BANK *of* ENGLAND

REPORT & ACCOUNTS

1997

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Eddie George
Governor

GOVERNOR'S FOREWORD

1996/97

For the fourth year in succession the Bank's financial year closed in February with the underlying rate of inflation below 3%. Retail prices, excluding mortgage interest payments, rose 2.9% during the 12 month period, the same rate as a year earlier, while unemployment fell and the economy continued to grow. This was despite the fact that the slowdown in Continental Europe did not reach its trough until the middle of last year. The UK's recent progress is the result of a combination of policies directed at monetary stability, fiscal sustainability and supply side flexibility. Monetary stability is an essential part, but it could not by itself have delivered the welcome improvements in economic performance we have seen.

During the second half of the year monetary policy was faced with an increasing dilemma. On the one hand it became progressively clearer that both the money supply and domestic demand, particularly consumer demand, were growing at a pace that could not be sustained for very long without putting the Government's target, of $2\frac{1}{2}$% or less for underlying inflation, at risk. This argued for a tightening of monetary policy to moderate the pace of monetary and domestic demand growth. On the other hand sterling's exchange rate appreciated very sharply against the core European currencies and the Yen in particular, creating potentially serious problems for many of our tradable goods and services industries, and that appreciation and the associated problems would have been aggravated by higher interest rates. In the short term sterling's strength was helpful in pushing down inflation, which was expected to fall to within the target during 1997. But it did nothing directly to restrain domestic demand, and the prospective worsening of our foreign trade balance appeared unlikely to be sufficient to prevent the emergence of inflationary pressures further ahead as aggregate demand approached supply-side limits to productive capacity.

Some of the influences on sterling's exchange rate - our more advanced cyclical position compared with that elsewhere in Europe, and perhaps market uncertainties about the prospective composition and character of the euro - are likely to reverse in time. But in the meantime they give rise to a genuine dilemma in the sense that there is no ideal short-run solution. We cannot, certainly, ignore the effect of the exchange rate on the tradable sectors of the economy. But nor can we expose the whole of the rest of the economy to significant inflationary risks which would then need to be addressed by a more abrupt tightening of policy at a later stage. Our approach in formulating our monetary policy advice has to be to allow as best we can for the effects of sterling's appreciation both directly in the short term on the price level and through its effect on future demand. These considerations lay behind the Bank's advice through last winter and into the spring for a moderate increase in interest rates. The Chancellor of the Exchequer judged the balance of risks somewhat differently and, after an increase of $^{1}/_{4}$%, to 6%, at the end of October last year, interest rates remained at that level until they were raised to $6^{1}/_{4}$% on 6 May.

Our experience of operating with an inflation target has so far been reasonably encouraging. Inflation has averaged around 2.75% over the last four years. That is not as low as it needs to be if we are to eliminate inflationary expectations, but it is nevertheless lower and has persisted for longer than we have seen in a generation. The best news of all is that this has been accompanied by steadily expanding economic activity and progressive falls in unemployment. After a disappointingly slow reduction in 1995, unemployment began to fall significantly in the later part of last year, a trend which has been particularly marked during recent months as the pace of economic growth has continued to quicken. The inflation target is designed to help to ensure that the pace of this expansion is moderated early enough to enable it to be sustained.

In this context, the Bank welcomes the commitment of the new Government to maintaining the inflation target. We also very much welcome the Government's decision to delegate the technical responsibility for setting interest rates to achieve its inflation target to a Monetary Policy Committee to be established within the Bank, with a number of its members appointed by the Chancellor from outside. We think that this will strengthen the process and make it more likely that we can over time achieve the stable economic growth which is the ultimate objective.

The stability, which we are pursuing in the UK, also underlies the Maastricht convergence criteria, which set the conditions for eligibility to join EMU. There is a macro-economic policy consensus that extends right across Europe and which is fundamentally important to the effective functioning of Europe's single market as well as to economic stability throughout the region. The pursuit of stability goes wider than EMU, and is something we must hold on to whether or not we are a part of it.

Against that background, the Bank has continued to emphasise the importance to the success of EMU of sustainable convergence between the economies that participate. Without sustainable convergence, and without greater structural supply side flexibility than is evident at the moment in some potential member countries there is a serious risk that the single monetary policy pursued by the European Central Bank could be inappropriate for the economic conditions in some of those countries. The Bank's sympathies therefore lie with those who emphasise the importance of sustainable convergence, rather than the calendar, for the start of monetary union. Nevertheless, our planning assumption is that the euro will go ahead on time, at least among a core group of countries.

The Bank remains closely involved in the technical preparations for EMU, through the European Monetary Institute. In January 1997, the EMI brought together in a single document much of its technical work on specifications for the operational framework for a single monetary policy in Stage 3.

The Bank welcomes the document, though in one or two areas it has not been possible to reach unanimous agreement. One of these areas is the possible need for reserve requirements in the banking system; another is the terms under which member states that are not part of the single currency have access to the liquidity, during daytime working hours, of the TARGET system which will link together national Real-Time Gross Settlement payments systems.

Other topics on which the Bank is working intensively with its other European counterparts include the drafting of legal regulations on the euro, the design of the revised (and voluntary) exchange rate mechanism and the specification of euro bank notes. The immediate priority is to ensure that 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. As part of our intensive effort to help the financial and business community to make preparations for EMU, which are necessary whether Britain is in or out of the single currency, we have published and widely distributed four reports on the practical implications for the UK. Although individual institutions vary in their state of preparedness, awareness of the importance of the issue is spreading rapidly. The Bank is confident that the necessary financial market infrastructure will be ready in time.

The Bank has also been playing an active part in the development of the UK domestic markets in particular through reform of our daily money market operations, where there have been four important developments. We have introduced gilt repo to our daily operations to provide liquidity to the market, replacing the previous twice-monthly facilities. We have broadened the range of counterparties in the markets from the small group of discount houses with which we have traditionally dealt, to include banks, building societies and securities houses in the bill or gilt repo markets, as long as they meet our criteria. We have also made transitional arrangements for discount houses that choose to continue in the reformed market. These changes were accompanied by technical improvements to our end-of-day operations, and an end to the requirement that firms in the money markets should be separately capitalised, with a special supervisory regime. This evolution of the London markets will make us better placed than ever to compete with other financial centres for business.

In the bond market, we decided to drop the requirement for separate capitalisation of gilt-edged market makers, ending the distinct existence of the GEMMs. Preparations also continued for the introduction of gilt stripping, which is the separation of the principal from the coupon, allowing trading in both instruments. A market in gilt strips is expected to commence trading after the planned upgrading of the Central Gilts Office settlement system, using the software designed for CREST, the equity settlement system.

A review of the gilt registration function was undertaken during the year. Here, we identified opportunities to achieve considerably enhanced operational efficiency though, sadly, at the cost of a number of jobs. In July we announced a reorganisation of the Registrar's Department in Gloucester, which will cut the staff there by more than half and reduce unit costs similarly.

On the supervisory side, following the Board of Banking Supervision report on the failure of Barings published in 1995, we undertook a management review of the effectiveness of our supervisory function, with the assistance of consultants Arthur Andersen. That review was completed early last summer, and its conclusions, together with the Arthur Andersen work that lay behind them, were published on 24 July.

The review identified a need to strengthen the staffing of the Supervision and Surveillance Divisions, both numerically and by adding outsiders with new skills and greater market experience. To facilitate that process we implemented an internal reorganisation which increased the number of Supervision and Surveillance Divisions from six to nine and created a Quality Assurance function. A number of new staff, including several people with very recent practical banking experience, have already been appointed.

The review also recommended codification of the objectives of banking supervision, and a more systematic and formal approach to the assessment of risk in individual banks, to allow Supervision and Surveillance to deploy its supervisory resources more effectively. It also identified opportunities for better use of prudential information and Information Technology and for the improvement of the section 39 reports which are commissioned by the Bank and carried out by the external auditors of individual institutions.

Since the publication of the review, the Bank has taken these recommendations forward rapidly. We have published a consultation paper on *The Objectives, Standards and Processes of Banking Supervision*, another on *A Risk Based Approach to Supervision (the RATE framework)*, and a third on *Banks' Internal Controls and the Section 39 Process*. All have attracted widespread interest and provided the material for a series of well-attended seminars for the staff of supervised institutions. Further details of all these developments can be found on pages 40 to 42 of this Report, and in the separate Annual Report under the Banking Act.

Beyond these initiatives to strengthen our own procedures, we have continued our efforts, alongside other G10 countries, to improve the practical arrangements for international regulatory co-operation. Progress is sometimes not as fast as we would like, but there is no doubt that the issue remains a high priority not just of regulators but also of finance ministers and heads of state. It was given particular prominence at the Lyon summit last June and will be on the agenda again this year at Denver. In parallel, we have been seeking to foster a better public understanding of the objectives and techniques of financial regulation and of the associated policy issues. The Financial Stability Review, which we launched last autumn jointly with the SIB, has helped us to do this.

Work on new arrangements for note issue and distribution has progressed during the year, following the announcement in March 1996 that we planned to close our branches in Birmingham, Bristol, Manchester and Newcastle, and to turn the Leeds branch into an expanded cash centre. We have also followed up the decision to expand our network of regional agencies. The agents perform an essential role in the monetary policy process, feeding in first hand information on the state of trade in their regions to inform the decision-making process. A new office was opened in Cardiff in December; we have added a new team at Head Office to ensure greater coverage of the Greater London region; and offices will open in Nottingham and Cambridge later this year. These changes will, we believe, help us to carry out our new monetary policy responsibilities more effectively.

Last year was also a significant one for the Printing Works at Debden. It marked the completion of the major refurbishment programme begun in November 1993. That programme was successfully concluded in February 1997. And it is pleasing to note that, in spite of the inevitable disruption, the Printing Works continued to achieve significant reductions in unit costs throughout the period, making it one of the most cost-effective bank note printing works in Europe, if not the world.

All these developments, taken together, amount to a very significant management challenge for the Bank. Expansion in some areas of our activity, balanced by contraction elsewhere, must be carefully planned, and must be achieved within a total paybill which - consistent with the then Government's public sector pay policy - cannot rise in nominal terms. This can only be achieved with the full support of our professional and highly dedicated staff. They have shown great loyalty during a period of rapid change, and the continued commitment even of those whose employment with the Bank was coming to an end has made me very proud indeed.

I am also grateful to Pen Kent, who after 35 years' service retired from the Bank at the end of February 1997 as Executive Director responsible for the Financial Structure Divisions, the Printing Works and the Registrar's Department. I would like to record my thanks to Sir Jeremy Morse, who also retired from Court at the same time. Sir Jeremy served as an Executive Director from 1965-1972 before returning as a non-executive member of Court in 1993. After the end of the Bank's financial year Sir David Simon was appointed Minister for Trade and Competitiveness in Europe by the new Government. Sadly, this required him to step down from Court. I am most grateful for his contribution over the last two years. I am grateful also to Ian Watt, who joined the Bank as Head of our Special Investigations Unit in 1992, and who retired in March.

We have made great progress over the last year, and look forward, under the new Government, to a further period of change and development. I have every confidence we will achieve our challenging objectives, including the important new task we have been set.

E. A. J. George

Governor of the Bank of England

OPERATIONAL INDEPENDENCE FOR THE BANK

On 6 May 1997, the Chancellor of the Exchequer announced that the new Government was giving the Bank operational responsibility for setting interest rates and would introduce legislation as soon as possible. Until the legislation comes into force, all aspects of the new arrangements will operate *de facto*.

The Bank's monetary policy objective will be to deliver price stability (as defined by the Government's inflation target) and, without prejudice to that objective, to support the Government's economic policy, including its objectives for growth and employment. The Government's inflation target will be confirmed in each Budget Statement. The Bank will continue to publish a quarterly *Inflation Report*.

Decisions on interest rate policy will be made by a Monetary Policy Committee (MPC) comprising the Governor, two Deputy Governors, two members (who will have executive responsibility within the Bank) appointed by the Governor after consultation with the Chancellor and four members (who will be recognised experts in the field) appointed by the Chancellor.

The MPC will meet on a monthly basis. Decisions will be made by a vote of the Committee on a one-person one-vote basis, with the Governor having the casting vote if there is no majority. The Treasury will have the right to be represented in a non-voting capacity. Decisions on interest rates will be announced immediately. The minutes of the meetings, including a record of any vote, will be published no later than six weeks after the meeting. The legislation will provide that if, in extreme circumstances, the national interest demands it, the Government will have the power to give instructions to the Bank on interest rates for a limited period. The Government has noted that this power is in line with practice in other countries, and could be exercised only through subordinate legislation approved by Parliament.

The Government has also made proposals relating to Court, the Bank's role in debt management, the foreign exchange reserves, and has initiated a review of the Bank's finances.

The ensuing Report covers the period prior to the Chancellor's announcement and does not reflect the changes outlined above.

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 Statement of the Bank's Purposes, Responsibilities and Philosophy sets out a continuing framework for the Bank's operations. In 1996, it was expanded to include a statement of the values which underlie the Bank's approach to its work. The Statement of Purposes, Responsibilities and Philosophy 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 strategy was approved by the Court of Directors in November 1996. Court concluded that the broad lines of the strategy set last year remained appropriate, and that the main focus in 1997/98 would be on implementation, but there were nonetheless some significant changes of emphasis, especially in the areas of the Bank potentially affected by EMU, and in Supervision and Surveillance.

MONETARY STABILITY

The Bank's strategic aims in relation to monetary stability are:

- 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.
- To increase public awareness of the Bank's analysis of the real economy.
- To participate in the preparatory work for EMU; although a final decision on UK membership in 1999 has not been made, the Bank is engaged fully in the work at the European Monetary Institute and in the European Union Monetary Committee, in order to exert as much influence as possible on the design of the system.
- To deepen 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. 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.
- To maintain the Bank's position as "preferred supplier" of core banking services to HM Government and the market by demonstrating superior performance and improving cost-effectiveness in all areas.

The priorities for 1997/98 include:

Monetary Analysis

- To contribute to the debate on the economic merits of EMU, and to provide more analysis of the costs and benefits of joining EMU and the implications of being out.
- To prepare for the possibility of a change in the domestic monetary framework after the election.
- To extract information from financial markets and to investigate the optimal composition of government debt.
- To upgrade work on structural issues: the development of the labour market; trade and competitiveness; and the UK's investment performance.
- To open new agencies and develop the agents' work, and to integrate it further with the Bank's economic analysis.

Monetary Operations

- To deepen analysis and understanding of market developments as an input to the Bank's monetary assessment process.
- To continue work on the transition to EMU on three fronts: active participation in the work of the European Monetary Institute; liaison with UK financial and business sectors to assist their practical preparations for the euro; and work to ensure that the Bank's own systems are ready to handle euro operations if EMU goes ahead on 1 January 1999 or at a later date, whether or not the UK is a member at that time.
- To produce, in consultation with practitioners, a critical path for settlement projects and an assessment of the market's, and the Bank's own, ability to deliver them.
- To implement HM Treasury's remit to the Bank on debt management and management of the Exchange Equalisation Account.
- To implement the money market reforms.
- To initiate stripping facilities for gilts.

Banking Activities

- To pursue work on future bank note security and design strategy taking account of developments relating to EMU. To complete the changes needed to the note distribution arrangements following the closure of the branches.

FINANCIAL STABILITY

The Bank's strategic aims in relation to financial stability are:

- To build public, political and market understanding of the appropriate role of banking supervision and of financial regulation generally - both in terms of what is possible and what is right.
- To strengthen the staffing and skills of the Bank's supervision divisions, clarify what constitutes good practice and establish 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, and participate in the development of payment and settlement systems for EMU.
- To monitor those UK financial markets which could pose a threat to monetary or financial stability, or impede the development of efficient and effective financial markets in the service of the wider economy. To identify market failures and respond, where appropriate, to requests for assistance where the Bank considers it has a comparative advantage in terms of expertise, or as a facilitator.

The priorities for 1997/98 include:

Supervision and Surveillance

- To implement the change programme following the Bank's Review of Supervision, including taking forward the proposed risk-based approach to supervision.
- To produce up-to-date policy guidelines and Statements of Principle.
- To strengthen still further co-operation with other supervisors in the UK and abroad.
- To continue to contribute actively to the debate, internationally and domestically, on supervisory policy.
- To maintain effective day-to-day supervision, including managing the process of building society conversions and responding to the new money and gilt market arrangements.

Financial Structure

- To develop work on systemic risk.

- To analyse the impact of new technology - such as the development of electronic money and the expanded use of the Internet - on risk in financial markets.

- To ensure the continued success of *Financial Stability Review*, published jointly by the Bank and the Securities and Investments Board.

- To contribute analysis and new ideas on the regulation of banks and other financial firms, and on the functioning of financial markets.

- To give greater prominence to work on savings intermediation, including developments in pensions, welfare reform and taxation.

OTHER AREAS

In the *statistics area*, the priorities for 1997 are to implement the Banking Statistics Review changes and to meet the quality targets set out in the Bank's agreement with the Office for National Statistics.

In the area of *bank note printing*, 1997 will see a continuation of the strategy which has been pursued for a number of years to reduce unit costs per note so as to maintain the Bank's reputation for cost-effectiveness. The Printing Works 2000 initiative proceeds. EMU has implications for the note strategy, whatever the UK's decision on membership.

In the case of the *registration of government stocks*, far-reaching changes are in progress which are designed to produce a reduction of 65% in unit costs over the next 18 months.

FINANCE AND PERSONNEL

The Bank's ability to deliver its strategic objectives depends on the efficient management of its financial and personnel resources.

The principal financial constraint is the paybill limit, which commits the Bank to keeping its expenditure on pay within a ceiling set in cash terms. The strategy necessitates higher staffing levels in some areas, to take account of the recommendations of the Bank's Review of Supervision and additional work relating to EMU and systems development. This requires the recruitment for Supervision and Surveillance of additional graduates, and staff with a particular specialism in this field, as well as mid-career recruits for deployment across the Bank. The skills and adaptability of existing staff will also be improved through enhancements to training. But there will be offsetting staff reductions in other areas of work to ensure compliance with the paybill limit. Within this context, the Bank has put increased emphasis on integrating the principles of equality of opportunity into its human resource policies.

IMPLEMENTATION

During the last three years the Bank's internal and management structures have been fundamentally re-organised. The Bank believes that it now has the framework it needs to operate efficiently and effectively. The Operational Reviews contained in this Report show how the key areas of the Bank are applying themselves to the implementation of the Bank's strategy.

Pictured above from left to right:
Sir Colin Southgate, Sir David Simon,*
Andrew Buxton, Frances Heaton,
Neville Simms, Dame Sheila Masters,
Sir David Cooksey, Sir David Lees,
Sir Chips Keswick and Sir David Scholey

THE COURT OF DIRECTORS

MEMBERS OF COURT

1 March 1997

Eddie George *(Governor)*

Howard Davies *(Deputy Governor)*

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

Mervyn King
(Executive Director)

Sir David Lees
(Chairman, Courtaulds plc
Chairman, GKN plc)

Sir Colin Southgate
(Chairman, EMI Group plc)

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

Sir Chips Keswick
(Chairman, Hambros Bank Ltd)

Sir David Cooksey
(Chairman, Advent Ltd)

Dame Sheila Masters, DBE
(Partner, KPMG)

Ian Plenderleith
(Executive Director)

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

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

Michael Foot
(Executive Director)

Sir John Hall
(Chairman, Newcastle United Football Company Ltd)

John Neill, CBE
(Deputy Chairman and Group Chief Executive, Unipart Group of Companies)

Andrew Buxton
(Group Chairman, Barclays plc)

Alastair Clark
(Executive Director)

* *Sir David Simon vacated his position as a Director of the Bank on taking up his appointment as a Government Minister on 7 May 1997.*

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.

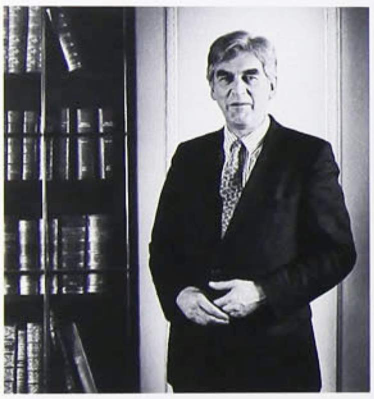
Court has delegated to the Executive the Bank of England's powers under the Banking Act 1987 and other supervisory legislation. It is thus not concerned with taking day-to-day decisions on supervisory cases, though it receives regular reports on the operation of the Banking Act and on resources in Supervision 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. During the year, Sir David Scholey, one of the Bank's Non-Executive Directors, was appointed as a lay member of the Board. 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.

Eddie George
Governor

Howard Davies
Deputy Governor

Mervyn King
Executive Director



Ian Plenderleith
Executive Director

Michael Foot
Executive Director

Alastair Clark
Executive Director

THE EXECUTIVE

Governor's Committee

Eddie George *(Governor)*

Howard Davies *(Deputy Governor)*

Mervyn King
(Executive Director, Monetary Stability)

Ian Plenderleith
(Executive Director, Monetary Stability)

Michael Foot
(Executive Director, Financial Stability)

Alastair Clark
(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)

John Footman
(Deputy Director, Financial Structure)

Graham Kentfield
(Deputy Director, Banking and Market Services)

Gordon Midgley
(Deputy Director, Finance and Resources)

Oliver Page
(Deputy Director, Supervision and Surveillance)

John Townend
(Deputy Director, Market Operations)

Merlyn Lowther
(Personnel Director)

Under Court, the Bank's senior policy making body is the Governor's Committee, comprising the Governors and Executive Directors.

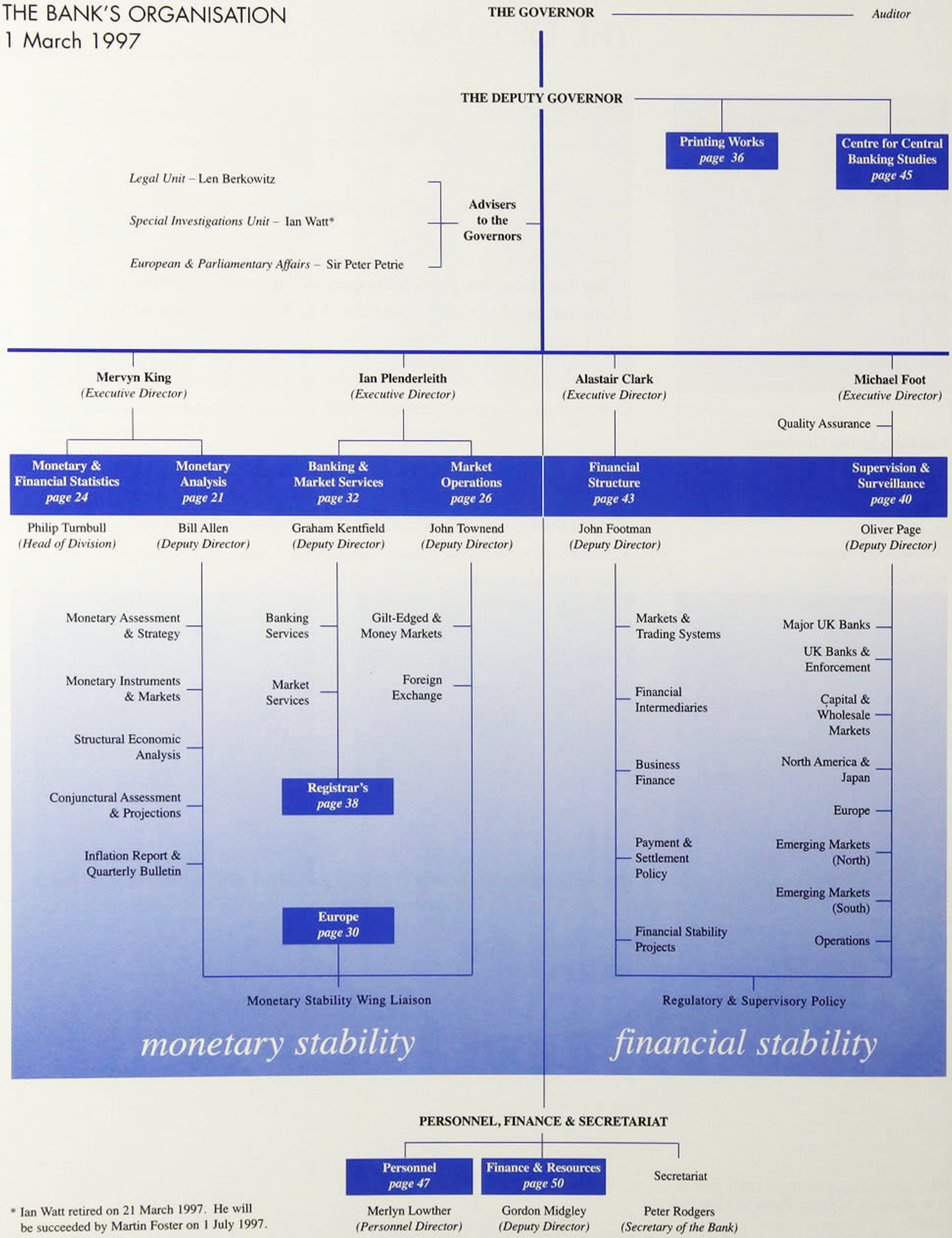
Members of the Governor's Committee also meet, with officials, as Policy Committee to deal with strategic issues. The Monetary Policy Committee, which includes Heads of Division in the Monetary Stability Wing, meets each month to discuss the Bank's advice to the Chancellor on interest rates.

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 and the Personnel Director.

The Bank's broad organisational structure is shown in the chart on page 20. 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 50 to 52.

* Ian Watt retired on 21 March 1997. He will be succeeded by Martin Foster on 1 July 1997.

THE BANK'S ORGANISATION
1 March 1997



* Ian Watt retired on 21 March 1997. He will be succeeded by Martin Foster on 1 July 1997.

MONETARY ANALYSIS

Mervyn King
(Executive Director)

Bill Allen
(Deputy Director)

Creon Butler
(Head, Monetary Instruments & Markets Division)

Paul Fisher
(Head, Conjunctural Assessment & Projections Division)

Neal Hatch
(Head, Inflation Report Division)

Nigel Jenkinson
(Head, Structural Economic Analysis Division)

Paul Tucker
(Head, Monetary Assessment & Strategy Division)

Stephen Collins
(Head, Monetary Stability Wing Liaison)

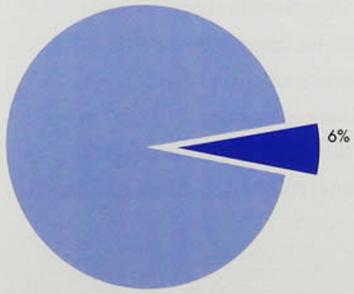
The Monetary Analysis Divisions provide the economic analysis which supports the Bank's work in pursuit of monetary stability. That includes the continuous analysis of the monetary and economic situation in the UK and overseas. Other aspects of the work are the analysis of structural economic issues affecting longer-term economic performance, including the industrial and social consequences of monetary policy; analysis of alternative monetary policy strategies; analysis of techniques for implementing monetary policy; and extraction of information about financial market expectations from financial asset prices. The plans for EMU have a large bearing on much of the work, and the Divisions contribute to preparatory work on EMU by the European Monetary Institute and the European Union Monetary Committee (see pages 30 to 31), and participate in other international forums.

The main published output of Monetary Analysis is the quarterly *Inflation Report*, which aims for 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.

The Monetary Analysis Divisions undertake extensive research to help maintain and develop the quality of the Bank's policy advice. Much of the research is published as speeches or articles or in summary form in the *Quarterly Bulletin* and in working papers published by the Bank, as well as in the proceedings of conferences in which members of the staff have participated. Over the past year, the Bank has published research in the *Quarterly Bulletin* on a range of subjects including:

- Monetary aggregates: the significance of broad money and the demand for Divisia money.
- Monetary policy strategies: how should central banks reduce inflation, the benefits of low inflation, the significance of simple monetary policy rules, and international monetary policy co-ordination.
- The differential industrial impact of monetary policy.
- The construction of yield curves for G7 countries and the application of yield curve techniques to recent developments in bond yields.
- Exchange rate behaviour.
- The probability distributions attached by the market to future asset prices, deduced from option prices.

Proportion of the Bank's operating costs



- Price setting behaviour: the initial results of a survey of 654 firms.
- "Increasingly weightless economies": the changing nature of output.

In addition, Monetary Analysis has provided supporting analysis for speeches by the Governors and Directors on monetary stability matters, including the case for price stability as the objective of monetary policy, the interaction between monetary policy and the real economy, the implications for monetary policy of regional economic developments and the economics of monetary union.

Monetary Analysis has benefited from the presence of two Houblon-Norman fellows during the year: Martin Evans of Georgetown University and Robert Aliber of the University of Chicago.

The Monetary Analysis Divisions encompass the economic liaison function of the Bank's regional agents, who report regularly on economic conditions in their region, and represent the Bank. During the year, the Bank has intensified its economic liaison activities by opening new agencies in Cardiff and Greater London, and a third new agency is soon to be opened in Nottingham, bringing the total to twelve. Members of the Head Office staff visit the agencies frequently, both to hear the views of those directly involved in productive industry and to convey the Bank's views on monetary issues. The agents frequently attend monetary policy discussions at Head Office.

Members of the Monetary Analysis staff participate in debate about policy-related subjects, both within the UK and internationally. In the autumn of 1996, the Bank and HM Treasury jointly organised an academic panel to discuss research on the optimal framework for government debt.

Staff members of the Monetary Stability Wing play an important role representing the Bank at international meetings. Many of the meetings are of European Union groups and are described on pages 30 to 31. In addition, staff members participate in other international forums, 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. The Bank was also involved in the negotiations on expansion of the General Arrangements to Borrow, which have now been successfully completed. The Bank currently provides the chairman of the G10 Gold and Foreign Exchange Committee.

162 staff are employed in Monetary Analysis, of whom 90 are engaged in economic analysis and related management, 24 are mainly engaged in economic liaison and 48 are support staff. A further 16 staff are involved in Monetary Stability Wing Liaison.

MONETARY AND FINANCIAL STATISTICS

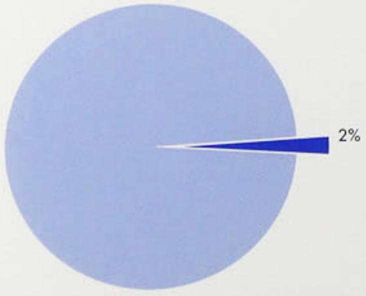
Mervyn King
(Executive Director)

Philip Turnbull
(Head, Monetary & 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), international organisations and private sector analysts. The Bank's aim is to provide a timely, high quality and cost-effective service, in line with its Statistical Code of Practice. It continually seeks to improve this service through reviews of the coverage and relevance of its statistics, the clarity of presentation and the cost of production. The Bank also plays an active part in international discussions on statistical developments in many forums including the European Monetary Institute, the Bank for International Settlements, the European Union, the Organisation for Economic Co-operation and Development and the International Monetary Fund.

The Division's main task is the processing and analysis of banking data, which are used for 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. These data also feed into the UK Economic Accounts prepared by the ONS. 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.

Proportion of the Bank's operating costs



During 1996/97, the Division issued the forms and definitions which are to be introduced later in 1997 as part of a review of banking statistics. This review covers requirements in relation to monetary policy as well as 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. Discussions were also opened with banks on the statistical reporting requirements of the European Central Bank under Stage 3 of EMU, to give banks adequate time to prepare, should the UK participate.

The Division works closely with the ONS to improve estimates of the UK's national accounts and balance of payments. In 1996/97, 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; further work on the geographical detail and frequency of balance of payments data; the statistical treatment of the Channel Islands and the Isle of Man; and the quality and coverage of interest rate data. As part of the continuing effort to maintain and improve the quality of the statistics, the Division's data supply to the ONS is governed by a Firm Agreement which covers areas such as timeliness, revisions and interpretative advice.

A new monthly publication *Bank of England: Monetary and Financial Statistics* was launched in January 1997. The Bank's statistics are also published in regular statistical releases, the annual *Statistical Abstract* and by the ONS in its publications (in particular, *Financial Statistics*). All regular releases are on the Internet, and some are made available via wire services, via a fax retrieval service and through a commercial software package. The Division has also been proactive in seeking a closer and more interactive relationship with its principal customers. To this end it was instrumental in establishing, jointly with the ONS, a Financial Statistics Users Group, which had its inaugural meeting in March 1997, attended by over 200 users.

The Division employs 83 staff, of whom some 31 are involved in compiling and presenting data and around 26 are engaged in analysis and interpretation. There is a senior management team of 8. The rest of the staff provide computing and clerical support.

MARKET OPERATIONS

Ian Plenderleith
(Executive Director)

John Townend
(Deputy Director)

Peter Andrews
(Head, Gilt-Edged & Money Markets Division)

Terry Smeeton
(Head, Foreign Exchange Division)

Stephen Collins
(Head, Monetary Stability Wing Liaison)

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 Treasury 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.

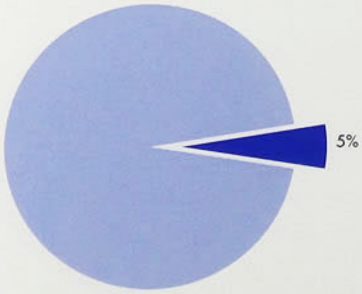
The Bank's money market operations are directed to establishing short-term interest rates at the officially-desired level by providing the marginal liquidity needs of the banking system at the appropriate interest rate in daily open market operations. The Bank's debt management function involves the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

The Division continued the progressive reforms in the structure of the gilt market during 1996/97, while maintaining the active programme of gilt-edged operations to finance the public sector deficit and an increasing amount of redemptions. Total gilt sales were £39.9 billion, including £6.4 billion of index-linked gilt sales.

During the year the Division, with help from several other parts of the Bank, developed proposals to reform the structure of the Bank's daily money market operations. Consultations with the market were held during the winter of 1996/97; and the new arrangements came into effect on 3 March 1997.

Four important developments were involved. First, the Bank decided to use gilt repo in its daily operations as an instrument to provide liquidity to the market. Hitherto, gilt repo had been used only as the basis for a twice-monthly facility.

Proportion of the Bank's operating costs



Second, the Bank chose to broaden the range of counterparties with which it is prepared to deal beyond the small group of discount houses to include those banks, building societies and securities houses active in either the bill or gilt repo markets, so long as they met a number of functional criteria. Transitional arrangements were made available for discount houses that chose to continue as counterparties. Third, technical changes to the Bank's end-of-day operations were introduced to allow the use of later and more accurate forecasts of the market's liquidity position. Finally, the Bank ended the requirement that its money market counterparties should be separately capitalised, specialised intermediaries subject to a special supervisory regime. At the same time, the requirement of separate capitalisation was dropped for the gilt-edged market makers (GEMMs), the Bank's counterparties in the gilt market, opening the way for group restructuring and a more effective use of capital during 1997.

Several changes were effected in the gilt market to build on the more structured auction programme introduced in 1995 and the open gilt repo market inaugurated in January 1996. The GEMMs were allowed to make more bids at auctions in the last moments before bidding closed, and to bid non-competitively for up to 0.5% each of the stock on offer. Both facilities were widely used, and contributed to an increase in auction bidding. In July 1996, the Bank opened its "Shop Window" for sales to GEMMs of residual official holdings of stocks.

Preparations continued during the year for the introduction of gilt stripping (the separation of principal from coupons), now expected about a month after the upgrade of the Central Gilts Office (CGO) scheduled for August 1997 (see pages 34 to 35).

During February 1997, the Division conducted further consultation exercises with the gilt market on the possible elimination of the ex-dividend period for gilts held in the upgraded CGO, changing from trading gilts in fractions (of a pound per £100) to decimals (pence per £100) and using a more accurate convention to calculate the rate at which interest accrues on gilts.

The Division has been heavily involved in the preparations for EMU. It has represented the Bank on the European Monetary Institute's Monetary Policy Sub-Committee which prepared the framework for monetary operations in the single currency; it has contributed to the Bank's work in establishing the impact of the single currency on the gilt market; and it is ensuring that the Bank is in a position to participate, if necessary, in the future monetary operations of the European Central Bank.

An expanded Annual Review of developments in the gilt market was published in July 1996, building on the regular review in the *Quarterly Bulletin*. Members of the Division have published some of their technical work, on subjects such as index-linked bonds.

The Division's activities include a continuous programme of liaison with the key players in the money and gilt markets. This forms the basis for more analytical and technical work underpinning advice to HM Government. The management information available on the gilt portfolio has been extensively modernised during the year. Some further improvements are scheduled.

The Division has led the work on further liberalisation of the regulations on the issuance by companies and others of commercial paper and other debt securities. The new regulations came into force on 3 April 1997.

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 establishment of the European Central Bank and introduction of the single currency.

During the year, some re-organisation of the staffing structure of the Division was undertaken, designed to create a "Middle Office", headed by a Compliance Manager. The restructuring should assist the Division in meeting its objectives and brings the operation into line with best banking practice.

Increased efforts were devoted to analysing developments in the exchange rate by extracting information from all available data sources, including the derivatives markets and by intensifying contacts with market participants. In recent months, this work has focused on identifying factors contributing to the rise in sterling as an input to the monetary policy process.

The Division's responsibility for organising HM Government's foreign currency borrowing programme also assumed a higher profile in 1996. A maturing $4 billion floating rate note issue, originally made in 1986, was successfully refinanced by two separate dollar borrowings, each of $2 billion: in July 1996, a fixed rate dollar bond was issued and this was followed in September by a floating rate note, both with a maturity of five years. Both issues, which were brought to the market on the finest terms, were heavily oversubscribed and have since performed well in the secondary market. In addition, the monthly auctions of ECU Treasury Bills were maintained and a further three-year ECU note was issued in January 1997, continuing the programme established in 1992.

About 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. The reserve management operation is frequently approached for advice and assistance, and during the year a seminar was held for around 20 reserve managers from other central banks.

Members of the Division have participated actively in the preparations for EMU being co-ordinated by the European Monetary Institute. In the foreign exchange area this involves designing operational frameworks for intervention by the European System of Central Banks, and for managing the foreign reserves to be pooled with the European Central Bank. This work is now moving to a more technical stage, including the design of IT support systems and communications networks to facilitate operations among the participating central banks. The Division is also starting to make plans for the changes that would arise in the foreign exchange and reserve management areas in the event of a move to a single currency. Some of these changes would in any event be necessary, whether or not the UK decided to participate.

The two Market Operations Divisions have a complement of 85 staff, whose responsibilities cover analysis, dealing, portfolio management and the provision of support, including management information. This represents an increase of 2 from the previous year, reflecting a heavier commitment of analytical resources to market reforms, management information systems and EMU.

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)

The Bank continues to play a full role in all of the technical preparations for EMU at the European Monetary Institute (EMI) in Frankfurt and in the European Union (EU) Monetary Committee. Much of the preparatory work undertaken at the EMI was brought together in a document specifying the operational framework for the single monetary policy in Stage 3, published in January 1997. The Bank welcomed the publication of this document and its substance. There are only a small number of areas where it has not proved possible to reach a unanimous view among central banks: one of these relates to the need for reserve requirements on the banking system and another to the terms of access of non-euro area Member States to intraday liquidity within TARGET (the proposed interlinking of Real-Time Gross Settlement payments systems). Other topics on which national central banks have been heavily engaged with the EMI include the drafting of the legal Regulations on the euro, the design of the revised Exchange Rate Mechanism (membership of which will be voluntary), the specification of euro banknotes and the specification of the statistical requirements for EMU.

In preparing the ground for formal and informal meetings of the Council of Economic and Finance Ministers (ECOFIN), the EU Monetary Committee has been engaged in all aspects of planning for EMU, including the relationships between participants and non-participants in the euro area, and legal provisions for the euro. It has also played its usual role in EU policy co-ordination.

The Bank has continued to co-ordinate preparations in the City and beyond to ensure that the euro may be used from the beginning of EMU, in particular in the wholesale payments system and financial markets. The Bank's work has intensified with the increased pace of activity in the private sector. Part of its role is to keep abreast of preparations and to ensure that they are widely promulgated. To assist this process, the Bank has, since the spring of 1996, been publishing quarterly reports on the practical issues arising from the introduction of the euro. Some 25,000 copies are now circulated to interested parties primarily, but not exclusively, in the UK financial sector.

These reports have helped the Bank to convey the message, which now seems generally accepted, that whether or not the UK participates in EMU, practical preparations are necessary to ensure that London's global financial position is not adversely affected. Although the state of individual institutions' preparations inevitably varies, at the financial infrastructure level the Bank remains confident that the UK will be ready in time.

In January 1997, the Bank organised a symposium for over 200 representatives of the associations with which it is in touch, to discuss the readiness of the wholesale financial sector and to identify any gaps. A record of the proceedings was published on 4 April 1997. In addition, Bank speakers participate in many of the commercial and other conferences on EMU which are now taking place.

The Bank has recently focused on the precise terms and conditions under which financial instruments are issued and market trading takes place, to see whether the single currency will provide an opportunity to harmonise market conventions. The Bank is also assessing market views on whether, when and how outstanding securities in national currency might be redenominated in euro. These are areas in which London, as an international financial centre, naturally has a close interest. Following an examination of the issues in relation to the gilt market, a committee has been established under Bank chairmanship with representation from across London's financial markets, and its report was published in April 1997.

Beyond the financial sector, many businesses - particularly those with pan-European activities - are planning intensively for the euro, from both a strategic and practical viewpoint. The Bank has participated with the Confederation of British Industry and the British Chambers of Commerce in a series of regional workshops for business, and has produced a booklet answering the questions most frequently asked.

Finally, the Bank is itself gearing up for EMU, planning for both "in" and "out" scenarios. The preparatory work is being overseen by a committee, chaired by the Deputy Governor, which includes representation from all relevant parts of the Bank.

BANKING AND MARKET SERVICES

Ian Plenderleith
(Executive Director)

Graham Kentfield
(Deputy Director & Chief Cashier)

John Bartlett
(Head, Banking Services Division)

Mike Phillips
(Head, Market Services Division)

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 the Bank's customers in a professional, secure and cost-effective way.

BANKING SERVICES

Banking in the Bank's branches finally ceased in May 1996. The rationalisation of note distribution arrangements, foreshadowed in last year's Report, has continued as planned; business at the Bank's branches in Birmingham, Bristol, Manchester and Newcastle will cease during the summer of 1997 with a net loss of some 150 jobs, leading to savings of some £4 million per annum. Thereafter, the commercial banks will take full responsibility for the re-issue of fit notes, while the Bank's remaining responsibilities in this area - the issue of new notes and the receipt, authentication and destruction of soiled ones - will be handled from Head Office and the Printing Works and from Leeds.

The value of the note issue was £22,011 million at the end of February 1997, £2,363 million (12.0%) larger than a year earlier.

Value of notes in circulation

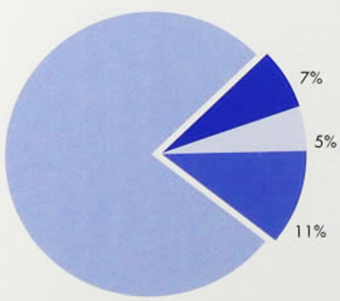
£ Millions

End-February	*1994*	*1995*	*1996*	*1997*
£1 (a)	57	57	56	56
£5	1,135	1,072	1,067	1,047
£10	5,245	5,348	5,688	5,915
£20	6,818	7,723	8,579	9,559
£50	2,884	2,852	3,104	3,273
Other notes (b)	1,024	1,004	1,154	2,161
Total	**17,163**	**18,056**	**19,648**	**22,011**

(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.

Proportion of the Bank's operating costs



Number of new notes issued each year by denomination

Millions

Year to end-February	*1994*	*1995*	*1996*	*1997*
£5	325	308	336	335
£10	622	624	575	617
£20	339	342	326	339
£50	22	39	43	25
Total	**1,308**	**1,313**	**1,280**	**1,316**

Counterfeiting activity has moderated somewhat and the number of counterfeits detected during 1996 was lower than in 1995. The Bank nevertheless continues to review the security features in its notes.

The Sterling Banking Office has been closely involved in developments described elsewhere in the Report including the arrangements for RTGS (see page 34); the money market reforms (see pages 26 to 27); the provision of settlement bank facilities for the upgraded Central Gilts Office (CGO) service (see pages 34 to 35); and facilities for wholesale payments in euro (see pages 30 and 35). It also provides final settlement facilities to the CREST settlement banks, as well as acting as a CREST settlement bank for its own customers. A participant link system (enabling customers to make CHAPS payments and internal account transfers themselves from a terminal at their own premises) has also been implemented.

Outsourcing arrangements were completed with First Data Resources Limited (FDRL) for paper clearing, and 74 staff were transferred to FDRL. After an initial period in London, this operation was successfully relocated to FDRL's premises in Basildon in May 1996. The Bank continues to participate as a settlement bank in the clearings, and is involved in a number of industry developments including the completion of the Inter Bank Data Exchange project and, more recently, the proposed merger of the English and Scottish Clearings.

The Bank has continued to administer financial sanctions (on behalf of HM Treasury) on the assets of Iraq and Libya.

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 the securities and/or cash which form 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 debt rescheduling operations for Panama, Peru, Nigeria, Albania and Russia.

MARKET SERVICES

The principal role of the Market Services Division is to provide settlement and custody services to the Bank's internal and external customers, and to the markets in general. The Division provides "back office" facilities for the Bank's operations in support of monetary policy, debt management and reserves management objectives. For the financial markets it operates book entry systems through which market participants can settle deals in gilt-edged securities and money market instruments, and ECU securities. It also provides a book entry transfer system for gold bullion for members of the London Bullion Market and the Bank's central bank customers.

During 1996/97, the Division has been greatly involved in progressing a number of financial infrastructure projects and in preparations for EMU. It has also been affected by the reforms in the Bank's sterling money market operations, implemented on 3 March 1997, which have widened the range of the instruments in which the Bank is prepared to deal to include gilt repo, and widened the range of counterparties to include key players in the repo market, including major banks and securities firms.

The collaborative development with the Association for Payment Clearing Services (APACS) of a Real-Time Gross Settlement system (RTGS) for sterling payments, an evolution from the previous CHAPS system, was referred to in last year's report. This work came to fruition in April 1996 when the new arrangements were inaugurated. RTGS involves the final settlement in central bank funds of each payment passing through CHAPS at the time it is made, rather than on a net basis at the end of each day. At the end of November 1996, a record 127,000 payments passed through CHAPS on a single day.

The project to develop RTGS was one of a series of initiatives to reduce systemic risks in the operation of the payment and settlement systems in the United Kingdom. In the first half of 1996, the Division took part in a strategic review, carried out by the Bank, to identify how best to progress these initiatives. Some key elements of strategy to emerge from this review, upon which work has continued, were as follows:-

First, to complete the work on upgrading the Central Gilts Office (CGO) gilt settlement system. This system was originally implemented in 1986, at the time of Big Bang, and although it has worked satisfactorily for ten years it is in need of enhancement. Following a period of consultation with the market, it was announced, in 1995, that the system would be upgraded using the software designed for CREST, the equity settlement system. In November 1996, the decision was taken to plan for the inauguration of the upgraded system on 26 August 1997. Initially, the aim had been to introduce the upgraded service in the spring of 1997, but an extension to the timetable was felt to be sensible to enable market firms to concentrate, during the autumn of 1996 and early 1997, on completing the transfer of equity settlement from Talisman, the system run by the Stock Exchange, to CREST. Many members of CGO are also members of CREST. It remains the firm intention of both the Bank and CRESTCo to keep open the option of consolidation of the two systems in the future. The upgraded CGO will provide the opportunity to introduce a strips market for gilt-edged stock in the UK. The aim is to introduce stripping facilities soon after the upgraded service is introduced.

Second, to continue to prepare for EMU whether or not the UK participates. One of the main areas is TARGET, the project co-ordinated by the EMI to link domestic RTGS systems across the European Union. The Bank has been heavily involved in EMI policy debates, notably about the terms under which "out" countries will access TARGET, and in the technical preparations with both the EMI and the CHAPS banks. The CHAPS Clearing Company is currently developing a new CHAPS Euro network which, if the UK is "out", will operate alongside the existing network for sterling payments. If the UK is "in" the existing network will switch from sterling payments to euro payments. The Bank is considering what changes would need to be made to the Bank's securities settlement systems (CGO, the Central Moneymarkets Office and the European Settlements Office), to accommodate EMU.

Third, to introduce full delivery versus payment (DVP) in domestic securities settlement systems. The Division chairs a working group with APACS, CRESTCo and market participants to examine the options for implementing DVP, a mechanism to synchronise the exchange of final funds against good title to the securities. Without DVP, neither the seller nor the purchaser of a security can be sure of retaining title to either the security or the cash payment in the event of default by a counterparty to a trade.

The Divisions employed 593 staff on 28 February 1997, including 191 at the five regional branches. The one percentage point fall in the Divisions' share of the Bank's operating costs in 1996/97 was due to the cessation of banking operations at the branches.

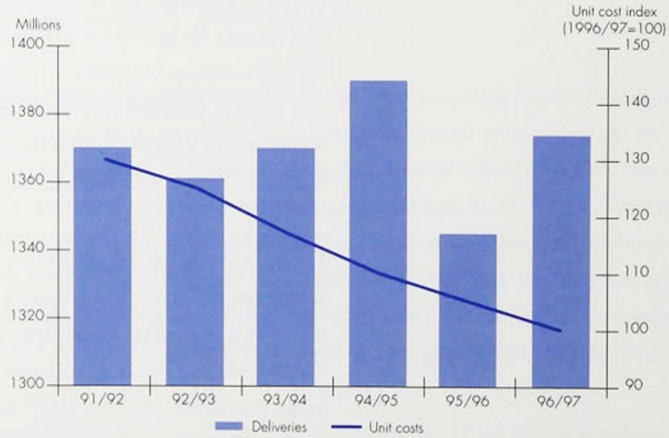
BANK NOTE PRINTING

Alex Jarvis
(General Manager, Printing Works)

The Printing Works operates in support of 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, security threads and printing plates: its expertise in these latter areas has led to commercial sales in overseas markets. The Printing Works' site 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 re-issue, the balance being destroyed.

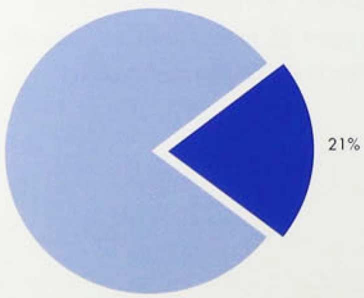
The trends of continuously improving productivity and reducing new note unit costs were maintained for the 10th successive year despite increases in pay rates and the cost of materials - mostly paper.

New note deliveries and unit costs*



* The unit cost data are not directly comparable with the figures for the cost of producing Bank of England notes shown in the statements of account of the Issue Department, since the latter are prepared on a cash basis.

Proportion of the Bank's operating costs



The recent modernisation programme - initially of equipment, followed by the major refurbishment of plant and buildings - has now virtually been completed.

Of equal importance is the continuing Printing Works 2000 Programme which aims to encourage staff to focus on three key values: team working, continuous improvement and customer partnership. Most teams have completed the initial re-design of their working methods and all have transferred to a new pay structure which rewards the acquisition of skills and demonstration of competencies. Associated with these changes has been a quality improvement scheme which has led to 74 staff being trained to coach widely drawn teams which evaluate suggestions by members of staff for quality improvements. Other similar initiatives are under way to consider the possible introduction of ISO 9001 standards, to gain Investors in People accreditation and to introduce quantitative benchmarking. These changes are aimed at keeping the Printing Works in the vanguard of the world's most efficient central bank printers.

Banknote Development has continued to focus on new and emerging security features as well as design and production process improvements. Such work augments the Bank's preparatory input to the European Monetary Institute whose working group on Printing and Issuing a European Banknote is chaired by Alex Jarvis, General Manager of the Printing Works. Now that the euro design competition has been completed, the Group's attention is turning to refining the conceptual design drawings and to undertaking a test bank note printing project. This project is aimed at evaluating the potentially complex issues which might arise from the simultaneous production of seven bank note denominations in up to fourteen different printing works.

The Printing Works continues to make progress towards reducing any adverse impact on the environment. Used and spoiled new bank notes and general waste are no longer incinerated; the former are shredded for land-fill; the latter is now segregated by those who create it, the overall aim being to minimise the creation of waste. The refurbishment has provided for improvements in the efficiency of plant and a reduction in heat loss. The Printing Works has a policy of using hardwoods from sustainable sources. An Energy Conservation Engineer has been appointed to advise on, and educate staff about the importance of, energy conservation.

In its eleventh year of operation, Debden Security Printing Limited, wholly owned by the Bank and located at the Printing Works, achieved a turnover of £1.5 million and made a pre-tax profit of £500,000. By using and paying for Printing Works skills and operations, DSP also provides revenue for the Works which, through the relief of overheads, contributes to the reduction in note issue costs charged to HM Treasury. This contribution was £530,000 in 1996/97.

The number of staff employed by the Printing Works fell by 74 during the year to 663 (80 of whom are employed on contracts of up to two years).

OPERATIONAL REVIEWS

REGISTRATION SERVICES

Ian Plenderleith
(Executive Director)

Graham Kentfield
(Deputy Director & Chief Cashier)

Peter Ironmonger*
(Chief Registrar)

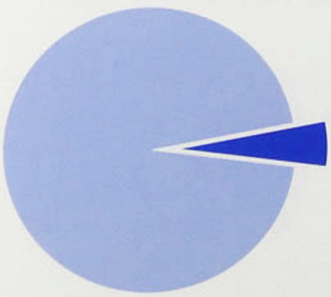
The Registrar's Department in Gloucester provides the principal stock registration service for HM Government. The main elements of the service include issuing gilt-edged stock, maintaining the register of stockholders, registering changes of ownership of stock and making, and accounting for, interest and redemption payments.

After a benchmarking exercise involving private sector comparators, HM Treasury agreed in July 1996 that the Bank should continue to provide the registration service provided that savings could be made to deliver substantial reductions in unit costs. To achieve these savings, which aim to reduce unit costs by 65%, the Department is currently restructuring. It will halve the staff, adopt a multi-disciplined, team-working approach to processing, develop and introduce a new computer system and move to smaller premises. In its revised form, the Department will employ around 115 staff. The restructuring exercise is to be completed by the end of 1997. HM Treasury has agreed that provided the new cost target is met, the work of the Department is assured for the next five years. The possibility of merging the National Savings Stock Register with the Bank Register is being discussed with HM Treasury and National Savings.

On the operational side, the Department is preparing for the introduction of the upgraded CGO settlement system (see pages 34 to 35) and the introduction of the gilt stripping facility (see page 27). An exercise has been undertaken to encourage stockholders to accept interest payments through the BACS system, which delivers savings in operational costs while offering stockholders prompt receipt of cleared funds. The Department is also preparing to respond to other changes in the gilt market such as the proposed reduction in the ex-dividend period for CGO members, and to any developments resulting from the introduction of the single currency.

During 1996/97, productivity rose by 19.2% and the volume of work handled throughout the Department fell by 1.4%.

Proportion of the Bank's operating costs



Transfers registered (000s)

Year to end-February	*1994*	*1995*	*1996*	*1997*
Stock transfer forms	509	469	385	377
Electronic transfers through CGO	533	586	599	790
Total	**1,042**	**1,055**	**984**	**1,167**
Change on year				+18.6%

* Peter Ironmonger will be succeeded by Geoff Sparkes during 1997.

Number of accounts (000s)

End-February	*1994*	*1995*	*1996*	*1997*
British government securities	1,155	1,018	946	830
Non-British government securities	10	11	10	9
Total	**1,165**	**1,029**	**956**	**839**
Change on year				-12%

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

End-February	*1994*	*1995*	*1996*	*1997*
British government securities				
Registered stock (a)	193,630	214,984	242,034	269,261
of which index-linked	*21,395*	*23,285*	*26,076*	*28,818*
Bearer bonds	26	23	19	17
	193,656	**215,007**	**242,053**	**269,278**
Change on year				+11%
Other securities				
Government-guaranteed	224	226	226	226
Commonwealth and overseas	2,990	3,485	3,484	3,148
Local authorities	41	41	41	41
The Agricultural Mortgage Corporation plc	22	22	20	0
Other	45	45	45	45
	3,322	**3,819**	**3,816**	**3,460**
Change on year				-9.3%
Total	**196,978**	**218,826**	**245,869**	**272,738**

(a) including National Investment Loans Office stocks

The Department has for some years maintained recognition as an Investor in People, and the recognition was reconfirmed in July 1996. This reflects its continued commitment, notwithstanding the current restructuring, to high levels of training and development for its staff. The Department also maintains its commitment to the NVQ programme and the Management Charter Initiative.

The Department has 251 staff of whom 27 are managers, 34 are involved in Information Systems, 185 are clerical and 5 are ancillary: these figures include 17 staff who are currently seconded to local organisations and who will leave on severance terms at the end of their secondment.

SUPERVISION AND SURVEILLANCE

Michael Foot
(Executive Director)

Oliver Page
(Deputy Director)

Clive Briault
(Head, Capital & Wholesale Markets Division)

David Green
(Head, European Division)

Stuart King
(Head, Operations Division)

Colin Miles
(Head, Emerging Markets (North) Division)

David Reid
(Head, Emerging Markets (South) Division)

Carol Sergeant
(Head, Major UK Banks Division)

Clifford Smout
(Head, Regulatory & Supervisory Policy Division)

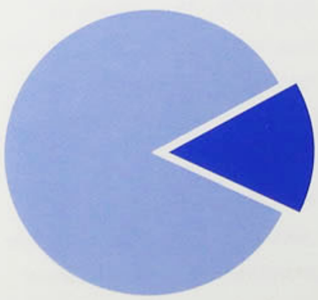
David Swanney
(Head, UK Banks & Enforcement Division)

Paul Wright
(Head, North America & Japan Division)

Len Berkowitz
(Head, Legal Unit)

Ian Watt*
(Head, Special Investigations Unit)

Proportion of the Bank's operating costs



* Ian Watt retired on 21 March 1997. He will be succeeded by Martin Foster on 1 July 1997.

Supervision and Surveillance (S&S) 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.

Last year's Annual Report noted that the Bank had appointed Arthur Andersen to undertake a review of the appropriateness and effectiveness of the operations of S&S (see below for further details). The review concluded that a key element of the change programme should be an internal reorganisation in S&S. With effect from 1 September 1996, the number of Divisions in S&S increased from six to nine (with the creation of two additional Divisions involved in supervising banks, and an Operations Division).

All nine Divisions report to an Executive Director through a Deputy Director. Two of the Divisions supervise the majority of the 212 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 four supervise the 254 branches of foreign banks authorised to take deposits in the UK, and most of their UK-incorporated subsidiaries. The Capital and Wholesale Markets Division brings together three separate areas in S&S which have a strong capital and wholesale market content: the UK Investment Banks Group, the Traded Markets Team and the Wholesale Markets area (responsible for supervising discount houses, gilt market firms and the Exchange Clearing House (ECHO) and for overseeing the Financial Services Act Section 43 "wholesale markets" regime, and institutions listed under Section 43). The Regulatory and Supervisory Policy Division provides advice across a range of banking supervisory issues and, since January 1996, has been linked also to the Financial Structure area of the Financial Stability Wing. The newly created Operations Division encompasses training, IT and other support functions and a Data Analysis Unit. A Quality Assurance (QA) function has been created, which reports directly to the Executive Director.

In October 1995, the Bank engaged Arthur Andersen to assist in implementing one of the key recommendations arising from the Barings Inquiry - the establishment of a QA function - and to undertake a review of the appropriateness and effectiveness of the operations of S&S, within the current legislative framework. The review was to make recommendations to improve the methods, organisation, structure and staffing of S&S, as well as to design and test a prototype QA system. The work included discussions with some 25 banks authorised in the UK, leading banking associations, other regulators in the UK and abroad, and with other relevant parties, such as the accountancy firms.

Arthur Andersen's Report was published in July 1996. It concluded that the Bank's supervisory style, where supervisors exercise informed judgements within approved standards and guidelines, should be maintained. The Report recommended, however, that the standards and processes of supervision should be linked more explicitly to the objectives of supervision; that a more systematic approach to the assessment of risk should be established, including a formal assessment of each bank; and that the effectiveness of the existing supervisory tools should be enhanced - in particular, prudential information and section 39 reports. The Report also recommended more effective use of information technology to support the supervisory process and to capture, manage and analyse the full range of information used in it; and that the experience, skills and number of S&S staff should be enhanced through an expanded training programme and the recruitment of more staff with specialist knowledge and skills, including a number of senior banking advisers.

The Bank's own Review of Supervision concluded that it would take forward all the proposals contained in the Report and established a change management programme to implement and develop the recommendations. Significant progress has been made since the programme's launch, including publication of a booklet setting out the Bank's objectives of supervision and standards for supervisors; the issue of a consultative paper outlining proposals to improve the effectiveness of the section 39 regime; and the issue of a consultative paper on the introduction of a risk based framework of supervision for UK incorporated institutions. The QA Unit has a wide remit to assure the quality of banking supervision through a process of continuous assessment in order to foster the development of best working practice. Staff numbers have risen by some 41 over the year, with further significant net recruitment to come. New heads of IT Strategy and Training have been recruited externally.

The Bank also continued to enhance its relations with other supervisors. On a bilateral level, the Bank now has Memoranda of Understanding and other forms of agreement with a number of banking and securities supervisors both overseas and in the UK. It is also actively engaged in a number of multilateral initiatives, including the work of the Joint Forum and the Basle/IOSCO Joint Initiative.

To implement the change programme, S&S has been building up its resources. The nine Divisions together currently employ 425 staff, of whom 55 are senior managers, 264 are middle managers, analysts and assistants, 10 are inward secondees and 96 are support staff. 4 staff are employed in the QA Unit and 3 in the Change Management Team. The Bank has also recruited 3 part-time senior banking advisers to provide support and advice to line supervisors. S&S is assisted in its work by a Legal Unit (23 staff), and by a Special Investigations Unit (18 staff) mainly composed of forensic accountants. The fall of one percentage point in S&S's share of the Bank's operating costs in 1996/97 was entirely due to lower legal fees. If the latter are excluded, S&S took a larger share of the Bank's resources.

More detail on the supervisory issues addressed by the Bank during the year is included in the Annual Report under the Banking Act.

FINANCIAL STRUCTURE

Alastair Clark
(Executive Director)

John Footman
(Deputy Director)

Ian Bond
(Head, Markets & Trading Systems Division)

Alex Bowen
(Head, Financial Intermediaries Division)

Patricia Jackson
(Special Adviser)

Michael Smith
(Head, Business Finance Division)

Clifford Smout
(Head, Regulatory & Supervisory Policy Division)

John Trundle
(Head, Payment & Settlement Policy Division)

The role of the Financial Structure Divisions is to identify and analyse developments relevant to the structure, functioning and regulation of the financial system; to ensure that the Bank's conduct of financial supervision and monetary policy is informed by this analysis; to promote, from the same base of information and analysis, public understanding of issues in regulation and financial structure, and of the Bank's role in the financial system; and to make policy proposals and to encourage change designed to increase the safety and effectiveness of the financial system.

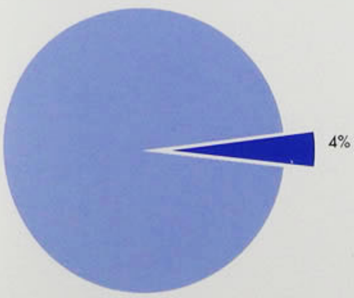
Key developments over the past year have included the launch, in association with the Securities and Investments Board, of the *Financial Stability Review*, a journal designed to promote the latest thinking on risk, regulation and financial markets and to provide a stimulus to debate on these issues. The two issues so far published have been well-received, and they have allowed the Bank to explain, more fully than in the past, its analysis of supervisory and risk issues. Much of this work is conducted in the Regulatory Policy Division, which has been closely involved with the analysis of Value at Risk models and the preparation of the new system for assessing the risk profile of banks (see page 41) as well as with broader questions about the structure and functioning of financial regulation.

The Bank's work on small firm financing issues, centred on Business Finance Division, continued with the publication in October 1996 of an analysis of the financing of high-technology firms. This was followed, in March 1997, by a conference, held jointly with the Royal Society and the Confederation of British Industry, to discuss the issues raised in the report. Among other corporate financing issues studied during the year has been the market in high-yield debt.

Another important area of work has been to consider the potential impact on the City of either joining or staying out of EMU in the context of analysing developments in the City's overall competitive position. The Bank has also been involved, with British Invisibles, the Corporation of London and other interested parties in a review of the effectiveness and institutional arrangements for promoting the City in overseas markets.

The Payment and Settlement Policy Division has taken a leading part in work on TARGET (see pages 30 and 35) and has been contributing in the relevant committees of the European Monetary Institute to the design of the system,

Proportion of the Bank's operating costs



seeking to ensure that it contributes as broadly as possible to the reduction in risk and the promotion of efficient payments mechanisms across the EU. It has also been working to implement the recommendations, published in 1996, of the G10 group on foreign exchange settlement risk. Domestically, the Division has been working with Market Services Division and APACS to prepare the ground for a move to DVP in domestic securities settlement systems (see page 35). It continues to monitor the general functioning and development of these systems, including that of CREST whose ownership and control passed from the Bank to the private sector in July 1996.

In addition to pursuing all these issues, and maintaining a dialogue with the City on a range of market and structural issues, the area's priorities for the present year include further work on systemic risk and on different approaches to supervision worldwide; deepening its analysis of the banking sector; contributions to thinking on desirable regulatory, supervisory and market structures in London; analysis of the market and regulatory implications of technological developments such as E-money; and further development of the work on small firms.

The area has 112 staff; about two-thirds are in managerial and/or analytical roles.

OPERATIONAL REVIEWS

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 continues to be the provision of 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 Centre also provides an international forum for specialist discussion of central banking questions.

In 1996/97, a total of 925 participants attended the Centre's programmes, at home and abroad - slightly fewer than in the previous year, reflecting a fall in the average number of participants per seminar as the format shifted towards interactive discussion rather than basic tuition. For 1997, the Centre's London programme has moved yet further towards seminars and workshops. In addition, the Centre helped organise and deliver some 25 short programmes in the Bank in 1996/97 for various specialists from central banks of developing or transition economies.

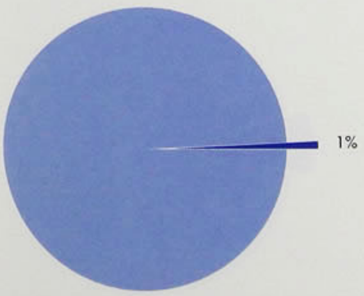
Countries of the former Soviet Union accounted for more than a third of all overseas participants in the Centre's activities, and east and central Europe about a quarter - the latter somewhat less than in previous years, reflecting the more specialist requirements of those central banks now. The remainder represented the Commonwealth (where moves towards financial liberalisation and economic reform, particularly in Africa and South Asia, have resulted in several additional requests for assistance) and a number of other countries, most notably China.

The subjects addressed by the seminars and courses have continued to evolve in response to changing demand. New areas of emphasis have been banking sector restructuring and European Union issues - in particular for countries which have applied for EU membership.

An innovation in 1996 was the launch by the Centre of a series of Handbooks in Central Banking. Ten titles, covering a variety of central banking topics, were published in English and in Russian in the course of the year, and more are planned.

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

Proportion of the Bank's operating costs



* Lionel Price will be succeeded by Professor Maxwell Fry on 1 September 1997.
† Tony Latter has been appointed Agent for Yorkshire and the Humber from 29 September 1997.

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.

OPERATIONAL REVIEWS

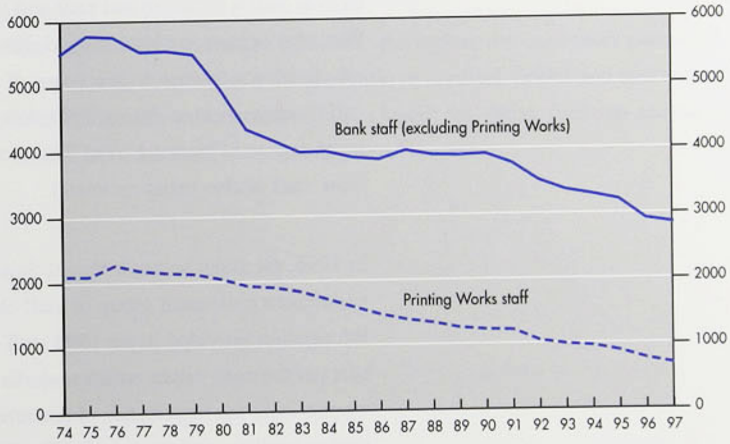
PERSONNEL

Merlyn Lowther
(Personnel Director)

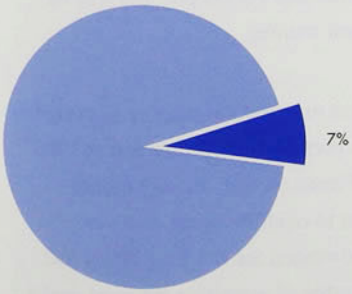
The Personnel Division's purpose is to help the Bank recruit, manage and motivate its staff in line with its changing needs. The Division has recently refocused the services provided by its area dedicated personnel units, to provide an increased emphasis on staff development. The remainder of the Division is organised into 3 areas: Policy and Employee Relations; Pensions, Loans and Welfare; and Systems and Administration.

At 28 February 1997, the Bank employed 3,320 full-time and 215 part-time staff; of these 485 were engaged on fixed-term contracts. Over the past year overall staff numbers (excluding the Printing Works) have reduced by 60 due mainly to the first stage of the branch closures, the outsourcing of the cleaning function and reductions at the Registrar's Department in Gloucester, offset in part by increasing numbers in the Supervision and Surveillance function following the Review of Supervision. Printing Works staff numbers have also fallen by 74.

Numbers of staff employed by the Bank at end-February



Proportion of the Bank's operating costs



Fifty high calibre university entrants joined the Bank during the year. This was an increase on recent years (35 to 40 entrants) and in part reflected the desire to increase staff numbers in the Bank's Supervision and Surveillance Divisions. The Bank has also increased its recruitment of staff with previous specialist experience and is developing a mid-career entry scheme to accommodate what is expected to be a continuing need. Recruitment of junior staff directly from school, both at GCSE and A-Level, has also increased somewhat over the last 2 years following the historically low levels of the early 1990s.

Last year's Review of Supervision highlighted the increasingly complex work being undertaken in the Bank. In response to this, it was decided that new graduate entrants should typically spend four years in their first area of the Bank in order to develop sufficient expertise to operate at a high standard. The Bank's training programme which prepares such entrants for careers across a range of the Bank's work is also being enhanced.

In response to the findings of the 1995 staff opinion survey, a booklet explaining the Bank's career development process, and highlighting the sharing of responsibilities for career management between individuals and the Bank, has been produced and issued to all managers and analysts. Within staff development, more emphasis is being placed on management skills, and upward feedback from staff to their managers is encouraged.

A new reward structure for analytical and managerial staff was implemented in October 1996. The structure, comprising 5 broad, overlapping salary bands, is underpinned by a job evaluation system and has been designed to allow greater flexibility and more local accountability in setting individuals' salaries.

A working party, made up of a cross-section of staff, undertook a review of the clerical staff's structure last year and made a number of recommendations. Work has begun on a new reward structure which will include extending the job evaluation system to this group of staff. The intention is that a new structure will be implemented during 1997, following negotiations with the Banking Insurance and Finance Union. The recruitment, training and development of these staff is also being reviewed.

In 1996, the Bank issued a Values Statement. Work on this was largely undertaken by a small group of staff chaired by Mervyn King and drew upon information provided in the 1995 staff opinion survey. The Values Statement sets out the core values which underlie the Bank's approach to work, emphasising the importance of discretion, impartiality, objective analysis, professionalism and teamwork. The Statement will be incorporated into the Bank's Statement of Purposes, Responsibilities and Philosophy and will be referred to in both induction and management training.

The Bank continues to provide active support to initiatives such as Opportunity 2000, Race for Opportunity and Employers Forum on Disability and in 1996 was a founding member of the Employers Forum on age. Family friendly policies are helping female staff in particular to combine home and work responsibilities; an increasing proportion of women are reaching junior and middle management levels, although the number of women in the most senior positions has fallen slightly. In 1996, a working group was set up to look at ethnic minority issues in the Bank: one of its recommendations was to publish data on the ethnic origin of the Bank's workforce. Ethnic minorities currently account for 5.3% of the total staff, and 6.2% of the Banking staff. Within the latter figure, the proportion of ethnic minority managers/analysts has risen from 1.6% to 3.4% over the past five years.

The Bank is committed to providing a safe and healthy work environment. Training and other initiatives have raised health and safety awareness and contributed to an overall reduction in the level of accidents. The Bank has continued to provide regular medicals for staff as well as promoting a number of screening and fitness initiatives. In October 1996, the Bank held its second Health and Fitness Exhibition which complemented the Lord Mayor of London's mayoral theme of "Good Health to the City and the Nation".

The Bank's community involvement 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 58.

The Personnel Division has 122 staff. As well as the customary personnel functions, its costs include the provision of medical, dental and welfare services to the staff and pensioners, the Bank's health and safety function and the costs arising from the Bank's community involvement.

OPERATIONAL REVIEWS

FINANCE AND RESOURCES

Gordon Midgley
(Deputy 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.

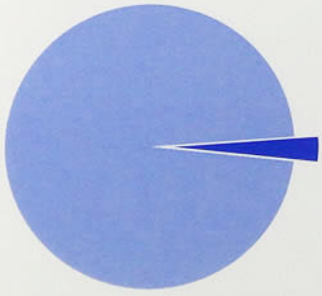
Finance handles financial and management accounting for the whole Bank including the Bank's budgetary control system and payments to suppliers. Finance also provides the Bank's input to the European Monetary Institute's work on the accounting principles to be used by the European System of Central Banks, including the European Central Bank. The Investment Unit is part of the finance function in the Bank. It is responsible for the management of Banking Department's gilt portfolio and 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 £3 billion.

Property Services Division is responsible for all aspects of the Bank's buildings, including maintenance, office planning and space allocation, and for security. Management Services Division provides information technology and telecommunications services and technical support to all areas of the Bank. The costs of Property Services Division are recharged to other areas of the Bank as are the bulk of the costs of Management Services Division. 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 main investment expenditure of the Bank and its main functional areas. During the year, the refurbishment of Bank Buildings - scheduled for completion in 1997 - continued. Other work in 1997 includes establishing the Leeds cash centre and the new agencies. Investments this year, with Management Services Division support, have included the continued replacement of banking systems, the development of a new Central Gilts Office system and the development of links between the Real-Time Gross Settlement system and the new TARGET system being developed by the European Monetary Institute and EU central banks. In keeping with the Bank's policy of giving business units prime responsibility for their own systems, the most significant developments are described in the Operational Reviews of the user areas.

The Bank is conscious of its impact on the environment. Energy consumption has been reduced through more efficient energy usage consistent with business needs. The Bank has also sought to minimise its use of, and contain, ozone

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.

depleting substances through conversion projects and appropriate designs for its cooling systems.

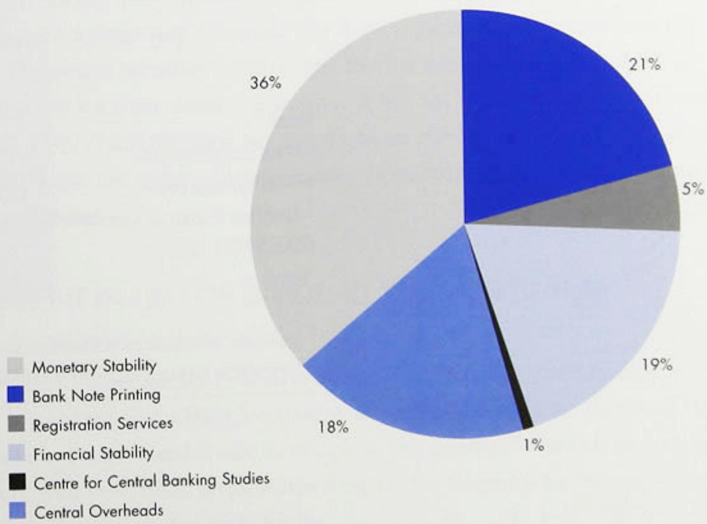
Finance and Resources employs 596 staff of whom 57 are in Finance, 412 are in Property Services and 127 are in Management Services.

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 21 to 51, is summarised in the chart below. The cost of the resources covered totalled some £210 million in 1996/97. Central overheads include the activities of Audit (1% of costs) and Secretary's Department including Governors and Directors (7%), as well as those of Personnel and Finance discussed on pages 47 to 51.

Summary of the Bank's operating costs



In recent years, the Bank has taken on new or increased responsibilities in the areas of supervision, market settlement systems and training for overseas central bankers. The preparations for EMU, which involve a considerable amount of work whether the UK joins or not, also increase the demands on staff resources. 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 the registration of gilts.

The table below gives the current staff position. 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 fell in 1996/97. This reflected above average staff vacancies and a slower than expected pace of recruitment during 1996, particularly in Supervision and Surveillance. The Bank has remained committed to keeping its paybill within the guidelines established in respect of public sector pay. During periods of restructuring, as has taken place this year in Supervision and Surveillance and at the branches, where the work is being wound down, the paybill may not be constant from year to year, but will remain within the ceiling established in earlier years.

Aggregate remuneration and average numbers of staff

	1996/97		*1995/96*	
	Aggregate remuneration £m	Average number of staff	Aggregate remuneration £m	Average number of staff
Bank†	97.2	3,722	99.1	3,959
Other subsidiaries:				
NMB Group plc	0.9	32	1.4	52
Minories Finance Limited	0.2	8	0.2	8
CRESTCo Ltd*	0.8	22	1.1	28
Total	**99.1**	**3,784**	**101.8**	**4,047**

† Includes subsidiaries whose functions are directly related to the operations of the Bank.
*CRESTCo Ltd ceased to be a subsidiary of the Bank in July 1996.

INCOME AND THE BASIS OF THE BANK'S PUBLISHED ACCOUNTS

The Bank 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 1996/97. 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 1996/97 and the Bank has stated 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 28 FEBRUARY 1997

Principal activities and review of operations

The Bank's Core Purposes are set out on page 10. The Governor's Foreword on pages 3 to 8, the summary of the Bank's Strategy on pages 11 to 15 and the Operational Reviews on pages 21 to 51 give a detailed account of the Bank's activities and operations during 1996/97.

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, particularly 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, than would be required under the Companies Acts and applicable accounting standards.

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 28 February 1997 are given on pages 60 to 81 and show a profit after provisions and before tax of £121.3 million compared with £214.4 million in 1995/96 (which included £118.4 million from the sale of the Bank's remaining interest in 3i Group plc).

The average interest rate during the year has been around 0.5% lower than in the previous year. The value of the Cash Ratio Deposits has on average increased by 13% compared to the previous year. The Bank has continued to exercise tight control over costs.

DIRECTORS' REPORT

After a payment in lieu of dividend to HM Treasury of £48.7 million (compared with £88.0 million in the previous year) and a tax charge of £23.8 million (1995/96 £38.1 million), the profit transferred to reserves amounts to £48.8 million which compares with £88.3 million last year.

The accounts for the Issue Department (which are given on pages 82 and 83) show that the profits of the note issue were £1,218.3 million compared with £1,294.4 million in 1995/96. 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 53.

Support operations

There have been significant developments on the two longest running of the Bank's support operations: the liquidation of Slater, Walker Ltd was finally completed and the company wound up, bringing to an end an operation dating back to the mid-1970s; and Minories Finance Ltd, for which the support operation began in 1984, was able to repay to the Bank £25 million out of its former share capital of £37.5 million.

The NMB Group plc (formerly The National Mortgage Bank PLC) has continued to realise its assets and reduce its operations and costs. The company surrendered its banking licence during the year, as it was no longer required. The history of the Bank's involvement with this company has been referred to in previous annual reports and is given in note 12 to the accounts on pages 72 to 73.

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 17. Andrew Buxton and Alastair Clark were appointed to Court with effect from 1 March 1997. Pen Kent and Sir Jeremy Morse retired on 28 February 1997 on completing their terms of office. The terms of office of Frances Heaton and Sir Chips Keswick expired on 28 February 1997; they were re-appointed for a further period of four years. Sir David Simon vacated his position as a Director of the Bank on taking up his appointment as a Government Minister on 7 May 1997.

The role of the Court of Directors is explained on page 17. The Directors' responsibilities in relation to the financial statements are set out on pages 57 to 58.

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 David Cooksey, Dame Sheila Masters and Neville Simms. The Deputy Governor, the Deputy Director (Finance and Resources) and the Auditor normally attend the meetings of the Committee.

Internal control

The Court of Directors is responsible for the system of internal financial control in the Bank and its subsidiaries. The responsibility for day-to-day operations is delegated to the executive management. The system of internal financial control is based on what the Directors consider to be appropriate to the Bank's activities, to the materiality of the financial and other risks inherent in those activities and to the relative costs and benefits of implementing specific controls. It should be recognised, however, that any such system can provide only reasonable, but not absolute, assurance against material misstatement and loss. The key features of the Bank's system of internal financial control are set out below.

(i) An organisational structure that is closely aligned to the Bank's core purposes in order to provide a framework for control of its various activities. Within this structure, authority levels are defined, requiring upward referral through heads of functions to the Executive Directors or Governors. The areas of responsibility of each Executive Director are clearly defined and are set out on page 20.

(ii) A planning framework covering a five-year period, with objectives and financial targets set at each level so that they are specific to the various operational areas in the Bank.

(iii) A system of financial reporting via the Executive to Court, including forecasts and budgets which allow management to monitor the key activities and progress towards financial objectives.

(iv) Defined procedures governing approval of capital and other project expenditure. These include annual budgets, detailed project approval procedures, monitoring reports and post-implementation reviews.

(v) The appointment of experienced and suitably qualified staff. Annual appraisal procedures exist to maintain standards of performance.

(vi) The undertaking by the Executive Directors and senior management, and subsequent reporting to the Audit Committee, of a risk assessment exercise to identify and evaluate key risks and the resources in place to control and monitor those risks.

The system of internal financial control is subject to scrutiny by management and internal audit, the head of which reports to the Governor. An internal audit programme is prepared annually, based on risk analysis, and is approved by the Management Committee and the Audit Committee. Monitoring the effectiveness of internal financial control is undertaken by the Audit Committee, which receives regular reports from management, from internal audit and, where appropriate, from the external auditors. It reviews the activities of the internal and external auditors to ensure comprehensive audit coverage.

On behalf of Court, the Audit Committee has reviewed the effectiveness of the system of internal financial control which operated during the period covered by this Annual Report.

The external auditors, Coopers & Lybrand, have confirmed that in their opinion, with respect to the Directors' statement on internal financial control above, the statement is not inconsistent with the information of which they are aware from their audit work on the financial statements. They were not required to perform the additional work necessary to, and did not, express any opinion on the effectiveness of the Bank's system of internal financial control.

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 28 February 1997 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.

DIRECTORS' REPORT

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 47 to 49.

Employee involvement

See Personnel section on pages 47 to 49.

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 97% of its bills within these timescales, compared with 94% in 1995/96 and 88% in the previous year.

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 of one per cent of its pre-tax profit to the community. During 1996/97, the Bank contributed £1,558,000 (1.3% of pre-tax profit) 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. £324,000 was donated to registered charities and £180,000 to other organisations, whilst the cost of community secondments and subsidised accommodation totalled £1,054,000. The Bank matched, on a £1 for £1 basis, the £60,600 donated by staff and pensioners to registered charities under the payroll giving scheme (Give As You Earn). It also matched £39,316 of Bank staff fund-raising.

No donations have been made for political purposes.

Auditors

Coopers & Lybrand will continue as auditors of the Bank.