

How we operate

As an integral part of the Government's debt management arrangements, NS&I is responsible for providing cost-effective financing to the Government by issuing and selling retail savings and investment products to the public.

NS&I is one of the largest savings organisations in the UK, with just under 27 million customers and more than £98 billion of investors' money at the end of March 2010. This represents just under 8% of the UK savings market. In 2009–10, our annual cash flows were in excess of £27 billion.

But unlike other financial services organisations, when customers invest in our products they are lending to the Government. In return the Government pays interest, stock market linked returns or prizes for Premium Bonds.

How we are measured

Our effectiveness in raising funds for the Government is measured in a number of ways, including:

- Net Financing
- Value Indicator
- efficiency.

Net Financing

Net Financing is the measure of the net change of NS&I funds, meaning total inflows from deposits, retention of maturing monies and capitalised and accrued interest, less the total outflows from withdrawals and interest or Premium Bonds prize draw payments. A positive Net Financing figure represents a positive contribution to government financing.

For 2009–10, our Net Financing target was £0 with a range of £2 billion either side of this and will remain the same for 2010–11. In 2009–10 we delivered £1.6 billion of Net Financing, within our target range.

Value Indicator

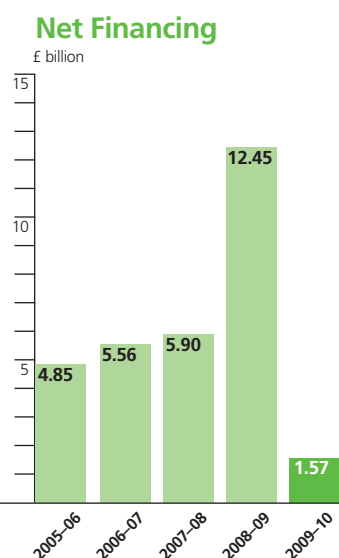
The Value Indicator is a measure of the total cost to deliver NS&I's Net Financing target and to service existing customers' deposits, compared with the cost to the Government of raising and servicing finance through equivalent maturity gilts.

For our fixed rate products the Value Indicator is calculated by looking at the cost of raising funds in the wholesale market of an equivalent term to the product. For our variable rate products it takes into account the average number of years that our customers hold their variable products for. This is then compared with current gilt yields with equivalent maturity dates – which equates to the potential cost to the Debt Management Office (DMO) if they had to raise these funds via gilts for this maturity at the time of calculation. Together these figures enable us to compare the relative efficiency of raising money through NS&I with the efficiency of raising it through gilt sales. A positive Value Indicator figure shows that NS&I is more efficient.

In 2009–10 we delivered a Value Indicator figure of £1.4 billion. Our forecast for 2010–11 is a Value Indicator figure of £750 million. The lower figure for 2010–11 reflects the unpredictability of market conditions in an election year.

Efficiency

Another useful measure of our efficiency is the ratio of total NS&I administrative costs to average funds invested by customers. In 2009–10 this ratio remained below our target of less than 20 basis points.



NS&I's budget is provided by Parliament and is used to deliver the products and customer service discussed throughout this report.

How we set interest rates

In the current low base rate environment, we set our rates to balance the interests of three groups: our customers – offering them a fair rate; taxpayers – with our remit to raise cost-effective finance for government; and supporting stability in the wider financial services marketplace by maintaining an appropriate competitive position.

What we spend our money on

NS&I's budget is provided by Parliament and is used to deliver the products and customer service discussed throughout this report. Our operating costs include our internal costs, the payments made to Siemens, our delivery partner, under a Public Private Partnership contract and the payments made to the Post Office®.

The basic payment for services to Siemens (the unitary fee) reduces over the life of the partnership as a result of the gains from capital investment and operational efficiency brought about by the agreement. Siemens also receives variable payments based on transaction volumes, new product and service channel developments, and its performance.

Our project costs were comparatively high in 2009–10, and are expected to be high again in 2010–11, as we complete some of the critical projects within our **NS&I adding value** strategy. These costs are entirely within the scope of the original strategy.

Full details of our finances and expenditure are in the following sections of this report, covering both:

- **Resource Accounts**, which show the costs of running NS&I in full, and
- **Product Accounts**, which show customer transactions and balances.

This year, we have moved to International Financial Reporting Standards (IFRS) for producing our accounts. Not only does this better enable comparison with other organisations globally, but it is also a cross-government requirement. The Resource Account opening balance sheet has been restated for this along with relevant 2008–09 comparatives.

Expenditure

The NS&I Vote is approved by Parliament. For 2009–10, Parliament approved a resource budget of £191.55 million, which included £7.80 million of annually managed expenditure (AME) (2008–09: £185.20 million), and a capital budget of £3.17 million (2008–09: £1.44 million). The voted net cash requirement was £184.03 million (2008–09: £183.63 million).

The resource outturn was £159.53 million, including £5.61 million AME (2008–09 restated: £173.33 million, including £3.40 million AME), and the capital outturn was £34.08 million, including £4.99 million capital departmental expenditure limit (DEL) (2008–09 restated: capital outturn £20.86 million, including capital DEL £0.93 million). The net cash requirement outturn was £174.16 million (2008–09: £181.40 million).

The 2009–10 voted administrative budget was £183.75 million (2008–09: £185.20 million). Net outturn against the administrative budget was £179.31 million (2008–09: £184.07 million). The underspend was £4.44 million (2008–09: £1.13 million). Part of the underspend (£1.82 million) was transferred to capital. Most of the remaining £2.62 million resulted from lower than expected depreciation and capital charges.

The difference between the resource budget (£191.55 million) and the resource outturn (£159.53 million) was £32.02 million. The following table shows the key differences between the resource budget and outturn during 2009–10.

Difference between resource budget and resource outturn 2009–10

	Difference between estimate and outturn £ million
Overspend/(underspend) category	
Increase in volume changes not in budgets	5.47
Project costs transferred to capital under IFRIC 12	(29.09)
Lower Post Office® costs due to customer shift to direct channels	(3.47)
Lower operational change costs	(0.97)
Lower than expected downward revaluation charge to Blackpool building	(2.19)
Lower depreciation and capital charges	(2.28)
Reduction in professional fees, marketing and research	(1.63)
Transfer to capital DEL to cover capital expenditure, including Moorland extension	1.82
Other differences	0.32
	(32.02)

The difference between the net cash requirement and the net cash outturn was £9.87 million (2008–09: £2.24 million). This was mainly due to the increase in trade payables to Siemens.

Reconciliation of resource expenditure between estimates, accounts and budgets

	2009–10 £000	Restated 2008–09 £000
Net resource outturn (against estimates)	159,531	173,325
<i>Adjustments to remove:</i>		
Provision voted for earlier years	–	–
<i>Adjustments to additionally include:</i>		
Non-voted expenditure in the operating cost statement (OCS)	–	–
Consolidated Fund extra receipts in the OCS	–	–
<i>Other adjustments</i>	–	–
Net operating costs (accounts)	159,531	173,325
<i>Adjustments to remove:</i>		
Capital grants to local authorities	–	–
Capital grants finance from the Capital Modernisation Fund	–	–
European Union income and related adjustments	–	–
Voted expenditure outside the budget	–	–
<i>Adjustments to additionally include:</i>		
Other Consolidated Fund extra receipts	–	–
Resource consumption of non-departmental bodies	–	–
Unallocated resource provision	–	–
<i>Other adjustments</i>	25,397	14,141
Resource budget outturn (against budget)	184,928	187,466
<i>of which:</i>		
Departmental expenditure limit (DEL) – net outturn against administration budget	179,314	184,069
Annually managed expenditure (AME)	5,614	3,397

The differences between net operating costs (accounts) and resource budget outturn (budget) result from the implementation of International Financial Reporting Standards (IFRS). The implementation of IFRIC 12 as interpreted by the *Government Financial Reporting Manual* (FRM) caused the main difference.

Comprehensive Spending Review settlement – securing value for money for our stakeholders

As part of the 2007 Comprehensive Spending Review (CSR), NS&I agreed a settlement with HM Treasury that requires average annual real reductions of 5% on its 2007–08 baseline costs for the period from 2008–09 to 2010–11, despite a planned rise in liabilities to investors over that period. NS&I was also permitted access to end-year flexibility and modernisation funds. The Resource Accounts demonstrate that NS&I's spending was within its remit.

In 2009–10, NS&I's resource departmental expenditure limit (DEL) was £183.7 million. In 2010–11, NS&I's resource DEL will be £157.4 million. Around 80% of NS&I's DEL is spent on the Public Private Partnership with Siemens and on the Post Office® distribution contract.

NS&I adding value is aligned with the need to achieve value for money savings over the CSR period. The strategy also aims to increase the use of direct sales channels, thereby reducing distribution costs. To meet the transitional and up-front costs of **NS&I adding value**, the CSR settlement confirmed NS&I's access to modernisation funds and to end-year flexibility, in accordance with standard procedures. The **NS&I adding value** strategy aims to lower the cost of operations by simplifying, standardising and modernising the business.

The unforecast and unsolicited 'flight to safety' has meant that NS&I is now substantially larger than envisaged at the time that the 2007 CSR was agreed and the financial strategy has been replanned and agreed to account for this material increase in base costs.

Meeting Financial Services Authority requirements

NS&I is governed by specific legislation that regulates the way in which our products are managed and because all strategic decisions require Ministerial consent, the Financial Services Authority (FSA) has formally stated that '*... it is difficult to see how FSA regulation would (materially) enhance consumer protection*'. However, we are expected

by HM Treasury to comply fully with FSA requirements where appropriate on a voluntary basis.

As NS&I holds no capital, has no lending or dealing activities and offers primarily simple, deposit-based products, many areas of the FSA regulatory regime are not directly relevant. The relevant FSA requirements have been identified and implementation continues on enhanced compliance and risk strategies to deliver these. Progress against the strategies is tracked monthly through the Compliance Committee, and progress is discussed every six months with the FSA.

Up to and including 2009–10, we have had a Service Delivery Measure (SDM) in relation to compliance with the Banking Code. Confirmation from the Banking Code Standards Board was received in May 2009 that we remained compliant with the Code. On 1 November 2009, the Code was incorporated into the FSA Banking Conduct of Business sourcebook. We will continue to comply with these requirements, although our SDM will change to accreditation of the new Customer Service Excellence award.

Some of the ways in which NS&I has enhanced the levels of compliance with FSA and other regulations in 2009–10 include the following. We:

- reviewed our risk frameworks, introducing new methodologies for tracking risk indicators to build on our existing policies and risk register
- further embedded Treating Customers Fairly within our culture (see 'Our customers' on page 12)
- introduced a new customer authentication security system for online and telephone transactions
- developed new e-learning modules to provide more effective compliance training for staff
- continued to embed compliance more deeply into our delivery partner Siemens and continued to work with Post Office® Limited (NS&I's key high street distributor) to formalise the NS&I compliance framework designed to support a network of over 11,000 branches
- moved all customer data into our new purpose-built data centres, providing a more secure environment and enhanced business continuity.

How we manage risk

We have well established governance structures, including a risk management framework and associated governance committees. Our governance structures are based on both the Code of Good Practice for Corporate Governance for Central Government Departments and financial services industry standards.

The Chief Executive, as Accounting Officer, has overall responsibility for risk and is advised by the board, the Audit Committee and the Executive Management Team. The Audit Committee meets quarterly and reviews a range of risk-related issues. The board formally considers all key risks twice a year.

We have considered the recommendations published in November 2009 by the Walker Review of Corporate Governance of the UK Banking Industry. We are mindful that HM Treasury is also undertaking a review of the corporate governance code in central government departments, and a revised code is due to be published in the second half of 2010. Once this revised code has been issued, we will review how best to comply with the relevant aspects of both sets of recommendations.

The principal risks and uncertainties facing NS&I which could cause our financial results or operational delivery to materially differ from expected results are set out below, along with a summary of how we managed these risks in 2009–10.

Net Financing results

Our ability to remain within the agreed Net Financing remit depends on a number of factors, including wider market conditions. This includes any potential impact of a changing deposit market or competition for retail deposits which may distort usual pricing patterns, market shocks that may impact on consumer confidence or material changes (and awareness of) depositor insurance arrangements. In 2009–10, our target was to reach Net Financing of £0

with a range of £2 billion either side of this. Following the anticipated high levels of outflows during the first half of the year, we increased our rates on some products and launched new Issues of Guaranteed Growth Bonds and Guaranteed Income Bonds. As soon as we reached our sales target, we took these Issues off sale. We ended the year within our Net Financing target range.

Availability of funding

In order to modernise our business through the **NS&I adding value** strategy, we require access to additional funding from end-year flexibility (EYF) and access to modernisation funds (as agreed in NS&I's 2007 CSR settlement) above the agreed level of NS&I's DEL. The 'flight to safety' in 2008–09 led to a material increase in our operational costs. This was funded through access to our EYF that was originally earmarked for our modernisation programme. HM Treasury approved access to EYF and modernisation funds in 2009–10 to contribute towards our modernisation programme, including the implementation of the IT strategy and modernisation of the Blackpool site.

Reliance on outsourced partners

NS&I's business model relies on Siemens for operational delivery and on the Post Office® as a sales channel for a significant proportion of its sales. In order to manage the risks associated with these partners, we have well developed governance and relationship structures, coupled with formal contract arrangements and targets, so that issues are dealt with promptly and the partnerships remain aligned.

Delivery of the change programme to time, within cost and with planned benefits

As part of the **NS&I adding value** strategy, we have embarked on a major upgrade to modernise our infrastructure. To manage the risks associated with this, we have put the requisite programme and project management disciplines in place, including enhanced joint working with Siemens, project/programme tracking processes and associated oversight over the end-to-end project lifecycle.

Brand health

Any national brand needs to actively monitor the way in which its broader reputation (or 'brand health') is perceived – particularly if it operates within the financial services sector – so we need to track brand awareness measures closely. The risks of any negative trends, for whatever reason, are significant. NS&I is no different, but has additional responsibilities given its unique role in ensuring public confidence across the sector. Brand risks can arise from a multitude of sources – and can be either internally or externally driven. In line with our overall risk management process, NS&I actively monitors a variety of indicators (e.g. through customer and media monitoring), and also places great importance on the anticipation, avoidance and management of risk events.

As a national financial services brand, we rely on a degree of marketing support to assist brand recognition and awareness to deliver our results. As is appropriate for a government agency, we operate within very tight financial parameters. Our marketing spend is very carefully targeted at those initiatives that best fit the profile of the target customer base.

Operational risks in the normal course of business

In any large organisation with many systems, processes, partners, suppliers and people, there is a risk that operational losses can occur. Sources of such risks include system reliability, IT security, failure of key partners or suppliers to deliver, change management, human error, fraud and failure to comply with legislation or regulations. The key processes used to manage these risks are highlighted in the statement on internal control in these accounts.

Suppliers

Payment of suppliers, policy and performance

NS&I is committed to a policy of prompt payment and is a signatory to the Better Payment Practice Code. It endeavours to pay all suppliers within 30 days of acceptance of the relevant goods or services, or receipt of a legitimate invoice if that is later. For 2009–10, the average time taken to pay suppliers was 20 days.

In 2009–10 NS&I paid 94.4% (2008–09: 96.0%) of bills within this standard. The Government made a commitment to speed up the payment process for small or medium-sized enterprises (SMEs). HM Treasury's *Managing Public Money* guidance states that: '*Public sector organisations should aim to pay suppliers wherever possible within 10 days.*' NS&I has followed this commitment and implemented a process to pay SMEs within 10 days of acceptance of the relevant goods or services or receipt of a legitimate invoice if that is later.

Summary of protected personal data-related incidents formally reported to the Information Commissioner's Office in 2009–10

Date of incident (month)	Nature of incident	Nature of data involved	Number of people potentially affected	Notification steps
n/a	There are no incidents to report	n/a	n/a	n/a

Further action on information risk	<p>Although no events are noted above, we will continue to proactively monitor and assess our information risks in order to identify and address any potential weaknesses and, in so doing, minimise the risk of personal data-related incidents and ensure continuous improvement of our systems and processes. A network of Information Asset Owners has been appointed to take responsibility for identifying and managing specific information risks and the overall risk is reviewed regularly by our Executive Management Team and board.</p> <p>We continue to regularly review our internal security policies and procedures, including those that specifically deal with the secure handling of information and protected personal data, and have ensured that these policies are compliant with the mandatory minimum standards of protection. All laptops are encrypted and encrypting is updated regularly to ensure that information remains secure.</p> <p>All current NS&I staff are security vetted, including financial and identity checks, and have received security training. Pre-employment checks are carried out on new starters and security training is included as part of the induction programme. This enhanced programme is being rolled out across Siemens during 2010–11.</p> <p>We continue to align policy and practices with Her Majesty's Government <i>Security Policy Framework</i> and best practice in the finance sector.</p>
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