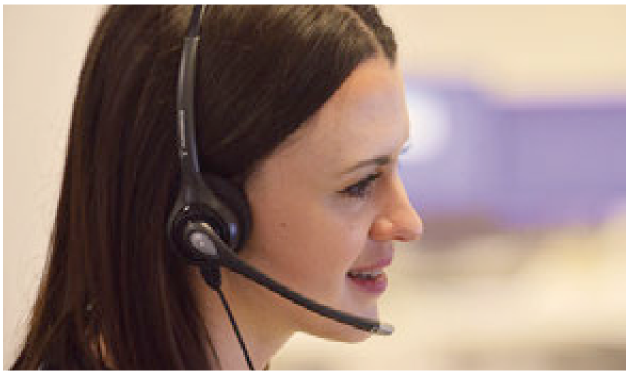
National friendly

Annual Report and Financial Statements



2014

Advisors

Independent Auditors
PricewaterhouseCoopers LLP,
31 Great George Street,
Bristol, BS1 5QD

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

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

Internal Auditors
Mazars LLP,
Clifton Down House,
Beaufort Buildings,
Clifton,
Bristol, BS8 4AN

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

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

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

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

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

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

With-Profit Actuary
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
info@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

INVESTOR IN PEOPLE

National friendly

Contents

Chairman's Review

This is my first Chairman's Review following my appointment in March 2014, and I am pleased to confirm that National Friendly is reporting an improvement in its capital position, to the point that returning to new business during 2015 is now a viable and realistic proposition, and how we plan to do this is outlined in the Strategic Report.

Having been on the National Friendly Board for the last five years, I have a thorough understanding of the Society, its history and its vision – and I am excited about our future.

2014 saw the UK economy grow by 2.6%, the fastest since 2007, but it slowed in the last two quarters when we also saw interest rates fall significantly. The Society wisely protected itself against this change in interest rates through carefully restructuring its investment portfolio two years ago, such that fixed income gilts and bonds were purchased that yielded cash inflows to match the payment of future expected liabilities. In the meantime, we have kept operating costs to a minimum whilst further developing our strategy to reopen to new business as soon as capital and risk appetite permit.

The National Friendly Board continues to evolve. I would like to thank John Greenhalgh, who retired in July, for all of his work, support and guidance. We welcomed Geoff Brown to the Board in June who brings with him a wealth of actuarial and healthcare insurance experience. With the departure of Alan Lewis last March we have reduced our number of Non-Executive Directors from five to four, but have since doubled our Executive Directors to two when we welcomed Sandy Richards to the Board in September. Sandy joined National Friendly in 2012 as the Head of Finance and Risk and will continue in this role during her appointment as an Executive Director.

The Society continued to make progress to ensure that we will be able to meet the requirements of Solvency II by the planned implementation date of 1 January 2016. Solvency II is the EU legislative programme to provide improved consumer protection and ensure a uniform and enhanced level of policyholder protection across the EU.

Our continued focus on 425 Financial Solutions has resulted in a leaner, more focused team. 2014 was a tough year for 425 as the announcement of the revised pension regime naturally reduced annuity sales, and although a level of uncertainty remains in this area, we anticipate that those who have postponed retirement will return to seek guidance and advice on their new options during 2015. Our strategy to diversify income streams has been implemented through new corporate partnerships as well as a variety of 'test and learn' campaigns to identify new lead generation sources.

November saw our relocation from Clifton to Queen Square in the heart of Bristol. The move not only freed up capital but reduced running costs and now provides a vibrant environment in which we can focus on our future as a modern mutual.

We will continue in our quest to establish ourselves as a key participator in later life care whilst remaining customer focused and doing the best for our members.

Finally, I would like to thank all of my colleagues for all their hard work and commitment throughout the year.

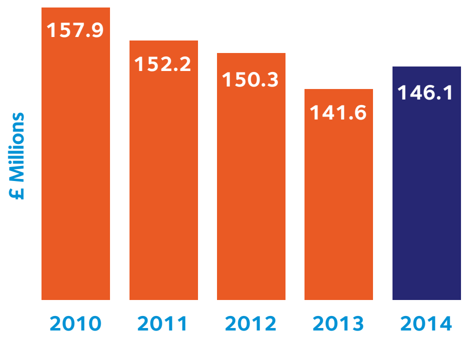
Tracy Morshead
Chairman

27 March 2015

Financial Highlights

Total Assets

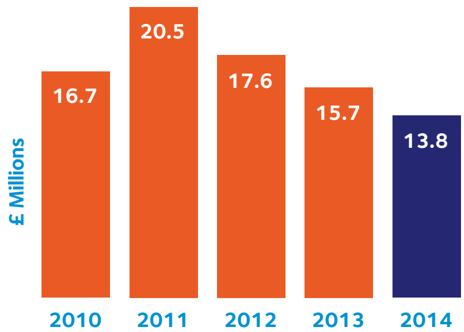
Our asset base has increased during the year due to a strong investment performance which outweighed the claim and administration costs of the policies.



Annual Premiums Earned & Premium Income

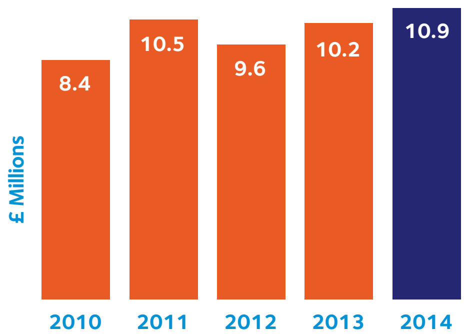
Premium income has reduced due to policy maturities and lapses and the temporary closure to new business.

Calculated using 10% of Single Premium Business.



Fund for Future Appropriations

The Fund for Future Appropriations has increased through a combination of strong investment growth and better matching of assets to liabilities but partly offset by increased policy expenses.



Strategic Report

Overall Strategy

Our vision to be a forward-thinking and trusted mutual that meets the changing welfare needs of our policy holders remains strong and our desire to re-open to new business as soon as is viable is looking to become a reality in 2015.

We want to provide our policy holders with products and services that look after their welfare, to give certainty and control over their wellbeing both now, and in the future.

Business Performance

Our focus throughout 2014 was on continuing to deliver our capital restoration plan, strengthening our capital management framework, continuing our system development programme and seeking to secure sustainable, profitable growth for 425.

We have seen a year-on-year improvement in capital position and in the course of 2014 our level of Pillar 1 free capital increased from £1.8m at 31 December 2013 to £3.8m as at 31 December 2014.

There are a number of contributing factors to this continued improvement of capital:

- Strong investment performance from our fixed income and property funds. The fixed income asset values grew significantly, driven by the fall in interest rates.
- A change in the way that the cost of policy guarantees is met as explained in the with-profits review section below.
- The re-pricing of some of our Healthguard and Healthcare Deposit Account policies as they reach their premium review points at their fifth anniversary of issue, taking account of past claims experience to cover the cost of anticipated future claims.
- A reduction in the amount of resilience capital required due to better matching of assets to liabilities.

Although these factors have provided a positive increase in capital, the Society also saw some leading to decreases mainly as a result of:

- A reduction in the projected rate of Healthcare policy lapses requiring the creation of additional morbidity reserves for future claims.
- An increase in per policy expense as the policy book continues to reduce in size; this will be remedied once we re-open to new business.

Critical Success Factors

We determined four key areas of critical success for 2014 and set out below the progress made on each:

1. Capital management

Capital restoration

2014 saw our capital restoration plan continuing to successfully deliver improvements to our capital position.

Despite good economic growth in the UK, interest rates fell sharply in Q3, creating a harsh business environment. Fortunately, due to changes we made in 2012 when we matched our assets and liabilities far more closely than before, we were protected from this fall in interest rates and the higher liabilities arising from reduced discount rates were largely offset by a rise in the value of fixed income assets.

However, this fall in interest rates has resulted in an increase in cost of the guarantees present in some of our with-profit policies, primarily pensions. Under the terms of our Principles and Practices of Financial Management ("PPFM") we may offset the cost of these guarantees against the return credited to with-profit policyholders if the inherited estate is below 10% of the overall liabilities. The inherited estate has remained below 10% of the liabilities since 31 December 2010 and the Board has decided to offset the cost of guarantees with effect from 1 January 2014. This represents a change in approach from prior years and has been triggered by the dramatic fall in interest rates during 2014 giving rise to strong investment return yet an increased cost of guarantees.

Morbidity

A comprehensive assessment of reinsurance for our legacy healthcare book has, to date, demonstrated that the cost of doing so outweighs the benefits. As such we will continue to manage morbidity carefully and remain open to employing other opportunities to mitigate further our exposure to morbidity risk for our existing book.

Solvency II

1st January 2016 sees the implementation of Solvency II, with further progress being made throughout 2014 and some key deliverables as follows:

- An Internal Audit review of the Governance framework.
- Changes at Board level to further strengthen risk experience.
- Review of the Society's risk appetite and risk reporting to improve transparency at Risk and Compliance Committee and Board level.
- Preparation of an interim Own Risk and Solvency Assessment considering key risks, scenario analyses and stress testing of these risks.
- Preparation of the balance sheet on a Solvency II basis and comparing this to the current reporting regulation and own assessment of risks and capital.

2. To re-open to new business

Despite capital continuing to be restored in 2014 we did not reach the level we set to confidently re-open to new business. That said, we continued to develop our overall welfare proposition and we are now designing the first of many products with which we plan to return to the market in 2015.

As part of this, we have commenced discussions with insurers and reinsurers. Partnering with an insurer or reinsurer will reduce the risk of writing new business both by ensuring that the pricing is appropriate and by reducing capital strain thereby protecting the current surplus. These dialogues continue into 2015 as we aim to re-open to new business.

3. Cost control

We are aware of the need to address future cost issues as the declining policy book provides progressively lower income to cover our cost base. Overall costs have been maintained within budgets and our office move has resulted in net cost savings as we 'right sized' our head office property footprint.

Project Asterix, our new policy administration system, continued to progress in 2014, with the bulk of the development work being undertaken by an outsourcing software specialist located in India. However, the project has not been without issues. The quality of the database design is of critical importance to the project, followed by the quality of application design and integration with the database. The delivery of the first part of the project was delayed due to anomalies in the database design, revealing a potential divergence from defined requirements.

A thorough risk analysis was prompted, resulting in the database and data migration design and development being re-assigned onshore to a Bristol based specialist IT consultancy with a track record of timely, within budget delivery. Reassignment has proven to be a positive step, providing confidence in the establishment of a stable, secure and efficient database design from which to drive application development and integration.

In turn, this database optimisation work has highlighted some improvements to be made to the application code. These improvements are being worked into the existing application such that it will benefit from enhanced functionality, faster transactional performance and more efficient maintainability.

Our end-to-end plan has been revised accordingly and development work continues throughout 2015.

4. Profitability of 425 Financial Solutions

Our strategy for 425 Financial Solutions is to grow profitably by diversifying our income streams and drawing on our strengths in retirement planning and unique telephone-based comparison service. We want to achieve this whilst operating an efficiently run business with services which offer the best financial solutions to meet our customers' needs.

2014 began with the streamlining of processes to enhance our customer experience as well as the restructuring of the sales administration support model, which maximises the support for our sales teams in order to deliver growth later on in the year.

However, the 2014 Budget announcement and changes to the pension regime had a significant impact on the business as a result of a fall in annuity sales and continued uncertainty in the retirement market. Many pensioners have deferred their decisions until further changes come into force from April 2015 and we are now well prepared for the increased demand that this will bring and expect 425 to exploit its strength and expertise in this market.

The drop in annuity sales meant that 425 incurred losses in 2014. As a result, we have revisited our business model, further reduced costs and looked to diversify income elsewhere and in this respect we now have a number of new corporate partnerships as alternative lead generation providers.

We launched 425's new website in the third quarter, swiftly followed by a growing social media presence and the digital marketing strategy will continue to gather momentum to deliver growth in 2015.

Our overall vision for 425 remains constant: to focus on our specialism in retirement planning and play an integral role in the Society's strategy in the later life market as it will become a significant distribution channel for the Society's products.

Critical Success factors for 2015

In 2015, the Society will continue to pursue the above strategic objectives. The key objective remains for the Society to re-open to new business and start writing new contracts of insurance. This will help reverse the increasing cost of administration relative to reducing number of policies. The plan is to launch a revised deposit-based healthcare product, available at different levels of cover providing insurance for a range of treatments. This product will provide an alternative option to our existing policyholders as well as providing affordable healthcare cover to new customers.

In designing the new product, we have learnt from past experiences and we are engaging with experts in the healthcare market so that the design, price and distribution provide the right solution at the right price and ensure that it is sustainable and poses no new risks to the Society and its existing policyholders. The new product will be underwritten with an insurer or reinsurer, which will reduce the risk of writing new business and in this respect, we have commenced discussions with a number of potential partners.

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
INSURANCE RISK **Morbidity Risk** Morbidity (claims higher than expected) experience continues to deteriorate over and above expectations either holding back capital restoration or reducing free capital.	Worsening morbidity results in increased reserves slowing capital restoration which could mean that the Society may have to defer opening to new business.	Management of morbidity claims remains a key focus. Better claims data and more sophisticated valuation methodology is used whereby statistical analyses are used to predict ultimate claims costs. Any new business will be written on an insured/re-insured basis either mitigating or significantly reducing the morbidity risk of new policies.
Lapse Risk Lapses are lower than predicted resulting in increased technical provisions.	Lapsed policies release future reserves but present a cost issue as cost per policy increases as policy numbers reduce.	Writing new contracts of insurance will provide income to cover the administration costs and reverse the increases in costs arising from reducing policy numbers.
Product Risk Lower interest rates make the cost of guaranteed benefits more onerous.	Increased burden of guarantees slows capital restoration.	The cost of guarantees may be offset against with-profit returns whilst the inherited estate remains below the target level.
STRATEGIC RISK The capital position does not meet the minimum risk appetite requirements to return to writing new business.	Continuing reduction in policies presents a cost issue impacting on level of free assets meaning that either the Society remains closed to new business or delays opening to new business, resulting in slower restoration of capital.	The Board has set interim risk appetite measures that would need to be met to enable the Society to return to new business ensuring that existing policyholders are protected.
EXPENSE OVERRUN Per policy costs continue to increase against a declining policy book.	Ongoing administration costs against continued decline in policies and income resulting in higher net cost to administer each policy.	Expenses are closely monitored and organisational restructuring to ensure the right cost base. Re-opening to new business and writing new contracts of insurance will reverse this trend.
OPERATIONAL RISK Administration system development project – Failure of the project to deliver quality results, on time and within cost estimated.	Continuing with existing system with manual workarounds poses control risks and it is costly to maintain and develop.	Delivery of the project in a phased approach including: - Strict cost control. - Regular monitoring of progress against deliverables.
PROFITABILITY OF 425 The Society's subsidiary does not generate a profit.	The subsidiary does not provide a positive financial contribution to the Society, resulting in an increase in expense reserves resulting from lower recharges.	425 has its own business plan with stretching targets to include: - Increase in performance and productivity. - Reducing the dependency on one key lead provider. Performance against plan is closely monitored and action taken as appropriate to control costs.

Investment Performance

Property

The commercial property market continued to move forward in 2014 with properties in London and the South East offering some of the highest returns.

The Society's portfolio increased in value over the year providing an attractive income return of over 7.5% for the period.

Purchases in Austin Friars, London EC2, and Queen Square, Bristol, at the beginning of 2014 both enjoyed increased capital values at the year-end valuation. Looking forward to 2015, a strategy of further asset management initiatives and selective sales and purchases should continue to strengthen the income return from the portfolio.

Fixed Interest

UK government bonds outperformed investment grade bonds during 2014 and were the best performing fixed income asset class during that period.

Economic data remained mixed into year-end, with the US continuing its steady recovery at one end of the spectrum, while deflationary pressures mounted in the euro-area. In the UK, the Bank of England trimmed its growth forecast and validated market expectations that interest rates will stay lower for longer. In Asia, the Bank of Japan unexpectedly increased the size of its Quantitative Easing programme in response to concerns that inflation will remain weak after accounting for April's sales tax hike, while China announced rate cuts amid rising expectations that it will lower its 2015 growth target to 7%.

During the first half of the year credit spreads narrowed, providing modest gains within the Society's cash-flow matching portfolios. The second half of the year saw somewhat of a reversal of this trend, with credit spreads widening given the pick-up in market volatility amid geopolitical tensions. Overall, the corporate bond exposure with the Society's portfolios enhanced returns during the year.

Equities

UK equities recorded sufficient gains in the second and final quarters of 2014 to record a positive year overall, with the FTSE All Share Index up 1.2%. The UK stock market experienced increasing levels of volatility in the second half of the year with the sharp decline in oil prices, geopolitical uncertainty, concerns about economic growth and a potentially deflationary environment in the euro-zone all contributing to the uncertainty.

Against this backdrop, the Society's UK equities portfolio underperformed in the first half of the year, but rallied strongly amidst the second-half volatility to deliver positive relative returns for the full year, rising 1.9% relative to its benchmark. Notably, the underweight stance in resources stocks contributed to these relative returns.

With-profits Review

Overall, investment returns for the with-profit policies were positive in 2014 and maturity pay-outs rose for many categories of policy. For example, a sample ten year endowment policy, originally taken out at age 30 and maturing at the end of 2014, would have received a payment around 5% higher than a similar policy that had matured at the start of 2014.

This positive investment return in 2014 was primarily due to significant growth in the value of both our fixed income and property assets, with the former being driven by the significant fall in interest rates in the second half of 2014. However, this fall in interest rates, although driving positive growth in asset value, has also given rise to an increase in the cost of guarantees on some with-profit policies.

Generally, the cost of meeting with-profit policy guarantees is met from the Fund for Future Appropriations ("FFA") this representing the surplus of the assets over the liabilities of the Society. The FFA has remained below the target level set out in our Principles and Practices of Financial Management ("PPFM") since 31 December 2010 and, in such circumstances, the PPFM states that the costs of meeting guaranteed benefits may be deducted from the surplus available to with-profit policyholders.

The Board has determined that in view of the continuing position whereby the FFA remains below the target level it is appropriate to deduct the cost of guarantees from the surplus available to with-profit policyholders. This is not expected to have a substantial impact on pay-outs at present as the estimated impact for the last year is that the reduction in surplus available to with-profit policyholders represents a reduction in investment return of around 0.1% in the return credited for 2014. Of course, the cost may increase in future years depending on the value of policies with guarantees that mature and the level of interest rates in future.

The Board believes that it is in the best interests of all policyholders to take this action, having taken appropriate professional advice, in order to protect the overall financial position of the Society and all of its policyholders. This change was made effective from 1 January 2014.

We set out in our Annual Report and Accounts last year our comments on our plans on how best to differentiate between the respective rights of our policyholders, in particular between with-profit and non-profit policies and also in respect of our deposit account-based healthcare policies. With the introduction of the new regulatory regime under Solvency II due for the start of 2016 this issue has not progressed at present but members will be advised of any future developments in due course.

Our Members

Engaging with our members

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

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

In 2014 this took place on 22nd July at The Council Chamber, Hallam Conference Centre, 44 Hallam Street in 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 last year and where they would like to see the Society going in the future. Following the main presentation the members are also welcome to talk to the Board and the senior management team independently on a one-on-one basis if they so wish.

Our Focus Groups
Our Focus Group currently consists of 36 members from across the Society and meets to discuss relevant issues and ideas going forward, usually twice a year. Our Focus Group members have a wide range of polices held with us and also range in age, gender and national coverage.

This year, we held one Focus Group which took place at the Hilton Hotel, London in mid-May. The Chief Executive Officer presented on the Society's financial position and its performance against its objectives, together with details on the changes to the Memorandum and Rules. In addition, there was an open discussion and feedback session on members' views on introducing later life care services through carefully selected strategic partners.

Once the presentations were completed the members were then given the opportunity to ask questions and discuss the proposed ideas. Feedback is also welcomed from all our members at any time throughout the year.

A second Focus Group meeting originally planned for November 2014 has been deferred into March 2015 to enable discussion and feedback on our return to writing new business and, in particular, our new product design.

Treating Customers Fairly

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

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

Delivering our strategy. Our members can be confident that they are dealing with a firm where fair treatment is central to the corporate culture.	This is achieved by: • Raising staff awareness through induction and refresher training. • Developing our TCF dashboards, intranet, working parties and management information. • A comprehensive review of Training and Competence requirements across the Society.
Providing products and services that are marketed and sold in the retail market, and are designed to meet the needs of identified consumer groups and are targeted accordingly.	We have undertaken: • Regular reviews of performance of products and we ensure that we are kept informed of changes in the industry. • Collection and evaluation of customer feedback across the Society. • Extensive sign-off processes for appraising and issuing financial promotions and website content.
Members are provided with clear information and are kept appropriately informed before, during and after the point of sale.	We undertake to: • Obtain feedback through our Member Relations strategy. • Maintain product literature that clearly reflects risks, rewards and product limitations where they apply. • Continue to commit to developing the use of plain language. • Continually review any claims statistics so that any links between documentation and declined claims are identified.
Ensuring that members do not face unreasonable post-sale barriers imposed by us.	We ensure: • All means of contacting the Society continue to be accessible to the member. • Any third parties used apply the same principles as we do. • We continue to guide customers through the complaints procedures and that these remain as straightforward as possible. • No unreasonable exit penalties are incurred on key products. • Complaints procedures are in line with the regulatory requirements and are monitored to ensure these requirements are met.
Where our members receive advice, the advice is suitable and takes account of their circumstances.	Developments include: • Strengthened controls in place around the provision of information rather than advice across the Society. • 425 is able to provide Independent Financial Advice service to customers if required. Firm controls, including external quality checking, are in place so that 425 meets high quality standards for their advice. • Incentives for sales staff do not reward behaviours that are inconsistent with the principles of TCF.
Providing members with products that perform as we have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect.	We commit to: • Maintaining defined service levels that are monitored so that members receive a timely and efficient service. • Investing in accordance with investment strategy that is reviewed regularly by the Investment Committee. • Protecting the interests of our with-profit policyholders through the With Profit Advisory Arrangement. • Protecting the interests of non with-profit policyholders through the Board.

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.

Community

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 was established to provide discretionary funds to deserving causes as per nominations from National Friendly members and staff. The Fund contributes £1 for every £1 raised towards the Society's Charity of the Year and in 2014, it contributed £5,000 towards the total donation to the Alzheimer's Society.

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

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

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

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

Our Charity of the Year

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

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 2014, staff voted to continue their support for the Alzheimer's Society for a second year. The choice of the Alzheimer's Society was particularly apt as we are pursuing an active business interest in later life care. There are currently around 800,000 people suffering from various forms of Dementia in the UK. That figure is expected to double in the next thirty years or so. The disease is devastating for sufferers, their carers and other family members. We hope our support will provide help in combatting the disease and help those afflicted by it.

As in previous years, National Friendly and 425 staff took part in a variety of activities to raise money, including sweepstakes, cake bake sales, together with sponsored events. Of particular note was the successful completion of the Bristol 10k by a number of staff, who raised over £1,500 for this event alone. Coupled with the Foundation Fund's contribution, we exceeded our target for the year. A fundraising cheque for the grand sum of £10,403 was subsequently presented to the Alzheimer's Society in February 2015.

▲ Alex Thorn and Neil Thompson walked from Bristol to Glastonbury.

▲ We host regular bake sales to raise funds.

▲ Richard Carroll, Neil Thompson and Rebecca Burr before running the Bristol 10k.

▲ Jonathan Long presenting a cheque for £10,403.13 to Adrian Williams from the Alzheimer's Society.

"Over two years the wonderful people at National Friendly have been working (and walking) hard to raise a fantastic amount of money to help people with dementia.

The money that they have raised will not only mean that people affected by dementia and their carers will receive the support that they need in their local community, but also it will help us as we strive to find a cure for this currently incurable condition.

What they have done through their efforts is to give real hope to real people. They have sent a message to all living with dementia that they are not alone."

Adrian Williams,
Regional Fundraising Manager (South) for Alzheimer's Society.

Alzheimer's Society | Leading the fight against dementia

▲ Alex Thorn cycling in Ride London 2014.

2015 Charity support

The staff has voted that 2015's Charity of the Year is to be the Wallace & Gromit's Grand Appeal in aid of Bristol Children's Hospital. Since it was established in 1995, Wallace & Gromit's Grand Appeal has raised a significant sum of money to provide life-saving equipment, accommodation and patient care facilities at Bristol Childrens' Hospital. This work is only possible due to the hard work and dedication of donations and fundraising activities from organisations such as ours and given previous success we have increased our fundraising target for 2015 to £12,000. We look forward to taking part in a number of exciting events this year. We are very grateful to our staff and their friends and families for all their efforts.

Additional Causes

In addition to our chosen charity of the year we also support Ablaze Reading Buddies programme. Ablaze is a charity that partners businesses with schools in the wider Bristol area, providing structured volunteering opportunities which are aimed at raising the aspirations, attainment and achievements in young people, with particular priority given to disadvantaged areas.

During the course of our involvement with the programme we have built a long-term, sustainable partnership with the teaching staff at Merchants' Academy (formerly Gay Elms) Primary School in Withywood, Bristol. Each week our volunteers gave up a lunch break to spend time with selected children listening to them read aloud and then talking about the subject matter together.

The aim is to encourage learning and explore new language and ideas, relating back to the children's own experiences and firing up their imaginations to take their reading further. All our volunteers share a belief that they're doing something really valuable in giving something back to the community and take great pride and enjoyment from the friendships cultivated with the children through their shared reading experiences.

Environment

We endeavour to benefit the community by our green office policies and continually assess how we may improve our environmental impact and ways in which we can operate on as close to a carbon neutral basis as is possible. This has been particularly important to the Society last year following its relocation from Clifton into its refurbished offices in Queen Square, Bristol.

One immediate benefit of the relocation has been a 25% decrease in our energy usage due to the reduction in space occupied and improvements such as the installation of light sensors in common areas.

We also recycled office furniture and equipment that was surplus to requirements as a result of the office relocation rather than disposing of it, with all proceeds from the sale of surplus materials being donated to the Society's Charity of the Year.

In addition, a number of initiatives have already been introduced including a 'cycle to work' scheme which has resulted in a significant increase in staff using bikes as their means of travel to work and a greater number of staff using public transport.

Our People

We pride ourselves on the quality of our staff and keeping them involved as we develop our strategy. We have a strong workforce who continue 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.

The Society also supports its staff to help them gain relevant qualifications in their respective field of expertise. During 2014, the Compliance Officer in 425 achieved further exam success in the CII exams to become Diploma qualified and the 425 Independent Advice team continue their progress to achieve 'Chartered' status. Within National Friendly, the Senior Trainee Actuary celebrated further success as she moves closer to becoming fully qualified and the Executive PA will complete her studies to achieve a BA Honours in Business Studies in 2015.

Staff policies and contracts

Starting in 2014 and into early 2015, a project is ongoing to review and update all HR related policies to ensure we continue to meet statutory requirements, provide consistency across the Society and provide better understanding to managers and staff. This review has also included a review of employee contracts and new contracts were issued to all staff to provide clearer understanding of individual employment terms.

Code of Conduct

The Society wants to promote a culture of honesty and integrity in all circumstances. All employees of National Friendly and its subsidiaries, including 425 Financial Solutions are required to behave in a responsible way and abide by the highest ethical standards and in relation to the values of the Society.

At the start of 2014, the Society issued a documented Code of Conduct to all staff to provide information and principles on how to behave in various situations and key policies including Conflicts of Interest and Data Protection framework. Each employee is required to sign up to this Code of Conduct to confirm that they:

1. Comply with the Code and all relevant laws and regulations.
2. Act with the highest ethical standards and integrity.
3. Act in the best interests of the customer.
4. Provide a high standard of service.
5. Comply with working policies and practices.

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 will be 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 will be regarded as misconduct and could lead to disciplinary proceedings.
- The Equality and Diversity policy is fully supported by senior management and the Board.

National Friendly Group Diversity*

Level	Total	Male		Female	
Group Board (NEDs and Executive Director)	6	5	83%	1	17%
Heads of Functions	1	0	0%	1	100%
Managers	13	9	69%	4	31%
Other staff	37	15	41%	22	59%
TOTAL	**57**	**29**	**51%**	**28**	**49%**

*As at 31 December 2014

Ethical Suppliers
We continue to deal with our customers and suppliers responsibly by:

- Being open and honest about our products and services.
- Using local suppliers wherever possible and appropriate.
- Working with suppliers and distributors who take steps to minimise their environmental impact.

Approved on behalf of the Board of Directors
Jonathan Long

27 March 2015
Chief Executive Officer

Our Services

We continued to offer the following services to our members during 2014:

Financial advice and comparison services

425 Financial Solutions (425) is a wholly owned subsidiary of National Friendly and provides invaluable financial advice and guidance in retirement planning and protection.

425 continues to provide an open market option when shopping around for annuities. However, following the Government's pension reform announcement in March 2014 we saw the volume of annuities purchased significantly reduce as consumers chose other options available to them or postponed their retirement until further new options come into effect from April 2015.

During this time of change, the 425 team has provided impartial guidance and advice to customers needing to understand their options.

We expect to see a surge in customers seeking retirement guidance and advice from April onwards and encourage National Friendly members approaching retirement to seek professional guidance in order to fully understand their options.

Retirement planning advice service.
Whether you're planning ahead, about to retire or already in retirement, 425 can help.

- They are experts in retirement planning including pensions, annuities, investments and estate and trust planning.
- Their specialist phone-based service makes it easy for you to contact them.
- They will provide an initial review of your circumstances without charge or obligation. If you wish to proceed they are competitively priced and agree any charges up front.

Financial protection – quote comparison service.
Protect your home, your partner, your family and all the things you've worked hard for with a carefully selected insurance policy through 425.

- They are experts in life cover and protection including life insurance, critical illness cover, funeral plans and long term income replacement.
- They make finding and comparing quotes easy – just call them and they'll do the rest.
- There's no fee and no obligation to purchase. 425 simply receives a commission payment from your chosen policy provider.

To find out more please call **425 Financial Solutions** on 0333 006 9707 (9am-5.30pm weekdays) or visit **www.425fs.co.uk**

Care advice service

The Care Advice Service is provided in partnership with Grace Care at a special discounted rate of £60 instead of the usual £120. This service is available to anyone who may be in need of later life care whether it may be for you, a family member or a friend.

The Care Advice Service is provided over the telephone. Each telephone consultation is conducted by one of Grace Care's advisers, who we believe have unrivalled knowledge of the range of care options and providers that are available to you.

During the telephone consultation your Grace Care adviser will:

- Talk to you about the needs and wishes of the person needing care.
- Provide a clear view of all the care options available – at home, in a care home or a solution which combines both.
- Have the key information needed to advise on the state benefits and allowances available.

At the end of the consultation they'll send you a summary of your call as well as relevant fact sheets. They can also provide more in-depth services if you feel you would like further advice and support from them.

To access the special offer or to find out more call us on 0800 195 9247 (8am-6pm weekdays) or visit **www.nationalfriendly.co.uk/care**

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 UK Corporate Governance Code 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 review.

Role of the Board

The Board's principal role is to determine the strategic direction of the Society ensuring the necessary financial and human resources are in place to meet its objectives and that financial control and risk management procedures are robust. In particular, it has a general duty to ensure that relevant legislation and regulations are adhered to, and that proper accounting records and effective systems and controls are established, maintained, documented and audited to safeguard the interests of members.

The Board meets a minimum of six times a year, and more often if necessary. Additionally it meets at least once a year for 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 23-25. 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, 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 2014 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 five Non-Executive Directors and one Executive Director at the start of 2014. In March 2014, with the departure of one Non-Executive Director, and then in September with the appointment of an additional Executive Director, it now comprises four Non-Executive Directors and two Executive Directors.

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 will be available to members if they have concerns which 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, the Non-Executive Directors are considered to be 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 24), 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 must always be made on merit as well as the skills, knowledge and experience of the Board as a whole.

The Code requires that the recruitment process for Directors involves relevant sources of external opinion, where appropriate. However, no external search consultancy was used for the appointment of Geoff Brown as Non-Executive Director. The Board agreed that Geoff provided an excellent match to the required skills and expertise at Board level in respect of actuarial and risk management experience, having held various senior positions over the last 20 years with Bupa Group as both Chief Risk Officer and Chief Actuary. Geoff was put forward for interview by the Nomination Committee as the first potential candidate and following a thorough interview to confirm experience and commitment the Nomination Committee recommended Geoff for the role.

All Directors are subject to election by members at the AGM following their appointment and re-election at least every three years. Any Non-Executive Director who has served the Society f or 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 the Financial Conduct Authority ('FCA') as an Approved Person. Accordingly, they are required to meet the tests of fitness and propriety set out by the regulators and to comply with their Principles for Approved Persons and Codes of Practice.

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 ensures 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.

The Secretary and Chief Executive Officer roles were the remit of one person until March 2014; this person was also responsible for the good flow of information between the Board, its committees, senior management and Non-Executive Directors. This combination of roles is now no longer the case with the appointment of Sandy Richards as Secretary on 18 March 2014.

Performance Evaluation

The Society considers as part of its Board evaluation 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 Officer 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 Code requires an externally-facilitated evaluation of the Board's performance to be conducted at least every three years. The Board recognises that its last external evaluation was completed at the end of 2010 and therefore is now overdue. The Board commissioned the Society's Internal Auditors in 2014 to undertake a review on the appropriateness of the Society's governance framework. The audit review gave a favourable opinion and the suggestions for improvement have been taken forward by the Board.

The Board considers that given the change in Chairman and departure of two Non-Executive Directors (including the previous Chairman), appointment of one new Non-Executive Director and one Executive Director in 2014, it was appropriate to postpone an external formal evaluation on the Board's performance until the new Board structure has been embedded for a number of months. Therefore, such a review is planned during 2015.

The Board has continued to undertake a formal self-evaluation exercise of its own performance and that of its Committees on an annual basis.

Audit Committee

Members	Responsibilities
Peter McIlwraith (Chairman) **Mark Jackson** **Tracy Morshead** (until 31 March 2014) **John Greenhalgh** (retired 22 July 2014) **Geoff Brown** (appointed to Committee 1 June 2014)	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 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 Executive Directors and internal and external auditors attend meetings of the Committee as appropriate. The internal and external auditors also have meetings with the Committee without the Executive Directors or any other members of staff present.

Internal audits of the regulated business are conducted by an independent external firm that reports to the Committee.

Investment Committee

Members	Responsibilities
Alan Lewis (resigned 31 March 2014) **Tracy Morshead** (appointed to Committee 1 April 2014) **Amanda Brown** (Head of Actuarial Function) **John Greenhalgh** (retired 22 July 2014) **Geoff Brown** (appointed to Committee 1 June 2014) **Jonathan Long** **Peter McIlwraith**	The Investment Committee meets as required but at least four times a year to ensure 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-Profit and non With-Profit 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.

Nomination Committee

Members	Responsibilities
Peter McIlwraith (Chairman) **John Greenhalgh** (retired 22 July 2014) **Geoff Brown** (appointed to Committee 1 June 2014) **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 and are normally consulted to ensure that non-executive vacancies on the Board are considered appropriately resulting in reduced reliance on the personal connections of any of the existing Board members. 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 review the remuneration policy and determines the remuneration packages of Executive Directors and senior managers. The remuneration of Non-Executive Directors is based upon a survey of similar organisations carried out and recommended by the Executive Directors and approved by the Board. Further details on Directors' remuneration are set out in the Directors' Remuneration Report on pages 34-36.

Risk & Compliance Committee

Members	Responsibilities
John Greenhalgh (Chairman) (retired 22 July 2014) **Geoff Brown** (Chairman) (appointed to Committee 22 July 2014) **Alan Lewis** (resigned 31 March 2014) **Tracy Morshead** (appointed to Committee 1 April 2014) **Jonathan Long** **Sandy Richards** **Amanda Brown** (Head of Actuarial Function)	The Risk Management Committee meets at least four times a year. The main function of the Committee is to provide the Board with advice on risk strategy and appetite and oversight of current risk exposures. It also provides assurance that the Society's risks are identified, recorded, monitored and managed effectively. The Committee has the additional responsibility of providing oversight of the Society's governance and regulatory compliance arrangements and their on-going effectiveness. The Chairman of the Committee meets the Head of Finance & Risk at least once a year, without management present, to discuss their remit and any issues arising from the risk and control assessments that have been carried out.

With-Profit Advisory Arrangement

Members	Responsibilities
John Greenhalgh (Chairman) (retired 22 July 2014) **Geoff Brown** (Chairman) (appointed to Committee 22 July 2014) **Mark Jackson** **Tracy Morshead** (until 31 March 2014)	The With-Profit Actuary attends meetings of the Advisory Arrangement as appropriate. The With-Profit 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 ensure that the Society complies with the requirements of the FCA & PRA Handbooks over the management and governance of With-Profit business.

Executive Committee

Responsibilities
The Executive Committee forms part of the 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								
J Greenhalgh ****	5	5	2	2			1	1
M Jackson	8	8	4	4	3	3	1	1
A Lewis ***	2	2	1	**				
P McIlwraith	8	8	4	4	3	3	1	1
T Morshead	8	8	1	1	3	3	1	**
G Brown	5	5	3	3			1	1
Executive								
J J Long	8	8	4	**	3	**	1	**
S Richards	3	3	2	**				

	Investment Committee		Risk & Compliance Committee		With Profit Advisory Arrangement	
	Meetings attended	Meetings held *	Meetings attended	Meetings held *	Meetings attended	Meetings held *
Non-Executive						
J Greenhalgh ****	3	3	2	2	3	3
M Jackson	1	**			3	3
A Lewis ***	1	1	1	1		
P McIlwraith	4	4			1	**
T Morshead	3	3	3	3	2	1
G Brown	2	1	3	2	2	**
Executive						
J J Long	4	4	4	4	3	**
S Richards	1	**	2	2		

* Meetings held whilst appointed to Board/Committee

** Attendance on an invitation basis

*** Resigned 31 March 2014

**** Retired 22 July 2014

Statement of Compliance with the Annotated Combined Code

The Board considers that throughout 2014 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 Provision C.1.1 of the UK Corporate Governance Code – An Annotated Version for Mutual Insurers ('the Code'), the Board states that it considers the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and Society's performance and strategy.

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

1. The Board notes the recommendation of the Code that Directors of larger organisations be subject to annual election by members. The Board considers, however, that the existing arrangements for re-election ensures proper accountability and underpins board effectiveness.
2. Peter McIlwraith has served on the Board for more than nine years from the date of first election and therefore, is subject to annual re-election, after having given consideration to independence.
3. Geoff Brown was recruited as Non-Executive Director without using an external search consultancy or open advertising. Geoff was recommended to the Board as he has a strong background and provides the required skills and expertise at Board level in respect of actuarial and risk management experience and therefore,was considered appropriate for the appointment.
4. The Code requires an externally facilitated evaluation of the Board's performance to be conducted at least every three years. The Board recognises that this is now overdue and therefore, it commissioned the Society's Internal Auditors in 2014 to undertake a review on the appropriateness of the Society's governance framework, and a performance evaluation will be planned in 2015.

Annual General Meeting

The 2014 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 as Auditors.
- Re-election of Peter McIlwraith as Non-Executive Director and the appointment of Geoff Brown as Non-Executive Director.
- Amendments to the Memorandum and Rules of the Society.

The response from members submitting their postal/proxy forms was just over 10% 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 2015 AGM to be held again in London.

The Board

Board of Directors

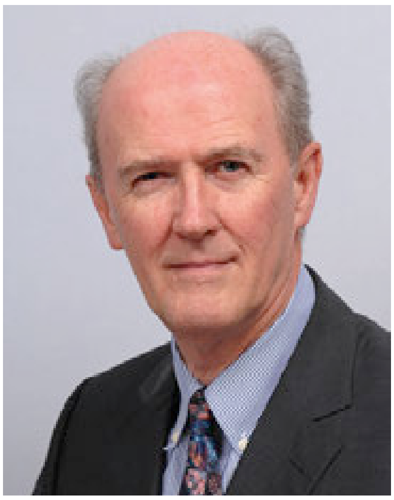
A list of Directors of the Board, who held office during the year, appears below.

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 Consulting Ltd, a Non-Executive Director of Assurant Group Limited, a Non-Executive Chairman of Mortgage Brain Holdings Ltd, a leading financial services software company, and a Non-Executive Director of Newbury Building Society. Tracy joined the National Friendly Board in June 2009 as a Non-Executive Director and was appointed as Chairman of the Board effective from 1 April 2014.

Jonathan Long
(Chief Executive Officer)

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



Peter McIlwraith
(Senior Independent Non-Executive Director)

Peter is a Chartered Accountant. He was a partner with PricewaterhouseCoopers (and prior to that Price Waterhouse) and was the Regional Chairman for the West and Wales and Senior Partner in Bristol from 1991 to 2001. Peter is also a Non-Executive Director of Bristol Water Plc.

Mark Jackson
(Non-Executive Director)

Mark is a medical doctor, a former GP and successful business man. Mark was CEO of Helphire which he founded and developed to the point of flotation on the main London Stock Exchange. He was also the co-founder and Non-Executive Chairman of The Assura Group from 2003 to 2008, and Non-Executive Deputy Chairman of Allied Healthcare, a company of Saga plc.

Geoff Brown
(Non-Executive Director)

Geoff is a qualified Actuary and has 44 years of experience in the financial services industry. He has spent most of his career in the health and care sector including 20 years with international healthcare company Bupa, where he had 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 Non-Executive Director of Medicover Forsakrings AB (publ.) which provides healthcare insurance propositions for individuals and companies in Poland, Romania and Hungary.

Sandy Richards
(Executive Director)

Sandy was appointed as Secretary to the Society on 18 March 2014 and as a Director on 1 September 2014, heading up our Finance, Risk 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 (a subsidiary of BNP Paribas), the Higher Education Funding Council for England and at the Royal Bank of Scotland, before joining the Society in 2012. Sandy is a qualified Fellow Chartered Certified Accountant.

Business Objectives and Activities

The Society's objective is to provide our policy-holders with products and services that look after their 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 change in line with the Society's objectives and priorities. For 2014 the KPIs were focused on capital management and, in particular, the restoration of free capital, system development, cost efficiency and profitability of 425 Financial Solutions.

The principal activities of the Society's subsidiaries are as follows: 425 Direct Ltd (trading as 425 Financial Solutions) operates two telephone based financial services, independent advice and a compare and buy service, while ND Member Services is dormant.

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 the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Disclosure of Information to Auditors

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

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 62.

The aggregate remuneration paid to Directors and staff employed by the Group during the year amounted to £2.6 million (2013: £3.0 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 page 11.

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 National Deposit Foundation Fund made charitable donations of £5,000 (2013: £6,009). There were no political donations (2013: £nil).

Re-appointment of Auditors
A resolution to re-appoint PricewaterhouseCoopers LLP as Auditors will be proposed at the forthcoming Annual General Meeting.

Approved on behalf of the Board
Sandy Richards
Secretary

27 March 2015

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.

Membership of the Committee was further strengthened in 2014 with the appointment of Geoff Brown as Non-Executive Director, with extensive actuarial and risk experience in the healthcare insurance sector. Geoff also chairs the Risk and Compliance Committee so that the two committees work together effectively to cover all relevant issues and ensure that any pertinent areas of overlap are appropriately addressed.

Appointment of the External Auditor

The Committee considers the reappointment of the external auditor, including the rotation of the audit partner, every year and also assesses their independence, the objectivity of the external audit and the effectiveness of the audit process on an ongoing basis. The external auditor is required to rotate the audit partner responsible for the Society audit every ten years. The current lead audit partner has been in place for seven years.

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

Accordingly a resolution proposing the reappointment of PricewaterhouseCoopers as our auditor was put to the members at the 2014 AGM and approval gained.

The Audit Committee approves and monitors the use of the external auditors for non-audit work to safeguard the continued independence and objectivity of the external auditors. The external auditors undertook a number of non-audit assignments during 2014 and in the opinion of the Audit Committee, these were considered to be consistent with the professional and ethical standards expected of the external auditors. The cost of this work for the year ended 31 December 2014 totalled £20,520 and related to IT advisory in connection with the development of our policy administration system.

Areas of particular focus

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

Significant Issue	How it was addressed
Assessment of morbidity assumptions and calculation of related liabilities	The Society has in place monthly procedures to analyse morbidity experience on Healthcare and Healthguard contracts. In addition, more 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. External specialist expertise is used to assist with the analysis and interpretation of morbidity data and trends. A quarterly review with the third party claims administrator includes analysis of claims experience and trends. The Society's Internal Auditors 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. Pillar 1 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 quarterly 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.
Allocation of costs relating to policy guarantees	The Society's With-Profit Actuary undertook a review of the approach to the allocation of the cost of policy guarantees. The PPFM allows the cost of guarantees to be deducted from surplus in the event that the inherited estate is below the minimum target level. The Society has adopted the recommendations made by the With Profits Actuary, including - that the approach would be applied from 1 January 2014 onwards. - the cost of guarantees each year will be charged to all with-profit policies by means of a reduction in the investment return credited to asset shares and therefore the proportional impact should be limited. - the cost will not be applied prior to being incurred; and - if the Society improves its financial position such that when the inherited estate surplus increases to over 10% of liabilities, then the adjustment in future years should be reduced or removed. The Board has reviewed the methodology used for the calculation in the 2014 year-end financial statements. It has considered the legal advice obtained in adopting this approach and determined that the approach is fair to all policyholders.
Adequate and Effective Control framework	The Society's Internal Auditors undertake financial, operational and strategic audits across the Society using a risk based approach. The internal audit function is provided by an outsourced partner and is 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 2014, internal audits were completed in areas including claims management, premium processing, finance operations, treating customers fairly and Governance. Internal Audit provided an overall annual opinion that the Society has a satisfactory framework of risk management, governance and internal control.

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

Peter McIlwraith
Chairman of the Audit Committee

27 March 2015

Directors' Remuneration Report

Introduction

The Board is committed to best practice in its remuneration policy for Directors. This Report of the Directors on Remuneration explains how the Society applies the principles in the Annotated Code for Mutual Insurers on 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. Data and advice provided by the remuneration specialists, Smith & Williamson, was also used to benchmark salary levels within the Society during the year.

Remuneration Committee

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

The Remuneration Committee is appointed by the Board and all members of the Committee are Non-Executive Directors. The Chief Executive Officer attends meetings of the Committee as appropriate.

The Committee, within the terms of the Remuneration policy agreed by the Board, sets the level of remuneration for the Chief Executive Officer 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 remuneration policy is designed to attract, retain and motivate good quality staff.

Remuneration for Executive Directors is in three parts comprising a basic salary, a non-pensionable annual performance award linked to each individual Director's own contribution to the Society and a non-pensionable long term incentive plan ('LTIP') linked to the achievement of strategic objectives over a potentially four year period, all designed to enhance overall business performance. Currently no LTIP is in place but this is a matter that will be given further consideration by the Remuneration Committee as capital restoration continues. In addition, Executive Directors receive a car cash allowance and access to benefits such as membership of a defined contribution pension scheme, private medical insurance and death in service benefit.

Remuneration for Non-Executive Directors comprises a basic fee plus a supplement for the Chairman of the Board and Senior Independent Non-Executive Director based primarily upon the time commitment required for the role.

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 March 2015

CHAIRMAN'S REVIEW
FINANCIAL HIGHLIGHTS
STRATEGIC REPORT
DIRECTORS' REPORT
AUDIT COMMITTEE REPORT
REMUNERATION REPORT
INDEPENDENT AUDITORS' REPORT
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NOTES TO THE ACCOUNTS

Directors' Emoluments

	Salaries & Fees £	Performance Related Pay £	Other Benefits[1] £	Total 2014 £	Total 2013 £
Chairman					
Alan Lewis (resigned 31 March)	10,000	-	-	10,000	40,000
Tracy Morshead[2]	45,250	-	-	45,250	31,000
Executive Directors					
Jonathan Long[3 4]	148,530	28,840	28,624	205,994	200,304
Sandy Richards[4] (appointed 1 September 2014)	33,333	-	7,160	40,493	-
Ian Talbot (resigned 20 March 2013)	-	-	-	-	29,640
Non-Executive Directors					
Geoff Brown (appointed 1 June 2014)	16,042	-	-	16,042	-
John Greenhalgh (retired 22 July 2014)	15,417	-	-	15,417	25,000
Mark Jackson	26,875	-	-	26,875	25,000
Peter McIlwraith	36,500	-	-	36,500	30,000
Total				**396,571**	**380,944**

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

[2] Appointed Chairman of the Board on 1 April 2014. The Chairman also provides Non-Executive support and chairs the Board of National Friendly's subsidiary company, 425 Direct Ltd.

[3] Performance related pay relates to 2013 but was awarded in 2014. Part payment of performance related pay deferred for 2010, 2011 and 2012 will be made in March 2015 with the balance paid in 2016 subject to continued capital restoration.

[4] Assessment of performance related pay for the Executive Directors for 2014 has been deferred until Q2 2015.

Emoluments have been pro-rated to reflect the period of service as a director if less than one year.

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 2014 £	Accrued pension as at 31/12/2014 £	Accrued pension as at 31/12/2013 £	Closing value at 31/12/2014 £	Opening value at 31/12/2013 £	Pension input amount over 2014 £
Jonathan Long	8	136	4,642	4,506	92,831	92,558	273

At the AGM, members voted on the resolution to approve the 2013 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 2013 remuneration report:

Number of votes cast for	Percentage of vote cast for	Number of votes cast against	Percentage of votes cast against	Total votes cast	Number of votes withheld
3,757	92%	181	4%	4,066	128

Executive Directors

Base Salaries

Base salaries are normally reviewed annually by reference to jobs carrying similar responsibilities in comparable organisations. Salary amendments are normally effective from 1 January each year.

Performance Related Pay

The Executive Directors have a part of their total emoluments linked to performance. The current annual performance related pay scheme represents up to a maximum of 30% of base salaries. The Remuneration Committee retains absolute discretion in the final determination of the total performance related pay.

The performance related pay scheme comprises two elements. The first which is assessed on a collective basis has identified four major corporate objectives and all Executive Directors participate on the same basis. The maximum amount payable under this element is 10% of base salaries.

The second element is an individual performance related programme where the Executive Directors are assessed against personal goals and objectives. The individual performance related element of the scheme can award up to a maximum 20% of base salaries.

LTIP

The Remuneration Committee is giving consideration to a successor to the previous LTIP (Long Term Incentive Plan) scheme.

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.

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 generally for a period of three years and is subject to election and re-election at the Society's AGM.

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 auditors' report to the members of National Deposit Friendly Society

Report on the group financial statements

Our opinion

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

- give a true and fair view of the state of the Group's and the Society's affairs as at 31 December 2014 and of the Group's and the Society's income and expenditure for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Friendly Societies Act 1992.

What we have audited

The financial statements, which are prepared by National Deposit Friendly Society ("the Society"), comprise:

- the Group and Society Balance Sheets as at 31 December 2014;
- the Group and Society Income Statements and Statements of total recognised gains and losses for the year then ended; and
- the notes to the financial statements, which include the accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our audit approach

Overview

- Overall group materiality: £175,000 which represents 1.75% of the fund for future appropriations
- The Group financial statements are a consolidation of three entities; the Society, 425 Direct Limited and ND Member Services Limited
- We performed an audit of complete financial information for the Society and 425 Direct Limited
- ND Member Services Limited is a dormant entity representing <1% of net assets, and is therefore considered immaterial to the Group
- Valuation of long-term business provision – morbidity, lapse, expense and cost of guarantees assumptions
- Segregation of duties

The scope of our audit and our areas of focus

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

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

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

Area of focus	How our audit addressed the area of focus
Valuation of long-term business provision The Society's financial statements include liabilities for the estimated cost of settling benefits and claims associated with long term products, including healthcare products, written by the Society. The long-term nature of the liabilities means that calculating their value is inherently uncertain because it involves making assumptions about future circumstances or events. In particular, in valuing the long-term business provision, the Society needs to take into account a range of demographic factors about its policyholders, including health-related factors. It also needs to make estimates of the likelihood that a policy will be retained year to year, the likely level of future per-policy expenses and future expenses related to guarantees. This is therefore an area of significant focus in our audit. In particular, we focused on the following assumptions and methodologies, to which the valuation of the provision is most sensitive, because small changes in them can result in material changes in the valuation:	Our work to address the valuation of the long-term business provision included the following procedures: • testing the underlying Society data, including key reconciliations; and • comparing the methodology, models and assumptions used against recognised actuarial practices and by applying our industry knowledge and experience. No exceptions were noted when performing these procedures. Further testing was also conducted on specific assumptions and methodologies, including our areas of focus, as set out below.
a) Morbidity assumption	**a) Morbidity assumptions**
See note 1 to the financial statements for the directors' disclosures of the related accounting policies, judgements and estimates, the Audit Committee Report areas of particular focus and note 19 for detailed long-term business provision disclosures. The morbidity assumptions are used to estimate the number of policyholders that will develop a disease, disability, or enter into poor health, triggering a claim to the Society. Judgements around these estimates are complex and highly subjective. We focused specifically on the morbidity assumptions in relation to Healthcare, Healthguard and Old Deposit products, because morbidity experience on these products has historically been volatile. The directors have estimated the rate of morbidity with reference to industry morbidity tables and the historic experience data of the Society.	We considered the appropriateness of the morbidity assumptions used by the directors in the calculation of the long-term business provision. Our work included: • comparing the assumptions to the Society's historical claims experience. In assessing the differences we considered the historical trends in the Society's experience along with future morbidity expectations using industry data tables and found them to be supportable; • assessing the appropriateness of morbidity prudence margins by testing the historical precision of the directors' estimates around expected claims. We compared the outturn of actual claims costs to expected claims costs for the last four years, and determined that the directors' estimates of margins for the current year were consistent with this experience; and • testing the reliability and completeness of the experience data used by the directors by agreeing it to source systems and, for a sample of items, agreeing it to independent supporting evidence such as invoices for claims amounts held by the Society's third party policy administrator. We consider that the experience data used by the directors was fit for this purpose and we did not identify any matters that caused us to question its reliability.

Area of focus	How our audit addressed the area of focus
(b) Lapse assumptions	**(b) Lapse assumptions**
See note 1 to the financial statements for the directors' disclosures of the related accounting policies, judgements and estimates, the Audit Committee Report areas of particular focus and note 19 for detailed long-term business provision disclosures. The lapse assumptions are used to estimate the number of policyholders that will terminate their policies in any particular year. We focused on lapse assumptions for Healthcare, Healthguard and Old Deposit products in particular, because the lapse experience on these products has historically been volatile given they have been impacted by changes to the policy terms and conditions relating to Own-Share and top-up benefits in recent years. The directors have estimated the lapse assumptions using the historic experience data of the Society.	We tested the methodology used to derive the lapse assumptions used by the directors in the calculation of the long-term business provision. Our work included; • assessing the appropriateness of the experience data used to derive the assumptions and comparing the assumptions to trends in the underlying data on both a long-term and short-term basis. We found the assumptions to be supportable given the experience data. We also assessed the appropriateness of how certain one-off events such as lapses caused by changes to top-up policies were treated, as we would expect these policies to follow a different lapse profile. We determined that the directors had reflected these one-off events appropriately in the assumptions; and • agreeing the experience data used by the directors to the Society's books and records to check that a complete and accurate data set was used, finding no material differences.
(c) Expense assumptions	**(c) Expense assumptions**
See note 1 to the financial statements for the directors' disclosures of the related accounting policies, judgements and estimates and note 19 for the financial impact of the changes in these assumptions. The expense assumptions are used to estimate the level of expenses per policy for the remaining period in the future for which each policy is expected to be in-force (i.e. not to have lapsed). The directors make these assumptions using expenses incurred during the current financial year, excluding those expenses that are considered one-off in nature and adjusting for any known future expenses that the Society is committed to. We focused on this area because it involves complex and subjective judgements to be made by the directors about future events, both internal and external to the business, such as the allocation of expenses to the Society's subsidiary 425 Direct which is currently loss making. This impacts the expenses allocated within the Society itself. If too little expense is allocated per policy, the long-term business provision would be understated.	We assessed the appropriateness of the methodology used by the directors to derive the expense assumptions by comparing the expenses used in the per policy expense assumptions to the actual level of expenditure incurred during the year. We evaluated differences by; • challenging the classification of excluded one-off expenses and agreeing a sample of these to the Society's underlying records and supporting documentation; • comparing previous yearly forecasts to actual expenditure to assess the precision of estimates made by the Society when considering the appropriateness of future expenses; • assessing whether the proposed management actions, that have an impact of the expected future level of expenses, were enforceable by agreeing that the actions were consistent with board plans and forecasts. We found the differences to be supportable. Through the procedures performed, we considered that the directors' expense assumptions were appropriate.

Area of focus	How our audit addressed the area of focus
(d) Cost of guarantees	**(d) Cost of guarantees**
See note 1 to the financial statements for the directors' disclosures of the related accounting policies, judgements and estimates, the Strategic report, the Audit Committee Report areas of particular focus and note 2 for the analysis of with-profit liabilities. The cost of guarantees is a future expense, representing the difference between the guaranteed value of with-profit policies and the expected future value or asset share of those policies, which is required to be provided for. This cost has previously been met by the Society but, as set out in the Strategic report on page 9, given that the FFA remains below the Society's target level (10% of total liabilities), the directors have determined it is appropriate to deduct a proportion of the cost of guarantees from the surplus available to provide policyholder benefits. This has had an impact of reducing the long-term business provision as set out in note 2 to the financial statements. We focused on this area given it is a change in methodology from prior year and the significant impact it has had on the long-term business provision.	We assessed the appropriateness of the change in methodology to deduct the cost of guarantees from the surplus available to provide policyholders benefits by agreeing that it is permissible under the Society's with-profit Principles and Practices of Financial Management (PPFM). To support this conclusion we used our actuarial expertise to consider whether the change in methodology was in-line with relevant guidance and regulations and determined that it was. In doing so we considered legal advice that the Society sought, and the report produced by the Society's independent external with-profit actuary; we determined that both the legal advice and with-profit actuary supported the consistency of the change in methodology with the PPFM and relevant guidance and regulations. In addition, in light of the complexity of the methodology, we performed detailed testing of the calculation and found it to be in line with the directors' revised methodology.

Area of focus	How our audit addressed the area of focus
Segregation of duties See note 1 to the financial statements for the directors' disclosures of the related accounting policies, judgements and estimates. Due to the small size of the Society's management team, small number of executive directors and a high level of manual processing, there is an inherent difficulty within the Society to enforce segregation of duties. The non-executive directors provide independent challenge over the significant judgements (such as the assumptions included as areas of focus above). However, given the nature of their role, they are not involved in the day to day running of the Society and therefore the scope of their challenge is limited to the more significant matters. As such, we focussed on this area because we consider there to be a heightened risk of material misstatement due to management override of controls or undetected error. In addition, ISAs (UK & Ireland) require that we focus our work on the risk of management override of controls.	We addressed this area of focus through performing substantive testing throughout our audit rather than seeking to rely on controls. We considered whether there was evidence of bias by management in the significant accounting estimates and judgements relevant to the financial statements, in particular in the valuation of the long-term business provision discussed above. We determined that the estimates and judgements applied were appropriate. In addition, we performed a test to identify significant or unusual journal transactions; we then agreed the transactions to supporting documentation and found them to be valid.

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

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

We performed an audit of the complete financial information for the Society and 425 Direct Limited, which gave us the evidence we needed for our opinion on the Group financial statements as a whole. ND Member Services limited ("NDMS") is a dormant entity representing <1% of net assets and is considered immaterial to the Group. As such we did not consider it necessary to perform audit work on NDMS in support of the opinion on the Group financial statements.

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

Based on our professional judgement, and consistent with last year, we determined materiality for the financial statements as a whole as follows:

Overall group materiality	£175,000 (2013: £148,000).
How we determined it	1.75% of the fund for future appropriations.
Rationale for benchmark applied	We believe the fund for future appropriations was the most appropriate benchmark as it best reflects the underlying interests of the members.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £8,750 (2013: £7,400) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Other required reporting

Consistency of other information
Friendly Societies Act 1992 opinion
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and has been prepared in accordance with the Friendly Societies Act 1992 and the regulations made under it.

ISAs (UK & Ireland) reporting
The directors comply with the UK Corporate Governance Code – An Annotated version for Mutual Insurers ("the Code"). Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

• information in the Annual Report is: – materially inconsistent with the information in the audited financial statements; or – apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Growup and Society acquired in the course of performing our audit; or – otherwise misleading.	We have no exceptions to report arising from this responsibility.
• the statement given by the directors on page 27, in accordance with provision C.1.1 of the Code, that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and Society's performance, business model and strategy is materially inconsistent with our knowledge of the Group and Society acquired in the course of performing our audit.	We have no exceptions to report arising from this responsibility.
• the section of the Annual Report on page 33, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report arising from this responsibility.

Propriety of accounting records and information and explanations received

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

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

We have no exceptions to report arising from this responsibility.

Other voluntary reporting

Matter on which we have agreed to report by exception

Corporate governance statement

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

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

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

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

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

What an audit of financial statements involves

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

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

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

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

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

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

27 March 2015

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

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

Income Statement

For the year ended 31 December 2014

	Notes	Group 2014 £'000	Group 2014 £'000	Group 2013 £'000	Group 2013 £'000	Society 2014 £'000	Society 2014 £'000	Society 2013 £'000	Society 2013 £'000
Gross premiums written and payments to deposit	4	13,750		15,774		13,750		15,774	
Outward reinsurance premiums		(21)		(28)		(21)		(28)	
Earned premiums net of reinsurance			13,729		15,746		13,729		15,746
Investment income	5		12,742		5,177		12,742		5,177
Unrealised gains / (losses)									
– Investments	5		4,705		2,128		4,705		2,128
– Assets held to cover linked liabilities	5		(245)		565		(245)		565
Other technical income	6		991		1,276		46		28
			31,922		**24,892**		**30,977**		**23,644**
Gross claims paid		20,449		25,258		20,449		25,258	
Reinsurers' share		-		(183)		-		(183)	
Net claims paid			20,449		25,075		20,449		25,075
Change in provision for claims			46		1,064		46		1,064
Change in long term funds Long term business provision			3,744		(10,067)		3,744		(10,067)
Investment contract liabilities			(196)		174		(196)		174
Provision for linked liabilities	21		(108)		(57)		(108)		(57)
Investment contract on linked liability	21		17		87		17		87
Bonuses and rebates			(160)		(18)		(160)		(18)
Net operating expenses	7a								
Acquisition costs		1,017		1,361		-		-	
Administrative expenses		3,847		4,277		3,382		3,847	
			4,864		5,638		3,382		3,847
Other technical charges – project costs	7b		1,228		1,295		1,191		1,372
– other			8		18		8		18
Investment expenses	8		992		707		992		707
Impairment of subsidiary	24		-		-		589		543
Redundancy and end of contract term payments			32		98		17		98
FRS17 retirement benefit charge/(credit)	20		17		79		17		79
Tax attributable to long term business	11a		20		99		20		99
Transfer to/(from) the fund for future appropriations			969		700		969		623
			31,922		**24,892**		**30,977**		**23,644**

All operating activities relate to continuing operations conducted in the United Kingdom. Neither gains nor losses of an insurance group arising on the holding or disposal of investments; nor the effect of fair value accounting for financial instruments is required to be included in a note of historical profit and losses. There are no other differences between the profit on ordinary activities before tax and the profit for the financial year stated above and their historical cost equivalents.

The information on pages 47 to 75 form an integral part of these financial statements.

Balance Sheet

As at 31 December 2014

Assets		Group				Society			
		2014		2013		**2014**		2013	
Investments	Notes	**£'000**	**£'000**	£'000	£'000	**£'000**	**£'000**	£'000	£'000
Land and buildings	12	27,551		24,672		27,551		24,672	
Other financial investments	13	110,427		109,673		110,427		109,673	
Investment in subsidiaries	24	–		–		12		21	
			137,978		134,345		137,990		134,366
Assets held to cover linked liabilities	16		2,056		3,183		2,056		3,183
Reinsurers' share of technical provisions	3		248		269		248		269
Debtors – Loans and receivables									
Debtors arising from direct insurance operations	3	274		293		204		254	
Other debtors	3	1,382		1,548		1,470		1,579	
			1,656		1,841		1,674		1,833
Other assets									
Tangible assets	17	1,733		832		1,711		832	
Cash at bank and in hand	14	146		186		97		159	
Net pension asset	20	–		23		–		23	
Deferred tax asset	11c	–		20		–		20	
			1,879		1,061		1,808		1,034
Prepayments and accrued income – Loans and Receivables									
Accrued interest and rent		2,101		715		2,101		715	
Other prepayments and accrued income		176		171		146		145	
			2,277		886		2,247		860
			146,094		**141,585**		**146,023**		**141,545**

The information on pages 47 to 75 form an integral part of these financial statements.

Balance Sheet (continued)

As at 31 December 2014

Liabilities	Notes	Group 2014 £'000	Group 2014 £'000	Group 2013 £'000	Group 2013 £'000	Society 2014 £'000	Society 2014 £'000	Society 2013 £'000	Society 2013 £'000
Fund for future appropriations			10,882		10,173		10,924		10,215
Technical provisions									
Long term business provision	19	125,446		121,723		125,446		121,723	
Investment contract liabilities		162		451		162		451	
Claims outstanding		4,385		4,339		4,385		4,339	
Provision for bonuses and rebates		672		832		672		832	
			130,665		127,345		130,665		127,345
Technical provision for linked liabilities	21		1,287		1,395		1,287		1,395
Investment contract liabilities on linked liability fund	21		379		375		379		375
Provision for other risks and charges									
Net pension liability	20		43		–		43		–
Derivatives	26		603		132		603		132
Creditors									
Arising out of direct insurance operations		49		49		49		49	
Other creditors including taxation and social security		331		661		276		636	
Accruals and deferred income		1,855		1,455		1,797		1,398	
			2,235		2,165		2,122		2,083
			146,094		**141,585**		**146,023**		**141,545**

The information on pages 47 to 75 form an integral part of these financial statements.

These financial statements were approved by the Board on 27 March 2015.

Jonathan Long
Chief Executive Officer

Tracy Morshead
Chairman

Statement of total recognised gains and losses

For the year ended 31 December 2014

		Group		Society	
		2014	2013	**2014**	2013
	Notes	**£'000**	£'000	**£'000**	£'000
Surplus/(deficit) for the financial year		969	700	969	623
Actuarial (loss)/gain on pension scheme	20	(240)	(102)	(240)	(102)
Movement in deferred tax on pension scheme		–	(12)	–	(12)
Other movements		(20)	(18)	(20)	(19)
Total recognised gains and losses relating to the year		**709**	**568**	**709**	**490**

The information on pages 47 to 75 form an integral part of these financial statements.

Notes to the accounts

For the year ended 31 December 2014

(1) Accounting policies

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

Basis of preparation

The financial statements have been prepared on a going concern basis, under the historical cost convention and in accordance with The Friendly Societies (Accounts and Related Provisions) Regulations 1994, and United Kingdom Generally Accepted Accounting Practice and with the Statement of Recommended Practices issued by the Association of British Insurers.

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. Payments to Healthcare Deposit Accounts are accounted for when received.

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 an accruals basis. Income from rents and securities is taken into account on an accruals basis. Bank interest is accrued in the period in which it arises.

Realised and unrealised gains and losses

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

Claims

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

Long term business provision

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

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

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

Bonuses

Bonuses charged to the long term business technical account in a given year comprise:

- new reversionary bonuses declared in respect of that year which are provided within the calculation of the long term business provision.
- terminal bonuses paid out to policyholders on maturity which are included within claims paid.

Claims outstanding

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

Notes to the accounts (continued)

For the year ended 31 December 2014

Depreciation

Properties

No depreciation has been provided on investment properties in accordance with SSAP 19.

No depreciation has been provided on non-investment properties as the Group's policy is to maintain the properties in good condition. Accordingly the Board consider that the lives of these assets and their residual values are such that their depreciation is insignificant and is thus not provided. The underlying assets are reviewed for impairment annually.

Tangible fixed assets and depreciation

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:

- 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.

Project costs

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

Projects costs are charged to the income statement with the exception of major projects where the outcome is assessed to be reasonably certain as regards viability and feasibility. 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 Financial Reporting Standard 17 "Retirement Benefits" ("FRS17").

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 total recognised gains and losses for the year to the extent they are attributable to members. The attributable deferred taxation is shown separately in the statement of total recognised gains and losses.

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

Taxation

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

Cash flow statement

The Society, being a mutual life assurance company, is exempt from the requirement under Financial Reporting Standard 1 "Cash Flow Statements" ("FRS1") to produce a cash flow statement.

Investments

Listed securities are shown in the financial statements at bid price. Properties are shown in the financial statements at market value except for the part owner occupied property which is valued as a combination of market value and existing use value for the proportion occupied by the Society.

Mortgages and loans are valued at amortised cost, which is not materially different from fair value. Investments in subsidiary companies are held at cost less any provisions for diminution in value. In accordance with Financial Reporting Standard 11 "Impairment of fixed assets and goodwill" ("FRS11"); the carrying value of the subsidiary undertaking is compared to its recoverable amount.

Acquisition costs

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

Notes to the accounts (continued)

For the year ended 31 December 2014

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.

Operating leases

The Group leases motor vehicles and 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.

Financial assets

The Society classifies its financial assets as fair value through the profit and loss or as loans and receivables. Such assets are measured at fair value based on the active market price with gains and losses recognised in the Income Statement. Financial assets are derecognised when the rights to receive future cash flows from the investments have expired or have been transferred and the Society has transferred substantially all risks and rewards of ownership.

Derivatives

The Society holds some forward contracts for foreign currency exchange. The Society also holds some gilt future contracts to ease 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.

Contract classification

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

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

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

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

Insurance contracts and participating investment contracts

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

The participating liabilities include an assessment of any future options and guarantees included in this business.

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

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

Investment contracts

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

Notes to the accounts (continued)

For the year ended 31 December 2014

(2) Capital management

	Society	
	Funding position as at 31 December 2014 **£'000**	Funding position as at 31 December 2013 £'000
Total balance sheet assets	146,023	141,545
Inadmissible	(10)	(59)
Inadmissible reinsurance asset	(248)	(269)
Total statutory assets	**145,765**	**141,217**
Total statutory reserves	132,083	128,846
Total other liabilities	2,768	2,215
Total statutory liabilities	**134,851**	**131,061**
Statutory surplus (before capital requirement)	**10,914**	**10,156**
Total minimum capital requirement	7,094	8,354
Excess over minimum capital requirement	**3,820**	**1,802**

	Society	
	2014	2013
Changes in capital	**£'000**	£'000
Statutory surplus at 1 January	10,156	9,574
Net new lives on existing policies	2,617	7,568
Healthcare 5 premium review	603	-
Adjustment to models	(164)	(338)
Adjustment to Care Plus benefits	-	188
Adjustment to per policy expenses	(1,536)	(1,038)
Provision for bonuses / benefits	159	18
Adjustment to decrement assumption (i)	(1,647)	1,073
Adjustment to morbidity assumption	(743)	(5,031)
Adjustment to interest rates	(5,344)	7,233
Adjustment to claim inflation	405	(950)
Adjustment to expense inflation	528	(148)
Adjustment to guarantees	(2,194)	1,570
Charge for cost of guarantees	4,402	-
Adjustment to outstanding claim reserve	(46)	(1,064)
Adjustment to expense overrun reserve	(276)	310
Change in statutory assets	4,547	(8,474)
Change in other liabilities	(553)	(335)
	10,914	**10,156**

(i) Decrement assumptions cover future policy movements such as lapses and exits on death.

Notes to the accounts (continued)

For the year ended 31 December 2014

The Society maintains a single long term business fund. The available capital for the fund is represented by the fund for future appropriations which represents the difference between the assets and liabilities of the Society and Group. For statutory purposes certain assets are deemed inadmissible for meeting the capital requirement. As at the date of these financial statements the item deemed inadmissible was the inadmissible part of the Investment in 425 Direct Limited. The inadmissible part of the investment in 425 Direct Limited comprises its minimum capital requirement and intangible assets.

The capital requirement for the Society is determined as the greater of the statutory requirement based on formulae and calculations specified by regulations and the capital requirement determined by reference to the Society's Individual Capital Assessment ("ICA"). The ICA is subject to guidance but is not prescriptive and involves a significant level of judgement to be exercised by the Board. The ICA requirement is subject to review by the PRA and an additional capital requirement known as an ICG may be imposed. For the Society, it is the statutory basis that provides the greater capital requirement.

The available capital of the long term business fund has been determined in accordance with the Prudential Regulation Authority (PRA) regulations and includes the Fund for Future Appropriation. The Fund for Future Appropriation represents surplus funds of the Society which have not been allocated to members and is available to meet regulatory and solvency requirements of the Society. Adjustments have been made to restate the assets and liabilities in line with PRA regulations.

The available capital resources in excess of the capital requirements on the statutory basis have increased by £2.0m (2013: £0.4m). This has resulted in the Society having a surplus of £3.8m of assets over its minimum capital requirement (2013: £1.8m).

The improvement in free assets has been driven by a combination of the following factors:

- Strong investment returns due to significant growth in value of fixed income and property assets.
- Change in the way that the projected cost of with profit policy guarantees are met.
- A reduction in the amount of resilience capital required due to better matching of assets and liabilities.
- Re-pricing of Healthcare and Healthguard contracts to reflect the cost of anticipated future claims.

However, these increases have been offset to some extent by:

- Lower projected level of Healthcare policy lapses requiring additional morbidity reserves.
- Increase in per policy expenses as the policy book continued to reduce in size.

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

Notes to the accounts (continued)

For the year ended 31 December 2014

Capital resource sensitivities

The preparation of the Society's capital position requires the Board to make complex judgments based 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 reporting 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, impacting the Society's future capital position and the ability of management to achieve the capital restoration plan.

A key determinant of our capital position is morbidity assumptions and modest changes in morbidity experience can cause significant movements in reserves. We have estimated our future claims experience based upon our current experience plus a margin for future adverse experience. We monitor claims closely to assess the continued validity of these assumptions.

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

- The market risk in relation to the with-profit business, which would arise if adverse changes in the value of the assets supporting this business could not be reflected in payments to policyholders because of the effect of guarantees and options.
- A fall in UK gilt yields which increases our liabilities as it reduces the valuation discount rate that we use to determine our reserves.
- An adverse change in the future morbidity experience has a significant impact on mathematical reserves. The extent of this is illustrated in the table under insurance risk.

The capital position of this business would also deteriorate if increases to the market value of derivatives resulted in an increase in the liability for guarantees and options.

The capital position is also sensitive to assumptions and experience relating to expenses, longevity and persistency.

	Society	
Analysis of Policy Holders Liabilities	**2014**	2013
With profit liabilities	**£'000**	£'000
Guarantees and options	5,502	3,309
Future charges to asset shares	(4,402)	
Other policyholder obligations	72,392	69,673
	73,492	**72,982**
Unit linked	1,666	1,770
Deposit and other non-profit liabilities	56,925	54,094
	132,083	**128,846**

Notes to the accounts (continued)

For the year ended 31 December 2014

(3) Risk management

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

Insurance risk

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

The valuation assumptions have been recommended by the Head of Actuarial Function and approved by the Board.

See note 19 for details of assumptions used in the calculation of the long term business provision. The impact on the policy reserves of sensitivities to key valuation assumptions are as follows:

Assumption	Increase in policy reserves
Increase in morbidity by 10%	£3.5 million
Decrease in mortality by 10%	£1.2 million
Reduction in lapses by 25%	£1.8 million
Increase in expense inflation by 1%	£2.5 million
Increase in claim inflation by 1%	£0.5 million
Reduction in yields by 1%	£6.1 million
Increase in expense amounts by 10%	£1.8 million

Financial risk

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

Each of the exposures to risk are analysed regularly to assess their likely impact and probability. The overall level of risk is then compiled into a detailed report taking into account the correlation of individual risks to arrive at a required level of capital as part of the Society's Individual Capital Assessment ("ICA") process. The Board is responsible for reviewing the risks faced by the Society and approving the required level of capital to be held against each risk element. The Society does not use hedge accounting.

i. Market risk

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

In view of the relatively low level of free assets, the Society has a lowered appetite for market risks and this is reflected in its investment strategy. The investment strategy is kept under regular review as part of the capital management and capital restoration plan.

a. Interest rate risk

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

A 100bps or 1% change in the interest rate would lead to a change of £9.7m (2013 £8.3m) 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% increase in the valuation discount rate would result in a £5.6m (2013 £4.1m) fall in the value of liabilities and a 1% fall in yields leads to an increase of £6.3m (2013 £5.0m) in the value of liabilities. This does not allow for any change from asset shares due to market movements in asset values.

Notes to the accounts (continued)

For the year ended 31 December 2014

b. Exchange rate risk

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

	Group & Society	
Market Value – Equities	**2014 £'000**	2013 £'000
UK pound	14,342	18,244
Euro	217	1,279
Swiss franc	649	204
USA dollar	140	227
	15,348	**19,954**

	Group & Society	
Market Value – Fixed Interest	**2014 £'000**	2013 £'000
UK pound	77,469	70,755
Australian dollar	242	237
Euro	1,700	2,269
USA dollar	11,306	10,742
	90,717	**84,003**

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 of our 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; these assets are instead held in term deposits and fixed interest securities.

A 10% change in the market value of equities would lead to a change of £1.5m (2013 £1.4m) in our total holding of equities.

A 10% change in equity values would lead to a change of £1.6m (2013 £1.8m) in the value of the liabilities matched by equity.

ii. Credit risk

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

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

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

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

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

Notes to the accounts (continued)

For the year ended 31 December 2014

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

	Group		Society	
	2014 £'000	2013 £'000	**2014 £'000**	2013 £'000
Derivative financial instruments	312	530	312	530
Listed fixed interest securities	90,717	84,003	90,717	84,003
Loans and receivables	4,106	2,917	4,094	2,883
Deposits with credit institutions	3,812	4,917	3,812	4,917
Cash at bank and in hand	146	186	97	159
Reinsurers' share of technical provisions	248	269	248	269
	99,341	**92,822**	**99,280**	**92,761**
AAA	30,644	27,052	30,644	27,052
AA	4,787	4,496	4,739	4,496
A	35,244	34,094	35,244	34,067
BBB	18,322	17,831	18,322	17,831
Below BBB	960	1,295	960	1,295
Not rated	9,384	8,054	9,371	8,020
	99,341	**92,822**	**99,280**	**92,761**

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 our 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 accounts (continued)

For the year ended 31 December 2014

(3) Risk management (continued)

Financial and insurance liabilities at 31/12/14	Society				
	No maturity date £'000	Within 1 year £'000	1 – 5 years £'000	Over 5 years £'000	**Total £'000**
Fund for future appropriation	10,924	-	-	-	10,924
Long term business provision	90,836	3,337	20,812	10,461	125,446
Investment contract liabilities	-	16	109	37	162
Claims outstanding	-	4,385	-	-	4,385
Provision for bonuses and rebates	110	54	342	166	672
Technical provision for linked liabilities	1,287	-	-	-	1,287
Investment contracts on linked liability fund	379	-	-	-	379
Derivatives	-	603	-	-	603
Defined benefit pension liability	43	-	-	-	43
Creditors arising out of direct insurance operations	-	49	-	-	49
Other creditors including taxation and social security	-	276	-	-	276
Accruals and deferred income	-	1,797	-	-	1,797
Total financial and insurance liabilities	**103,579**	**10,517**	**21,263**	**10,664**	**146,023**

For the Group as above except the fund for future appropriation was £10,882,000, other creditors including taxation and social security were £331,000 and accruals and deferred income were £1,855,000.

Total Group financial and insurance liabilities	**103,537**	**10,630**	**21,263**	**10,664**	**146,094**

Financial assets at 31/12/14	Society				
	No maturity date £'000	Within 1 year £'000	1 – 5 years £'000	Over 5 years £'000	**Total £'000**
Equity investments	15,348	-	-	-	15,348
Fixed interest securities	-	333	8,905	81,479	90,717
Derivatives	-	312	-	-	312
Deposits with credit institutions	-	3,812	-	-	3,812
Freehold ground rents	-	-	-	65	65
Mortgages	134	9	20	10	173
Assets held to cover linked liabilities	2,056	-	-	-	2,056
Reinsurers' share of technical provisions	-	3	42	203	248
Debtors arising from direct insurance operations	-	204	-	-	204
Other debtors	-	1,470	-	-	1,470
Cash at bank and in hand	97	-	-	-	97
Accrued interest and rent	-	2,101	-	-	2,101
Other prepayments and accrued income	-	146	-	-	146
Total financial assets	**17,635**	**8,390**	**8,967**	**81,757**	**116,749**

Group as above except debtors arising from direct insurance operations were £274,000, other debtors were £1,382,000, cash at bank and in hand was £146,000 and other prepayments and accrued income were £176,000.

Total Group financial assets	**17,684**	**8,402**	**8,967**	**81,757**	**116,810**

Notes to the accounts (continued)

For the year ended 31 December 2014

Financial and insurance liabilities at 31/12/13	Society				
	No maturity date £'000	Within 1 year £'000	1 – 5 years £'000	Over 5 years £'000	**Total £'000**
Fund for future appropriation	10,215	–	–	–	10,215
Long term business provision	86,771	3,575	16,960	14,417	121,723
Investment contract liabilities	–	235	140	76	451
Claims outstanding	–	4,339	–	–	4,339
Provision for bonuses and rebates	211	58	313	250	832
Technical provision for linked liabilities	1,395	–	–	–	1,395
Investment contracts on linked liability fund	375	–	–	–	375
Derivatives	–	132	–	–	132
Creditors arising out of direct insurance operations	–	49	–	–	49
Other creditors including taxation and social security	–	636	–	–	636
Accruals and deferred income	–	1,398	–	–	1,398
Total financial and insurance liabilities	**98,967**	**10,422**	**17,413**	**14,743**	**141,545**

For the Group as above except the fund for future appropriation was £10,173,000, other creditors including taxation and social security were £661,000 and accruals and deferred income were £1,455,000.

Total Group financial and insurance liabilities	**98,925**	**10,504**	**17,413**	**14,743**	**141,585**

Financial assets at 31/12/13	Society				
	No maturity date £'000	Within 1 year £'000	1 – 5 years £'000	Over 5 years £'000	**Total £'000**
Equity investments	19,954	–	–	–	19,954
Fixed interest securities	–	464	9,725	73,814	84,003
Derivatives	–	530	–	–	530
Deposits with credit institutions	–	4,917	–	–	4,917
Mortgages	143	9	23	15	190
Assets held to cover linked liabilities	3,183	–	–	–	3,183
Reinsurers' share of technical provisions	–	2	40	227	269
Debtors arising from direct insurance operations	–	254	–	–	254
Other debtors	–	1,579	–	–	1,579
Cash at bank and in hand	159	–	–	–	159
Accrued interest and rent	–	715	–	–	715
Other prepayments and accrued income	–	145	–	–	145
Total financial assets	**23,439**	**8,615**	**9,788**	**74,135**	**115,977**

Group as above except debtors arising from direct insurance operations were £293,000, other debtors were £1,548,000, cash at bank and in hand was £186,000 and other prepayments and accrued income were £171,000.

Total Group financial assets	**23,466**	**8,649**	**9,788**	**74,135**	**116,538**

Notes to the accounts (continued)

For the year ended 31 December 2014

(3) Risk management (continued)

iv. Fair value estimation

The principal financial assets held at 31 December 2014, analysed by their fair value hierarchies are:

Assests 2014	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets at fair value through the profit and loss				
- Equity investments	15,348	-	-	15,348
- Fixed interest investments	25,773	64,944	-	90,717
- Financial Instruments	-	312	-	312
Total assets	**41,121**	**65,256**	**-**	**106,377**

The principal financial assets held at 31 December 2013, analysed by their fair value hierarchies are:

Assests 2013	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets at fair value through the profit and loss				
- Equity investments	19,954	-	-	19,954
- Fixed interest investments	22,754	61,249	-	84,003
- Financial Instruments		530	-	530
Total assets	**42,708**	**61,779**	**-**	**104,487**

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 accounts (continued)

For the year ended 31 December 2014

(4) Gross premiums written and payments to deposit

	Group & Society	
	2014 **£'000**	2013 £'000
Assurance	3,523	4,244
Bonds and other single premiums	–	84
Healthcare and Healthguard	9,830	11,003
Payments to deposit	341	381
Unit linked	56	62
	13,750	**15,774**

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

	Group & Society	
	2014 **£'000**	2013 £'000
Healthcare and Healthguard	31	51
	31	**31**

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

New business premiums are in respect of additional lives being added to existing contracts of insurance in accordance with the terms of the original contracts.

Notes to the accounts (continued)

For the year ended 31 December 2014

(5) Investment income

	Group & Society	
	2014	2013
Income from other financial investments:	**£'000**	£'000
Loans and receivables interest income	26	29
Total interest income on financial assets not at fair value through profit and loss	**26**	**29**
Income from financial investments at fair value through profit and loss:		
Fixed interest stocks	3,979	3,847
Ordinary shares	386	590
Mortgages and ground rents	5	7
Income from financial assets at fair value through profit and loss	**4,370**	**4,444**
Income from land and buildings	2,259	1,844
Net gains on realisation of investments	6,087	(1,140)
	12,742	**5,177**
Net unrealised (losses)/gains on investments	4,460	2,693
Total investment return	**17,202**	**7,870**

	Group & Society	
	2014	2013
Net gains/(losses) on investments:	**£'000**	£'000
Included in the total investment return are net realised gains on financial assets at fair value through profit and loss		
Designated upon initial recognition	3,830	293
Included in the total investment return are net unrealised gains/(losses) on financial assets at fair value through profit and loss		
Designated upon initial recognition	5,738	162
Total net realised and unrealised gains/(losses) included in investment return	**9,568**	**455**

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

Notes to the accounts (continued)

For the year ended 31 December 2014

(6) Other technical income

	Group		Society	
	2014 £'000	2013 £'000	**2014 £'000**	2013 £'000
Insurance commission	948	1,252	3	4
Other income	43	24	43	24
	991	**1,276**	**46**	**28**

(7) Net operating expenses

	Group		Society	
(a) Included in operating expenses are:	**2014 £'000**	2013 £'000	**2014 £'000**	2013 £'000
Fees payable to external auditors:				
Audit of the Group and Society financial statements	240	211	234	205
Taxation compliance services	-	-	-	-
Other non-audit services	21	31	21	31
Fees payable to internal auditors in respect of:				
Internal audit	27	32	27	32
Actuarial fees	105	100	105	100
Depreciation of tangible assets	50	94	48	52
Amortisation of intangible assets	-	6	-	-
(b) Other technical charges – project costs:				
Capital management	835	637	835	714
Distribution	148	222	111	222
Systems and processing	118	114	118	114
Risk management	127	322	127	322
Total project costs	**1,228**	**1,295**	**1,191**	**1,372**

(8) Investment expenses

	Group		Society	
	2014 £'000	2013 £'000	**2014 £'000**	2013 £'000
Investment management expenses	535	442	535	442
Investment property direct costs	457	265	457	265
	992	**707**	**992**	**707**

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For the year ended 31 December 2014

(9) Staff costs

	Group		Society	
	2014	2013	**2014**	2013
Average monthly number of employees:	**£'000**	£'000	**£'000**	£'000
Administration	35	41	35	41
Distribution	19	28	4	4
	54	**69**	**39**	**45**

The average full-time equivalent is 52 (2013: 66) for the Group and 37 (2013: 43) for the Society. Excludes Non-Executive Directors of 4 (2013: 5).

	Group		Society	
	2014	2013	**2014**	2013
	£'000	£'000	**£'000**	£'000
Wages and salaries (inc commission)	2,221	2,526	1,680	1,829
Social security costs	243	272	185	204
Pension costs	145	164	121	126
	2,609	**2,962**	**1,986**	**2,159**

This includes Executive Directors' emoluments totalling £246,487 (2013: £229,944). Details of Directors' remuneration are set out on page 35.

(10) Directors' emoluments

	Group & Society	
	2014	2013
	£'000	£'000
Aggregate emoluments	397	353

Retirement benefits are accruing to one Executive Director as at 31 December 2014 (2013: one) under a defined benefit scheme. The aggregate amount of pension contribution made by the Society to a defined contribution scheme was £21,824 (2013: £18,599).

	Group & Society	
	2014	2013
	£'000	£'000
Total emoluments and amounts receivable under long-term incentive schemes	188	183
Defined benefit scheme:		
Pension accrued during the year	1	1
Defined contribution scheme:		
Contributions made by the Society	18	17

Notes to the accounts (continued)

For the year ended 31 December 2014

(11) Taxation

(a) attributable to long term business	Group & Society	
	2014	2013
Tax charged in the long term business technical account comprises:	**£'000**	£'000
Current tax		
UK corporation tax	-	-
Prior year adjustments	-	21
Total current tax	**-**	**21**
Deferred tax		
Origination and reversal of timing differences	20	78
Total deferred tax	**20**	**78**
Total tax charged in the long term business technical account	**20**	**99**

(b) Factors that may affect future tax charges	Group & Society	
	2014	2013
	£'000	£'000
The deferred tax assets which have not been recognised due to the uncertainty of their recoverability in the foreseeable future comprise:		
Realised and unrealised capital losses	122	440
Expenses deductible in future years	175	355
Undiscounted deferred tax asset balance	**297**	**795**

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	
	2014	2013
	£'000	£'000
The deferred tax balance included within other assets comprises:		
Unrelieved expenses carried forward	-	-
Realised capital gains/(losses)	-	-
Accelerated capital allowances	-	20
Deferred tax on Pension Scheme deficit	-	-
Undiscounted deferred tax asset balance	**-**	**20**

(d) Reconciliation of deferred taxation balances	Group & Society	
	2014	2013
	£'000	£'000
Opening deferred tax asset	20	110
Charge to operating profit	(20)	(78)
Charge to statement of total recognised gains and losses	-	(12)
	-	**20**

Notes to the accounts (continued)

For the year ended 31 December 2014

(12) Investments

	Group & Society			
	2014	**2014**	2013	2013
	£'000	**£'000**	£'000	£'000
Land and buildings	**Cost**	**Valuation**	Cost	Valuation
Freehold investment properties	21,815	19,681	17,658	17,002
Long leasehold properties	10,254	7,870	10,254	7,670
	32,069	**27,551**	**27,912**	**24,672**

The Society's properties are included at Market Value. The only exception is 11-12 Queen Square, Bristol which is valued as a combination of Market Value and Existing Use Value. The Properties are valued by Mellersh and Harding LLP in accordance with the requirements of the Royal Institution of Chartered Surveyors' Valuation – Professional Standards effective from 6 January 2014 on a triennial basis. The two properties purchased during 2014 were valued on the same basis by Gerald Eve LLP given that Mellersh and Harding had advised on the purchase of these properties. The most recent valuation being at 31 December 2014.

(13) Other financial investments

	Group & Society			
	2014	**2014**	2013	2013
	£'000	**£'000**	£'000	£'000
	Cost	**Valuation**	Cost	Valuation
Listed fixed interest securities	83,912	90,717	86,138	84,003
Listed shares	12,064	15,348	13,529	19,954
Derivatives	-	312	-	530
Deposits with credit institutions	3,812	3,812	4,917	4,917
Mortgages	173	173	190	190
Freehold ground rent	9	65	8	79
	99,970	**110,427**	**104,782**	**109,673**

Of the listed fixed interest securities £33,242,322 (2013: £43,705,428) relates to overseas fixed interest securities, with the remainder relating to UK fixed interest securities.

Of the listed shares £1,640,131 (2013: £1,709,779) 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. The gain in the value of these contracts has been recognised through the income statement. The contracts will mature in 2015.

Included within deposits with credit institutions is £494,399 (2013: £547,946) 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 accounts (continued)

For the year ended 31 December 2014

(14) Financial assets

		Group & Society			
		2014	**2014**	2013	2013
		£'000	**£'000**	£'000	£'000
Financial assets at fair value through profit and loss	Notes	**Cost**	**Valuation**	Cost	Valuation
Designated upon initial recognition		101,419	112,655	107,110	113,094
		101,419	**112,655**	**107,110**	**113,094**
Loans and receivables		4,094	4,094	2,883	2,883
Total financial assets		**105,513**	**116,749**	**109,993**	**115,977**
Included in the balance sheet as:					
Listed fixed interest securities		83,912	90,717	86,138	84,003
Listed shares		12,064	15,348	13,529	19,954
Derivatives		–	312	–	530
Deposits with credit institutions		3,812	3,812	4,917	4,917
Mortgages		173	173	190	190
Freehold ground rent		9	65	8	79
Other financial investments	13	**99,970**	**110,427**	**104,782**	**109,673**
Assets held to cover linked liabilities	16	1,525	2,056	2,359	3,183
Reinsurers' share of technical provisions		–	248	–	269
Debtors arising from direct insurance operations		204	204	254	254
Other debtors		1,470	1,470	1,579	1,579
Cash at bank and in hand		97	97	159	159
Accrued interest and rent		2,101	2,101	715	715
Other prepayments and accrued income		146	146	145	145
Total financial assets		**105,513**	**116,749**	**109,993**	**115,977**

For the Group as above except debtors arising from direct insurance operations were £274,000 (2013: £293,000), other debtors were £1,382,000 (2013: £1,548,000), cash at bank and in hand was £146,000 (2013: £186,000) and other prepayments and accrued income were £176,000 (2013: £171,000). Total Group financial assets cost £105,574,000 (2013: £110,554,000) with a market value of £116,810,000 (2013: £116,538,000). Loans and receivables are carried in the balance sheet at amortised cost. Their fair values are not materially different from the values shown above.

Notes to the accounts (continued)

For the year ended 31 December 2014

(15) Financial Liabilities

	Group & Society			
	2014	**2014**	2013	2013
Financial liabilities at fair value through profit and loss	**£'000 Cost**	**£'000 Valuation**	£'000 Cost	£'000 Valuation
Designated upon initial recognition	–	603	–	132
Other financial liabilities at amortised cost	2,664	2,664	2,909	2,909
Total financial liabilities	**2,664**	**3,267**	**2,909**	**3,041**
Included in the balance sheet as:				
Derivatives	–	603	–	132
Investment contract liabilities	162	162	451	451
Investment contract liabilities on linked liability fund	379	379	375	375
Arising out of direct insurance operations	49	49	49	49
Other creditors including taxation and social security	276	276	636	636
Accruals and deferred income	1,798	1,798	1,398	1,398
Total financial liabilities	**2,664**	**3,267**	**2,909**	**3,041**

For the Group as above except for other creditors including taxation and social security were £331,000 (2013: £661,000) and accruals and deferred income were £1,855,000 (2013: £1,455,000). Total Group financial liabilities have a cost of £2,776,000 (2013: £2,990,000) with a market value of £3,379,000 (2013: £3,122,000).

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 liability

	Group & Society			
	2014	**2014**	2013	2013
	£'000 Cost	**£'000 Valuation**	£'000 Cost	£'000 Valuation
Assets held to cover unit linked insurance contracts	1,178	1,589	1,859	2,509
Assets held to cover unit linked investment contracts	347	467	500	674
	1,525	**2,056**	**2,359**	**3,183**

Included within assets held to cover linked liabilities is £390,962 (2013: £1,412,840) 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 accounts (continued)

For the year ended 31 December 2014

(17) Tangible assets

	Group			
	Computer Equipment	Office Equipment	Assets under Construction	**Total**
Cost	£'000	£'000	£'000	**£'000**
At 1 January	149	164	762	1,075
Additions	59	136	774	969
Disposals	(8)	(146)	-	(154)
At 31 December	**200**	**154**	**1,536**	**1,890**
Depreciation				
At 1 January	109	134	-	243
Provided in the year	38	12	-	50
Disposals	(6)	(130)	-	(136)
At 31 December	**141**	**16**	**-**	**157**
Net Book Value				
31 December 2014	59	138	1,536	1,733
31 December 2013	40	30	762	832

	Society			
	Computer Equipment	Office Equipment	Assets under Construction	**Total**
Cost	£'000	£'000	£'000	**£'000**
At 1 January	149	164	762	1,075
Additions	35	136	774	945
Disposals	(8)	(146)	-	(154)
At 31 December	**176**	**154**	**1,536**	**1,866**
Depreciation				
At 1 January	109	134	-	243
Provided in the year	37	11	-	48
Disposals	(6)	(130)	-	(136)
At 31 December	**140**	**15**	**-**	**155**
Net Book Value				
31 December 2014	36	139	1,536	1,711
31 December 2013	40	30	762	832

(18) Capital commitments

Amounts authorised and contracted for at 31 December 2014 £317,000 (2013: £210,000).

Notes to the accounts (continued)

For the year ended 31 December 2014

(19) Long term business provision

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

Rates of interest	2014 valuation assumptions	2013 valuation assumptions
Old deposit contracts	1.88% per annum.	3.00% per annum.
Healthcare and Healthguard contracts	2.08% per annum.	3.20% per annum.
Other PHI contracts	2.09% per annum.	3.17% per annum.
With profits life assurance policies	2.45% per annum for tax exempt policies and 1.96% per annum for taxable policies.	2.49% per annum for tax exempt policies and 1.99% per annum for taxable policies.
With profits bonds and investment ISAs	Not applicable since the basic reserve is equal to current death benefits.	Not applicable since the basic reserve is equal to current death benefits.
With profits personal pensions and retirement annuities	3.47% per annum before vesting and 0.00% per annum after vesting (for retirement annuities).	3.83% per annum before vesting and 1.70% per annum after vesting (for retirement annuities).
Other non-profit business	2.09% per annum for tax exempt policies, 1.67% for taxable policies and 0.63% for short term non-profit bonds.	3.17% per annum for tax exempt policies, 2.54% for taxable policies and 0.47% for short term non-profit bonds.

Rates of mortality	2014 valuation assumptions	2013 valuation assumptions
DBO contracts	33% of the AMN00 and 39% of the AFN00 ultimate table for assured lives (assumed to be transferred to suspense at age 100).	27% of the AMN00 and 32% of the AFN00 ultimate table for assured lives (assumed to be transferred to suspense at age 100).
Deposit (non-DBO) contracts	86% of the AMN00 and 97% of the AFN00 ultimate table for assured lives.	86% of the AMN00 and 97% of the AFN00 ultimate table for assured lives.
Healthcare contracts	86% of the AMN00 and 97% of the AFN00 ultimate table for assured lives.	86% of the AMN00 and 97% of the AFN00 ultimate table for assured lives.
PHI deferred sickness claims in payment	Nil.	Nil.
Other PHI contracts	70% of the AMN00 ultimate table for assured lives.	73% of the AMN00 ultimate table for assured lives.
Critical illness policies	Table provided by reinsurer combining mortality and sickness rates.	Table provided by reinsurer combining mortality and sickness rates.
50+ life plan policies	140% of the AMN00 ultimate table for non-smokers or 140% of the AMS00 ultimate table for smokers.	140% of the AMN00 ultimate table for non-smokers or 140% of the AMS00 ultimate table for smokers.
Other life assurance policies	75% of the AMN00 ultimate table for assured lives of 93% of the AMS00 ultimate table for smokers.	75% of the AMN00 ultimate table for assured lives of 93% of the AMS00 ultimate table for smokers.

Rates of morbidity	2014 valuation assumptions	2013 valuation assumptions
Healthcare & Healthguard contracts	Morbidity assumptions are based upon the Society's actual experience plus a margin for prudence.	Morbidity assumptions are based upon the Society's actual experience plus a margin for prudence.

Lapses	2014 valuation assumptions	2013 valuation assumptions
All policies	Lapse assumptions are based upon the Society's actual experience less a margin for prudence.	Lapse assumptions are based upon the Society's actual experience less a margin for prudence.

Full details of the method and assumptions used in calculating the long term business provision are given in the Society's PRA return.

Notes to the accounts (continued)

For the year ended 31 December 2014

(20) Pensions

National Deposit Staff Superannuation Fund

The Fund is a defined benefit arrangement which provides retirement benefits based on final pensionable salary. The Fund was closed to new entrants and future accrual from 31 May 2009.

The valuation used for FRS17 disclosures has been based on a full assessment of the liabilities of the Fund. The last valuation was performed as at 31 December 2013. The present values of the defined benefit obligation and any past service cost (if applicable) were measured using the projected unit method.

The amounts recognised in the balance sheet on closure are as follows:

	Society	
	2014	2013
	£'000	£'000
Fair value of fund assets	19,946	18,802
Present value of funded obligations	(19,989)	(18,779)
	(43)	**23**
(Liability)/asset recognised on the balance sheet	(43)	23
Net pension asset	**(43)**	**23**
Amounts in balance sheet		
Assets	–	23
Liabilities	(43)	–
Net pension asset	**(43)**	**23**

The amounts recognised in income statement are as follows:

	Society	
	2014	2013
	£'000	£'000
Interest on obligation	833	783
Expected return on fund assets	(816)	(704)
Past service costs	–	–
Expense recognised in income statement	**17**	**79**
Actual return on fund assets	**17**	**79**

Changes in the present value of the defined obligation are as follows:

	Society	
	2014	2013
	£'000	£'000
Opening defined benefit obligation	18,779	19,083
Interest cost	833	783
Actuarial losses	1,308	231
Past service costs	–	–
Benefits paid	(931)	(1,318)
Closing defined benefit obligation	**19,989**	**18,779**

Notes to the accounts (continued)

For the year ended 31 December 2014

(20) Pensions (continued)

	Society	
	2014	2013
	£'000	£'000
Opening fair value of fund assets	18,802	19,096
Expected return	816	704
Actuarial gains	1,068	129
Contributions by employer	191	191
Benefits paid	(931)	(1,318)
Closing fair value of fund assets	**19,946**	**18,802**
Analysis of amounts recognised in statement of total recognised gains and losses (STRGL)		
Total actuarial (losses)/gains	(240)	(102)
Total (loss)/gain in STRGL	(240)	(102)
Cumulative amount of loss recognised in STRGL	**(5,960)**	**(5,720)**

The Employer expects to contribute £191,000 to the Fund from 1 January 2015 to 31 December 2015.

	%	&
The major categories of fund assets as a percentage of the total fund assets are as follows:	**£'000**	£'000
Equities	26	27
Gilts	-	-
Corporate bonds	38	37
Index linked bonds	12	13
Property	15	13
Cash	9	10

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

	Society	
	2014	2013
	%pa	%pa
Discount rate at 31 December	3.5	4.6
Expected return on fund assets at 31 December (for following year)	N/R	4.9
Rate of increase in pensionable salaries	3.1	3.6
Rate of increase in deferred pensions	1.9	2.5
Rate of increase in pensions in payment – service pre 06/04/2005	2.8	3.2
Rate of increase in pensions in payment – service post 06/04/2005	2.0	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 88 if they are male and until 90 if female. For a member currently aged 50 the assumptions are that if they attain age 65 they will live on average until age 89 if they are male and until 91 if female.

Notes to the accounts (continued)

For the year ended 31 December 2014

Description of the basis used to determine the expected rate of return

The employer adopts a building block approach in determining the expected rate of return on the fund's assets. Historic markets are studied and assets with high volatility are assumed to generate higher returns consistent with widely accepted capital market principles.

Each different asset class is given a different expected rate of return. The overall rate of return is then derived by aggregating the expected return for each asset class over the actual asset allocation for the fund at the year end.

Employee benefit obligations for National Deposit Friendly Society Limited

Amounts for the current and previous years are as follows:

	2014 £'000	2013 £'000	2012 £'000	2011 £'000	2010 £'000
Defined benefit obligation	19,989	18,779	19,083	19,183	18,203
Fund assets	19,946	18,802	19,096	18,483	18,203
Surplus/(deficit)	(43)	23	13	(700)	-
Experience gains/(losses) on fund assets	1,068	129	726	230	233
Experience gains/(losses) on fund liabilities	68	(128)	280	(471)	319
Change in assumptions underlying the present value of fund liabilities	(1,376)	(103)	(229)	(941)	(473)
Experience gain/(losses) on fund liabilities	(1,308)	(231)	51	(1,412)	(154)

Defined contribution scheme

The contributions to the defined contribution scheme in the year amounts to £120,810 (2013: £125,928).

(21) Technical provisions for linked liabilities

	Group & Society					
	Insurance contracts		Investment contracts		Total	
	2014	2013	**2014**	2013	**2014**	2013
	£'000	£'000	**£'000**	£'000	**£'000**	£'000
At 1 January	1,395	1,452	375	338	1,770	1,790
Payments made to policy holders of investment contracts	-	-	(13)	(50)	(13)	(50)
Change in technical provision as shown in the income statement	(108)	(57)	17	87	(91)	30
At 31 December	**1,287**	**1,395**	**379**	**375**	**1,666**	**1,770**

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

(22) Assets attributable to the long term business fund

Other than assets of £2,056,412 (2013: £3,183,430) used to match linked liabilities all of the assets shown on page 44 are attributable to the long term business fund.

Notes to the accounts (continued)

For the year ended 31 December 2014

(23) 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.

The future aggregate minimum lease payments under cancellable operating leases are as follows:

	Society			
	Plant & Machinery		Other	
	2014 £'000	2013 £'000	**2014 £'000**	2013 £'000
No later than 1 year	-	-	**-**	1
Later than 1 year and no later than 3 years	-	20	**-**	10
Greater than 3 years	26	-	**-**	-
Total	**26**	**20**	**-**	**11**

(24) 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 £580,000 (2013: £525,000) 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 value of £12,000 (2013: £21,000) after an impairment charge of £589,000 (2013: £543,000).

ND Member Services Limited is dormant and held in the Society at a value of £1 at 31 December 2014 (2013: £1) which represents the net realisable value of its assets.

The results of all subsidiaries for the year ended 31 December 2014 have been consolidated into the Group financial statements.

(25) Related party transactions

425 Direct Limited was charged £464,229 (2013: £430,291) by the Society in respect of service charges.

As at 31 December 2013, 425 Direct Limited was owed £44,765 by the Society (2013: £9,809) and ND Member Services Limited owed the Society a net amount of £42,844 (2013: £42,844).

Tracy Morshead, a non-executive Director, did not provide any consultancy services to the Society beyond the scope of the contractual duties of a non-executive Director in 2014. In 2013 services to the value of £14,819 were provided on normal commercial terms.

Notes to the accounts (continued)

For the year ended 31 December 2014

(26) Derivatives

Included within assets are forward currency contracts with a fair value of £13,904,000 (2013: £13,337,000) that cost £14,101,000 (2013: £13,070,000). These are used to manage the exchange rate risk arising from investments in non-sterling denominated bonds. Cash flows under these contracts are dependent on exchange rates at the dates on which the contracts mature. Movements in fair value arise due to variations in exchange rate and are reflected in the income statement. Fair value losses included in the income statement for 2014 in relation to the forward currency contracts amounted to £197,000 (2013: gain of £267,000).

Bond future contracts with a fair value of £21,397,000 (2013: £16,867,000) and a cost of £21,491,000 (2013: £16,867,000) was also held to manage the duration of the fixed interest portfolio. Fair value losses for the year of £94,000 (2013: gain of £131,000) are included in the income statement in respect of bond future contracts.

The details of the contracts are outlined below:

Contracts held at 31 December 2014	Group & Society			
	Contract value £'000	Amount receivable £'000	Amount payable £'000	Unrealised gain/(loss) £'000
Australian dollar contracts				
6 Nov 2014 – 12 Feb 2015	166	166	162	4
Euro contracts				
6 Nov 2014 – 12 Feb 2015	876	876	870	6
16 Nov 2014 – 12 Feb 2015	751	751	746	5
UK Pound contracts				
20 Nov 2014 – 12 Feb 2015	63	63	63	-
4 Dec 2014 – 12 Feb 2015	319	319	317	2
6 Nov 2014 – 12 Feb 2015	41	41	41	-
19 Dec 2014 – 12 Feb 2015	65	65	65	-
US Dollar contracts				
6 Nov 2014 – 12 Feb 2015	5,121	5,121	5,217	(96)
27 Nov 2014 – 12 Feb 2015	82	82	83	(1)
15 Dec 2014 – 12 Feb 2015	85	85	85	-
6 Nov 2014 – 12 Feb 2015	6,181	6,181	6,297	(116)
27 Nov 2014 – 12 Feb 2015	59	59	60	(1)
15 Dec 2014 – 12 Feb 2015	95	95	95	-
Total forward currency contracts	**13,904**	**13,904**	**14,101**	**(197)**

Notes to the accounts (continued)

For the year ended 31 December 2014

(26) Derivatives (continued)

Contracts held at 31 December 2014	Notes	Group & Society Contract value £'000	Amount receivable £'000	Amount payable £'000	Unrealised gain/(loss) £'000
Euro bond futures					
Eurex Deutschland Future Mar 15		475	475	484	(9)
Euro Buxl 30 Y Future Mar 15		345	345	361	(16)
UK pound bond futures					
Long gilt future Mar 15		1,912	1,912	1,860	52
Long gilt future Mar 15		1,485	1,485	1,577	(92)
Long gilt future Mar 15		6,932	6,932	6,743	189
Short gilt future Mar 15		103	103	103	-
Ultra long gilt future Mar 15		920	920	866	54
US dollar bond futures					
US 10yr T-note future Mar15		971	971	976	(5)
US 5yr T-note future Mar15		76	76	76	-
US long C-bond future Mar15		901	901	927	(26)
US ultra (CBT) future Mar15		2,539	2,539	2,648	(109)
US 10yr (CBT) note future Mar15		567	567	569	(2)
US 5yr (CBT) note future Mar15		686	686	686	-
US (CBT) bond future Mar15		1,352	1,352	1,390	(38)
US long C-bond future Mar15		2,133	2,133	2,225	(92)
Total bond futures		**21,397**	**21,397**	**21,491**	**(94)**
Total derivatives		**35,301**	**35,301**	**35,592**	**(291)**
Included in:					
Financial assets	14				312
Financial liabilities	15				(603)
					(291)

Notes to the accounts (continued)

For the year ended 31 December 2014

Contracts held at 31 December 2013	Notes	Group & Society			
		Contract value £'000	Amount receivable £'000	Amount payable £'000	Unrealised gain/(loss) £'000
Australian dollar contracts					
15 Nov 2013 – 21 Feb 2014		179	179	167	12
Euro contracts					
15 Nov 2013 – 21 Feb 2014		1,026	1,026	1,020	6
15 Nov 2013 – 21 Feb 2014		1,169	1,169	1,162	7
US Dollar contracts					
15 Nov 2013 – 21 Feb 2014		4,916	4,916	4,770	146
15 Nov 2013 – 21 Feb 2014		88	88	87	1
15 Nov 2013 – 21 Feb 2014		1,795	1,795	1,742	53
11 Dec 2013 – 21 Feb 2014		4,109	4,109	4,068	41
13 Dec 2013 – 21 Feb 2014		55	55	54	1
Total forward currency contracts		**13,337**	**13,337**	**13,070**	**267**
Euro bond futures					
Eurex Deutschland Future Mar 14		464	464	459	5
Euro Buxl 30 Y Future Mar 14		304	304	300	4
UK pound bond futures					
Long gilt future Mar 14		1,812	1,812	1,848	(36)
Long gilt future Mar 14		6,287	6,287	6,383	(96)
US dollar bond futures					
US 10yr note future Mar 14		1,040	1,040	994	46
US long bond future Mar 14		1,085	1,085	1,040	45
US ultra (CBT) future Mar 14		2,139	2,139	2,055	84
US 5yr note future Mar 14		727	727	714	13
US long bond future Mar 14		1,256	1,256	1,229	27
US ultra (CBT) future Mar 14		1,753	1,752	1,713	39
Total bond futures		**16,867**	**16,866**	**16,735**	**131**
Total derivatives		**30,204**	**30,203**	**29,805**	**398**
Included in:					
Financial assets	14				530
Financial liabilities	15				(132)
					398

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www.nationalfriendly.co.uk
info@nationalfriendly.co.uk

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