EXPLANATORY MEMORANDUM TO

THE SAVINGS CERTIFICATES (AMENDMENT) REGULATIONS 2012

2012 No. 1882

1. This explanatory memorandum has been prepared by the Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations amend the Savings Certificates Regulations 1991 (S.I. 1991/1031) (the "1991 Regulations"). Their purpose is to alter certain features of savings certificates offered by National Savings and Investments ("NS&I"), so as to modernise and make more cost effective the administration of such certificates and facilitate the introduction of a new computer system. These Regulations will also assist NS&I to manage the risks of money laundering and fraud.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The Treasury raises money under section 12 of the National Loans Act 1968 (c. 13) by issuing securities under the auspices of the Director of Savings, who is a statutory office-holder and the Chief Executive of NS&I. Savings certificates issued under the auspices of the Director of Savings (other than Children's Bonus Bonds) are governed by the 1991 Regulations and contractual terms and conditions.

4.2 The Treasury wish to change certain features of savings certificates, as set out in paragraph 7 below, and to do so need to amend the 1991 Regulations.

4.3 The amendments made by these Regulations are similar to those made by the National Savings Stock Register (Amendment) Regulations 2012 and the Savings Certificates (Children's Bonus Bonds) (Amendment) Regulations 2012. These instruments have been laid on the same date as these Regulations.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is not subject to affirmative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 NS&I is engaged in a programme to modernise its products, as part of its remit to provide the Government with cost-effective retail financing. The current phase of the programme requires changes to be made to savings certificates which offer a fixed return for a specified period of time (a "term"), such as Fixed Interest Savings Certificates and Index-Linked Savings Certificates.

7.2 The amendments made by these Regulations and the changes they facilitate (such as electronic applications and increased maximum holdings for joint customers) will have effect for all certificates purchased on or after 20 September 2012 ("new certificates"). This is the coming into force date.

7.3 Except where specifically described below, certificates which are purchased before these Regulations come into force will continue to operate in an unchanged manner until the end of the term that is current on 19 September 2012. If repayment of such certificates has not been requested by the end of that term and they are "rolled-over" into a new term, the amendments made by these Regulations, and the changes they facilitate, will have effect for such certificates from the beginning of that new term. These are "rolled-over certificates".

Communication and manner of operation

7.4 Currently, certificates are managed by post. To lower operating costs, to meet customer demand for easier access and to improve the security of fund transfers, NS&I intends to allow customers holding new certificates and rolled-over certificates the opportunity to manage their holdings online or by telephone. In order to permit the Director of Savings to make these options available, it is necessary to amend certain provisions of the 1991 Regulations, which require applications to be made in writing.

7.5 In addition, if a partial repayment is made, rather than issuing a replacement certificate in documentary form, as required by the current terms and conditions, the Director of Savings will instead be required to issue an investment record. This amendment will apply to new certificates and to other certificates from the anniversary of their date of purchase that falls after 19 September 2012 and before 20 September 2013.

Persons eligible to purchase and hold certificates

7.6 Regulation 5 of these Regulations makes changes in respect of classes of persons who are eligible to purchase Savings Certificates. The 1991 Regulations allow certificates to be purchased and held by anyone aged 7 or over and by anyone aged 7 or over on behalf of a person under 7. The NS&I Children's Strategy, which was developed taking account of industry practice, determined that Savings Certificates are not a suitable investment to be purchased or held by persons under 16 years of age (minors). No new purchase by a minor will be allowed after 19 September 2012.

7.7 The 1991 Regulations also allow certificates to be purchased and held by two or more individuals, corporate bodies and groups, friendly societies and charities. Such holdings involve cumbersome manual processes for operating and managing investments, and present potential money laundering and fraud related risks. To tackle these issues, regulation 5 also limits the number of individuals who may purchase certificates to one person or two persons jointly. Three or more persons, corporations, friendly societies and charities will no longer be able to purchase certificates.

7.8 Certificates held on 20 September 2012 by minors, corporations, friendly societies and charities will have to be repaid at the end of the term which is the current term on that date.

Joint holders – holding limits

7.9 The 1991 Regulations provide that a person may not purchase certificates if that would result in that person holding more than is permitted by the prospectus (currently £15,000 per issue of certificates). For these purposes, a person's holding includes the full purchase price of both certificates they hold individually and certificates they hold jointly. This has been recognised as being unfair, as it means that customers who prefer to invest jointly are able to invest a smaller amount than those who prefer to invest individually.

7.10 To address this point, regulation 6 removes the requirement to take account of the full purchase price of joint holdings. NS&I intends to vary the terms and conditions for new certificates and rolled over certificates to the effect that each joint holder will be treated as holding an equal share of the certificates purchase price. This change will allow joint customers to invest a greater amount in certificates than is currently the case.

Interest

7.11 The terms and conditions of certificates and other NS&I products set out different methods for calculating and capitalising interest. In order to offer an integrated and transparent product range using a single computer system it is necessary to adopt a uniform method for calculating and capitalising interest.

7.12 In particular, following changes in industry practice it has been recognised that NS&I's existing practice for taking account of the extra day in a leap year has had potential for a small number of customers to be disadvantaged. The 1991 Regulations do not make detailed provision for interest because interest terms are agreed by the Treasury from time to time and set out in the product terms and conditions, but these Regulations do alter the practice for taking account of leap years.

7.13 Regulation 7 of these Regulations inserts a new regulation 5A, which provides that interest for a rolled-over certificate and a new certificate is to accrue on a daily basis at a rate of 1/365th of the value of the Certificate on that day multiplied by the interest rate. The new interest rate provision will be simpler and provide a greater level of transparency for investors.

Penalty for early repayment

7.14 The Government, like commercial financial institutions, has an interest in achieving a degree of security in its funding. One of the ways in which it achieves this is through the issue of fixed term products. For Savings Certificates, the traditional means of discouraging applications for early repayment, and compensating the Government where early repayment is requested, has been to include a provision in the terms and conditions to the effect that certificates will not earn any interest or, in the case of Index Linked Savings Certificates, index-linking, if they are repaid during the first year of investment. Additionally, NS&I has traditionally used stepped interest rates, which increase over the course of a term, to encourage customers to keep their money invested for the full term.

7.15 A review of industry practice showed that NS&I is out of step with the way other financial institutions address the problem of security of funding. Some fixed term bonds issued by other providers do not allow any access until the bond matures, while others allow access but impose a penalty (usually in the form of loss of interest) which increases with the length of the term of the bond. In addition it has been recognised by NS&I that the existing approach to applying penalties was not as clear and transparent to customers as it should be to meet our commitment to treating customers fairly. NS&I intends to adopt a standard and more transparent approach for all fixed term products that are fully or partially encashed prior to the end of a term. This will enable NS&I to be more closely aligned with industry practice and to meet regulatory standards.

7.16 New certificates and rolled-over certificates will earn interest if encashed during the first year of their fixed term, but regulation 9 inserts new regulation 6A in the 1991 Regulations which provides that such a certificate that is fully or partially encashed at any point before the end of any term will be subject to an early repayment penalty equivalent to 90 days' loss of interest on the amount encashed. In addition, if the certificate is index-linked, there will be no index-linked return on the whole certificate for the investment year in which the application for early repayment is made.

7.17 The penalty will not apply in a number of circumstances, such as where early repayment is requested following the death of the holder. In addition, the Director of Savings will be able to decide that the penalty should not apply in a particular case where it would operate unjustly.

Ceasing to make payments by uncrossed warrant

7.18 Regulation 10 amends regulation 7 of the 1991 Regulations so that payment in respect of a certificate may not be made by uncrossed (cash) warrant. This is due to changes in arrangements for transacting NS&I business at post offices. No transactions relating to certificates will be available through the Post Office network. Consequently there will be no facility for holders of certificates to receive repayment in cash.

7.19 These changes apply to all certificates from 20 September 2012. Those customers who are affected will be notified in advance of the change.

Joint holders - payment

7.20 Where certificates are held in joint names the 1991 Regulations currently require all holders to request payments together. This requirement would prevent joint customers from operating their holding online or by telephone, as there would be no practical means for NS&I to ensure that any instructions received had been given with the authority of all joint holders. To address this problem, regulation 13 of these Regulations permits joint holders of new certificates and rolled-over certificates to authorise one of themselves to make requests for and receive repayment on behalf of all of them.

Forfeiture of new certificates and rolled-over certificates

7.21 Regulation 17 introduces different provision for the forfeiture of new certificates and rolled-over certificates. Such certificates may be forfeited in a broader set of circumstances than is currently the case. However, unlike under the current provisions, holders of such certificates will have the right to receive payment of at least the purchase price of their certificates. This amendment will bring NS&I's position more into line with commercial banks, which tend to benefit from extensive termination clauses in the terms and conditions of their products.

Settlement of disputes

7.22 Regulation 19 revokes an obsolete provision relating to the settlement of disputes. The power to appoint an adjudicator under the Friendly Societies Act 1992 (c. 40) was repealed by section 69 of the Finance (No. 2) Act 2005 (c. 22).This change applies to all certificates from 20 September 2012.

Indemnity in respect of payments by electronic transfer

7.23 Making payments by electronic transfer gives rise to certain risks for the Treasury and the Director of Savings. Regulation 20 provides protection to the Treasury and the Director of Savings where loss is suffered by customers as a result of matters that are beyond the control of the Director of Savings.

- ***Consolidation***

7.24 It is intended that the 1991 Regulations and the enactments that amend them, including these Regulations, will be consolidated within three years of these Regulations being made.

8. Consultation outcome

8.1 No consultation was conducted in relation to these Regulations.

9. Guidance

9.1 No guidance has been produced for this legislative change. However, NS&I will provide information and guidance to customers before they are impacted by the proposed changes, including personal communications where possible. Revised terms and conditions will be published by NS&I on its website (www.nsandi.com).

10. Impact

10.1 There is no impact on the costs of business or on charities or voluntary bodies.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 While no specific review is planned of these amendments, the Treasury keeps all legislation governing NS&I under review, to ensure that NS&I is able to carry out its functions effectively.

13. Contact

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