in provision for claims	2	(131)	(11)	(142)
Bonuses and rebates	2	(330)	293	(37)
		3,152	**1,283**	**4,435**
Transfer from fund for future appropriation	1,2,3	**(1,170)**	**(1,283)**	**(2,453)**

[1]Recalculation of reinsurers' share of technical provisions on a Solvency II basis.

[2]Recalculation of technical provisions on a Solvency II basis.

[3]Please note that the movement between the FFA in the 2015 and 2016 restated balance sheets is (£5,914k) as per the Statement of Movements in Funds below. The figure of (£2,453k) above is the income statement element only of the movement in FFA as the restatement only impacts the income statement.

(29) Prior year restatement (continued)

Fund for Future Appropriations	Group		Society	
	2017 £'000	Restated 2016 £'000	2017 £'000	Restated 2016* £'000
At 1 January	18,254	12,526	18,297	12,568
Restatement	–	11,643	–	11,643
Fund for future appropriations as at 1 January (restated)	18,254	24,169	18,297	24,211
Transfer to/ (from) the fund for future appropriations	5,425	(2,453)	5,427	(2,453)
Actuarial (loss)/gain on defined benefit pension scheme (note 21)	1,058	(3,720)	1,058	(3,720)
Movement in deferred tax on pension scheme	–	22	–	22
Revaluation of occupied land and buildings	244	256	244	256
Other comprehensive income	(13)	(20)	(13)	(19)
Total comprehensive income	**6,714**	**(5,915)**	**6,716**	**(5,914)**
As at 31 December Fund for future appropriations	**24,968**	**18,254**	**25,013**	**18,297**

YOUR NOTES

National friendly

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

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

8am-6pm Monday to Friday excluding bank holidays – calls are recorded for training and quality purposes.
www.nationalfriendly.co.uk
info@nationalfriendly.co.uk

National Friendly is the trading name of National Deposit Friendly Society Limited. Incorporated and registered Friendly Society no. 369F.
Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.
Annual Report and Financial Statements published: July 2018.