Review of 2008/09

The strategic priorities endorsed by Court for 2008/09 and published in last year's *Annual Report* were:

Strategic priority 1 The Bank should continue to improve the quality and efficiency of the processes supporting the Monetary Policy Committee, advance the analysis, practice and communication of inflation targeting, and enhance its understanding of the changing inflation process.

Strategic priority 2 Money market operations should ensure stable overnight sterling interest rates and support improved banking system liquidity management, including by providing longer-term finance through open market operations.

Strategic priority 3 Banking operations should be focused on ensuring monetary and financial stability, thus eliminating activities that do not contribute to those activities, while also being efficient and resilient, in large part to be achieved by continuing to deliver the Customer Banking Transition Programme and developing clear plans for future systems and processes required to run the remaining business.

Strategic priority 4 The Bank should ensure that its banknotes are designed and produced in order to maintain a high level of security against counterfeiting, and that distribution of notes ensures a secure and efficient circulation that meets the Bank's objectives for integrity and quality.

Strategic priority 5 The Bank should draw on its upgraded analytical and market intelligence capabilities to deepen its understanding of the major risks to the UK financial system, to promote wider understanding of these risks among financial market practitioners and work effectively with others to lower them.

Strategic priority 6 The Bank should continue to manage the consequences of the recent financial crisis within the Standing Committee framework, and continue to work with others to strengthen international crisis management preparations. The Bank will contribute to work towards a special resolution scheme for banks and will contribute to a review of the Tripartite arrangements in the light of recent events in financial markets.

Strategic priority 7 The Bank should promote safe and efficient payments and settlements systems, clarifying and implementing a revised remit for its payment systems oversight work following the conclusion of the statutory consultation process, while remaining at the forefront of best practice in operational and policy areas.

Strategic priority 8 To deliver these strategic priorities, the Bank will aim for the highest professional standards and will continuously improve its internal business processes.

Enabling priorities for 2008/09 were:

- Delivering changes to HR services to focus on providing efficient, value-added support to business areas.
- Developing an improved system of performance measurement.
- Implementing a new business-led IT operating model.

The objectives set by Court for 2008/09, which are reproduced opposite, proved a considerable underestimate of the demands that would be placed on the Bank by the continuing financial crisis and developments in the global economy. The main lines of the Bank's responsibilities remained clear: to meet the inflation target set by the Government; and to contribute to the maintenance of financial stability through effective liquidity provision, supporting a sound payment and settlement system infrastructure, supporting the effective resolution of banks in difficulty and sound analysis of risk going forward. But the delivery of these goals required new and unconventional policy approaches; and, internally, the rapid development of new processes and systems. Staff numbers rose by 6%, the first significant increase since 1987. The Bank's balance sheet more than doubled in size. During the year a new Banking Act was passed, giving the Bank a statutory financial stability objective, and new responsibilities for bank resolution and payment system oversight.

Monetary policy

The inflation target was reconfirmed by the Chancellor in March 2008 at 2%, measured by the twelve-month increase in the consumer prices index (CPI). The monetary policy framework requires that if CPI inflation deviates from the target by more than 1 percentage point, the Governor must write an open letter to the Chancellor explaining why, and outlining the measures being taken to bring inflation back in line with target. CPI inflation rose sharply through the first half of 2008 to a peak of 5.2% in September 2008, driven by energy, food and import prices. The increase in CPI inflation above 3% resulted in a series of four open letters from the Governor to the Chancellor in June, September and December 2008 and March 2009. From October 2008, CPI inflation fell back towards the target, in large part reflecting a reduction in energy prices and the temporary cut in VAT.

Subject to meeting the inflation target, the Monetary Policy Committee (MPC) is also charged with supporting the Government's general economic policy objective of achieving high and stable levels of growth and employment. Annual GDP growth (measured on a calendar-year basis) is estimated to have slowed in 2008, to 0.7%, and is expected to be negative in 2009, amidst a sharp and synchronised downturn in the global economy. The Labour Force Survey measure of the unemployment rate rose throughout 2008, reaching 6.3% of the workforce in the fourth quarter.

The downturn in the economy led the MPC to forecast that inflation would fall well below the 2% target in the medium term. During the latter part of 2008, and into 2009, the MPC reduced Bank Rate, from 5% in September 2008 to 0.5% in March 2009.

At the March 2009 MPC meeting, with Bank Rate close to zero, the Committee chose to use the Asset Purchase Facility (see below) to finance asset purchases through the issuance of central bank reserves. Although this changed the instrument of monetary policy, the objective was unchanged — to meet the inflation target of 2%.

The decisions of the MPC, together with its analysis and forecasts, are published in the minutes of their meetings and in the *Inflation Report*, and are not covered further here.

Implementing MPC decisions

In its market operations the Bank aims to maintain overnight market interest rates in line with Bank Rate so that there is a flat money market yield curve and very little volatility in market interest rates out to the next MPC decision date.

During the year, to help stabilise market interest rates in line with Bank Rate, the Bank:

- held a number of fine-tuning repo operations to inject extra reserves into the banking system;
- expanded the range within which reserves were remunerated in order to accommodate the extra reserves supplied;
- held fine-tuning and scheduled operations to drain extra reserves injected through long-term repo operations, using Bank of England bills for the first time for such operations; and
- introduced Operational Standing Facilities to absorb frictions in the overnight money markets.

Other changes, intended to support bank liquidity, are described on page 17.

Asset Purchase Facility

The Government announced on 19 January 2009 that it was authorising the Bank to purchase a range of high-quality assets as part of a package of measures to improve financing conditions in the UK economy. The first phase, which began on 13 February 2009, involved the Bank purchasing short-term commercial paper issued by

Review of 2008/09 continued

Members of the Monetary Policy Committee

Mervyn King Governor

Charlie Bean Deputy Governor

Paul Tucker Deputy Governor

Kate Barker

Tim Besley

David Blanchflower

Spencer Dale

Paul Fisher

Andrew Sentance

corporates, financed by the issue of Treasury bills. The second phase commenced in March 2009, when the MPC began setting a target for the level of asset purchases to be financed by central bank reserves over a period of its choosing. At its March meeting, the MPC voted to undertake a programme of asset purchases of £75 billion financed by the issuance of central bank reserves. That sum covered both the continuing programme of private sector asset purchases, and the purchase of medium and long-maturity conventional gilts in the secondary market. Gilt purchases began on 11 March. On 25 March the Bank extended the Asset Purchase Facility to purchases of corporate bonds.

Support for the MPC

The Bank aims to provide high-quality and comprehensive analytical support to the MPC. It conducts an annual survey of MPC members' general satisfaction with the various inputs to the policy process. The latest survey suggests that MPC members remain satisfied with the conjunctural and forecast material that they receive, although the general level of satisfaction was a little lower than that found in the previous year's survey.

With the outlook for demand and output changing rapidly, the Bank's analytical support for the MPC increasingly focused on high-priority areas such as unconventional policy options and the Asset Purchase Facility. There was additionally work on the impact on the economy of banks restructuring their balance sheets, including the potential impact on demand and inflation from the tightening in the availability of credit and increased levels of uncertainty. In the Statistics area, work was undertaken to collect detailed lending statistics and information from individual financial institutions, and the first in a monthly series of *Trends in Lending* reports was published in April 2009.

Various initiatives are in train to improve the efficiency of work processes within the Monetary Analysis and Statistics area, and thus allow it to run with smaller staff numbers. For example, a project to further automate production of the statistical chart pack used by the MPC is on course to be completed in 2009. Within the Bank's Agency network, the project to relocate the regional offices to smaller premises was completed, generating significant financial savings while maintaining the Agencies' intelligence gathering and representational activities.

Financial stability

Pressure on bank liquidity remained severe in 2008, and the global financial market turmoil intensified in the period following Lehman Brothers' failure in September 2008. During the year the Bank undertook a range of measures in the money markets, intensified its monitoring of banking sector issues, and supported action by the Tripartite Authorities to resolve individual banking problems under the Banking (Special Provisions) Act 2008. With the passage of the new Banking Act the Bank became directly responsible for operating the bank resolution regime.

Money market operations

In addition to their role in implementing monetary policy, the Bank's market operations aim to reduce the cost of disruption to payment and liquidity services provided by commercial banks. In this context the Bank launched a number of initiatives in response to the acute pressures on financial markets and banking systems.

Special Liquidity Scheme

In April 2008, the Bank introduced the Special Liquidity Scheme to allow banks and building societies to swap, for up to three years, high-quality currently illiquid assets for Treasury bills. Eligible assets are restricted to those on the participating institutions' balance sheets as at 31 December 2007. The aim of the Scheme is to improve the liquidity position of the banking system and contribute to confidence in financial markets. The drawdown window to access the Scheme closed (after an extension) on 30 January 2009, but the Scheme will remain in place for three years, providing participating institutions with continuing liquidity support. Use of the Scheme has been considerable, totalling £185 billion of Treasury bills, with the nominal value of securities held by the Bank as collateral amounting to approximately £287 billion at 30 January.

Discount Window Facility

The Special Liquidity Scheme addressed the overhang of illiquid assets on balance sheets up to the end of 2007. But financing conditions remained difficult for banks and building societies and in October 2008 the Bank introduced a permanent Discount Window Facility, as part of a series of changes to its procedures for operating in sterling money markets. The Discount Window Facility provides liquidity insurance to the banking system. It allows eligible banks and building societies to borrow gilts against a wide range of collateral — wider than that accepted in the Special Liquidity Scheme, and not limited to assets on balance sheets before a particular date. In recognition of the continued stresses in financial markets, the Bank announced in January 2009 that, for an additional fee, access to the Discount Window Facility was being extended to allow the option of a 364-day term for transactions in addition to the normal 30-day term, which would continue to be available.

Long-term repo operations

Since December 2007, and especially since September 2008, the Bank has increased the amount and frequency of three-month lending and has extended the range of acceptable collateral. In the October consultation paper the Bank proposed a basis for making these arrangements permanent.

Banking system monitoring and market intelligence

The Bank has undertaken heightened monitoring of conditions in the financial system and in financial markets over the past year. This has involved intensive analysis of the liquidity and capital positions of United Kingdom financial institutions on a high-frequency basis. A project has also been put in place to devise an analytical and organisational framework for enhancing the Bank's monitoring of the banking sector. This complements and supports the Bank's new statutory responsibilities under the Special Resolution Regime (SRR) (see box on page 19). It provides a systematic approach to analysing the banking sector in normal times, with particular focus on systemically important institutions. It will also ensure a basic level of information and analysis of firms subject to the SRR. This is a formalisation of some of the activities the Bank has anyway been undertaking during the course of the crisis.

In assessing risks to the UK and global financial system, and in determining appropriate responses to these stresses, timely and well-informed market intelligence has been crucial. Using its operational relationships and expertise, the Bank has established a global network of contacts in banking and capital markets. In addition to bilateral contacts, the Bank meets regularly with market participants through the Money Market Liaison Group, the Foreign Exchange Joint Standing Committee, the Securities Lending and Repo Committee and other groupings. Market intelligence is provided to the MPC and the Bank's Financial Stability Board.

Review of 2008/09 continued

Bank resolution

The Bank has been closely involved with the Tripartite Authorities in the resolution of a number of institutions, including Northern Rock, Bradford and Bingley and two Icelandic banks. These were conducted under the Banking (Special Provisions) Act 2008, and a key aspect of the Banking Act 2009 (see box on page 19) was the design and implementation of a permanent Special Resolution Regime (SRR). The Bank has formal responsibility for the operation of this regime and was particularly closely involved in developing the provisions governing partial property transfers under the Act and in designing the protection for creditors and counterparties, most notably the 'no creditor worse off' safeguard. The Bank contributed to the key features of the secondary legislation and to the drafting of the Code of Practice relating to the use of the SRR.

In order to fulfil its new responsibilities under the SRR, the Bank has established a Special Resolution Unit. This reports directly to the Deputy Governor for Financial Stability, and comprises a core team of Bank staff with experience of financial crisis management and resolutions, together with external experts with a background in for example law and accountancy. In steady state, the Unit will work to enhance and refine the Bank's and the United Kingdom's approach to bank resolution. It will work closely with the FSA, HM Treasury and the Financial Services Compensation Scheme, as well as with financial firms and practitioners.

On 30 March 2009 the Bank announced that it had transferred core parts of Dunfermline Building Society to Nationwide Building Society. This followed a sale process conducted by the Bank over the weekend of 28–29 March, and was the first use of the powers conferred to the Bank under the Banking Act 2009. The social housing loans of Dunfermline's customers (and related deposits) were transferred temporarily to DBS Bridge Bank Ltd, a 'bridge bank' owned and controlled by the Bank.

System-wide measures

In order to address concerns about the stability of UK banks and building societies, the authorities have announced a range of policy initiatives over the past year. The two most important system-wide measures were in October 2008 and January 2009:

- In October 2008 the Government announced measures to invest in UK banks and building societies to help stabilise their position and support the long-term strength of the economy, including making capital investments in RBS and, upon successful merger, in HBOS and Lloyds TSB.
- In January 2009 the Government announced a package of measures to reinforce financial stability, increase confidence and capacity to lend, and support recovery of the economy. This included offering loss protection on those assets most affected by the current economic conditions, in order to reduce banks' uncertainty about the value of past investments, hence providing them with greater confidence to lend in the future to creditworthy businesses, homeowners and consumers.

The Bank played a role in the design, assessment and implementation of both packages, alongside HM Treasury and the FSA. For example, the Bank has helped design and apply stress tests to the solvency position of UK banks and building societies, working together with the FSA. This contributed to HM Treasury decisions on the scale of the October recapitalisations. The Bank also contributed to assessing losses on different portfolios of assets submitted to the Government's Asset Protection Scheme, announced in January. The Bank's participation in these initiatives emphasised the value of the suite of financial stability models that the Bank has been developing over the past few years. More recently, these models have also been useful in assessing the implications of low interest rates for the profitability of the UK banking system.

Payment and settlement systems

One positive factor during the crisis has been the resilience of the payments and settlement infrastructure in the United Kingdom and globally. The Bank has responsibility for the oversight of systemically important payment systems in the United Kingdom. Their resilience at a time of large increases in volumes and significant increases in market volatility underscores the importance of the improvements to the design of the United Kingdom's payment and settlement infrastructure over the past fifteen years.

During September and October 2008, there were no serious delays to payment or settlement, or major service outages, and defaults were on the whole dealt with effectively under systems' existing procedures. The Bank's Real Time Gross Settlement (RTGS) platform, introduced in 1996 to provide real-time settlement for CHAPS payments in sterling, was available for 99.8% of the time during 2008, compared with 99.7% in 2007. The average daily payment values in the two main payment and settlement

The Banking Act 2009

The Banking Act 2009, which received Royal Assent on 21 February, aims to strengthen the United Kingdom's statutory framework for financial stability and depositor protection. It expands the 1998 Bank of England Act to provide the Bank, for the first time, with a statutory objective to contribute to protecting and enhancing financial stability in the United Kingdom. The implications for Court and for Bank governance more generally are described on page 6. Specific new responsibilities are summarised below.

The Special Resolution Regime

The Act creates a permanent Special Resolution Regime (SRR) for dealing with distressed banks and building societies, thereby achieving one of the Bank's strategic objectives for 2008/09 (see page 14).

The SRR powers, which came into force on 21 February, enable the authorities to:

- transfer all or part of a bank to a private sector purchaser;
- transfer all or part of a bank to a bridge bank — a subsidiary of the Bank of England — pending a future sale;
- place a bank into temporary public ownership (HM Treasury's decision);
- apply to put a bank into the Bank Insolvency Procedure (BIP) which is designed to allow for rapid payments to Financial Services Compensation Scheme (FSCS) insured depositors; and
- apply for the use of the Bank Administration Procedure to deal with a part of a bank that is not transferred and is instead put into administration.

The Bank is in the lead in operating the SRR and in choosing which tools to apply in any particular case, subject to HM Treasury taking the lead if it is decided to place the bank into temporary public ownership. A decision on the choice of tool is determined on the basis of five key objectives, which are set out in the Banking Act.

The Banking Act includes provisions to protect creditors and counterparties, most notably the 'no creditor worse off' safeguard. This is intended to ensure that no creditor of the failed bank will be penalised by the application of a partial property transfer, compared with an independently evaluated assessment of what that creditor could have expected had the whole bank been placed into an immediate liquidation. These safeguards have been further enshrined in secondary legislation under the Act and a Code of Practice relating to the operation of the SRR, which was laid before Parliament on 23 February 2009.

Payment systems oversight

The Act provides the Bank with statutory responsibility and new powers to oversee certain payment systems from Summer 2009, enhancing the system of informal oversight which previously existed. HM Treasury, with advice from the Bank, will decide which payment systems are sufficiently important to the United Kingdom that they should be recognised for oversight. The Act gives the Bank a graduated range of powers and sanctions to help it fulfil this role. The Bank will have new powers to collect information on payment systems, make and change system rules, appoint inspectors, and take a range of actions in cases of non-compliance. This brings the Bank more closely into line with the more formal approach taken to payment system oversight by most other major central banks.

Scottish and Northern Irish banknotes

Finally, the Act modernises the existing framework for overseeing issuance of Scottish and Northern Irish banknotes by banks, with the Bank provided with new powers to ensure full protection for the holders of these banknotes.

Review of 2008/09 continued

systems which use the RTGS platform — the CHAPS high-value sterling payment system and the CREST delivery-versus-payment system — were £284 billion and £478 billion respectively.

The Banking Act gives the Bank statutory responsibility for payment system oversight, as described in the box on page 19.

International regulatory initiatives

The global nature of the crisis, and the problems experienced with dealing with cross-border firms, has highlighted the importance of cross-border crisis management. In April 2008, the Financial Stability Forum (FSF) recommended that a small group of supervisors and central banks be formed to address these issues. Sir John Gieve chaired the group, which proposed a set of high-level principles for co-ordination on cross-border crises. Going forward, the Bank will work with other authorities to implement the group's proposals, under the chairmanship of Paul Tucker. These include developing a common toolkit, including an international systemic impact assessment framework, a guide that outlines possible *ex-ante* planning steps, and a list of practical lessons from recent cross-border cases.

The Bank has also contributed to various longer-term initiatives to strengthen the financial soundness of banks, working alongside the FSA. The Basel Committee's working group on liquidity, chaired by Nigel Jenkinson, published a paper with good practice standards for liquidity risk management in 2008. In 2009, the group has worked to reach international agreement on measures of liquidity risk. The Bank is also involved in efforts to strengthen the macroprudential framework. This would include the capital framework for the banking system, ensuring that banks build up buffers in good times which they can run down when needed, and is a key element in the broader debate on how to reduce cyclicality in the financial system.

The G20 is playing a leading role in co-ordinating the international response to the current global economic problems. The United Kingdom holds the G20 presidency in 2009 and the Bank of England and HM Treasury have worked together to prepare the substance and co-ordinate the logistics for a successful Presidency. The Bank has been actively engaged in a number of the G20's work strands which relate to Bank priorities, including reforming international financial institutions and the international monetary system, enhancing cross-border crisis management and reforming liquidity risk management. In addition, the Bank has also contributed to the G20 process through its involvement in various FSF and other international fora.

Banking services

During 2008, the Bank continued to implement its customer banking strategy, which involves focusing on those banking activities required to enable the Bank to fulfil its responsibility as the central bank of the United Kingdom. The main focus of activity is now on the migration of retail banking activities for major government users, notably Her Majesty's Revenue and Customs (HMRC), the Government Banking Service (GBS — formerly Office of the Paymaster General) and National Savings & Investments (NS&I). RBS and Citibank will be the new banking providers and the Bank is working with them to support the migration plan. It is expected that this business will have migrated by mid-2010.

The Bank will remain an important provider of banking services to government, but with the focus on high-value activities. The Bank will likewise continue to provide custodial services to a range of customers. As of 28 February 2009 total assets held by the Bank as custodian are around £225 billion (2007/08: £220 billion), of which £102 billion are holdings of gold (2007/08: £72 billion).

Banknotes

The Bank is responsible for issuing banknotes that the public can use with confidence. The average value of notes in circulation over the past year was £42.4 billion. Last year the Bank issued 1.1 billion new notes and, at the year end, the number of Bank of England notes in circulation was 2.5 billion. In terms of the value of notes in circulation, the £20 note accounts for the largest share, at around 63%.

Since the launch, in March 2007, of the new £20 note featuring Adam Smith, the Bank has been working with the cash industry to replace the Elgar £20 with the new design. As at end-February 2009, the Adam Smith design accounted for 69% of the £28.1 billion of £20 notes in circulation. The changeover between the two designs is expected to take at least one more year, in line with the withdrawal period of the earlier Faraday £20 design.

Over several years the Bank has observed a rise in the share of £20 notes as a proportion of total notes in circulation by value. This has risen from 49% in 1997 to 63% during 2008. Much of this increase is probably due to a gradual move by ATM owners towards stocking more £20 notes and fewer lower denomination (£10 and £5) notes. At the same time the number of ATMs has increased from around 23,000 in 1997 to around 63,000 in 2007, as ATMs have become the main channel for acquiring cash. Last year, the Bank started to work with some owners of large estates of ATMs to encourage them to ensure their machines are stocked with a sufficient proportion of lower-denomination notes. This should help ensure that the public has access to a suitable quantity and quality of lower-denomination notes for small-value transactions and as change items. This work continues.

Since 2006 the Bank has been implementing a new IT system to meet the Bank's requirements in the Notes business area. This covers matters such as warehouse management, demand forecasting, recording counterfeit and mutilated banknotes, improved electronic links to members of the Note Circulation Scheme as well as management information. The implementation of this system is due for completion during Summer 2009.

Counterfeits

During calendar year 2008, 686,000 counterfeit Bank of England notes were taken out of circulation with a face value of £14 million. The Bank has estimated that 88% of these were taken out of circulation during machine sorting of notes by the members of the Bank's Note Circulation Scheme (NCS). In 2008 around 12 billion banknotes were machine sorted in the NCS so that the share of counterfeit notes found in this total was 0.0057%. The equivalent figures for the previous two years were 0.0037% (2006) and 0.0026% (2007).

Technical analysis reveals that organised criminal gangs are behind the vast majority of all counterfeits detected and that three major gangs have been responsible for 90% of the counterfeits passed during 2008. The number of counterfeits discovered during 2008 reached a peak during the second quarter, and was 36% below that peak by the fourth quarter. The Bank continues to work closely with law enforcement agencies to detect and stop counterfeiting. During 2008, the police successfully stopped one of the major sources; the police have also shut down a number of other smaller operations and achieved successful convictions. The Bank is grateful for the support of the Serious Organised Crime Agency and the police forces around the country. It is important that counterfeiters are eliminated as rapidly as possible.

The Bank makes available, free of charge, to police, retailers, banks and the public, a range of banknote educational and training materials to help them identify genuine banknotes. Information is provided on the Bank's website, in leaflets and posters, in a short film guide and on a computer-based training CD Rom aimed at professional cash handlers. Further details can be found at: www.bankofengland.co.uk/banknotes/security/index.htm.

Scottish and Northern Irish banknotes

The Banking Act 2009 (see box on page 19) updates regulation of the issue of banknotes by seven banks in Scotland and Northern Ireland. Around £5 billion of Scottish and Northern Irish notes were in circulation in February 2009. The new arrangements will ensure that these notes are backed by Bank of England liabilities (notes and a deposit at the Bank) and coin at all times, and that note holders can exchange their notes for these backing assets if an issuing bank fails. The Bank of England will also act as the regulator for note circulation in Scotland and Northern Ireland. The new regime will begin in the autumn, after Parliament has approved the necessary regulations.

Communication

The policy framework

The Bank promotes understanding of its monetary policy framework, and the case of low inflation, through its publications, speeches, website and other means. The *Inflation Report* and MPC minutes explain monetary policy decisions and the MPC's judgements about the outlook for the economy and inflation, and the *Quarterly Bulletin* includes articles relevant to monetary policy and other aspects of the Bank's work. The Bank's network of twelve Agencies, located throughout the United Kingdom, continues to play an important role in explaining monetary policy objectives and decisions to businesses and other organisations, in addition to gathering intelligence about business conditions for the MPC.

The difficult external environment in 2008/09, and the related changes in monetary policy reinforced the need for the Bank to communicate effectively and build understanding of the monetary policy framework and

Review of 2008/09 continued

Regional Agents

Peter Andrews
London

Chris Brown
East Midlands

David Buffham
North East

Kevin Butler
South West

Graeme Chaplin
West Midlands

Phil Eckersley
South East & East Anglia

Paul Fullerton
Yorkshire and The Humber

Frances Hill
Northern Ireland

Adrian Piper
Wales

Chris Piper
Central Southern England

Tony Strachan
Scotland

John Young
North West

decisions taken by the MPC. Most recently, considerable effort was made to explain the MPC's decision to inject money directly into the economy through asset purchases, via the media, speeches, public and parliamentary appearances, and the Bank's website.

Financial Stability assessment

The bi-annual *Financial Stability Report* (*FSR*) sets out the Bank's assessment of developments and challenges facing the UK financial system. In May 2008, the *Report* discussed the difficulties the system faced as market participants sought to reprice risk and reduce leverage, against a backdrop of impaired market functioning after the collapse of Bear Stearns in mid-March. The October 2008 *FSR* explained how these financial risks had crystallised and begun to interact negatively with the slowdown in the real economy, heightening fears of an adverse spiral of falling asset prices, tighter credit conditions and slower economic growth. Interest in the Bank's *FSR*s has increased markedly over the past two years. Media coverage has been extensive. Internet hits in the first two weeks following publication were over 276,000 in October 2008, which is a six fold increase compared to average pre-crisis levels.

The Bank has implemented various measures to improve the communication of the messages in the *Report*. This included the inclusion of a new summary, which is sent to executive and non-executive directors of major financial institutions, and speeches by senior Bank staff at the time of publication. There have also been Q&A sessions with market participants on the date of *FSR* publication and briefings for the Bank's contacts, including banking analysts and rating agencies.

Speeches and hearings

Throughout the year, MPC members have continued to undertake a significant number of speeches and visits around the United Kingdom, along with other public appearances. Formal published speeches by MPC members totalled 38 in 2008/09. These were supplemented by a large number of talks and discussions with different audiences as part of the regular programme of visits to all parts of the United Kingdom, facilitated by the Bank's Agencies. During the past year, a total of 48 such visits were undertaken outside Greater London.

The Governor, other members of the MPC and senior Bank staff attend parliamentary hearings to answer questions about monetary policy and the financial crisis. In 2008/09 the Bank provided a total of 35 witnesses at 13 hearings of the Treasury Committee of the House of Commons. The Committee held four hearings on the Bank's *Inflation Report*, five appointment hearings for MPC members, and four hearings on banking reform and the banking crisis. Bank staff also gave evidence to the Banking Bill Committee.

Education

The Bank continues to present information and tools about monetary policy through its museum, website and schools' resources. An exhibition, *The Pound in Your Pocket*, on the topic of inflation and its control, opened in the Bank's museum in April 2008. The Bank's museum attracted over 92,000 visitors in 2008/09, an increase of 17% from the previous year. Development of the Bank's website also remains an important part of the Bank's efforts to inform the public of its role and work. In 2008/09, the site attracted over 8½ million visitors.

The Bank's schools' programme also contributes to building wider public understanding of monetary policy and the Bank's role. Over the past year, there has been increased take-up of the Bank's school resources. In total, well over 11,000 primary and secondary schools have requested the Bank's educational packs and films — up from 6,000 at the end of the previous year. The Bank's annual economics competition for schools and colleges, Target Two Point Zero, continues to be popular. In its ninth year the competition attracted 296 participants. The national final in March 2009 was won by Peter Symonds College from Winchester.

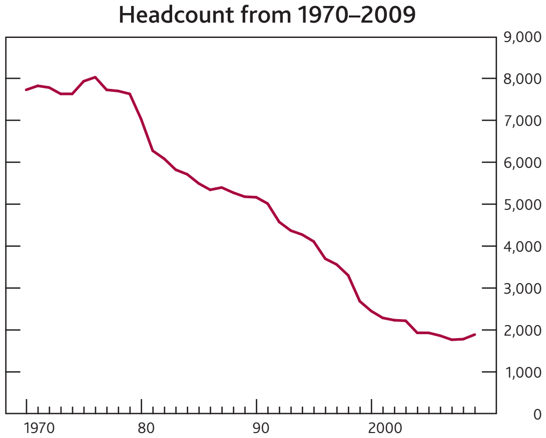
To monitor public opinion and awareness of the Bank and its role, regular opinion polls are undertaken. In the February 2009 poll, carried out by NOP, 38% of respondents said they were 'very satisfied' or 'fairly satisfied' with the way the Bank is doing its job to set interest rates to control inflation; 28% were 'dissatisfied', with the remainder neutral or undecided. The net satisfaction rating of 10% compared with 30% in February 2008. Survey results are published quarterly and in the *Quarterly Bulletin* each year.

Resources

Staffing

At the end of February 2009 the Bank employed 1,642 full-time staff and 215 part-time staff; 1,666 of these staff were on permanent contracts, up from 1,579 as at end-February 2008. In total this is approximately 6% more staff than at end-February 2008; it is the first significant increase in staff numbers since 1987. During the period, 344 individuals joined the Bank and 241 left (including temporary staff). Of the staff recruited, 172 were recruited on permanent contracts, an increase from 81 in 2008. Of these new permanent staff, 38 were new graduates (up from 23 the year before), 64 were experienced hires appointed to analytical and management roles (an increase from 32 the year before) and 70 were appointed to clerical or non-technical roles (up from 26 the year before).

Headcount from 1970–2009



The increase in staff numbers was due to the extra workload brought on by the Bank's new responsibilities. In addition, many staff were temporarily reassigned during the year to work on policy initiatives such as the Asset Purchase Facility and the Special Liquidity Scheme, and on bank resolution issues. In recognition of the exceptional workload over the past year, the Bank increased its bonus and special payments budget from the usual 7% of salaries to 8.1%.

Review of 2008/09 continued

Employee relations and diversity

The Bank maintains its arrangements for consulting staff on matters affecting their interests including with representatives of the recognised trade union, Unite. A new flexible working framework *'Flexible Working For You'* was introduced following pilots and extensive consultation in January 2008 and has been positively received by both staff and managers; the framework has achieved improvements in quality and quantity of work in many teams as well as in staff commitment to the Bank. The next in the series of biennial staff opinion surveys will take place in the latter part of 2009 when staff will again be given an opportunity to express their views on a range of issues.

During 2008, the Bank continued to progress with the implementation of its Diversity Strategy. Andrew Bailey and James Strachan were the executive and non-executive sponsors respectively.

The proportion of women in senior roles stood at 24% at the end of February 2009, down slightly from 25% at end-February 2008. The proportion of staff from ethnic minority backgrounds has increased to just under 10% and within our graduate intake in 2008 they represented 16%. Part-time staff constitute 12% of all Bank staff and 8% of those at analyst and managerial level.

Staff development and performance management

The Bank remains committed to the development of all staff and provides extensive training targeted at all levels.

Managers are developed through a number of coaching, mentoring and training programmes. This year has seen the introduction of new development workshops for talented senior managers. These workshops provide opportunities for delegates to compare themselves against the Bank's leadership framework and identify both their strengths and areas for further development.

The graduate intake forms a very important part of the talent pipeline, and receives a wide range of development opportunities, particularly in the first few years with the Bank. This year the Bank was awarded the prize for the Best Graduate Development Programme by the Association of Graduate Recruiters. The Association also awarded the Bank its *Best of the Best* Award which goes to the year's overall winner out of all six categories.

The Bank introduced a new performance management system in early 2009. The new system encourages staff and managers to set focused objectives based on business plans and performance measures. It also encourages staff to take greater personal responsibility for their performance and development.

Information technology

A new IT Operating Model was implemented in 2008 to support clear focus on the main business lines of the Bank while managing the Bank's IT infrastructure as a shared service. This initiative included the appointment of IT Business Partners and a new Chief Technology Officer to improve visibility of business and IT needs in the future. Implementation of a shared service organisation to support infrastructure also netted a £1 million saving in like-for-like recurrent cost.

During the year the system development teams have been asked to move quickly to implement several special schemes to provide support to the capital markets. This has required close co-operation of project teams throughout the Bank and the creation of several new systems to help the Bank's operational functions manage new schemes in a controlled and efficient way.

IT support teams have also worked hard to maintain high levels of system availability and service through an often extended working week. This work has been managed alongside ongoing activity to ensure that the Bank's IT assets are properly secured and maintained. These initiatives will be further developed in the coming year as a project to refresh the Bank's data centres gets under way.

In November 2008 the Bank appointed its first Chief Information Officer to lead the further development of information and technology. This appointment reflects recognition of the increased importance of IT to the Bank's operations, and an understanding of the need to manage IT resources to more closely support the Bank's strategic priorities.

As part of that, a strategy has been agreed to promote new ways of working throughout the staff, using collaboration technologies and improved re-use of information. The IT Division will also be seeking to build on the IT Operating Model work to develop a 'high performing IT organisation' by improving the maturity of its solution delivery, improving business engagement and building standard service processes to manage the Bank's IT estate.

Performance measurement

During 2008 the Finance Directorate launched an initiative to improve the Bank's internal performance measurement framework. The work is aimed at better linking the processes and outputs of individual business functions to the outcomes defined by the Bank's Core Purposes and strategy. In its broadest sense, the performance measurement framework involves all of the following elements:

- Operational strategy and priority setting.
- Business planning and the budget process.
- Planning and delivery of key strategic milestones and projects.
- Design and monitoring key performance indicators and measures.
- Management of operational risks.

A business planning process is conducted annually which takes as an input the Governor's strategy, as endorsed by Court. This process feeds into the budget discussions which aim to match resources to business aims and plans for the year ahead. The business plan is approved by Court ahead of the start of the financial year. Quarterly reports on the delivery of the plan are then provided to the Executive Team and Court along with financial and risk reporting.

During the planning process for the 2009/10 financial year performance indicators and measures were included for both of the Bank's Core Purposes, and for individual Directorates and business functions. These measures will form a key part of the performance reporting to Executive Team and Court in 2009/10. Further work is planned in 2009 to refine the existing performance measures, and to add to the framework in order to reflect the Bank's redefined role in Financial Stability. As well as improving the planning and reporting process at Executive Team and Court level, the framework is designed to be used by individual business areas in their own operational management processes, and ultimately to set and measure individual staff objectives.