EXPLANATORY MEMORANDUM TO

THE SAVINGS CERTIFICATES (CHILDREN'S BONUS BONDS) (AMENDMENT) REGULATIONS 2012

2012 No. 1880

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 (Children's Bonus Bonds) Regulations 1991 S.I. 1991/1407 (the "1991 Regulations"). These Regulations modernise National Savings and Investments ("NS&I") Children's Bonus Bonds so as to make the product more flexible, make its administration more cost-effective 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 by issuing securities under the auspices of the Director of Savings (a statutory office-holder and the Chief Executive of NS&I). The securities offered include savings certificates issued in the form of Children's Bonus Bonds, which are governed by the 1991 Regulations and contractual terms and conditions.

4.2 The Treasury wish to change certain features of Children's Bonus Bonds, 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 being made by the National Savings Stock Register (Amendment) Regulations 2012 and the Savings Certificates (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

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

7. Policy background

- ***What is being done and why***

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 Children's Bonus Bonds.

7.2 The amendments made by these Regulations, and the changes that they facilitate (for example, in relation to electronic applications), will have effect for all certificates purchased on or after 20 September 2012. This is the coming into force date.

7.3 Except where specifically described below, certificates purchased before these Regulations come into force will continue to operate in an unchanged manner until the end of the five-year fixed interest term that is current on 19 September 2012. If repayment is not requested by the end of that term and, instead, the certificates commence a new fixed interest term, the amendments made by these Regulations, and the changes that they facilitate, will have effect for that new term.

7.4 The Regulations use the term "Children's Bond" to refer to the two categories of affected certificate mentioned above.

<u>Communication and manner of operation</u>

7.5 Children's Bonus Bonds are currently 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 Children's Bonds to be managed 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.

7.6 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 make available an investment record. This amendment will apply to Children's Bonds issued after 19 September 2012 and to other certificates from the anniversary of their date of purchase that falls after 19 September 2012 and before 20 September 2013. It will facilitate the timely introduction of the new computer system and reduce the amount of time NS&I staff spend processing such partial repayments.

<u>Persons who may purchase and hold certificates</u>

7.7 Children's Bonus Bonds may currently be purchased by any person aged 16 or over, or by any two or more such persons, for a child aged under 16 years of age (see regulation 4 of the 1991 Regulations). Regulation 5 of these Regulations makes amendments restricting the persons who may purchase for a child to their parent, guardian, grandparent or great-grandparent. This brings Children's Bonds into line with the other NS&I products that can be purchased for a child, and makes it easier for NS&I to obtain the information that it needs to be able to administer such products.

7.8 Currently holders of Children's Bonus Bonds are entitled to continue to hold their certificates for successive five-year fixed interest terms until they reach the age of 21. Regulation 5 of these Regulations provides that no person may continue to hold a certificate after the end of a fixed interest term ending after 19 September 2012 if, at that time, the holder has attained the age of 16. In such cases, the Director of Savings must make repayment to a person entitled to receive it. The purpose of this is to achieve consistency in the treatment of the age of a child across NS&I's product range and to reduce the cost of maintaining the new computer system in the future.

Interest

7.9 The terms and conditions for 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.

7.10 Following changes in industry practice, it has been recognised that NS&I's existing practice in relation to interest in a leap year causes disadvantage to customers. Children's Bonus Bonds currently operate on the basis that the holder will receive the same amount of interest in a leap year as they would in a normal year. Regulation 7 inserts provision for the accrual of interest on a daily basis, with the result that customers will get an additional day of interest in a leap year than they would in a normal year. In order to facilitate the introduction of the new computer system this amendment is to take effect for certificates purchased after 19 September 2012 and for other certificates, from the anniversary of their date of purchase that falls after 19 September 2012 and before 20 September 2013.

No bonus on Children's Bonds

7.11 Children's Bonus Bonds are currently structured so that an annual rate of interest is paid each year, plus a bonus on the fifth anniversary of the original purchase date, with the overall return being equal to the headline Annual Equivalent Rate ("AER"). The bonus is only paid if the holder has held the Children's Bonus Bonds for an entire five-year fixed interest term. The terms and conditions indicate that this pattern is to continue until Children's Bonus Bonds mature on the holder's 21st birthday, but allow the Treasury to determine the interest rate and bonus that is to apply for each five-year fixed interest term before it commences.

7.12 Regulation 7 of these Regulations provides that no bonus is to be payable on Children's Bonds. The intention is to cease the practice of offering a conditional bonus and instead to reflect the bonus element of the return in an increased fixed interest rate. The application of the bonus often causes confusion with customers who expect to receive the headline AER, even if they seek repayment before the end of a fixed interest term.

Early repayment penalty

7.13 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, such as Children's Bonus Bonds. For Children's Bonus Bonds, the traditional means of discouraging applications for early repayment, and compensating the Government where early repayment is requested, has been the use of the conditional bonus and a further provision in the terms and conditions which has the effect that holders receive no return if they cash in their certificate within a year of its purchase.

7.14 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. As part of NS&I's recent work on Treating Customers Fairly, it was recognised that the existing means for promoting security of funding were not as clear and transparent for customers as they should be. 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 help to manage the demand for certificates (sales and repayments) more effectively and be more closely aligned with industry practice.

7.15 Children's Bonds will earn interest if encashed during the first year of their fixed term, but regulation 11 provides that Children's Bonds that are 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.

7.16 The penalty will not apply where early repayment is sought following the death of a 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.

Unit of investment

7.17 Children's Bonus Bonds are purchased and repaid in fixed value units (currently £25 per unit). This is reflected in the provisions of the 1991 Regulations relating to the maximum holding limits and repayments. These Regulations allow Children's Bonds of any value to be purchased and repaid on a more flexible basis going forward, though they will be subject to the maximum limit and a new minimum holding limit (regulations 6 and 8 of these Regulations).

Means of repayment

7.18 The 1991 Regulations require that all repayments are to be made by crossed warrant. Regulation 9 makes more flexible provision for repayments. It permits holders to request that repayment be made by crossed warrant, electronic transfer or by reinvestment. The Director of Savings need not give effect to such requests where the customer has no entitlement to payment by such means under their terms and conditions. It is intended that the Director of Savings will generally accede to requests for payments to be made by electronic transfer where the holder has Children's Bonds.

Forfeiture of Children's Bonds

7.19 Regulation 14 introduces different provision for forfeiture of Children's Bonds. Children's Bonds may be forfeited in a broader set of circumstances than is currently the case for Children's Bonus Bonds. However, unlike under the current provisions, holders of forfeited Children's Bonds 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.

Indemnity in respect of payments by electronic transfer

7.20 Making payments by electronic transfer presents certain risk for the Treasury and the Director of Savings. Regulation 17 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.

Settlement of disputes

7.21 These Regulations revoke 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 Children's Bonus Bonds and Children's Bonds from 20 September 2012.

- ***Consolidation***

7.22 It is intended that the rules set out in the 1991 Regulations and the enactments that amend them, 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. Revised terms and conditions will be published on NS&I's website (www.nsandi.com) and will be communicated personally to customers where possible.

10. Impact

10.1 There is no impact on business, 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 of these amendments is planned, 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

13.1 Jackie Paterson-Borland at NS&I (Tel: 020 7932 6701 or email: jackie.paterson-borland@nsandi.com) can answer any queries regarding the instrument.