

MEETING OF THE COURT OF DIRECTORS

Wednesday, 16 September 2015

Present:

Anthony Habgood, Chairman
The Governor (for items 1-10)
Mr Bailey, Deputy Governor – Prudential Regulation
Mr Broadbent, Deputy Governor – Monetary Policy
Sir Jon Cunliffe, Deputy Governor – Financial Stability
Mr Fried
Mr Frost
Baroness Harding
Mr Prentis
Mr Robert
Mr Stewart
Ms Thompson

In attendance:

Ms Hogg, Chief Operating Officer
Dame Minouche Shafik, Deputy Governor – Markets & Banking

Secretary:

Mr Footman

1. Minutes

The minutes of the meeting held on 15 July 2015 were approved.

2. Matters Arising

The Court noted a report from the Remuneration Committee.

3. Nominations Committee - Approvals

On a recommendation from the Nominations Committee, Court approved the following appointments consequent upon the retirement in November of Mr Stewart:

Mr Fried as Senior Independent Director

Baroness Harding as Chair of the Remuneration Committee

Mr Frost as a member of the Remuneration Committee

Ms Thompson as a member of Nominations Committee

4. **The Treasury Committee**

The Chairman reported on the Treasury Committee hearing on 9 September, at which he and Mr Fried had given evidence. The Committee had shown considerable interest in the Government's proposal to give the National Audit Office (NAO) freedom to conduct value for money studies within the Bank, subject to a policy carve out. It had been agreed that there was ambiguity over the scope of that carve-out – most of the Bank's functions had some element of policy – and the Committee, like Court, was concerned that the circle should be drawn so as not to undermine the Bank's policy independence. The Committee had asked for a review of the MPC Code in the light of the controversy over Jan Vlieghe's financial interests, and the discussion of the Code planned for September had accordingly been deferred to October so that ARCO could undertake a broader review of the Bank's conflicts rules. Mr Fried said that he had told the Committee that in his view the Bank's decision in the Vlieghe case had nevertheless been correct. The Committee had also asked for further information on the evolution of the PRA's cost base since legal cutover, and on the Bank's diversity targets; this would be provided.

In response to a question, Charlotte Hogg said that all Bank staff and contractors were paid at or above the "London living wage".

5. **Bank Conflict of Interest Provisions**

(Ms Branch in attendance)

Ms Branch said that the Bank was asking the Treasury to incorporate in the forthcoming Bill conflict of interest provisions that were broadly consistent for the three policy committees, covering both appointments and subsequent committee practice. Separately, a review was being undertaken of the Codes for the Committees and other internal policy documents to ensure that they were consistent and appropriate. This would (as the Chairman had said at the Treasury Committee) be brought to ARCO in October and subsequently to Court.

6. **Update on Investigations**

(Ms Branch in attendance)

Ms Branch updated Court on the progress of investigations previously reported to the Oversight Committee.

7. **Bank of England Bill**

(Ms Branch in attendance)

Court noted progress on the draft Bill, which was likely to be introduced in October.

Directors expressed concern about the provisions relating to the NAO attending the Audit and Risk Committee of the Bank. This was intended to give the NAO the opportunity to scrutinise the financial audit of the Bank, and should therefore be restricted to those parts of ARCO's meetings that related to the financial audit.

Directors were also concerned to ensure that Court was consulted by the NAO about the individual value for money reviews that it would undertake, as there would inevitably be issues about the scope in relation to the proposed policy carve-out.

8. **Europe**

Sir Jon Cunliffe updated Court members on the project to review, ahead of the Referendum, the implications for the delivery of the Bank's objectives of EU membership. As the Bank had made clear, it was their intention to publish the result of this work in due course.

9. **Cyber Resilience**

(Messrs Gracie and Brandon in attendance)

(i) **The Bank**

Mr Brandon, the Chief Information Security Officer, described progress made in controlling risks to the Bank's information security, in particular from cyber-attack. Significant progress had been made in applying controls, but at the same time external threats had been increasing. The Bank had numerous information assets and was a key part of the UK critical national infrastructure. A £20mn three-year investment programme had been agreed in 2013 and there

had also been a substantial increase in day-to-day resources in the IT Security and Information Security Divisions, with an uplift of 74 FTE staff. Technical controls put in place had strengthened the Bank's ability to prevent, detect and respond to attacks. But no technical fix could guarantee security 100%, so at the same time significant effort had been made to improve security awareness among all staff, and incident handling procedures had been strengthened.

A particular concern had been to address staff issues. Inevitably some individuals had privileged access to information and/or systems, and those individuals were natural targets for profiling by potential attackers. Staff had to be aware of the risk of revealing their Bank roles through social media (easily hacked) as well as the risk from phishing attacks in the Bank. Education about the latter had included testing the staff through fake attacks – this was clearly working as fewer now took the bait and many more reported suspicious traffic.

(ii) The Financial Sector

Mr Gracie outlined the government structure within which the Bank's external facing cyber resilience team operated, led by the Cabinet Office's National Cyber Security Programme, which set standards and co-ordinated information sharing. The Treasury had lead responsibility for the financial sector and operated mainly through the Bank and the FCA, looking respectively at resilience and consumer detriment. The Bank's role was exercised through the FPC, which had made specific recommendations, the PRA, which monitored the safety and soundness of firms, the FMI Board, which oversaw infrastructure, and the operational side of the Bank, which managed key payments systems. Activity was co-ordinated by the Bank's operational resilience team. Work had been focussed on identification and assessment of risks, standard setting, sector co-ordination including information sharing, crisis response frameworks, and international engagement.

An assessment questionnaire had been completed by 35 major firms and FMIs, and themes had been shared with Chief Risk Officers and Chief Information Security Officers of more than 130 firms. A vulnerability testing framework, CBEST, had been developed by the Bank and launched in 2014; it was intelligence-led, and provided an independent assessment of firms' individual cyber defences. The findings from CBEST were used to help firms develop their defences and to shape the sector resilience programme going forward. Information sharing would remain critical and an industry body – CMORG – had been established as a focal point,

chaired by the Bank. Response frameworks have been reviewed and market-wide exercises conducted – another was due in 2016. Internationally a G7 group had been established with similar aims, jointly chaired by the Bank and the US Treasury.

Mr Gracie noted that all of the steps taken had been seen as constructive and innovative, but given the rapidly evolving nature of the risk there were no grounds for complacency. The industry tended to focus on conventional attacks that might cause consumer loss, while the potential threats to financial stability were typically more complex and insidious.

Directors expressed concern that CBEST testing remained voluntary. Mr Gracie said that was the formal position, but the supervisors were making participation a clear expectation and in practice it was becoming close to mandatory for the bigger firms. Directors asked how the Bank was ensuring that cyber risk was taken seriously at the highest level of institutions: Chairmen and CEOs had to understand the nature and scale of the threat to their businesses. Mr Gracie said that would be (and had been) part of the supervisory discussions and would particularly focus on governance. Directors also wanted to understand how the Bank would respond in the event of a successful attack against a firm. Mr Gracie said that the Bank could provide technical and intelligence back-up as necessary – delivery of CBEST had provided a good understanding of individual firms' systems and vulnerabilities. The response framework would be in place and liaison with Government agencies through COBRA.

One Director noted that responsibilities were quite widely spread across the Bank and suggested they be brought together. Mr Gracie said that the aim of his team was to avoid a fragmented approach. The Bank had many interfaces with the financial sector – prudential regulation, payments, infrastructure – and all had to work together. It might be unhelpful to separate cyber response into a specialist box. Sir Jon Cunliffe said that the field was evolving fast, and the Bank would certainly keep under review the way in which the work was organised.

10. **Staff Survey**

(Ms Place, Messrs Bailey, Ramsay, Stewart and Shellard in attendance)

Mr Ramsay outlined the Bank's general response to issues raised in the staff survey, which would supplement measures being taken in business areas. These would include a weekly written briefing to Heads of Division to keep them informed of policy issues; measures to

improve delegation and decision-making; a restatement of the Bank's flexible working policy; and greater transparency around performance management. Court was content with the Bank's response, and intended to monitor progress.

11. **PRA report**

(Mr Fisher in attendance)

Mr Fisher noted that Mr Thorburn and Mr Bryson had now joined the Board.

The Board had made and published final rules for the Senior Managers Regime for non-EEA branches, and the Senior Insurance Managers Regime.

The Board had also set Internal Capital Guidance (Pillar 1 plus Pillar 2A) for the seven largest UK banks and building societies. This was the first time that ICG levels had been considered for all the major UK banks at the same time, rather than in separate supervisory reviews. Referring back to the earlier discussion, a Director asked whether an additional capital charge was made for cyber risk. Mr Fisher said that if there were thought to be governance issues around a bank's response to this issue a Pillar 2B scalar could be applied.

Mr Fisher said that the Board had also reviewed its guidance on booking model structures. Around 30-40% of global OTC derivative trades were booked through London, and the PRA's concern was to ensure that these were properly risk managed in the entity to which they were booked, and that the arrangements were transparent and aligned with incentives for orderly resolution.

Directors asked about progress on the HBOS Report, which was being overseen by a joint PRA/FCA steering committee. It was agreed that there would be a discussion at October's Court.

12. **MPC Report**

(Mr Haldane in attendance)

Mr Haldane commented on developments in China over the summer and the impact on emerging market economies and commodity prices. These posed some downside risks to the global environment, although there was a considerable uncertainty about the duration and scale

of contagion from the developments in China to the global economy and the UK. Market expectations of MPC tightening had moved a little further out.

13. **Open Forum**

(Mr Haldane in attendance)

Mr Haldane spoke about the Open Forum, which had been announced in the Governor's Mansion House speech and would be held at the Guildhall on 11 November. The aim was to review the progress made thus far in reforming markets and to explore what more might be done, providing a means by which all interested parties could be involved. The shape of the forum was being guided by a steering group, members of which would lead individual sessions. It was intended to engage a wide range of stakeholders from across society.

14. **Banking and Markets Report**

Dame Minouche Shafik reviewed the actions taken following the five reviews completed since she joined the Bank in 2014. These were:

The Grabiner Report

Although Lord Grabiner did not find that anyone in the Bank was involved in, aware of or should have been aware of foreign exchange market manipulation, he did make three high level recommendations:

- To clarify the relationship between the Bank and market participants in the context of Market Intelligence and its uses. This had been largely addressed by the MI Review.
- To provide education in the NIPs code for those working directly in the FX market. All staff had now been trained and the Bank was leading on development of a new Global FX Code. The Bank was also looking at how to update the non-FX parts of NIPS covering sterling wholesale deposits and bullion.
- To review the Bank's record management practices. Since the publication of the Report, the Markets area senior management had conducted a review of practices relating to all of the multilateral meetings that the directorate has with participants.

MI Review

The MI Review had been completed in February of this year, with two broad findings: that MI needed to be refocused in order to serve the entire, expanded Bank and its mission; and that safeguards needed to be improved so as to provide a more robust and formalised framework within which MI gatherers operate.

Of the 11 recommendations, nine had already been implemented, including:

- A publicly available MI Charter that sets out the reason why we do MI, and the rules of engagement.
- An internally available MI gathering policy, along with a programme to enable compliance with it via a training and certification framework.
- A cross-Bank executive level MI Steering group to set the focus of MI gathered within Markets, to ensure it serves the whole Bank.

The main outstanding action was to develop options for a suitable IT system for disseminating Market Intelligence.

Financial Risk Management Review

Phase 1 of the financial risk management review had been finalised in May. The target now was to set out a Bankwide risk tolerance framework, which would come to ARCo for sign off later this year. A new Executive Risk Committee had been formed and met several times, supported by a strengthened Risk Division.

A second-line Financial Risk Management division had been set up within the Banking, Payments and Financial Resilience directorate. This division, headed by a risk expert from the PRA, would provide objective challenge on financial risk decisions and would also focus on the technical implementation of the financial risk management review, including independent model evaluation and stressing the Bank's own capital position.

RTGS Review

The implementation of the recommendations of the Deloitte Review into the 2014 RTGS incident was on track and being monitored by the RTGS Strategy Board, which had been improving the strategic oversight and governance around RTGS. This included improvements to the testing strategy and the change approvals process, and completing the technology risk review. Ms Hogg's area has put in place the Bank's internal Critical Incident Management Framework: all the Governors had participated in a test and it also been used in real time.

FEMR

Implementation of the FEMR Report was being coordinated by a small team in Markets. The Bank had committed to a public implementation update in June 2016, and expected to have either completed, or made good progress on, all of the recommendations by then.

The BIS Foreign Exchange Working Group (FXWG), the group responsible for creating a new Global FX Code, had been established and had met for the first time. The target date for finalisation of the Code, as well as of the proposals to ensure greater adherence, was May 2017.

The FICC Markets Standards Board was up and running. 32 of the largest global firms had committed to joining the Board, and it would meet for the first time on 15 September. The Bank and the FCA had also had an opportunity to comment on the FMSB's work priorities for the coming year.

In the coming weeks the PRA and FCA would be publishing a consultation paper on mandatory employee references to prevent the recycling of staff with poor conduct records between firms, and intended to have the regime in place in time for the launch of the Senior Managers Regime in April 2016.

15. FPC Agenda Items

(Mr Brazier in attendance)

Mr Brazier briefed Court on the key issues on the FPC's agenda: Bank Capital, leading to a framework for setting systemic risk buffers for ring-fenced banks and a strategy for setting the countercyclical capital buffer; stress testing (jointly with the PRA Board); market liquidity;

and on housing and mortgages, the case for action in the buy-to-let sector and the annual assessment of the government's Help-to-Buy scheme.

16. Directorships and other interests to be declared

A list of Director's interests was circulated, and the Chairman reminded Court of the importance of giving him and the Secretary notice of any changes before they were agreed.

The meeting of Court was closed.