BANK *of* ENGLAND

REPORT & ACCOUNTS

1996

CONTENTS

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GOVERNOR'S FOREWORD

The past year was another period of relatively low inflation. Underlying retail price inflation in the year to February 1996 was 2.9%; this is the third year in succession when prices have risen by less than 3%. Meanwhile, unemployment fell further and the economy continued to grow, though at a more moderate pace than during the previous year, partly as a result of the economic downturn in continental Europe. Monetary policy had been tightened between September 1994 and February 1995, with interest rates raised in three $^1/_2$% steps to $6^3/_4$%, against the background of increasing cost pressures as a result of rising commodity prices and quite strong growth in demand and output. Despite a 5% depreciation in sterling's external value in the early part of 1995, these inflationary pressures had been contained by the end of the year, and, on the basis that the Government was more likely than not to meet its inflation target two years ahead, interest rates were then reduced, in three $^1/_4$% steps, to 6%.

This represents a considerable success for the new monetary policy framework, introduced in 1992 and based on an explicit target for inflation (measured after excluding the effect of changes in mortgage interest payments). Originally set at 1 - 4% and in the lower half of that range by the end of this Parliament, the target was revised last year, and policy is now consistently directed to achieving an inflation rate of $2^1/_2$% or less. The framework provides for a high degree of transparency, including in particular the quarterly *Inflation Report* from the Bank, and the publication, after a short delay, of the advice that the Bank gives the Chancellor of the Exchequer. This exposes more clearly than in the past the technical debate about short-term policy settings, and over the past year it became known that the Bank would have preferred a slightly higher level of interest rates over the summer, and that we would have marginally preferred to delay one of the three $^1/_4$% cuts in interest rates last winter.

Too much has been made of these differences of view. The attention paid to them may owe something to the novelty of our being required to expose our thinking to public view. For us, the novelty has been rather in debating whether the peak of the interest rate cycle would be $6^3/_4$% or $7^1/_4$% — either outcome representing a profound improvement compared with earlier cycles. And the fact that we have been able to move interest rates in small steps, on the basis of monetary analysis rather than in response to market pressure, suggests that we have moved to a more stable monetary environment. These developments demonstrate the success that the new framework has had in enabling us to respond quickly and pre-emptively to changes in inflationary pressure, avoiding the big swings in interest rates and activity levels that characterised earlier cycles.

The progress towards greater stability means that this country has as good a chance as the other major European economies of being eligible to join the European Economic and Monetary Union (EMU). It is of course important that all countries which participate should have achieved sustainable convergence but, whether or not we ultimately choose to join, it is in our national economic interest that we should continue to pursue the policies directed at monetary stability and fiscal consolidation that would enable us to meet the Maastricht convergence criteria. The most damaging outcome would be for us to exclude ourselves simply on the basis of inadequate economic performance.

In the meantime, the Bank continues to be fully engaged in the technical preparations for EMU, through the European Monetary Institute (EMI) and in other fora. During the year, the EMI published its "changeover" scenario, describing the way in which a new currency would be introduced, and the Bank has been discussing this with banks and other organisations. It is clear that, whether or not the UK participates in EMU, the immediate priority will be to ensure that the wholesale payment arrangements can cope, from the outset, with payments in euro as well as sterling, and that financial markets can trade in euro instruments. The more complex operation of introducing the euro for retail transactions cannot be completed before euro notes and coins are introduced from the beginning of 2002, providing time to make the transition in this area once it is known whether the UK will participate.

On the supervisory side, the year has been one of immense activity and, for staff and management, it has been a testing period. The events leading up to the failure of Barings in February 1995 were examined in a report commissioned by the Chancellor of the Exchequer from the Board of Banking Supervision. I was extremely grateful to the members of the Board and the review team for the immense personal effort that they put into the report. It was an extremely thorough piece of work and, although completed very quickly, remains an authoritative and definitive account of the Barings failure. Although some doubted at the outset that a report prepared by a body close to the Bank could be impartial, this overlooked the fundamental independence of the majority of the Board from the Bank. It was the independent members, sitting alone, who investigated and reported upon the role of the Bank of England itself. And the process had the overwhelming virtue of speed: this was important, not just to satisfy curiosity, but to enable regulators and market participants to draw the necessary lessons from the Barings debacle as quickly as possible.

That we have done. The Board identified a number of areas for improvement in the Bank's supervision. We have been addressing these as a matter of urgency with the help of a major review being conducted by Arthur Andersen.

It has also been a year of great activity in the gilt market. The Bank has again successfully fulfilled the funding remit given to it by the Treasury. Of perhaps more lasting significance, the gilt market has undergone the largest series of reforms since Big Bang in 1986. The borrowing programme was made more transparent and structured. The introduction of a gilt repo market, from January 1996, has liberalised arrangements for stock lending and borrowing, and is likely to have important implications for the functioning of the money markets as well. And finally, we have consulted the market about the development of a gilt stripping facility, which will be introduced early in 1997.

As in past years, a major focus for the Bank has been payment and settlement issues. Here there is substantial progress to report. First, the real time gross settlement (RTGS) project went live, as planned, on 22 April 1996, following a long period of development and testing. RTGS means that large value payments in the UK are now finally settled as they occur during the business day rather than by means of end of day net settlement. This greatly reduces the risk in the system and opens the way to other possibilities for reducing settlement risk such as delivery-versus-payment in securities settlement and the simultaneous settlement of both legs of a foreign exchange transaction. Second, the CREST project, for equity market settlement, has continued to meet its deadlines and is on course to go live on time in July 1996. At the same time, control of CRESTCo will pass from the Bank to the private sector shareholders. Pen Kent will continue as chairman during the early phase of live operations but will resign before the end of 1996.

We have decided to proceed with an upgrade of the Central Gilts Office system, to enable more efficient settlement of repo among other enhancements. The new system, which will be based on CREST software, is likely to be in operation in the early part of 1997; it will be built so as to retain the option of merger with CREST in due course.

We have continued to monitor carefully the rate of counterfeiting of our bank notes. While it would be wrong to exaggerate the problem, which remains very small relative to the stock of notes outstanding, it was until recently clearly growing. The police have had some success, evidenced by the number of bulk seizures, but our main defence must lie in the quality of the security features in the notes and the alertness of the public. We are committed to continued upgrading of note security, and to continued efforts to educate the public through counterfeit awareness campaigns.

During the year we have decided on major changes in our banking and note distribution arrangements, affecting both the cheque clearing centre and the branches. Cheque clearing is a declining activity for all banks, and the Bank of England is no exception. It was clear that to remain competitive we would need to reduce our costs significantly and, in May 1995, we announced an outsourcing arrangement; by the end of the year our clearing centre activity at Eagle House had been transferred to First Data Resources Ltd. At the same time we announced that banking operations at the branches would end by May 1996. These operations were small-scale and, without the support of our cheque clearing business, banking at the branches was no longer viable.

Our review of note distribution highlighted increasing duplication between our activities and those of the clearing banks. The changes that we have decided to make in this area — essentially restricting ourselves to the issue of new notes and the collection and destruction of soiled ones, leaving recycling and reissue to the banks — will enable us to concentrate all our note distribution into two centres, London/Debden (the Bank's Printing Works) and Leeds. The branches at Birmingham, Bristol, Manchester and Newcastle will be closed during the course of 1997. However, in all of those cities we are retaining an agency, the main function of which is the gathering of economic intelligence, and we are expanding that network further with agencies in Cardiff, Nottingham and Greater London. This will deepen and enhance our understanding of economic developments in the country as a whole, to which we attach considerable importance.

Many of the developments in the Bank over the past two years have been unsettling for the staff. The Bank's reorganisation in 1994 involved the loss of a number of posts. Job losses at the branches, the outsourcing of our cheque clearing work and the current review of our stock registration service can only have reinforced a sense of uncertainty, as has the management review of supervision. Naturally, I regret this. It would be foolish to pretend that these issues can be quickly resolved. We know that, to maintain our position, to keep our business, we must provide a service of the highest quality as cost-effectively as possible. I believe that across the whole range of our functions we are capable of doing that — indeed in many functions this is already the case. I hope that the management changes made last year — the clarification and publication of our forward strategy, the creation of a Management Committee — will enable us to manage the changes that we have to make and secure the support of the staff. We have a staff that is throughly professional and extremely dedicated and which is proud to work for the Bank. I am grateful to them for their loyalty and indeed forbearance over the past year.

I am grateful also to Brian Quinn, who retired from the Bank at the end of February 1996 after 26 years — the last 14 of them in supervision. As Director for supervision since 1988, he occupied one of the most taxing and thankless positions in the Bank with great distinction. He also played an invaluable role in the Bank during 1995, acting as Deputy Governor for the six months between Rupert Pennant-Rea's departure and Howard Davies' arrival. I also record thanks to Christopher Hogg and Roland Smith who retired from Court at the end of February 1996, and to Peter Peddie, who also retired in February 1996 after acting as the Bank's main legal adviser for many years, and who subsequently joined the Bank in 1992 to set up our Legal Unit.

In this Annual Report we have attempted to set out more clearly than in previous years the Bank's strategic aims and how they are being implemented. The agenda is formidable, but we have made great progress in the past year and I have every confidence that we will succeed in achieving the tasks we have set ourselves.

Governor of the Bank of England

THE BANK'S CORE PURPOSES

As the central bank of the United Kingdom, the Bank is committed to promoting the public good by maintaining a stable and efficient monetary and financial framework as its contribution to a healthy economy. In pursuing this goal, it has three core purposes; achieving them depends on the work of the whole Bank.

1

- **Maintaining the integrity and value of the currency**. Above all, this involves securing price stability as a precondition for achieving the wider economic goals of sustainable growth and employment. The Bank does this by influencing decisions on interest rates, on the basis of economic and financial analysis of developments both at home and abroad; by participating in international discussions to promote the health of the world economy; by implementing agreed policy through its market operations and its dealings with the financial system; and by maintaining confidence in the note issue.

2

- **Maintaining the stability of the financial system, both domestic and international.** The Bank seeks to achieve this through supervising individual institutions and markets; through monitoring the links between financial markets; through analysing the health of the domestic and international economy; through co-operation with other financial supervisors, both nationally and internationally; and through promoting sound and efficient payment and settlement arrangements. In exceptional circumstances, the Bank may also provide or organise last resort financial support where this is needed to avoid systemic damage.

3

- **Seeking to ensure the effectiveness of the UK's financial services.** The UK needs a financial system that offers opportunities for firms of all sizes to have access to capital on terms that give adequate protection to investors, and which enhances the international competitive position of the City of London and other UK financial centres. The Bank aims to achieve these goals through its expertise in the market place; by acting as a catalyst to collective action where market forces alone are deficient; by supporting the development of a financial infrastructure that furthers these goals; by advising HM Government; and by encouraging British interests through its contacts with financial authorities overseas.

Because the Bank is a national institution, its three core purposes relate primarily to the UK. Achieving them requires it not only to understand the international developments that may have a bearing on them, but also to co-operate actively with other monetary authorities and international organisations.

THE BANK'S STRATEGY

The Bank's statement of its core purposes sets out a continuing framework for all its operations. It is supplemented by an annual strategy statement, which identifies current emphases and directions, and provides a guide both to individual areas of the Bank, and to the allocation of resources within the Bank as a whole.

The current strategic objectives were approved by the Court of Directors in November 1995. They are:

MONETARY STABILITY

- To build public support for low inflation and monetary stability.
- To strengthen further the Bank's understanding of the dynamics of the inflation process, and the techniques of inflation control, and the Bank's reputation as a centre of excellence in this and related areas.
- To increase public awareness of the Bank's analysis of the real economy.
- To deepen further the Bank's market expertise, both as an input to policy and to ensure effective execution.
- To take a leading role in promoting efficient structures in the markets in which the Bank operates, and to promote further changes in instruments and in techniques in money and capital markets to ensure that London markets are deep and liquid and match international best practice.

EUROPE

To participate actively in the planning process for EMU, to help ensure that the arrangements, should the UK join them, are sensible and practicable; and to guard against any potential discrimination against those who do not join at the outset.

BANKING ACTIVITIES

To maintain the Bank's position as "preferred supplier" of core banking services to HM Government and the market, by demonstrating superior performance in all areas. The Bank will concentrate, through internal organisation and through harnessing advances in information technology, on improving its cost effectiveness in these core services.

FINANCIAL STABILITY

The short-term agenda in Supervision and Surveillance is driven by the recommendations of the Board of Banking Supervision Inquiry into the collapse of Barings. One aspect of that work is the Arthur Andersen management review of Supervision and Surveillance. It is likely that, as a consequence of the post-Barings review, the Bank will need significantly to augment the resources devoted to supervision in the future. The Bank's overall strategy encompasses such a reallocation of resources.

The strategic aims in relation to financial stability are:

- To build public, political and market understanding of the appropriate role of banking supervision — both in terms of what is possible, and of what is right.
- To rebuild confidence among the Bank's banking supervisors, strengthening the staffing and skills, redefining good practice and establishing a robust quality assurance mechanism.
- To continue to build strong relationships with other regulatory bodies in the UK and overseas.
- To build on the Bank's reputation as a leader in the debate on financial supervision and regulation.
- To continue to push forward with the reform of payment and settlement systems in the UK and abroad.

EFFECTIVENESS OF THE UK'S FINANCIAL SERVICES

- To monitor those UK financial markets which could pose threats to monetary or financial stability, or impede the development of efficient and effective financial markets in the service of the wider economy. The Bank's aim is to identify market failures and act as a catalyst in resolving them.
- To bring the CREST project to a successful conclusion.

OTHER AREAS

In the *statistics* area, the Bank's objective remains the provision of a timely high-quality, cost-effective service covering all three core purposes.

In the area of *bank note printing*, the Printing Works will soon complete a major re-investment programme and is introducing a new management culture. These changes are delivering operational efficiencies, which will maintain its reputation for cost-effectiveness. There are continued concerns about counterfeit notes which will require decisions on new and potentially costly security features.

In the case of the *registration of government securities*, the Bank has agreed to undertake a major project to identify ways of meeting the best cost and quality standards delivered by registrars in the private sector.

The *Centre for Central Banking Studies* supports the Bank's core purposes by improving its understanding of the financial systems of developing and transitional economies, and by training the staff of their central banks in techniques to promote monetary and financial stability.

FINANCIAL ASPECTS

The strategy requires some redistribution of resources, particularly towards Supervision and Surveillance. It is achievable over the next two years within the Bank's financial constraints but will require continued efficiency improvements. Much of the Bank must operate within HM Government's cash limits regime. In addition, the Bank is committed to operating within a constant pay bill. These are increasingly tight constraints, but it nonetheless believes that the strategy outlined above is achievable within them over the next two years.

IMPLEMENTATION

The Operational Reviews contained in this Report show how the key areas of the Bank are applying themselves to the implementation of the strategy.

THE COURT OF DIRECTORS

MEMBERS OF COURT
1 March 1996

Eddie George *(Governor)*

Howard Davies *(Deputy Governor)*

Sir David Scholey, CBE *a*
(Chairman, Swiss Bank Corporation International Advisory Council)

Mervyn King
(Executive Director)

Sir David Lees *b*
(Chairman, GKN plc)

Sir Colin Southgate *c*
(Chairman, THORN EMI plc)

Frances Heaton *d*
(Director, Lazard Brothers & Co., Ltd)

Sir Chips Keswick *e*
(Chairman, Hambros Bank Ltd)

Sir Jeremy Morse, KCMG *f*
(Former Chairman, Lloyds Bank plc)

Pen Kent
(Executive Director)

Sir David Cooksey *g*
(Chairman, Advent Ltd)

Sheila Masters *h*
(Partner, KPMG)

Ian Plenderleith
(Executive Director)

Neville Simms *i*
(Deputy Chairman and Group Chief Executive, Tarmac plc)

Sir David Simon, CBE *j*
(Chairman, The British Petroleum Company plc)

Michael Foot
(Executive Director)

Sir John Hall
(Chairman, Newcastle United Football Club)

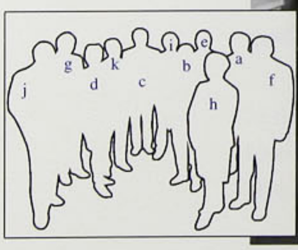
John Neill, CBE *k*
(Group Chief Executive, Unipart Group of Companies)

The Bank's Court of Directors consists of a Governor, a Deputy Governor and 16 Directors, up to four of whom may have executive responsibilities in the Bank. Members of Court are appointed by the Crown — Governors for terms of five years and Directors for four years.

Court is responsible under the Charter of the Bank of England for the "affairs" of the Bank — that is, setting the strategic direction of the Bank as a corporation, and ensuring in particular that the Bank's resources are effectively deployed in pursuit of its key responsibilities. Court does not take decisions on monetary policy but acts as a source of advice for the Governor on business and market conditions. Court's main meetings are held monthly, but shorter weekly meetings are also held.

Court has delegated to the Executive the Bank of England's powers under the Banking Act 1987 and other supervisory legislation. It is thus not concerned with taking day-to-day decisions on supervisory cases, though it receives regular reports on the operation of the Banking Act and on resources in Supervision and Surveillance.

Court also has annual meetings with the Board of Banking Supervision, which is separate from Court and is established under the Banking Act 1987. The Board consists of the Governor, the Deputy Governor and the Executive Director for supervision, together with six lay members drawn from the banking, legal and accountancy professions. The lay members give advice to the ex-officio members on supervisory policy and on individual supervisory cases. The Board publishes its own Annual Report.



THE EXECUTIVE

Governor's Committee

Eddie George *(Governor)*

Howard Davies *(Deputy Governor)*

Mervyn King
(Executive Director, Monetary Stability)

Pen Kent
(Executive Director, Financial Stability)

Ian Plenderleith
(Executive Director, Monetary Stability)

Michael Foot
(Executive Director, Financial Stability)

Advisers to the Governors

Len Berkowitz
(Head, Legal Unit)

Sir Peter Petrie
(European and Parliamentary Affairs)

Ian Watt
(Head, Special Investigations Unit)

Management Committee

Howard Davies *(Deputy Governor)*

Bill Allen
(Deputy Director, Monetary Analysis)

Alastair Clark
(Deputy Director, Financial Structure)

Graham Kentfield
(Deputy Director, Banking and Market Services)

Oliver Page
(Deputy Director, Supervision and Surveillance)

John Townend
(Deputy Director, Market Operations)

John Footman
(Secretary of the Bank)

Roy Lecky-Thompson*
(Personnel Director)

Gordon Midgley
(Finance Director)

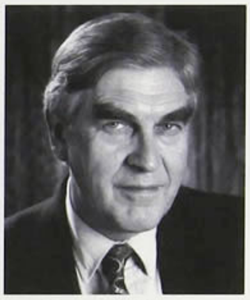
*Roy Lecky-Thompson will be succeeded by Merlyn Lowther in June 1996.

Eddie George
Governor

Howard Davies
Deputy Governor

Mervyn King
Executive Director

Pen Kent
Executive Director



Ian Plenderleith
Executive Director

Michael Foot
Executive Director

Under Court, the Bank's senior policy making body is the Governor's Committee, comprising the Governors and Executive Directors. The Governor's Committee sets broad policy over a range of matters.

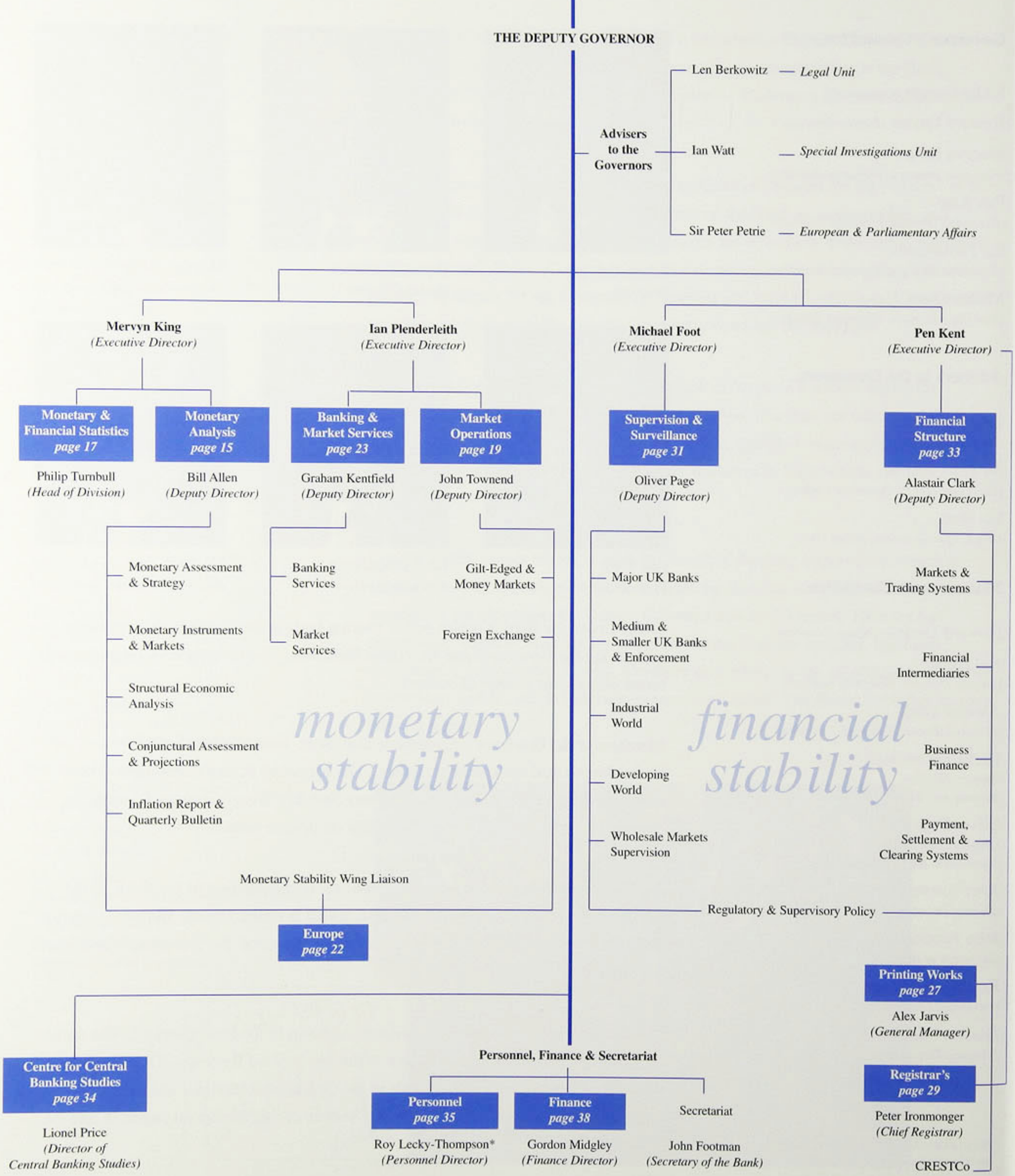
Members of the Governor's Committee also meet, with officials, as Policy Committee to deal with strategic issues. The Monetary Policy Committee, which includes Heads of Division in the Monetary Stability Wing, meets each month to discuss the Bank's advice to the Chancellor on interest rates.

Detailed implementation of policy, and internal administration of the Bank, is the responsibility of Management Committee, which is chaired by the Deputy Governor and comprises the Deputy Directors, the Finance Director, the Personnel Director and the Secretary.

The Bank's broad organisational structure is shown in the chart overleaf. The names of the key heads of function are given in the Operational Reviews. The distribution of the Bank's resources is also shown in the Operational Reviews and is discussed in more detail in the Finance and Resources section of this Report on pages 38 and 39.

THE BANK'S ORGANISATION

1 March 1996



* Roy Lecky-Thompson will be succeeded by Merlyn Lowther in June 1996

OPERATIONAL REVIEWS

MONETARY ANALYSIS

Mervyn King
(Executive Director)

Bill Allen
(Deputy Director)

Alex Bowen
(Head, Inflation Report Division)

Clive Briault
(Head, Monetary Assessment & Strategy Division)

Creon Butler
(Head, Monetary Instruments & Markets Division)

Paul Fisher
(Head, Conjunctural Assessment & Projections Division)

Nigel Jenkinson
(Head, Structural Economic Analysis Division)

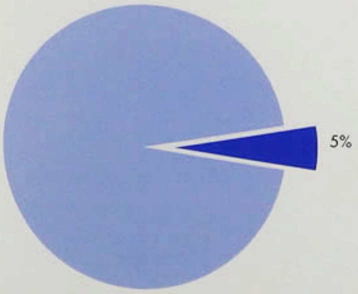
Stephen Collins
(Head, Monetary Stability Wing Liaison)

The Monetary Analysis Divisions provide the economic analysis which supports the Bank's work in pursuit of monetary stability. That includes the continuous analysis of the monetary and economic situation and outlook in the UK and in other important countries. Other aspects of the work are the analysis of structural economic issues affecting longer-term economic performance, including the industrial and social consequences of monetary policy; analysis of monetary policy strategies such as inflation targeting and exchange rate targeting; analysis of techniques for implementing monetary policy; and extraction of information about financial market expectations from financial asset prices. The Divisions also contribute to preparatory work on Economic and Monetary Union being done in the European Monetary Institute and the European Union Monetary Committee (see page 22) and participate in other international fora.

The main published output of Monetary Analysis is the quarterly *Inflation Report*, which has established a high reputation as a comprehensive and rigorous account of the factors affecting inflation in the UK, and which includes the analysis and projections which underlie the Bank's advice to the Chancellor of the Exchequer on monetary policy.

Analysis and research produced in Monetary Analysis is also published in the *Quarterly Bulletin*, in research papers published by the Bank, and in other media. Examples from the past year's issues of the *Quarterly Bulletin* include "Bond Yield Changes in 1993 and 1994: an Interpretation", "The Housing Market and the Economy", "The Bank's New UK Commodity Price Index", "Can We Explain the Shift in M0 Velocity?", and "Central Bank Independence and Accountability: Theory and Evidence". Economists in the Divisions contributed to sixteen Working Papers published during the year, with subjects as diverse as "Base Money Rules in the United Kingdom", "Bidding Information: Evidence from Gilt-Edged Auctions", and "How Cyclical is the PSBR". The Bank's Working Papers are refereed by external academics — one means by which the intellectual standard of the area's work is maintained at a high level. Analysts are encouraged to interact with outside experts and benefited during the year from the presence of Professors Robert Barro of Harvard University and Martin Evans of New York University, the most recent Houblon-Norman Fellows. Monetary Analysis also provides material for speeches by the Governors and Directors on monetary stability matters.

Proportion of the Bank's operating costs



The Monetary Analysis Divisions encompass the economic liaison function of the Bank's regional agents, who are responsible for reporting regularly on economic conditions in their region, and for representing the Bank. In March 1996, the Bank announced that it intends to develop this function further by opening three new regional offices, in Cardiff, Nottingham and Greater London, bringing the total number of agencies to twelve. In addition, it has begun publication of a quarterly national summary of its agents' reports on economic conditions in their regions.

Members of the Monetary Analysis staff participate in debate about policy-related subjects, both within the UK and internationally. In March 1995, the Bank held a conference for those central banks engaged in conducting monetary policy by means of inflation targeting in order to exchange ideas and experiences. The papers presented at the conference have been published in book form. The Monetary Analysis Divisions were responsible for the Bank's research contribution to the Debt Management Review conducted with HM Treasury (see page 20): the Bank released a number of related research papers in August 1995. The Bank held a conference in September 1995 on the future development of the index-linked gilt market for investors, market intermediaries and academics. In advance of the conference and in order to assist discussion, the Bank released a booklet of background papers on index-linked government securities.

The Monetary Stability Wing, together with other parts of the Bank, is closely involved in the Bank's active and constructive role in international fora: in particular, in the G7, the G10, the International Monetary Fund, the Organisation for Economic Co-operation and Development and the Bank for International Settlements, where the Governor attends the monthly meeting of central bank governors. In the past year, for example, the Bank chaired a working group of the G10, which produced a study of savings and investment, and the Bank also currently provides the chairman of the G10 Gold and Foreign Exchange Committee. In addition, it has been heavily engaged in two projects which arose in the Halifax Economic Summit in 1995 relating to the possible expansion of the General Arrangements to Borrow and the possible development of sovereign debt workout procedures.

138 staff are employed in Monetary Analysis, of whom 78 are engaged in economic analysis and related management, 18 are mainly engaged in economic liaison and 42 are support staff. A further 12 staff are involved in Monetary Stability Wing Liaison.

OPERATIONAL REVIEWS

MONETARY AND FINANCIAL STATISTICS

Mervyn King
(Executive Director)

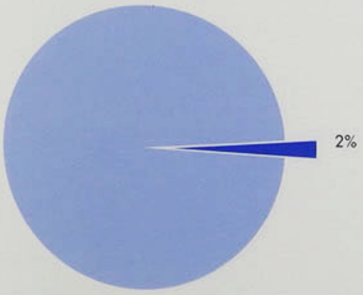
Philip Turnbull
(Head, Monetary and Financial Statistics Division)

The Bank, through its Monetary and Financial Statistics Division, collects, processes and publishes a range of monetary and financial statistics both in support of its three core purposes and for use by Government Departments, in particular the Office for National Statistics (ONS — formerly the Central Statistical Office), international organisations and private sector analysts. The Bank's aim is to provide a timely, high quality and cost-effective service, which it continually seeks to improve through reviews of the coverage and relevance of its statistics, the clarity of their presentation and the cost of their production. The Bank also plays an active part in international discussions on statistical developments.

The Division's main task is the processing and analysis of banking data, which are used for banking supervisory as well as monetary policy purposes. Data from banks are supplied, in disaggregated form, to the banking supervisors. In aggregated form, banking sector data and building society data, supplied by the Building Societies Commission, contribute both to measures of domestic money and credit, used by the Bank's Monetary Analysis and Market Operations Divisions, and to measuring international credit flows and indebtedness. The Division also compiles statistics on government financial transactions, official reserves and official borrowing, and other data especially relevant to the Bank's core purposes such as capital issues, interest and exchange rates and on certain non-bank financial institutions. In support of the Bank's third core purpose, the Division services the British Invisibles Statistics Committee and advises the Bank and ONS on non-bank financial institutions and on financial services statistics.

During 1995/96 the Division reviewed and improved its dissemination of statistics and assisted with the survey of the foreign exchange market and derivatives markets (see pages 21 and 33). In consultation with users of its data and representatives of the banking industry, it completed the first phase of a review of banking statistics that introduced, among other changes, the reporting of gilt repos (see page 20) and new arrangements for the measurement of capital adequacy (see page 32). The second phase of the review, to be completed in 1996/97, will focus on statistical requirements in relation to monetary policy and the implementation of the European System of Accounts 1995 standard to improve the comparability of national accounts data both within the European Union and with the rest of the world.

Proportion of the Bank's operating costs



The Division works closely with the ONS to improve estimates of the UK's national accounts and balance of payments. In 1995/96 the work included conceptual and empirical studies of repurchase agreements and derivatives; institutional sub-sectors, such as banks, building societies and other financial institutions from which the Bank collects data; the geographical detail and frequency of balance of payments data; and the statistical treatment of the Channel Islands and the Isle of Man. During 1996/97, work will include the UK's preparations for an internationally co-ordinated survey of portfolio investment positions; and the quality and coverage of interest rate data.

The Bank's statistics are published in regular releases, the *Quarterly Bulletin* and an annual *Statistical Abstract*, and by the ONS in its publications (in particular, *Financial Statistics*). Some are also made available on wire services and via a fax retrieval service. During 1995/96, dissemination was improved by introducing a new format for press releases, use of the Internet and release through a commercial software package. The Bank also established and published a Code of Practice for its statistics.

The Division employs 85 staff, of whom some 30 are involved in compiling and presenting data and around 30 are engaged in analysis and interpretation. There is a senior management team of nine. The rest of the staff provide computing and clerical support.

OPERATIONAL REVIEWS

Ian Plenderleith
(Executive Director)

John Townend
(Deputy Director)

Terry Smeeton
(Head, Foreign Exchange Division)

Paul Tucker
(Head, Gilt-Edged & Money Markets Division)

Stephen Collins
(Head, Monetary Stability Wing Liaison)

MARKET OPERATIONS

The Market Operations Divisions are responsible for the Bank's activities in the core markets through which it executes monetary policy. They carry out the Bank's market operations, including debt management and reserves management operations as agent for, and within guidelines set by, HM Treasury; contribute to the Bank's advice on monetary policy, including the provision of market intelligence; and seek to promote efficient structures in the markets in which the Bank operates, including developing new instruments and techniques.

GILT-EDGED AND MONEY MARKETS

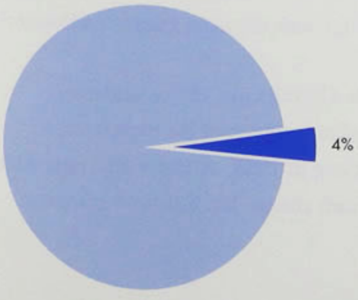
The Gilt-Edged and Money Markets Division is responsible for providing advice on domestic monetary conditions; executing domestic open market operations; advising HM Government on funding strategy and implementing policy as its debt manager; promoting the development and efficiency of the core sterling markets; and contributing to the technical preparations for a single currency.

The Bank's money market operations are directed to establishing short-term interest rates at the officially-desired level by providing the marginal liquidity needs of the banking system at the appropriate interest rate. This involves daily open market operations supplemented by a fortnightly gilt repo facility. The Bank's debt management function involves the provision of strategic advice to HM Treasury, and implementation through regular auctions of gilt-edged stock supplemented on occasion by discretionary tap issues.

In the Bank's money market operations during 1995/96, the Division consistently established a market rate structure in line with official rates and reduced volatility in very short maturity rates through modest adjustments to its operating techniques. With a large public sector deficit to be funded, gilt-edged operations were again very active with nine auctions being held during the year. Total gilt sales amounted to £30.7 billion, including £4.6 billion via index-linked gilts.

The Division is devoting increased effort to analysis, drawing on enhanced information systems and analytical tools, and to external contacts and communications. Liaison with practitioners has been expanded and, to improve communications, in addition to the regular publication in each *Quarterly Bulletin* of a description of the operation of monetary policy, the Division now produces an annual review of the gilt market. It has also produced consultative papers on the structural reforms referred to overleaf.

Proportion of the Bank's operating costs



The year saw significant progress in the programme of reform in the gilt market, designed to contribute to the objective of reducing HM Government's funding costs over time and to promoting the efficiency and international standing of the market. The Division made a major contribution to the Debt Management Review with HM Treasury, the main conclusions of which were published in the joint report in July 1995.

Reforms have been implemented in four areas. First, after discussions with the Bank, HM Treasury clarified that the objective of debt management policy is to minimise over the long term the cost of meeting HM Government's financing needs, taking account of risk, whilst ensuring that debt management policy is consistent with monetary policy. Work is underway, with Monetary Analysis, on the framework for making judgements on the desired structure of gilt-edged debt and each year's pattern of issuance.

Second, the gilt issuance programme has been made more transparent and structured through the publication of an agreed annual funding remit, from HM Treasury to the Bank, setting out the planned pattern of issuance for the financial year (including the split between indexed and conventional debt and the maturity distribution) and a schedule of auction dates. This is supplemented by the Bank announcing a more detailed auction programme each calendar quarter.

Third, in order to enhance the liquidity and efficiency of the secondary market, from the beginning of 1996, gilt stocklending and borrowing has been liberalised and an open gilt repo market introduced. Preparations included the development, with the Wholesale Markets Supervision Division and Settlement Services, of a Code of Best Practice, a master legal agreement and enhanced settlement arrangements. It also required tax reform; advice was provided to the Inland Revenue and HM Treasury.

Fourth, in order to enhance the potential attractiveness of gilts to investors, the Bank published consultation papers in May 1995 and January 1996 on the development of a gilt stripping facility which, when introduced early in 1997, will allow coupon to be separated from principal and make available zero coupon government securities. The Division has also been encouraging public debate on the index-linked market sector, including a conference of practitioners and academics in September 1995 organised with Monetary Analysis and subsequent meetings with the main market participants.

Taken together with the planned upgrade of the Central Gilts Office settlement system (see pages 25 to 26), these structural reforms represent the most intense period of change in the gilt market since Big Bang in 1986. Additionally, repo adds a new element to the sterling money markets. Each change has followed extensive consultation with the market.

Ian Plenderleith, who as Government Broker is a member of the Board of the London Stock Exchange, was appointed as a Deputy Chairman of the Exchange, in a non-executive capacity, in January 1996, to assist the Chairman pending the appointment of a new Chief Executive.

FOREIGN EXCHANGE

The Foreign Exchange Division is responsible for providing advice on, and implementing, HM Government's exchange rate policy; undertaking foreign exchange transactions on behalf of Government Departments and other central banks; managing the official reserves and foreign currency borrowing on behalf of HM Treasury; and contributing to the work on the introduction of a single currency.

The Division continuously monitors developments in sterling as an important indicator of monetary conditions, and because of its potential to influence the inflation outlook. In liaison with Monetary Analysis, it uses modern analytical tools and theory to help explain sterling's development. Thus, the Bank keeps pace with the evolution of foreign exchange derivatives, including options, and monitors their movement for any implications which they might convey for sterling. In addition to improving its management information systems, the Division has increased the effort devoted to monitoring credit exposures.

During the year, the Division, along with its counterparts in other major central banks, conducted the fourth triennial survey of the foreign exchange market, which showed that London had consolidated its position as the world's leading centre. A full report of the findings of the survey of the London market was published in the November 1995 *Quarterly Bulletin*.

Over half of the Division's staff are involved in the active management of the UK's foreign currency and gold reserves on behalf of HM Treasury. Performance is measured against benchmarks. Individual portfolio managers are given responsibility for the management of a particular portfolio subject to risk limits, providing first-hand trading experience in a number of the major international fixed-income markets. Liquidity management aims to ensure that a sufficient part of the reserves is available in cash or readily realisable assets.

Separately, the Bank is responsible for HM Government's foreign currency borrowing, including the arrangement and execution of any borrowings and their repayment on maturity. Monthly auctions of ECU Treasury bills were maintained and a further three-year ECU note was issued in January 1996, and re-opened in April 1996, continuing the programme established in 1992.

The analytical resources devoted to market operations have greatly increased in the last ten years: at present the two Divisions have a complement of 81 staff, including analysts, dealers and those providing support.

EUROPE

John Townend
(Deputy Director, Governor's Alternate on the EMI Council)

Bill Allen
(Deputy Director, Member of the EU Monetary Committee)

Stephen Collins
(Head, Monetary Stability Wing Liaison)

Although the UK has a formal option under the Maastricht Treaty not to participate in EMU, the Bank is committed to playing its full part in the technical preparations. This is to help ensure that the arrangements, should the UK join, are sensible and practicable, and to guard against any potential discrimination against Member States which do not join at the outset. The Bank plays an active role in the work of the EMI in Frankfurt at all levels from the Council, with the participation of the Governor, downwards through the Committee of Alternates, to membership by Bank staff in the increasingly numerous sub-committees, working groups and task forces. Separately, the Bank also participates in the European Union (EU) Monetary Committee, which comprises representatives of Finance Ministries and central banks of all EU Member States.

During the past year a major preoccupation has been the design of the practical arrangements for the introduction of, and transition to, the single currency. The Bank was actively involved in, and helped significantly to shape, the EMI's proposed "changeover" scenario, which was endorsed at the December 1995 Summit in Madrid of the EU Heads of State and Governments. A summary of the scenario was published in the February 1996 edition of the *Quarterly Bulletin*. Since December 1995, the Bank has been engaged in a dialogue with the main interest groups in the UK, explaining the "changeover" scenario and learning what preparations they themselves are planning. The Bank has sought to establish what it might do to assist them in their preparations for EMU. The Bank has emphasised the need to consider the actions necessary whether the UK is in or out. Discussions are expected to continue throughout much of 1996.

The Bank has also been working to ensure that it could operate effectively within a European System of Central Banks. Discussions have been taking place, and will continue, on the operational framework for monetary policy in EMU. Broad agreement has been reached on the basic model within which monetary operations could be conducted. Later this year, there will be debates on the operational objectives of monetary policy. In addition, there are discussions at a technical level in relation to foreign exchange policy and operations, payment and settlement systems, statistical, legal and accounting issues, information systems and the bank note design (a design competition for the euro bank note was launched in February 1996). Following the Madrid Summit, the Bank has been fully engaged in discussions about the possible future relationship between those inside and those outside the euro area and a possible fiscal stability pact.

Contributions to the Bank's work on EMU come from across the Bank. Overall there are at least 50 people who are actively engaged in EMU-related work, the cost of which is included in the figures in the other operational reviews.

OPERATIONAL REVIEWS

Ian Plenderleith
(Executive Director)

Graham Kentfield
(Deputy Director & Chief Cashier)

John Bartlett
(Head, Banking Services Division)

Merlyn Lowther
(Head, Market Services Division)

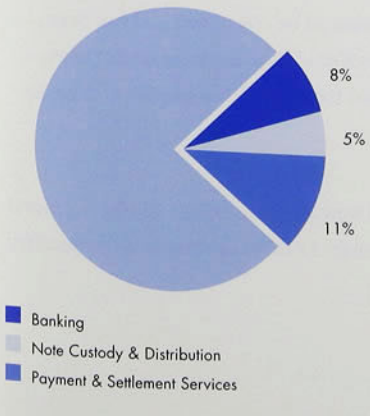
BANKING AND MARKET SERVICES

Banking and Market Services Divisions provide the banking infrastructure in support of the Bank's monetary policy operations and other core central banking functions. The key objective is to provide banking services to our customers, especially HM Government, in a professional, secure and cost-effective way. In pursuit of this objective, the Divisions have been engaged over the past two years in a major project to replace 17 mainframe computer systems (some of them nearly 30 years old) with modern, locally-managed but integrated systems. This programme should be completed during 1996.

BANKING SERVICES

During 1995/96 there was an extensive review of the work carried out at the Bank's five regional branches. In May 1995, it was announced that, largely on account of the decision to outsource cheque processing referred to below, banking operations at the branches would cease by May 1996. This business was small-scale and could no longer justify the resources devoted to it. All remaining customers were offered the opportunity to transfer their accounts to London and the necessary reduction in staff (affecting some 40 people) is expected to be achieved through voluntary severance. In March 1996, the Bank announced that, in the light of the review of the arrangements for distributing bank notes within the UK, note distribution would in future be handled solely through Head Office in London, the Printing Works at Debden and a cash centre in Leeds. Note issue activity at the branches in Birmingham, Bristol, Manchester and Newcastle will therefore cease during 1997 with a net loss of some 150 jobs. This decision reflected discussions with the major note-handling banks, which concluded that the banks themselves could take on full responsibility for sorting, storing and re-circulating used, but fit, notes. The Bank's remaining responsibilities in this area — the issue of new notes and the receipt, authentication and destruction of soiled ones — can be handled satisfactorily through the sites in London/Debden and Leeds.

Proportion of the Bank's operating costs



The closure of four branches will save the Bank, and the public sector, some £4 million per annum, without diminishing the service given to the general public. As explained on pages 15 to 16, the economic liaison work of the branches will continue and will be expanded.

During 1995/96, the Banking Services Division reviewed its cheque processing operations, most of which are undertaken on behalf of Government Departments. The use of cheques in the UK is declining and, like others in the industry, the Bank has been faced with acute cost pressures in this highly competitive market. After careful consideration of a number of options, the Bank decided to outsource the processing to First Data Resources Limited (FDRL). 74 staff were affected by the transfer, all of whom were offered employment by FDRL.

The value of the note issue was £19,648 million at the end of February 1996, £1,592 million (8.8%) larger than a year earlier.

Value of notes in circulation

£ Millions

End-February	*1993*	*1994*	*1995*	*1996*
£1 (a)	58	57	57	56
£5	1,163	1,135	1,072	1,067
£10	5,348	5,245	5,348	5,688
£20	6,101	6,818	7,723	8,579
£50	2,732	2,884	2,852	3,104
Other notes (b)	1,563	1,024	1,004	1,154
Total	**16,965**	**17,163**	**18,056**	**19,648**

(a) No £1 notes have been issued since 1984.

(b) Includes higher value notes used internally in the Bank, for example as cover for the note issues of banks of issue in Scotland and Northern Ireland in excess of their permitted issues.

Number of new notes issued each year by denomination

Millions

Year to end-February	*1993*	*1994*	*1995*	*1996*
£5	318	325	308	336
£10	752	622	624	575
£20	329	339	342	326
£50	23	22	39	43
Total	**1,422**	**1,308**	**1,313**	**1,280**

There has been some increase in counterfeiting in recent years, although the actual number of counterfeits remains very small in relation to the number of notes in circulation. Although the police have been successful in seizing counterfeit notes before they get into circulation, the Bank continues to be concerned and has been reviewing the security features of its notes. The *Know Your Banknotes* campaign, launched in late 1994, has considerably enhanced the public's awareness of what to look for in a genuine Bank note.

The Bank has continued to administer financial sanctions (on behalf of HM Treasury) on the assets of Iraq, Libya and, until 22 November 1995 when they were suspended, Serbia and Montenegro.

MARKET SERVICES

The Market Services Division provides settlement and custody services in sterling and foreign currency to the Bank's internal and banking customers, and to the market in general. In particular, the Division provides the "back office" support for the Bank's market operations in the areas of monetary policy, debt management and management of the UK's foreign currency reserves. For the market in general, it operates book-entry transfer systems through which market participants can settle transactions in gilt-edged securities, money market instruments and ECU securities. It also provides a book-entry transfer system for gold bullion for members of the London Bullion Market Association and the Bank's central bank customers.

The Division has been responsible for taking forward, in collaboration with the CHAPS Clearing Company and the Association for Payment and Clearing Services (APACS), a major programme of work to develop a real time gross settlement (RTGS) system by evolution from the current CHAPS system. RTGS involves the final settlement of each payment at the time it is made rather than on a net basis at the end of the day. The introduction of RTGS in the UK will improve the payments infrastructure by creating a more secure environment for high-value, same-day payments and thus reduce systemic risk. It will also provide the foundation for several other risk-reducing developments in the fields of securities and foreign exchange settlement.

Analysis and debate began in the late 1980s and the development project started in 1992. By the spring of 1995, all the new software had been developed and a prolonged period of testing had begun. In December 1995, banks started the process of migrating to the new software. The new system also required new or revised arrangements for handling the settlement of the other clearings (eg cheques and payments through Bankers' Automated Clearing Service (BACS)) and other payments which the Bank undertakes. In addition, new intra-day repo transactions were required to provide liquidity to the payment system. All these arrangements were introduced during March 1996 and full real time gross settlement went live, as planned, on 22 April 1996.

As part of the work to introduce a gilt repo market (see page 20), the Division reviewed, with Gilt-Edged and Money Markets Division, the settlement services which it provides to the gilt market through the Central Gilts Office (CGO). Amongst other minor changes, additional capacity was put in place to meet the demand envisaged by the repo market and a revised daily timetable was drawn up in consultation with the CGO members and implemented from 2 January 1996. More generally, the changes underway in the gilt market are such that the CGO system, in place and operating satisfactorily since Big Bang in 1986, needs to be developed. A major upgrade of the software is therefore underway. Following a period of consultation, the Bank announced, in November 1995, its decision to upgrade the

CGO using the software being developed for the CREST equity settlement system, and to do so in a way that retains the option of merging the settlement of gilts and equities in a single system in due course. That question is one of a number of issues being covered by a review, also announced in November 1995, of the strategic development of London's payment and settlement systems once RTGS and the main book entry securities settlement systems are in place.

The Division's services were called upon, during the administration and subsequent sale of Barings from February 1995, to ensure that the administration and sale could be carried out with as little disturbance as possible to the smooth functioning of the markets.

The Division has continued to play a part in facilitating international debt rescheduling operations, acting as "escrow" agent or in a similar trustee capacity, by holding securities and/or cash which forms part of an overall settlement between the debtor country and its creditor commercial banks. In the past year, the Bank has been involved in a custodial capacity in the debt rescheduling operations in Brazil, Ecuador, Nigeria, Albania and Russia. An arrangement is also being put in place for Peru.

Banking and Market Services employ 624 staff including 230 in the five regional branches.

OPERATIONAL REVIEWS

BANK NOTE PRINTING

Pen Kent
(Executive Director)

Alex Jarvis
(General Manager, Printing Works)

The Printing Works supports the Bank's first core purpose — maintaining the integrity and value of the currency. In addition to the responsibility for printing the Bank's notes, the Works manufactures its own inks and printing plates: its expertise in these latter areas has led to commercial sales in overseas markets. The Printing Works also includes a Returned Note operation which, using high speed sorting machines (replaced during 1995/96), authenticates used notes returned by the commercial banks and sorts those suitable for reissue, the balance being granulated.

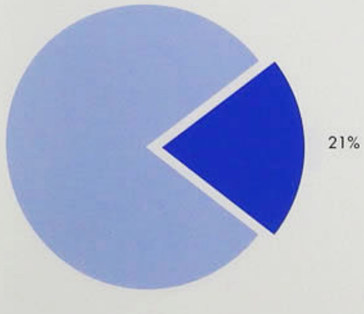
Research and Development continues to keep abreast of new features and technologies which could be incorporated into the notes to maintain the security of the note issue. This work is also relevant to the Bank's contribution to the preparatory work of the EMI, whose Working Group on Printing and Issuing a European Banknote is chaired by Alex Jarvis, General Manager of the Printing Works. This group has defined the emerging technical specification of the euro note and has launched the design competition (see page 22), to which a design team from the Printing Works is submitting proposals.

The trend of annual reductions in unit costs of producing new notes continued during 1995/96.

New note deliveries and unit costs

This reflects the programme of modernisation which is nearly complete. It comprises the renewal of the printing machinery, introduction of a new management style (explained overleaf) and major refurbishment of the site. This has done much to position the Bank as one of the leading and most efficient central bank printers in the world.

Proportion of the Bank's operating costs



The turnover of Debden Security Printing Ltd — a wholly owned subsidiary of the Bank, located at the Printing Works and set up to market the latter's surplus skills and capacities — substantially exceeded target in 1995/96. This made a significant contribution to the reduction in note issue costs charged to HM Treasury. It resulted from an increase in overseas orders for certain products and from a printing order for bank notes as a sub-contract.

Of particular significance during 1995/96 was the increasing impetus of the programme aimed at changing the Printing Works' culture — Printing Works 2000 — which encourages staff to focus on the three key values: teamworking; continuous improvement; and customer partnership. A number of area teams were designated, each of which is re-evaluating its working methods. Under an associated Quality Initiative, some 40 staff have been trained as quality coaches to lead improvement teams.

The number of staff employed by the Printing Works fell by 73 during the year to 737 (93 of whom are employed on contracts of up to two years).

OPERATIONAL REVIEWS

REGISTRATION SERVICES

Pen Kent
(Executive Director)

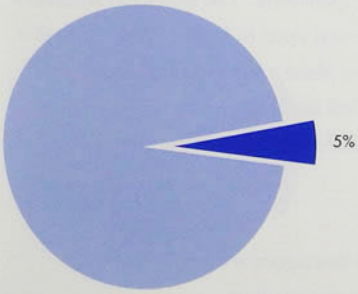
Peter Ironmonger
(Chief Registrar)

Through its Registrar's Department in Gloucester, the Bank provides the principal stock registration service for HM Government. The main elements of the service include the issue of gilt-edged stock, the maintenance of the register of stockholders, the registration of changes of ownership of stock and the making of, and accounting for, interest and redemption payments. The Department's overriding aim is to identify options which deliver the services at the lowest cost whilst maintaining quality standards, with the interests of the staff firmly in mind. The Department's immediate objective is to maintain its high-quality service while responding to changes in the gilt market described on page 20.

The Department is involved in two initiatives relating to costs. The first is directed towards the feasibility of achieving substantial cost reductions and of the associated transitional issues. The initial stage of this exercise has been concluded and the Bank is now considering the next steps. The second inquiry, involving HM Treasury, various parts of the Bank and the Department for National Savings, is seeking to benchmark the costs of providing the service against private sector comparators, and will also examine the feasibility and the cost impact of integrating our services with those of the National Savings Stock Register. The outcome of this exercise is expected shortly.

Many areas of the Department were heavily involved in the project to shorten to seven working days the ex-dividend period for British government stocks (with the exception of $3^{1}/_{2}$% War Loan which has been shortened to ten working days) and the parallel project to move away from the long-standing system of paying dividends by means of the bulk distribution system and to pay them instead through the BACS. Both projects culminated successfully, on 6 February 1996, with the payment of the first interest under the new system and the issue of income tax vouchers separately by post, thereby providing an enhanced service for stockholders.

Proportion of the Bank's operating costs



Transfers registered (000s)

Year to end-February	*1993*	*1994*	*1995*	*1996*
Stock transfer forms	609	509	469	385
Electronic transfers through CGO	523	533	586	599
Total	**1,132**	**1,042**	**1,055**	**984**
Change on year				-6.7%

Number of accounts (000s)

End-February	*1993*	*1994*	*1995*	*1996*
British government securities	1,238	1,155	1,018	946
Non-British government securities	17	10	11	10
Total	**1,255**	**1,165**	**1,029**	**956**
Change on year				-7%

Securities in issue under management at the Bank of England £ millions nominal

End-February	*1993*	*1994*	*1995*	*1996*
British government securities				
Registered stock (a)	148,343	193,630	214,984	242,034
of which index-linked	*16,362*	*21,395*	*23,285*	*26,076*
Bearer bonds	32	26	23	19
	148,375	**193,656**	**215,007**	**242,053**
Change on year				+13%
Other securities				
Government-guaranteed	257	224	226	226
Commonwealth and overseas	3,027	2,990	3,485	3,484
Local authorities	41	41	41	41
The Agricultural Mortgage Corporation plc	121	22	22	20
Other	45	45	45	45
	3,491	**3,322**	**3,819**	**3,816**
Change on year				-0.1%
Total	**151,866**	**196,978**	**218,826**	**245,869**

(a) including National Investment Loans Office stocks

Productivity rose by 2% in 1995/96 despite a fall of 6.9% in the volume of work (including redemption work) handled by the Department. The restricted severance scheme, announced in October 1994, has remained open to higher paid staff and a major restructuring of the Department has taken place affecting managerial and senior clerical staff. During 1995/96, 22 staff left the Bank under the severance scheme and many of the 12 staff currently seconded to local organisations will sever at the end of their term.

The Department has 289 staff, of whom 30 are managers, 41 are involved in Information Systems, 210 are clerical and eight are ancillary.

OPERATIONAL REVIEWS

SUPERVISION AND SURVEILLANCE

Michael Foot
(Executive Director)

Oliver Page
(Deputy Director)

David Green
(Head, Industrial World Division)

David Reid
(Head, Developing World Division)

Carol Sergeant
(Head, Major UK Banks Division)

Clifford Smout
(Head, Regulatory & Supervisory Policy Division)

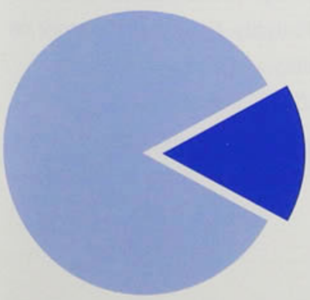
David Swanney
(Head, Medium & Smaller UK Banks & Enforcement Division)

Vacancy
(Head, Wholesale Markets Supervision Division)

Len Berkowitz
(Head, Legal Unit)

Ian Watt
(Head, Special Investigations Unit)

Proportion of the Bank's operating costs



Supervision and Surveillance contributes, within the Bank, to maintaining the stability of the financial system, both domestic and international, primarily by fulfilling the statutory obligations set out in the Banking Act 1987. The Bank makes a full report to Parliament each year on its activities under the Act, which is published alongside this Report.

Supervision and Surveillance is organised into six Divisions, reporting to an Executive Director through a Deputy Director. Two of the Divisions supervise the great majority of the 220 UK-incorporated banks currently authorised to take deposits in the UK and also seek to detect and, where appropriate, prosecute illegal deposit-takers. A further two supervise the 258 branches of foreign banks authorised to take deposits in the UK and most of their UK-incorporated subsidiaries. The fifth — the Wholesale Markets Supervision Division, which until January 1996 reported directly to the relevant Executive Director — supervises discount houses, core participants in the gilt-edged market (such as the market makers), the Exchange Clearing House (ECHO) and also oversees the Financial Services Act Section 43 "wholesale markets" regime and institutions listed under Section 43 of the Act. The sixth Division provides policy advice across the range of banking supervisory issues and, since January 1996, has been linked also to the Financial Structure area of the Financial Stability Wing (see next section), and renamed the Regulatory and Supervisory Policy Division.

Public perception of the Bank's supervisory work in the year to February 1996 was dominated by the collapse of Barings, in late February 1995, and its consequences, including the resulting Inquiry by the Board of Banking Supervision and the start of the implementation of the recommendations made by the Board. A number of these recommendations go to the heart of the question of how best to supervise complex and internationally active banking groups and will involve extensive international consultation and co-operation. The Bank has already begun this work and has raised the main international aspects of the Board's recommendations in international fora, including the Basle Supervisors' Committee, the EU Banking Advisory Committee and the EMI Banking Supervisors' Committee. At the same time, the Bank, together with the Securities and Futures Authority (SFA) and the Securities and Investments Board (SIB) and a number of US regulators, has collaborated in joint visits to a leading investment banking firm in each of the UK and US with the aim of improving mutual understanding of good practice. The Bank has also kept up its direct bilateral contact with other supervisors and, in a domestic context, has conducted several joint on-site visits with the SFA and has agreed, or is on the point of agreeing, Memoranda of Understanding for the first time with the London International Financial Futures and Options Exchange (LIFFE), the London Metal Exchange and the London Clearing House, as well as updating existing Memoranda of Understanding with Financial Services Act regulators in the light of the Barings Inquiry and the Investment Services Directive.

In October 1995, the Bank engaged Arthur Andersen to assist in implementing one key recommendation of the Inquiry — the introduction of a Quality Assurance capability, to allow better monitoring of the consistent application of policies — and to facilitate a major review of the objectives and methods of banking supervision. The review involves detailed analysis of the approach of other regulators in the UK and of the conduct of banking supervision in other countries. It also entails discussion with a structured sample of authorised banks in the UK and the main banking associations, to hear their views on the Bank's present operations and how these compare with other regimes with which they are familiar. The review is nearing completion.

Among the many other major supervisory issues which arose during the year (and which are detailed in the 1995/96 Annual Report under the Banking Act), two deserve particular mention. First, on 1 January 1996 the UK implemented the EU Capital Adequacy Directive on schedule. This followed extensive consultation with the banking industry and major systems development by the banks and the Bank of England. Although not every bank affected was able to report fully from 1 January on the new basis, the UK seems to have moved faster to meet its legal obligations than most of the other members of the EU. The year also saw extensive discussions in the Basle G10 Supervisors' Committee on how best to apply capital weights to the market risk that banks run in holding and trading marketable instruments. One of the main working groups of the Basle Committee was chaired by a member of the Bank and the final proposals on market risk were published in January 1996.

In August 1995, ECHO, a clearing house for wholesale foreign exchange contracts, became the first institution to be listed by the Bank under Section 171 of the Companies Act 1989. This exempts ECHO from certain aspects of UK insolvency law which might otherwise impaire its safe operation.

The six Supervision and Surveillance Divisions together currently employ 384 staff, of whom 52 are senior managers, 235 are middle managers, analysts and assistants, 10 are inward secondees and 87 are support staff. Roughly 40 of the total work on international surveillance issues relevant to the stability of UK banks operating abroad or of foreign banks authorised or seeking authorisation in the UK. Supervision and Surveillance is assisted in its work by a Legal Unit (25 staff) primarily dedicated to supervisory issues and by a Special Investigations Unit (19 staff) composed mainly of forensic accountants.

FINANCIAL STRUCTURE

Pen Kent
(Executive Director)

Alastair Clark
(Deputy Director)

Peter Allsopp
(Special Adviser)

Caroline Atkinson
(Special Adviser)

Ian Bond
(Head, Markets & Trading Systems Division)

Patricia Jackson
(Special Adviser)

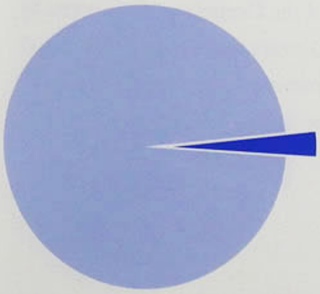
Michael Smith
(Head, Business Finance Division)

Clifford Smout
(Head, Regulatory and Supervisory Policy Division)

John Trundle
(Head, Payment, Settlement & Clearing Systems Division)

Angela Wright
(Head, Financial Intermediaries Division)

Proportion of the Bank's operating costs



The role of the Financial Structure Divisions is: to identify and analyse developments relevant to the structure and functioning of the financial system; to ensure the Bank's operational responsibilities for monetary policy and banking supervision are informed by this analysis; to propose, where appropriate, a policy response; and, from the same base of information and expertise, to help promote changes which promise to increase the safety and efficiency of the financial system. The Divisions therefore contribute to all three of the Bank's core purposes. They aim to look especially at the way in which banking supervision fits into the structure of financial regulation as a whole, at the functioning of markets both in cash instruments and derivatives, at the behaviour of the main groups of financial intermediaries, at the structure and operation of payment and settlement systems and at the relationship between the financial sector and industry. The Financial Structure area was established at the beginning of 1996 as a regrouping of Divisions following an internal review in December 1995. The Financial Stability Wing now has a structure which matches more closely that of the Monetary Stability Wing.

Given the role of the Divisions, the range of issues with which they are involved is extremely wide. Some recent examples are: a survey, under the auspices of the G10 Central Bank Governors, of transaction volume and exposures in over-the-counter derivatives; chairmanship of an international group reviewing the risks involved in settling foreign exchange transactions and possible ways in which these risks could be reduced; contributing to discussions about how the regulatory structure, both in the UK and internationally, might evolve; continuing the Bank's involvement in and support for efforts to improve the availability of finance to small businesses; statistical research on the measurement of market risk in the context of setting regulatory capital requirements; and developing and explaining the London Approach to the handling of company workouts. Amongst the Divisions' tasks for the period ahead are the development of a strategy for the payment and settlement infrastructure for UK financial markets, a re-examination of the objectives and techniques of financial regulation and an effort to improve understanding of the interaction between macro-economic developments and the commercial performance of financial intermediaries.

The Bank's formal control of the CREST project is exercised by Pen Kent, who is Chairman of CRESTCo. The Bank's sole voting rights will lapse when CREST goes live on 15 July 1996 and control passes to the private sector owners of CRESTCo. Pen Kent will continue as Chairman for some time after the transfer of power but will resign no later than the end of 1996.

The Financial Structure Divisions have a staff of 103, about two thirds in management and analytical roles and one third providing support services.

CENTRE FOR CENTRAL BANKING STUDIES

Lionel Price
(Director of Central Banking Studies)

Tony Latter
(Director for Technical Assistance)

The main function of the Centre for Central Banking Studies is to provide technical assistance and training to overseas central banks. This helps other countries achieve and maintain monetary and financial stability — a worthwhile aim in itself, but one that can also bring indirect benefits to the UK where there are financial, economic, or political ties with the country concerned. The contacts made and goodwill generated should also help promote the UK's financial services and other industries.

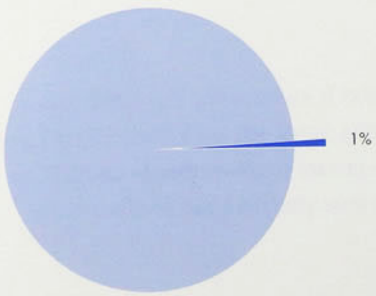
The Centre was set up in 1990 in the particular context of new demands from central banks of countries in transition to a market economy in central and eastern Europe and the former Soviet Union. Almost two thirds of course participants still come from these countries (half the remainder come from the Commonwealth). However, in view of the progress made by the central banks of central and eastern Europe, their staff are increasingly included on courses with people from other parts of the world.

The pace of development of these central banks has been reflected in the nature of the courses provided. Not only are more seminars rather than basic courses now held, but last year saw the successful introduction of workshops at which senior central bankers have the opportunity to discuss mutual problems and possible solutions. To meet widespread demand, courses are also being introduced on new topics such as derivatives, and counter-measures to money-laundering.

The Centre's activities expanded in 1995/96. The number of course participants, at home and abroad, rose from 800 to over 1,000, and there was a commensurate increase in the number of courses. In addition, the Centre helped organise and deliver some 25 short programmes in the Bank for various specialists from central banks of developing or transition economies.

The Centre's staff of 16 includes six managers with a wide range of experience in most aspects of central banking and staff who provide the logistical support needed to sustain the Centre's various activities. The Centre also draws on the experience of staff elsewhere in the Bank. The bulk of the cost of the Centre's work is borne by the Bank, but some expenses are financed by the Government's Know How Fund, the PHARE and TACIS funds of the European Commission, and the International Monetary Fund. The Bank is grateful to all of these bodies for their support.

Proportion of the Bank's operating costs



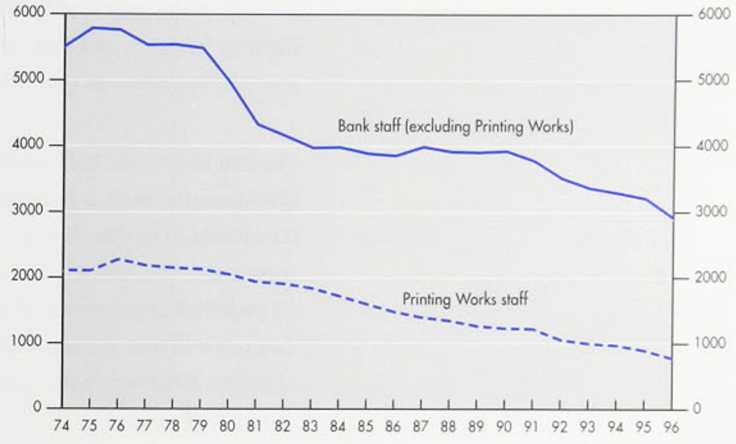
OPERATIONAL REVIEWS

PERSONNEL

Roy Lecky-Thompson*
(Personnel Director)

At 29 February 1996, the Bank employed 3,425 full-time and 245 part-time staff; of these 320 were engaged on fixed-term contracts. Total staff numbers (excluding the Printing Works) have halved in the last 20 years.

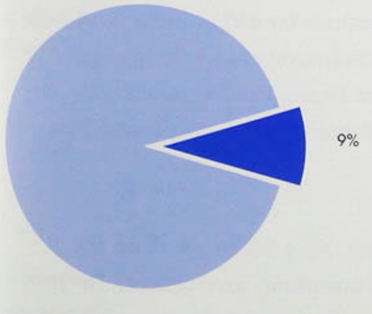
Numbers of staff employed by the Bank at end-February



Today's flatter management structure has resulted in a reduction in the number of middle management positions while, in common with many other financial sector companies, operational demands have dictated the need for more analytical but fewer clerical staff. The Bank continues to recruit about 35-40 high-calibre university graduates each year who enter its four-year training programme, introduced in 1995 and designed as preparation for careers across a range of the Bank's work. The Bank also recruits junior staff directly from school, both at GCSE and A-Level. As a result of a shortage of experienced analysts over the last few years, principally in economics and supervision, the Bank has recruited an increasing number of staff with previous specialist experience.

The Personnel function's prime responsibility is to ensure that the Bank has the most appropriate staff resources to meet its core purposes and to provide the necessary support to management. The Division was reorganised in July 1995 to provide a service which focuses on helping managers to deliver their business goals more effectively. The resulting three dedicated personnel units offer operational support and professional consultancy advice to the Bank's two Wings and Central Services. The units are supported by specialist staff in Training and Development, Employee Relations, Pension Fund and Loan Administration, Payroll, Occupational Health, Health and Safety and Community Affairs.

Proportion of the Bank's operating costs



* Roy Lecky-Thompson will be succeeded by Merlyn Lowther in June 1996

Recent changes have included a new Performance Review System for analysts and managers, with an emphasis on personal development, identified competencies and on achievement of an optimum balance between performance in the job and job satisfaction. Staff are also encouraged to take more responsibility for their own careers, aided by competitive job advertising through the Bank's staff newspaper and with support from their line and personnel managers. This approach will be complemented by providing greater relevant training opportunities for all staff.

The Bank's reward structures for managerial, analytical and clerical staff are currently under review and it is intended that, following negotiations with the Banking Insurance and Finance Union, new structures will be implemented later this year. A job evaluation system is currently being considered.

The first Bank-wide staff opinion survey was undertaken in the summer of 1995. Questionnaires were completed anonymously and returned direct to external consultants. The overall response rate was 63%, sufficient for the results to be statistically valid and reliable. A small number of working groups were subsequently set up from a cross-section of staff to address key issues identified in the survey and they reported their findings to the Bank's Executive. These findings are now an important influence on the development of effective communications, management and training policies.

The Bank is committed to its policy of equal opportunities and endeavours to avoid any form of discrimination. Underpinning this commitment is the Bank's active support for a number of related initiatives. For example, it recently agreed to become a "champion" of the Race for Opportunity campaign launched in late 1995 and has been supporting the Windsor Fellowship since 1986. It is also a member of Opportunity 2000 and the Employers' Forum on Disability; participation in the latter has involved the Bank in discussions about the new Disability Discrimination legislation.

The Bank is committed to providing a safe and healthy work environment. Internal training continues to raise awareness in this field as well as enabling an increasing number of line managers to take greater responsibility for health and safety in their own areas. The Bank has provided regular medicals for staff as well as well-woman screenings, exercise, fitness assessments and cholesterol checks. In November 1995, the Bank held the first in a series of Health and Fitness Exhibitions and is actively supporting the Lord Mayor of London in his theme for his mayoralty of "Good health to the City and the nation".

The Bank reviewed its community involvement policy last year with the aim of becoming a centre of excellence for corporate community involvement. The policy focuses on initiatives which enable people from disadvantaged backgrounds to access worthwhile employment through training. It encourages staff involvement and recognises the added value in terms of staff development. Details of donations are given in the Directors' Report on page 45.

The Personnel function has 121 staff. As the pie chart on page 35 shows, Personnel accounts for 9% of the Bank's operating costs. This includes the cost of seconding Bank staff to other organisations.

FINANCE AND RESOURCES

Gordon Midgley
(Finance Director)

Gerry Everett
(Head, Property Services Division)

Colin Mann
(Head, Management Services Division)

Nigel Wilson
(Head, Investment Unit)

The Finance and Resources area comprises three divisions: Finance, Property Services and Management Services.

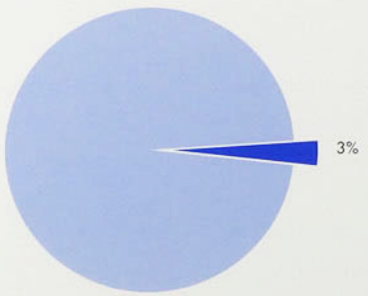
Finance handles financial and management accounting for the whole Bank. Its major responsibilities are: setting the overall framework for the Bank's finances; the Bank's budgetary control system; payments to suppliers; and ensuring appropriate cost recovery for the services which the Bank provides externally, in particular to HM Treasury. The Investment Unit is part of the finance function in the Bank. It is responsible for the management of the gilt portfolio within the Bank's overall reserves and also for investment of the Bank staff's pension funds (the latter under the sole guidance of its trustees). Funds under management by the unit amount to some £2 billion.

Property Services Division is responsible for all aspects of the Bank's buildings, including maintenance, office planning and space allocation. It is also responsible for the security of the buildings. Management Services Division provides information technology and telecommunications services and technical support to all areas of the Bank. The costs of Property Services are recharged to other areas of the Bank. Premises costs are recharged on the basis of the floorspace occupation and security costs are charged direct to the relevant function, mainly note issue. Management Services Division also recharges the bulk of its costs to users. The cost figures shown for the operational areas elsewhere in this Report include these recharged items.

Property Services and Management Services Divisions are responsible for implementing the major investments on behalf of the Bank and its main functional areas. During the year, the refurbishment of Bank Buildings began under the management of Property Services Division. Once complete, this building, which is situated adjacent to the Bank's main building, will house the majority of the staff in the technical support and overhead areas of the Bank. Major investments this year, with Management Services Division support, have included the real time gross settlement project, the continued replacement of banking systems, enhanced dealing room information systems and implementation of the EU Capital Adequacy Directive. In keeping with the Bank's policy of giving business units prime responsibility for their own systems, major developments are described in the Operational Reviews of the user areas.

Finance and Resources employs 654 staff of whom 58 are in Finance, 451 are in Property Services and 145 are in Management Services.

Proportion of the Bank's operating costs



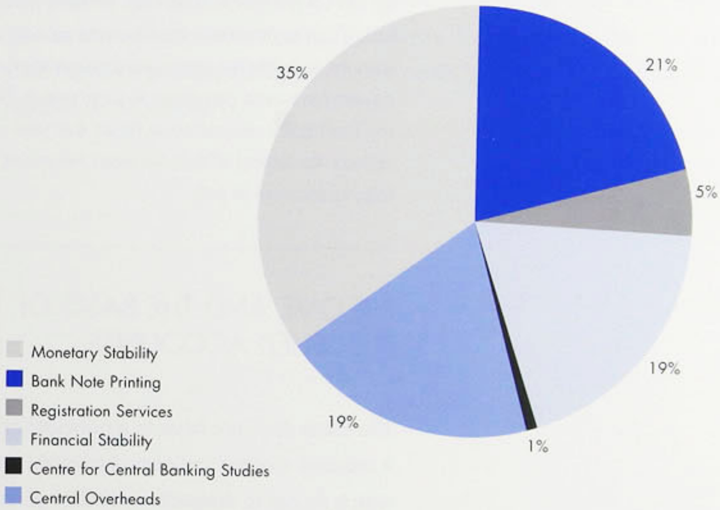
Finance only. The costs of Property Services and Management Services are included in the costs of the operational areas which they serve.

DISTRIBUTION OF THE BANK'S RESOURCES

The Bank has a responsibility to manage its resources and activities so as not to impose an unnecessary burden on the banking community, whilst satisfying its shareholder, HM Treasury, that it makes effective use of its capital and provides, through payments in lieu of dividend, an appropriate return. These responsibilities and obligations provide the financial framework within which the Bank determines its ability to match its expenditures with its aims and objectives.

The distribution of the Bank's resources by main organisational area, as shown in the Operational Reviews on pages 15 to 38, is summarised in the chart below. The cost of the resources covered totalled some £220 million in 1995/96. Central overheads include the activities of Audit (1% of costs) and Secretary's Department including Governors and Directors (6%), as well as those of Personnel and Finance discussed on pages 35 to 38.

Summary of the Bank's operating costs



In recent years, the Bank has taken on new or increased responsibilities in the areas of supervision, provision of market settlement systems and training for overseas central bankers. This process continues. In other areas, the Bank has either reduced costs through greater efficiency in its operations, for example in bank note printing and in banking, or because demand for its services has been less, for example in respect of the registration of gilts.

The table overleaf gives the current position in relation to staff. It shows the average number of people employed during the year by the Bank and its subsidiaries, including the Governors and Executive Directors, and their aggregate remuneration.

In aggregate, staff remuneration remained constant in 1995/96, in line with the Bank's voluntary commitment to the guidelines established by the Chancellor of the Exchequer in respect of public sector pay.

Aggregate remuneration and average numbers of staff

	1995/1996		*1994/1995*	
	Aggregate remuneration £m	Average number of staff	Aggregate remuneration £m	Average number of staff
Bank	97.3	3,832	97.5	4,106
Subsidiaries:				
CRESTCo Ltd (a)	1.1	28	0.7	17
NMB PLC (b) (from 29 September 1994)	1.4	52	0.8	60
Other subsidiaries	2.0	135	2.2	150
Total	**101.8**	**4,047**	**101.2**	**4,333**

(a) On 1 April 1995, Bank staff working on the CREST project were transferred to CRESTCo Ltd. Prior to this, their salaries were paid by the Bank and recharged to CRESTCo Ltd and were included in the aggregate remuneration of the Bank. To aid comparison, the 1994/95 figures have been presented so as to match the current position.

(b) The higher remuneration figure this year in respect of The National Mortgage Bank PLC reflects the timing of that company becoming a Bank subsidiary in September 1994 rather than an increase in pay.

INCOME AND THE BASIS OF THE BANK'S PUBLISHED ACCOUNTS

The Bank does not have as a principal objective the making of profit. Nevertheless, it requires income and capital to enable it to carry out its functions, the majority of which do not in themselves directly generate revenue. Since 1844, the Bank has, for accounting purposes, been divided into "Issue" and "Banking". The Issue Department is solely concerned with the note issue, the assets backing the issue, the income generated by those assets and the costs incurred by the Bank in printing, issuing, sorting and destroying notes. The entire profits of the note issue are paid over to HM Treasury.

The Banking Department's income derives principally from investments in British government securities, Treasury and commercial bills and advances to customers. The main source of funds is Cash Ratio Deposits (CRDs), which banks in the UK place interest-free with the Bank. The sum each bank deposits is calculated on the basis of the size of its eligible liabilities. The deposits are re-calculated twice a year. The investment of these funds, and of the Bank's accumulated capital and reserves, produced the majority of the Bank's income in 1995/96. The remaining income is derived mainly from charges to HM Government matching the cost of services provided to them, including an appropriate allowance for overheads.

During the 1980s, the liabilities on which CRDs are calculated grew faster than the rate of inflation and the Bank, without risk to the security of its income and capital, was able to reduce the percentage rate for CRDs: first from 0.45% to 0.4% in January 1991, and then to 0.35% in January 1992. The latter was stated to be a temporary reduction; the Bank indicated that it would raise the rate if it became necessary to do so, and that the rate would revert to 0.4% in 1996 unless the Bank decided otherwise. It has not been necessary to raise the rate in 1995/96 and the Bank has announced that the rate will remain at 0.35% until further notice and that it will give at least six months notice if it sees the need for an increase.

PAYMENT IN LIEU OF DIVIDEND TO HM TREASURY

The Bank of England Act 1946 requires the Bank to pay to HM Treasury, in lieu of dividend on the Bank's capital, a sum agreed between the Bank and HM Treasury. The dividend is paid in two parts. An interim dividend is payable on 5 April each year, based on provisional figures for the profit for the year. The final dividend is payable on 5 October.

DIRECTORS' REPORT

FOR THE YEAR ENDED 29 FEBRUARY 1996

Principal activities and review of operations

The Bank's core purposes are set out on page 8. The Governor's Foreword on pages 3 to 7, the summary of the Bank's Strategy on pages 9 to 11 and the Operational Reviews on pages 15 to 41 give a detailed account of the Bank's activities during 1995/96 and its future direction.

Presentation of the financial statements

Banking Department

Although the Bank is not governed by the Companies Acts, the Court of Directors present the financial statements of the Banking Department so as to follow, as far as is appropriate for a central bank, and with the major exception described below, the accounting requirements for banks as laid down in the legislation or in accounting standards and practice.

In exceptional circumstances, as part of its central banking responsibilities, the Bank may act as "lender of last resort" to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. In some cases confidence can best be sustained if the Bank's support is disclosed only when the conditions giving rise to potentially systemic disturbance have improved. Accordingly, although the financial effects of such operations will be included in the Banking Department's financial statements in the year in which they occur, these financial statements may not explicitly identify the existence of such support. However, the existence of such support will be disclosed in the Annual Report when the need for secrecy or confidentiality has ceased.

As a result, the Banking Department's financial statements disclose less detail of the constituent elements of the profit and loss account than would be required under the Companies Acts. In particular there is less disclosure in respect of interest income and expense and any provisions for bad and doubtful debts, together with consequential restrictions in detailed disclosures in the balance sheet, cash flow statement and the notes to the financial statements.

Issue Department

The statements of account of the Issue Department are prepared in accordance with the requirements of the Currency and Bank Notes Act 1928 and the National Loans Act 1968.

Financial results

The Banking Department financial statements for the year ended 29 February 1996 are given on pages 48 to 67 and show a profit after provisions and before tax of £214.4 million (including £118.4 million from the sale of 3i Group plc shares) compared with £225.9 million in 1994/95 (including £119.5 million from the flotation of 3i Group plc).

The average interest rate during the year has been around 1% higher than in the previous year, despite the reductions towards the end of the financial year. The value of the Cash Ratio Deposits has on average increased by 8% compared to the previous year. The Bank has continued to exercise tight control over costs, which has resulted in aggregate staff remuneration remaining constant in 1995/96, in line with government pay policy. Movements in provisions include a release in respect of the The National Mortgage Bank PLC (NMB) described on page 43. The accounts include, for the first time, a depreciation charge on the refurbishment of the Printing Works.

As mentioned above, this year's pre-tax profit benefits, by £118.4 million, from the profit on the sale of the Bank's shares in 3i Group plc. As reported last year, 3i Group plc was floated in 1994 when the Bank's shareholding was reduced. The Bank's remaining shares were sold in June 1995.

After a payment in lieu of dividend to HM Treasury of £88.0 million (compared with £102.2 million in the previous year) and a tax charge of £38.1 million (1994/95 £32.7 million), the profit transferred to reserves amounts to £88.3 million, which compares with £91.0 million last year.

The accounts for the Issue Department (which are given on pages 68 and 69) show that the profits of the note issue were £1,294.4 million compared with £967.2 million in 1994/95. These profits are all payable to HM Treasury. In accordance with the Currency and Bank Notes Act 1928, the assets of the Issue Department comprise securities sufficient to cover the fiduciary note issue.

Dividend

The requirements of the Bank of England Act 1946 in relation to the payment in lieu of dividend to HM Treasury are explained on page 41.

Provisions for support operations

As stated in previous Reports, the Bank has made provisions in respect of indemnities given to lenders to a number of small authorised banks. These indemnities arose out of arrangements that the Bank put in place in 1991 to support the liquidity of the banks concerned; this support was designed to avert the possibility of widespread difficulties in the banking system and in the economy, and was successful in containing the potential problem. These provisions amounted to £105 million at 28 February 1995, the same as in 1994 and down from £115 million in 1993.

The Bank acquired, on 29 September 1994, NMB, the institution which necessitated the major part of the provision. This acquisition, which was for the nominal sum of £1, was to facilitate better control over the process of realising the assets. Over the last year, the NMB group has made good progress in realising its assets and reducing its operations and costs. As a consequence, the Bank is able to release £10 million of its provision, leaving total provisions in respect of support operations at £95 million as at 29 February 1996.

Governance of the Bank

Directors

The names of the members of the Court of Directors, together with the principal outside appointments of the Non-Executive Directors, are given on page 12. Michael Foot, Sir John Hall and John Neill CBE were appointed to Court with effect from 1 March 1996. Brian Quinn, Sir Christopher Hogg and Professor Sir Roland Smith retired on 29 February 1996 on completing their terms of office. The term of office of Mervyn King expired on 29 February 1996. He was re-appointed for a further period of four years.

The role of the Court of Directors is explained on page 12. The Directors' responsibilities in relation to the financial statements are set out on page 44.

The main committees of Court are as follows:

Remuneration Committee

The function of the Remuneration Committee is to consider all questions relating to the remuneration of the Governors, Executive Directors and Advisers to the Governors, and to make recommendations to Court. The members of the Committee are Sir David Scholey (Chairman), Sir David Lees, Sir Colin Southgate, Frances Heaton and Sir Chips Keswick.

Audit Committee

The functions of the Audit Committee are:

- To keep under review the internal financial controls of the Bank.
- To receive reports from, and review the work of, the internal and external auditors, including consideration of the nature and scope of their work. The committee also considers and makes recommendations on the appointment of the external auditors and their fees.
- To review the annual financial statements prior to their submission to Court, including consideration of the appropriateness of the accounting policies and procedures adopted.

The Committee reports its conclusions to Court. The current members of the Committee, which meets at least three times a year, are Sir David Lees (Chairman), Sir Jeremy Morse, Sir David Cooksey, Sheila Masters and Neville Simms.

Statement of Directors' responsibilities in respect of the financial statements

The Bank of England is not formally governed by the Companies Act 1985 but has chosen, for the financial statements of the Banking Department, to comply with the accounting provisions of the Act, as applicable to banks, modified as set out in note 1 of the financial statements. The Court of Directors is responsible for ensuring that these financial statements, on the basis set out in note 1 of the financial statements, present fairly the state of affairs of the Banking Department as at 29 February 1996 and of the profit for the year to that date. The statements of account of the Issue Department are drawn up in accordance with provisions agreed between the Bank and HM Treasury to implement the requirements of the Currency and Bank Notes Act 1928 and the National Loans Act 1968. The Court of Directors is responsible for ensuring that the statements of account are drawn up in accordance with these requirements.

The Court of Directors is responsible for ensuring proper accounting records are kept, which disclose at any time the financial position of the Bank and enable the Court to ensure that the financial statements comply with the requirements set out in note 1 thereto. The Court of Directors is also responsible for safeguarding the assets of the Bank and its subsidiaries, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Court of Directors confirms that suitable accounting policies, consistently applied and supported by reasonable and prudent judgement and estimates, have been used in the preparation of the financial statements of the Banking Department. Accounting standards applicable in the United Kingdom have been followed in preparing the financial statements of the Banking Department in so far as they are appropriate to the basis of accounting set out in the notes to the financial statements.

Equal Opportunities

See Personnel section on pages 35 to 37.

Employee involvement

See Personnel section on pages 35 to 37.

Payment of bills

The Bank's policy is to pay all suppliers within 30 days of receipt of a valid invoice or within specifically agreed terms of payment, if these are shorter. Sampling during the year shows that the Bank paid 94% of its bills within these timescales, compared with 88% in the previous year.

The Bank has undertaken a number of internal initiatives to improve its speed of payment during the past year and these will continue in the coming year. These include making the purchasing areas of the Bank more aware of the importance of agreeing payment terms as part of the purchasing process and monitoring the payment performance of individual areas of the Bank, with follow-up where this is required.

Community involvement and donations

Although not a member, the Bank subscribes to the principles of Business in the Community's Per Cent Club in that it contributes no less than half a per cent of its pre-tax profit to the community. Last year the Bank contributed £1,450,000 (1.5% of pre-tax profit excluding the proceeds from the sale of 3i Group plc shares) in support of its community programme. This covers the cost of secondments, donations to charities and to academic research and contributions to other community-related activities. £340,000 was donated to registered charities and £182,000 to other organisations, whilst the cost of community secondments and subsidised accommodation totalled £928,000. The Bank matched, on a £1 for £1 basis, the £58,700 donated by staff and pensioners to registered charities under the payroll giving scheme (Give As You Earn). It also matched £15,000 of Bank staff fund-raising.

No donations have been made for political purposes.

Auditors

Coopers & Lybrand will continue as auditors of the Bank.