

How we operate

As an integral part of the Government's debt management arrangements, NS&I is responsible for providing cost-effective financing to 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. In 2008–09, our annual flows were in excess of £35 billion. 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.

NS&I is a government department and an Executive Agency of the Chancellor of the Exchequer.

The Chancellor of the Exchequer is responsible for:

- determining the policy and financial framework within which NS&I operates
- approving interest rates and the terms and conditions of NS&I products
- appointing the Chief Executive and Non-executive Directors to the NS&I board
- setting and monitoring key performance targets for NS&I

The Chancellor delegates these responsibilities to Treasury Ministers.

Departmental Report

The majority of the data and information previously published in NS&I's Departmental Report was also shown in our Annual Report. Both were previously published as separate documents.

This year we have combined the two documents and where data and/or information in the Departmental Report was not previously presented in the Annual Report it has been included in this section.

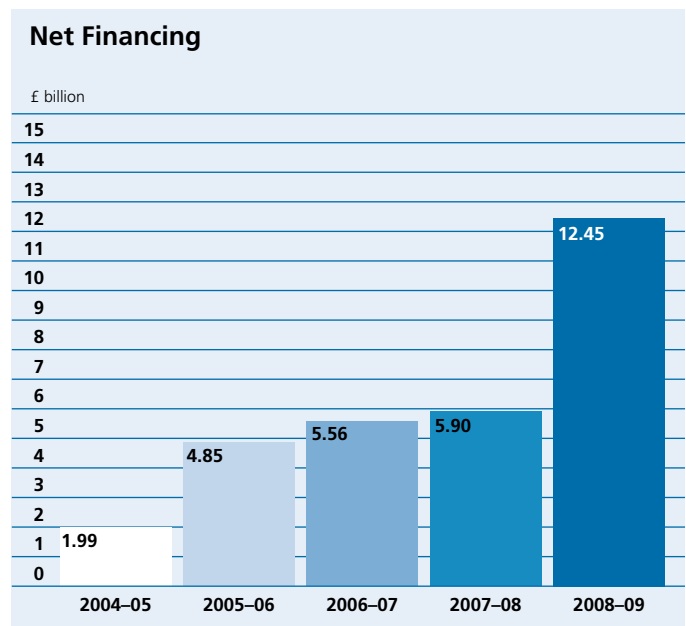
How we are measured

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

- Net Financing
- Value Add
- efficiency

Net Financing

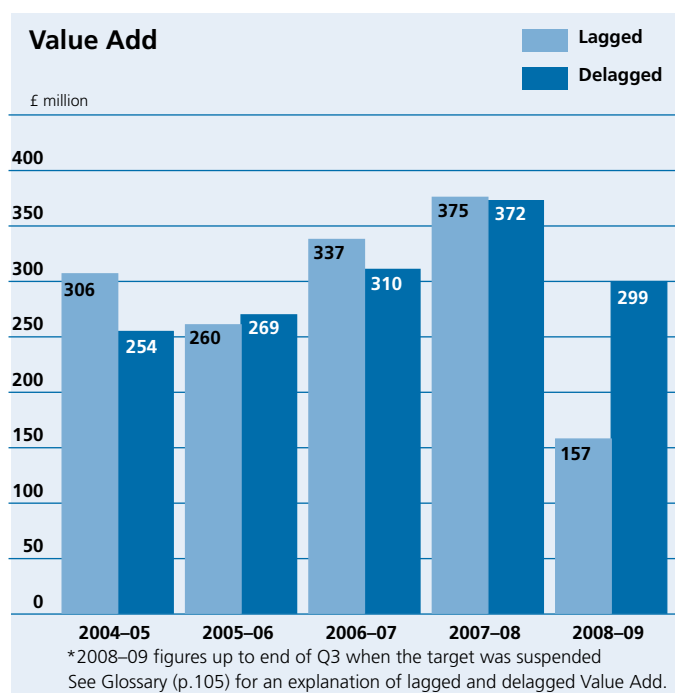
Net Financing is the measure of the net change of NS&I funds, meaning total inflows from deposits, retention of maturing monies and capitalised and accrued interest, less the total outflows from withdrawals and interest or Premium Bond prize draw payments. A positive Net Financing figure represents a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



Value Add

Value Add is a relative measure of efficiency, which compares NS&I's performance with other methods the Government uses to raise funds – such as selling gilts. It compares the total costs of raising funds through NS&I, including our operating costs and tax foregone, with the costs of raising funds in the wholesale market. The difference – ie the saving – is our Value Add.

Our target for 2008–09 was to achieve at least £275 million in Value Add. However, unprecedented market conditions have had a significant effect on this measure during the last year. Financial market conditions have been unusually volatile and the Bank of England base rate has fallen to exceptionally low levels. As a result, the comparators on which Value Add is based have become temporarily invalid as a current measure of our performance and HM Treasury and NS&I agreed to suspend this measure for 2008–09 and that no Value Add target would be set for 2009–10. Our objectives are agreed each year with HM Treasury and the reintroduction of Value Add will be considered at least annually as part of this process.



Efficiency

Another measure of our efficiency is our administrative ratio: comparing our administrative costs with the average funds invested by our customers. It is calculated in a straightforward way, by dividing the total annual cost of running NS&I by the average amount of funds we hold in that year.

This has been one of our targets for some years and our performance against it has been highly creditable, with the ratio currently at 20 basis points against a 2008–09 target of less than 23.

As the total amount of funds invested with NS&I increases, this will require greater administration costs. Our challenge therefore is to minimise increases to administration costs while continuing to invest in the business and maintain service levels.

How we set interest rates

As with any commercial operation, a reasonable return must be provided to both customers and owners. For NS&I, the 'owner' is the Government. Prior to the temporary suspension of the Value Add target, we effectively calibrated our interest rates against two benchmarks:

- the Bank of England base rate for our variable rate products, and
- the yield on equivalent gilts for our fixed rate products

Since the Value Add target was temporarily suspended, we have sought to set our rates by reference to the three factors we seek to balance:

- the interests of our customers
- delivering on our core remit of raising cost-effective finance for government, and
- to support financial stability by maintaining an appropriate competitive position

When we set our interest rates any changes are communicated to meet the requirements of the Banking Code.

What we spend our money on

£000

Objective	2009–10 (Plans)	2008–09 Actual	2007–08 Actual	2006–07 Actual	2005–06 Actual	2004–05 Actual
Gross administration costs⁽¹⁾	188,000	189,817	159,232	173,692	180,415	170,442
Operating income (rent received)	(6,096)	(5,748)	(5,625)	(5,347)	(5,212)	(4,678)
Net resource outturn	181,904	184,069	153,607	168,615	175,203	165,764
Net cash requirements, including:	177,000	181,395	155,224	164,456	170,270	163,843
– PPP contract costs (Siemens)	120,550	120,662	95,914	101,080	107,628	99,428
– selling agents (primarily Post Office®)	27,170	28,828	27,469	32,242	29,280	33,330

⁽¹⁾ 2009–10 plans includes end-year flexibility to be approved by Parliament in 2009–10.

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 the payments made to Siemens, our delivery partner, under a Public Private Partnership (PPP) contract and the payments made to our distribution partners.

The increase in PPP contract costs in the last year reflects the overall volumes of work performed by Siemens due to the 'flight to safety' and increased investment in products and services. The basic payment for services (the unitary fee) originally contracted 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 transactions, new product and service channel developments, and its performance.

Full details of our finances and expenditure are in the next section 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.

Meeting FSA requirements

NS&I is committed to adhering to the principles and standards of the Banking Code. The 2005 Landscape Review of NS&I by HM Treasury determined that it was not appropriate for NS&I to be subject to FSA regulation because it is governed by specific legislation that regulates the way in which its products are managed and because all strategic decisions require Ministerial consent. The FSA formally stated that: '... it is difficult to see how FSA regulation would (materially) enhance consumer protection'. However, HM Treasury noted that it expects NS&I to comply fully with FSA requirements where applicable and that NS&I should extend compliance with FSA requirements 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 and is discussed every six months with the FSA.

Some of the ways in which NS&I has enhanced the level of compliance with FSA and other regulations in 2008–09 include:

- continuing to implement a risk-based approach to anti-money laundering in line with the Money Laundering Regulations 2007
- embedding Treating Customers Fairly within our culture:
 - conducting regular reviews with every area of the business
 - implementing an electronic workflow approval process for any financial promotions issued to make sure that these are fair, clear and not misleading
 - enhancing the complaints-handling processes
- refining data protection and retention rules to be built into new systems
- conducting a comprehensive audit of our compliance arrangements with the Post Office®
- making further enhancements to our overall risk framework, including key policies and related assurance
- refining and reviewing the effectiveness of our governance committees to ensure that they are working as required
- providing ongoing training to our staff on key compliance issues
- continuing to embed compliance more deeply into our delivery partner, Siemens.

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 looks at a range of risk-related issues. It formally reviews all key risks at least annually.

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 2008–09.

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 weakening deposit market or competition for retail deposits which may distort usual pricing patterns, market shocks that may impact on consumer confidence or material changes to (and awareness of) depositor insurance arrangements. In 2008–09, we experienced a large unsolicited inflow as a result of the ‘flight to safety’ following the financial turmoil post-September 2008. This was then reflected in HM Treasury agreeing to a revised 2008–09 Net Financing remit in the November 2008 Pre-Budget Report.

Value Add targets

We measure Value Add on a lagged basis, so the swift unexpected fall in base rates has had a material effect on planned results. As explained on page 29, the interest rate comparators used for Value Add, namely base rates (for variable rate products) and gilt rates (for fixed rate products), do not operate effectively in a very low interest rate environment and were not designed for the current unusual market conditions. Therefore, HM Treasury and NS&I agreed at the end of quarter three that this service delivery measure should be temporarily suspended.

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 Comprehensive Spending Review settlement) above the agreed level of NS&I’s departmental expenditure limit (DEL). The ‘flight to safety’ in 2008–09 has led to an increase in our operational costs. HM Treasury therefore approved access to EYF to fund these additional costs. Access to modernisation funds meanwhile was approved to support the modernisation of the business, 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 over half 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, cost and 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 the requisite programme and project management disciplines in place, including enhanced joint working with Siemens and project / programme tracking processes over the project lifecycle.

Brand health

As we did not want to encourage additional funding during the 'flight to safety', there was very limited brand promotion and related advertising of a non-discretionary nature between September 2008 and February 2009. This significant reduction in marketing support led to a marked reduction in the planned percentage of customers moving towards direct channels such as the telephone and the internet. A short online, press and TV campaign started in March 2009 to encourage greater direct channel usage, which is important for our cost reduction programme as well as for improving the service and choices offered to customers.

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 or failure to comply with legislation or regulations. The key processes used to manage these risks are highlighted in the statement on internal control in the Resource and Product Accounts.

The Landscape Review

The Landscape Review takes place every five years and establishes the basic framework for NS&I's development as an organisation. The most recent Landscape Review was in 2005. In 2008–09 we continued to work with HM Revenue and Customs towards fulfilling the one outstanding recommendation made in the review, namely that we should develop a business case to evaluate the adoption of the Tax Deduction Scheme for Interest.

Table 1: NS&I public spending

£000

	Outturn 2003-04	Outturn 2004-05	Outturn 2005-06	Outturn 2006-07	Outturn 2007-08	Outturn 2008-09	2009-10 Projected	2010-11 Projected
Resource departmental expenditure limit (DEL)								
Reducing the costs to the taxpayer of government borrowing now and in the future	172,081	165,794	175,202	168,615	153,607	184,069	162,101	158,154
Total resource budget DEL	172,081	165,794	175,202	168,615	153,607	184,069	162,101	158,154
<i>of which: near-cash</i>	168,287	161,541	171,983	164,456	157,670	180,030	157,606	153,769
Total resource budget	172,081	165,794	175,202	168,615	153,607	184,069	162,101	158,154
<i>of which: depreciation and amortisation</i>	2,693	3,807	2,666	2,703	2,872	3,002	3,015	2,983
Capital DEL								
Reducing the costs to the taxpayer of government borrowing now and in the future	1,129	137	237	68	45	926	3,176	464
Total capital budget DEL	1,129	137	237	68	45	926	3,176	464
Total capital budget	1,122	139	238	68	45	926	3,176	464
Total departmental spending ⁽¹⁾								
National Savings and Investments	170,517	162,124	172,773	165,980	150,780	181,993	162,262	155,635
Total departmental spending ⁽¹⁾	170,517	162,124	172,773	165,980	150,780	181,993	162,262	155,635

⁽¹⁾ Total departmental spending is the sum of the resource budget and the capital budget less depreciation. Similarly, total DEL is the sum of the resource budget DEL and capital budget DEL less depreciation in DEL, and total annually managed expenditure (AME) is the sum of resource budget AME and capital budget AME less depreciation in AME.

Table 2: NS&I resource budget

£000

	Outturn 2003-04	Outturn 2004-05	Outturn 2005-06	Outturn 2006-07	Outturn 2007-08	Outturn 2008-09	2009-10 Projected	2010-11 Projected
Resource DEL								
Reducing the costs to the taxpayer of government borrowing now and in the future	172,081	165,794	175,202	168,615	153,607	184,069	162,101	158,154
<i>of which: National Savings and Investments</i>	172,081	165,794	175,202	168,615	153,607	184,069	162,101	158,154
Total resource budget DEL	172,081	165,794	175,202	168,615	153,607	184,069	162,101	158,154
<i>of which:</i>								
Near-cash	168,287	161,541	171,983	164,456	150,006	180,030	157,606	153,769
<i>of which: ⁽¹⁾</i>								
Pay (permanent staff)	6,155	6,711	7,497	7,692	7,993	8,922		
Procurement	162,132	154,830	164,486	156,764	142,013	171,108		
Current grants and subsidies to the private sector and abroad	–	–	–	–	–	–	–	–
Current grants to local authorities	–	–	–	–	–	–	–	–
Depreciation and amortisation	2,693	3,807	2,666	2,703	2,872	3,002	3,015	2,983
Total resource budget	172,081	165,794	175,202	168,615	153,607	184,069	162,101	158,154

⁽¹⁾ The breakdown of near-cash in Resource DEL by economic category may exceed the total near-cash Resource DEL reported above because of other income and receipts that score in near-cash Resource DEL but are not included as pay, procurement, or current grants and subsidies to the private sector, abroad and local authorities.

Table 3: NS&I capital budget

£000

	Outturn 2003-04	Outturn 2004-05	Outturn 2005-06	Outturn 2006-07	Outturn 2007-08	Outturn 2008-09	2009-10 Projected	2010-11 Projected
Reducing the costs to the taxpayer of government borrowing now and in the future								
Capital DEL	1,129	137	237	68	45	926	3,176	464
<i>of which: National Savings and Investments</i>	1,129	137	237	68	45	926	3,176	464
Total capital budget DEL	1,129	137	237	68	45	926	3,176	464
Total capital budget	1,129	137	237	68	45	926	3,176	464

Table 4: NS&I capital employed

£000

	Outturn 2003-04	Outturn 2004-05	Outturn 2005-06	Outturn 2006-07	Outturn 2007-08	Outturn 2008-09	2009-10 Projected	2010-11 Projected
Assets on balance sheet at end of year								
Fixed assets								
Intangible	109	141	222	144	89	40	200	300
Tangible	29,953	24,841	25,318	25,204	26,830	25,703	29,000	31,000
<i>of which:</i>								
Land and buildings	26,672	22,014	22,842	23,139	25,156	23,838	27,500	28,000
Plant and machinery, IT, furniture and fittings ⁽¹⁾	3,281	2,827	2,476	2,065	1,674	1,865	1,500	3,000
Vehicles								
Investments								
Current assets	11,706	10,384	9,145	4,641	3,593	1,577	3,000	3,000
Creditors <1 year	(20,612)	(17,833)	(23,161)	(26,356)	(20,113)	(19,197)	(19,000)	(19,000)
Provisions	(1,480)	(1,575)	(1,045)	(728)	(547)	(543)	(500)	(500)
Capital employed within main department	19,676	15,958	10,479	2,905	9,852	7,580	12,700	14,800

⁽¹⁾ Includes asset under construction in 2008-09.**Table 5: NS&I staff numbers**

Staff number at	1 April 2004	1 April 2005	1 April 2006	1 April 2007	1 April 2008	1 April 2009
Permanent	110	123	125	129	135	141
Casual	8	4	7	4	1	6
Total	118	127	132	133	136	147

Table 6: NS&I consultancy and professional services

£000

	Outturn 2003-04	Outturn 2004-05	Outturn 2005-06	Outturn 2006-07	Outturn 2007-08	Outturn 2008-09
Consultancy services	1,616	1,400	853	1,341	1,585	2,042
Professional services other	495	1,025	1,726	1,983	2,035	3,626
Professional services legal	370	502	340	169	310	390
Contract staff/interim managers	862	557	670	583	943	908
Other services	721	574	977	1,090	950	1,031
Total	4,064	4,058	4,566	5,166	5,823	7,997 ⁽¹⁾

⁽¹⁾ Apart from the contract staff costs of £908,000 that are included in Note 7 (page 70) of the Resource Accounts, the remainder is included in Note 8 (page 72) under other expenditure.