EXPLANATORY MEMORANDUM TO

THE FIRST OPTION BONDS (EXCHANGE OF SECURITIES) RULES 2011

2011 No. 1306

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

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 These Rules facilitate, and govern the effect of, the exchange of maturing National Savings and Investments ("NS&I") FIRST Option Bonds for NS&I Guaranteed Growth Bonds.

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

3.1 This is the first time that the rule-making power in section 14(3) of the National Loans Act 1968 (c. 13) ("the Act"), has been used to make rules deeming holders of maturing securities to accept an offer of exchange.

4. Legislative Context

4.1 Section 12 of the Act gives the Treasury the power to raise money. The power to raise money in section 12 was extended by section 109 of the Post Office Act 1969 (c. 48) to include raising money through the issue of securities under the auspices of the Director of Savings. The Director of Savings is a statutory office-holder and the head of NS&I, which is a government department and an executive agency of the Treasury. Both FIRST Option Bonds and Guaranteed Growth Bonds are securities issued by the Director of Savings. They are governed by the National Savings Stock Register Regulations 1976 (S.I. 1976/2012) and contractual terms and conditions.

4.2 Under section 14(3) of the Act, the Treasury has the power to make rules with respect to the exchange of securities issued under section 12. Section 14(4) of the Act provides that the rule-making power in section 14(3) extends to deeming holders of securities that are to be redeemed to accept an offer of exchange if they fail to request repayment within a specified period.

4.3 These Rules provide that a holder of maturing FIRST Option Bonds will be deemed to accept an offer of exchange for one-year Guaranteed Growth Bonds made by the Director of Savings unless, prior to the relevant maturity date (referred to as the "redemption date" in the Rules), that holder has either requested repayment or requested Guaranteed Growth Bonds with a term longer than one year. The Rules also govern the procedure and effect of such exchanges.

4.4 These Rules will govern any exchange of FIRST Option Bonds for Guaranteed Growth Bonds in place of the Exchange of Securities (General) Rules 1979 (S.I. 1979/1678), in which the definition of "exchange" specifically excludes exchanges for which the Treasury has made separate rules.

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 modernisation programme to ensure that it meets changing customer demands, improves the customer experience and continues to fulfil its role of providing the Government with cost-effective retail financing. One aspect of the modernisation is streamlining NS&I's product offering and dispensing with out-dated products. Another aspect of the modernisation is moving NS&I's products onto a new, more efficient, I.T. platform.

7.2 The FIRST Option Bond is a one-year, fixed interest, bond product that was launched in 1992. Although closed to new business in 1999, existing holders have been allowed, on maturity, to continue their investments for successive one-year terms. However, the number of customers holding FIRST Option Bonds has reduced to the extent that it is no longer cost-effective to continue to manage the product, or to develop the new I.T. platform to cater for the product.

7.3 Under the contractual terms and conditions of FIRST Option Bonds the Treasury may issue a notice informing customers that extension terms will no longer be offered. It is anticipated that the Treasury will issue such a notice.

7.4 In order to promote the continuity of funding and to minimise the potential disruption to customers, it is anticipated that the Director of Savings will offer customers the opportunity to exchange their maturing FIRST Option Bonds for Guaranteed Growth Bonds (a similar fixed interest bond product).

7.5 The Rules will operate to deem a customer to accept an offer of exchange for one-year Guaranteed Growth Bonds, unless, prior to the maturity of their FIRST Option Bonds, that customer makes an application requesting either repayment or an exchange for Guaranteed Growth Bonds with a term longer than one year.

7.6 The deeming effect of the Rules will save NS&I money on the costs of processing responses and will benefit most customers. The interest rate for one-year Guaranteed Growth Bonds is currently 2.20%, whereas the interest rate for FIRST Option Bonds is 1.75%. The Rules will not force customers to accept an exchange. However, the Rules will mean that customers who wish to participate in the exchange need take no immediate action, and that customers who cannot be located continue to earn a comparable rate of interest on similar terms. This latter point is an advantage because in the past, when NS&I's products have been closed, money owed to customers who could not be contacted has instead been transferred into a product called the Residual Account. The Residual Account offers a significantly lower rate of interest than Guaranteed Growth Bonds.

- ***Consolidation***

7.7 It is not intended that the rules concerning the exchange of securities will be consolidated.

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 ahead of any proposed exchange of FIRST Option Bonds. This guidance 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 No monitoring or review is planned in relation to the amendments made by these Regulations.

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.