Bank of England

Annual Report 1999

Contents

Eddie George, Governor

Governor's Foreword

Life at the Bank of England is rarely dull, but the past year has presented some particular challenges. Institutionally, we have had to adapt to our new role in the implementation of monetary policy and the transfer of our earlier responsibility for banking supervision, together with some 450 members of our staff, to the Financial Services Authority, as well as to new governance arrangements under the Bank of England Act which came into effect on 1 June 1998. Meanwhile, both the domestic and international economic situations have been marked by pronounced and protracted imbalances, which have complicated our twin tasks of maintaining monetary and financial stability. And technically we have needed both to prepare ourselves, and help the rest of the financial sector to prepare, for the introduction of the euro, and now prospectively for the millennium. I am grateful to my fellow members of Court, to our Executive and Deputy Directors, to all the members of the Monetary Policy Committee, and not least to the Bank staff, for all that they have done in their respective roles to help us to meet these various challenges.

To begin with the domestic economy, it was apparent, certainly from early 1997, that overall demand and output growth needed to moderate if we were to avoid capacity constraints and a rise in inflation. That was the background to the tightening of monetary policy which continued through the middle of 1998. Throughout that period we were acutely conscious that the strength of sterling – for reasons that were never entirely clear – was already creating difficult trading conditions for the internationally exposed sectors of the economy. And we allowed for that in our projections of overall demand pressure. But right up to last summer there was evidence of increasing tightness in the labour market, reflected in increasing skills shortages and recruitment difficulties, in the employment and unemployment data and in gradually rising pay settlements as well as in the available earnings data. So, if we were to adhere to the Government's inflation target, we could not avoid tightening monetary policy to moderate the growth of domestic demand, even though we recognised that this would be likely to increase the pressure on those exposed sectors.

Into the autumn there were signs that the domestic economy was beginning to slow, and sterling's exchange rate started to ease in the run-up to the introduction of the euro. But at much the same time the world economic environment changed abruptly. Whereas the earlier Asian financial crisis by itself had seemed likely to have a limited impact on the world economy, the financial collapse in Russia, and the subsequent losses incurred by LTCM, an unusually highly-geared hedge fund, had a more dramatic effect on financial market fragility, which was compounded by deepening recession in Japan and increasing uncertainties in Brazil and elsewhere.

The low point, in terms of general financial confidence came at around the time of the IMF and World Bank annual meetings in Washington in October, since when there have been significant improvements on a number of these fronts. The ensuing challenge has been to cope with the economic after-effects of the financial disturbances, which have resulted in major imbalances both between the emerging countries and the industrial world and within these respective groups.

For the UK these developments added to the existing pressures on many of the internationally exposed sectors, both through their direct impact on external demand, and through their exchange rate effects – which have included a persistent depreciation of the euro since its introduction. Business confidence weakened sharply through the latter part of last year, as also did consumer confidence in this country. The prospect of a necessary slowdown in overall demand growth to keep inflation on track risked turning into an unnecessary downturn with a prospective undershooting of the inflation target. The Monetary Policy Committee accordingly reacted by reducing interest rates aggressively from October - by $2^1/_4$% to $5^1/_4$% - by the time of publication of this report. As a result the risk of an overall downturn has been substantially reduced. We are now reasonably confident that the slowdown of activity and employment growth in the economy as a whole will be relatively short-lived, and that we will return to around trend growth next year.

Through this action we have, I believe, demonstrated convincingly the merits of a symmetrical inflation target, delivering on the promise made in a speech to the TUC last September that we would be just as vigorous in cutting rates if the evidence pointed to undershooting the target as we had been in raising rates when the balance of risks was on the upside. But we are for the time being still having to cope as best we can with the painful imbalance between the different sectors of the economy which largely reflects the disequilibrium in the world economy.

It was, of course, a considerable wrench last year to say goodbye to over 450 staff who, under the Government's bold plan to reform the regulation of the financial services industry, left the Bank as part of the transfer of responsibility for banking supervision to the Financial Services Authority (FSA) from 1 June 1998. Most of them remained in the Bank until near the end of the year, when their premises in Docklands were ready to receive them. But I am glad to report that the Bank and the FSA have made a splendid start in co-operating in their respective tasks of ensuring systemic stability in the financial system and of supervising individual institutions. This has been done within the framework of the Memorandum of Understanding between the Bank, the FSA and the Treasury, which – as I described in last year's report – sets out our responsibilities and those of the other parties. It has been much helped by the close personal relationships between the Bank and the FSA at a number of levels, including the most senior. Howard Davies, Chairman of the FSA, sits on our Court of Directors, and David Clementi, one of our Deputy Governors, sits on the FSA Board.

During the course of the year we saw some real examples of potential systemic risk arising out of the emerging markets financial crisis, particularly after the events of the autumn mentioned earlier. For a brief period investors' attempts to cut their exposures to all but the best credits, and then only in highly liquid instruments, threatened to engulf the industrial as well as emerging world in a serious credit crunch. Such fears were not, thankfully, realised, but they pointed up the potential problems.

In these and other areas, such as payments systems, the Bank continued to develop its capacity to identify and address emerging threats which might have a disruptive effect on the financial system as a whole rather than on individual financial institutions. We set up an internal Financial Stability Committee paralleling, in the field of financial stability, the work of the Monetary Policy Committee. It oversees the Bank's work in the financial field and feeds in to the three way consultative process under the Memorandum of Understanding with the Treasury and the FSA. It feeds in, too, to the Bank's continuing very close involvement with the Bank for International Settlements, the IMF and the new Financial Stability Forum, with governments and other central banks, and with other regulatory bodies and financial institutions, monitoring and containing threats to the global financial system. It would be wrong to make light of the events of last autumn, but there is no doubt that the risks to financial stability have subsequently diminished.

There was one historic event at the beginning of this year in which the UK did not participate directly, but in which the Bank was deeply involved. This was of course the introduction of the single currency among 11 of the 15 countries in the European Union. The Chancellor had already announced in October 1997 that the UK would exercise its opt-out and not participate in the first wave. Had we in fact done so, it would have seriously complicated the operation of monetary policy both for the Eurozone countries and for ourselves, not least because of the continuing cyclical divergence between us.

In the event, the years of detailed preparation resulted in a technically triumphant changeover weekend at the New Year, a tribute to the skills of Europe's central banks, including the European Central Bank. I fully share the confidence of my European colleagues that, despite its present weakness in foreign exchange markets, the euro is destined over time to become a widely-used international trading, portfolio and reserve currency alongside the dollar.

A necessary condition for this is the integration of Europe's financial markets, of which London is the biggest international centre by far, and a major trading market in the currencies that joined the euro. This is why the City of London, with the advice and detailed help of the Bank, put such a sustained effort into preparing its wholesale markets for the advent of the euro. Our work included *Practical Issues Arising from the Introduction of the Euro*, a highly successful publication from the Bank, which we know was read intensively in all the Continental financial centres as well as in the London markets. I am glad to report that Practical Issues will continue to appear twice a year to contribute to the UK's policy of 'prepare and decide' ahead of a referendum on whether to join monetary union. As a result of all this effort, the New Year changeover weekend went exceptionally smoothly in London. The essential euro payments, settlements and market infrastructure is now in place, as the foundation for the development of truly pan-European markets. Whether the UK is in or out, the City of London's broad and liquid markets in the euro are an asset for the whole of Europe.

In much the same way the Bank has been preparing itself, and helping, with the FSA, to prepare the financial sector, for the millennium at the end of this year. Our work in this context is communicated through another regular publication, *Financial Sector Preparation for the Year 2000* launched in February 1998. It aims to draw attention to the key issues and to provide information on the progress made by the financial system and its key service providers in addressing those issues. I am pleased to report that our own systems are now millennium compliant, and that we have now turned our attention to contingency planning and to the possible need for exceptional liquidity provision over the year end.

The Bank has seen a number of significant changes in its governance as a result of the 1998 Act, including an increase in the number of non-executive Directors and a new structure for the Court of Directors. I would in particular like to thank Dame Sheila Masters, who was nominated by the Chancellor last summer as Chairman of the sub-committee of non-executive Directors, for all the excellent work she has done in preparing for, and setting up, her new committee, and in guiding it through its first annual report, which reviews the performance of the Bank and the procedures of the MPC. You will see on page 60 that under the Act the sub-committee's report is published as a part of our Annual Report.

I was very pleased last summer to welcome Roy Bailie, Graham Hawker, Sheila McKechnie, Bill Morris and Jim Stretton as new members of Court. I would of course like to thank Sir David Lees and Sir Colin Southgate who retire from Court at the end of this month after eight years of outstanding service. I am very grateful indeed for all they have done for the Bank.

Alan Budd has decided not to seek reappointment to the Monetary Policy Committee when his term expires on 31 May. I would like to thank him for the strong contribution he has made to the Committee in its first two years and I wish him well in his new role as Provost of Queen's College, Oxford. In his place, I am very pleased to welcome Dr Sushil Wadhwani with effect from 1 June.

A number of senior staff have retired this year and I would like to thank them all for their long and valuable service, especially Graham Kentfield, our Chief Cashier since 1991.

Finally, I would like again to record my thanks to all our staff, who have been through a period of rapid change, not least of which was the departure of so many of their colleagues to the FSA in Docklands. This is now necessitating upheavals of a different kind, in that the departures allow us to bring most of our London staff back into the headquarters building, and that requires an extensive refurbishment over the next couple of years, which will inevitably cause some disruption for those who work here. I am sure staff will bear with us while these essential modifications are carried out. I have to say that with our new responsibilities, Bank staff have taken on a far greater workload, and I am very grateful indeed for their continued loyalty and support which has allowed us to achieve so much in the last two years and which is vital to carrying forward our task into the new millennium.

E. A. J. George

Governor of the Bank of England

Bank of England Act 1998

The Bank of England Act 1998 received Royal Assent on 23 April 1998 and came into force on 1 June 1998. It gives legislative force to the major changes to the Bank's powers, responsibilities, governance and financial framework, which were announced by the Chancellor of the Exchequer in May 1997.

The Bank of England Act 1998 provides a statutory basis for the functions of the Monetary Policy Committee and transfers responsibility for the supervision and surveillance of banks from the Bank to the Financial Services Authority. The governance of the Bank is changed by the Act, which also makes new provision relating to the funding, the accounts and the profits of the Bank. The collection of monetary statistics is backed by legislation for the first time.

Monetary stability

The Act provides that the Bank's objectives in relation to monetary policy shall be to maintain price stability and, subject to that, to support the Government's economic policies, including its objectives for growth and employment. At least once a year, the Government is to specify what price stability is to be taken to consist of and what the Government's economic policy is to be taken to be. Also in relation to monetary policy, the Government's power to direct the Bank, first taken in the 1946 nationalisation, is withdrawn, although the Act provides for directions to be given in 'extreme economic circumstances'. The Act establishes the Monetary Policy Committee (MPC) as a committee of the Bank, and sets a framework for its operations. The Bank is given for the first time a statutory power to collect information for monetary policy purposes.

Financial stability

The Act provides for the transfer to the Financial Services Authority of the Bank's responsibilities for the supervision of individual banks. The Memorandum of Understanding between the Bank, the Treasury and the Financial Services Authority (FSA), published in October 1997, establishes that the Bank is responsible for the overall stability of the financial system as a whole, involving the stability of the monetary system, the financial system infrastructure, the overview of the system as a whole, the conduct in exceptional circumstances of official financial operations and the efficiency and effectiveness of the financial sector.

Governance

The Act makes changes to the Court of Directors, and to Court's role in the governance of the Bank. Changes to the composition of Court are described in detail on page 12. The Act provides for the creation of a sub-committee of the Directors, all of whom are non-executive, with a Chairman designated by the Chancellor. While Court as a whole is responsible for managing the affairs of the Bank, including setting its objectives and strategy, the sub-committee of Directors is responsible for reviewing the Bank's performance in relation to objectives and strategy, and monitoring the extent to which the Bank's financial management objectives are met. The sub-committee also reviews the procedures followed by the MPC. The non-executive Directors make their own report as part of the Bank's Annual Report. It is included in this Report on pages 60-61.

Financial framework

The Act makes new provision relating to the funding and reporting arrangements of the Bank. The cash ratio deposits scheme, under which the Bank has been partly financed by the banking system on a voluntary basis, has been put on a statutory basis with the rate set by the Government, and extended to include building societies. For the first time, the Bank is required, by statute, to publish an Annual Report. The Act includes a formula in which the Bank's annual payment in lieu of dividend to HM Treasury will be 50% of post-tax profits, or such other sum as HM Treasury and the Bank may agree.

The Court of Directors

Members of the Court of Directors

Eddie George
Governor

David Clementi
Deputy Governor

Mervyn King
Deputy Governor

Dame Sheila Masters, DBE
Appointed to Court in March 1994. Appointed Chairman of the sub-committee of Directors in June 1998. Dame Sheila is a Partner at KPMG.

Sir David Lees
Appointed in March 1991. Sir David is Chairman of GKN plc.

Sir David Cooksey
Appointed in March 1994. Sir David is Chairman of Advent Limited.

Sir Neville Simms
Appointed in March 1995. Sir Neville is Group Chief Executive & Deputy Chairman of Tarmac plc.

John Neill, CBE
Appointed in March 1996. Mr Neill is Deputy Chairman and Group Chief Executive of Unipart Group of Companies.

Roy Bailie, OBE
Appointed in June 1998. Mr Bailie is Chairman of W&G Baird (Holdings) Limited.

Graham Hawker, CBE
Appointed in June 1998. Mr Hawker is Chief Executive of Hyder plc.

Sheila McKechnie OBE
Appointed in June 1998. Ms McKechnie is Director of the Consumers' Association.

Sir Colin Southgate
Appointed in March 1991. Sir Colin is Chairman of EMI Group plc.

Frances Heaton
Appointed in March 1993. Mrs Heaton is a Director of Lazard Brothers & Co., Limited.

Sir Chips Keswick
Appointed in March 1993. Sir Chips is an Adviser, Banking and Capital Markets, at SG Hambros.

Andrew Buxton
Appointed in March 1997. Mr Buxton is Adviser at Barclays Bank, Middle East & North Africa.

Christopher Allsopp
Appointed in June 1997. Mr Allsopp is a Fellow in Economics, New College, Oxford.

Howard Davies
Appointed to Court as Deputy Governor in September 1995. Resigned in July 1997. Reappointed to Court in March 1998. Mr Davies is Chairman of The Financial Services Authority.

Bill Morris
Appointed in June 1998. Mr Morris is General Secretary of the Transport and General Workers Union.

Jim Stretton
Appointed in June 1998. Mr Stretton is Director and Chief Executive of UK Operations, Standard Life Assurance Company.

Members of the Court of Directors

Additional information

Eddie George
Governor

David Clementi
Deputy Governor

Mervyn King
Deputy Governor

Dame Sheila Masters, DBE
Partner, KPMG.
Member of Court, Worshipful Company of Chartered Accountants.
Governor, London Business School.
Deputy President, Institute of Chartered Accountants in England and Wales.
Trustee, Reuters Founder Share Company.

Sir David Lees
Chairman, GKN plc.
Chairman, Tate & Lyle plc.
Director, Royal Opera House.

Sir David Cooksey
Chairman, Advent Limited.
Governor, The Wellcome Trust.
Chairman, Bespak plc.
Chairman, William Baird plc.

Sir Neville Simms
Group Chief Executive and Deputy Chairman, Tarmac plc.
Chairman, Major Contractors Group.
Director, National Power plc.

John Neill, CBE
Deputy Chairman and Group Chief Executive, Unipart Group of Companies.
Director, Board of RAC.
Director, Business in the Community Limited.
Director, Charter plc.
Director, National Railway Supplies (Holdings) Limited.
Director, UGC Limited.
Director, Unipart Group Limited.
Director Unipart Rail Holdings Limited.
Vice-President, Council Member and Executive Committee Member, Society of Motor Manufacturers and Traders Limited.

Roy Bailie, OBE
Chairman, W&G Baird (Holdings) Limited.
Director, W&G Baird Limited.
Director, MSO Limited.
Director, Biddles Limited.
Director, Textflow Services Limited.
Director, The Thanet Press Limited.
Non-Executive Chairman, Northern Ireland Tourist Board.
Non-Executive Director, UTV (Ulster Television).

Graham Hawker, CBE
Chief Executive, Hyder plc.
Director, Business in the Community (Wales).

Sheila McKechnie OBE
Director, Consumers' Association.
Member, Inland Revenue's Tax Law Rewrite Steering Committee.
Director, International Consumer Research & Testing Limited.
Chief Executive, Which? Limited.

Sir Colin Southgate
Chairman, EMI Group plc
Chairman, Royal Opera House.
Trustee, The National Gallery.

Frances Heaton
Director, Lazard Brothers & Co., Limited.
Deputy Chairman, W S Atkins plc.
Director, The British United Provident Association Limited.

Sir Chips Keswick
Adviser, Banking and Capital Markets, SG Hambros.
Director, AA plc.
Director, Anglo American Corporation of South Africa Limited.
Director, De Beers Consolidated Mines Limited.
Director, The Edinburgh Investment Trust plc.
Director, IMI plc.
Director, Persimmon plc.

Andrew Buxton
Adviser, Barclays Bank, Middle East & North Africa.
President, British Bankers' Association.
Member, HMT Standing Committee on EMU Preparations.
Governor, Imperial College of Science, Technology & Medicine.

Christopher Allsopp
Fellow in Economics, New College, Oxford.
Editor, Oxford Review of Economic Policy.

Howard Davies
Chairman, The Financial Services Authority.

Bill Morris
General Secretary, Transport and General Workers Union.
Member, Council of the Advisory, Conciliation and Arbitration Service.
Joint-Chair, National Trade Union and Labour Party Liaison Committee.
Member, TUC General Council.
Member, TUC Executive Committee.
Chairman, TUC Representation at Work Task Group.
Member, Board of Governors, South Bank University.

Jim Stretton
Director and Chief Executive, UK Operations, Standard Life Assurance Company.
Director, Edinburgh International Festival Limited.
Member, Court of the University of Edinburgh.

The governance and accountability of the Bank was greatly strengthened by the Bank of England Act 1998, which reformed the constitution and duties of the Court of Directors. Under the Act, the responsibilities of Court are to manage the Bank's affairs other than the formulation of monetary policy, which is the responsibility of the Monetary Policy Committee. This includes determining the Bank's objectives and strategy, and aiming to ensure the effective discharge of the Bank's functions and the most efficient use of the Bank's resources. Court must meet at least once a month.

Until the Act came into force on 1 June 1998, Court consisted of the Governor, the Deputy Governor and 16 Directors, four of whom had executive responsibilities in the Bank. Members of Court were appointed by the Crown - the Governors for five years and the Directors for four years. The 1998 Act provides for Court to consist of the Governor, two Deputy Governors and 16 Directors. The Directors are non-executive. The Governors are appointed by the Crown for five years and the Directors for three years, although the initial terms of some of the Directors is less than three years to ensure that the terms of office of all the Directors do not expire at the same time. The Executive Directors ceased to be members of Court.

Directors

When the Act came into force on 1 June 1998, the 11 serving non-executive Directors were appointed to the reconstituted Court: Dame Sheila Masters, Sir David Lees, Sir Colin Southgate, Frances Heaton, Sir Chips Keswick, Sir David Cooksey, Sir Neville Simms, John Neill, Andrew Buxton, Christopher Allsopp and Howard Davies. Five new Directors were appointed: Roy Bailie, Graham Hawker, Sheila McKechnie, Bill Morris and Jim Stretton. Mervyn King, an Executive Director, was appointed a Deputy Governor. The other three Executive Directors ceased to be members of Court. Alastair Clark and Ian Plenderleith remained Executive Directors of the Bank. Michael Foot left to take up his responsibilities at the Financial Services Authority.

Statements on the responsibilities of the Court of Directors in relation to the financial statements, internal controls and risk management are given in the Report from Members of Court on pages 50-59. The main committees of Court during 1998/99 are given below.

Sub-committee of the Court of Directors

The Act stipulates that the 16 Directors of the Bank will form a sub-committee of Court. The Chancellor of the Exchequer has designated Dame Sheila Masters to chair the sub-committee, and to chair Court in the Governor's absence, as provided for by the Act. The sub-committee is known as NedCo. The functions of NedCo include reviewing the Bank's performance in relation to its objectives and strategy, monitoring its financial management, reviewing its internal financial controls and determining the Governor's and Deputy Governors' remuneration and pensions. The Act also requires the sub-committee to determine the terms and conditions of service of the four members of the Monetary Policy Committee (MPC) appointed by the Chancellor of the Exchequer. NedCo has agreed that the Remuneration Committee should recommend the salaries and pensions of the Governors and the members of the MPC appointed by the Chancellor. NedCo is also responsible for reviewing the procedures of the MPC, and in particular whether the Committee has collected the regional, sectoral and other information necessary for formulating monetary policy. NedCo is required to make a report as part of the Bank's Annual Report. The report is on pages 60-61.

Remuneration Committee

The members of the Remuneration Committee during 1998/99 were Sir Colin Southgate (Chairman), Dame Sheila Masters, Sir David Lees, Frances Heaton, Sir Chips Keswick and Sir David Cooksey. The Governor may be invited to attend meetings that do not consider his own remuneration. Court's report on remuneration is on pages 45-49.

Audit Committee

Sir David Lees (Chairman) and Sir Neville Simms were members of the Audit Committee throughout 1998/99. Sir David Cooksey and Dame Sheila Masters served until 15 July 1998. John Neill, Andrew Buxton and Graham Hawker joined the Committee with effect from 15 July 1998. The Deputy Governor (Financial Stability), the Finance Director and the Auditor normally attend the meetings of the Committee.

The functions of the Audit Committee are to:-

a/ Keep under review the internal financial control in the Bank.

b/ To receive reports from, and review the work of, the internal and external auditors. The Committee also considers and makes recommendations on the appointment of the external auditors, and their fees.

c/ 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.

Both the Remuneration Committee and the Audit Committee support NedCo in the discharge of its functions under the Bank of England Act 1998.

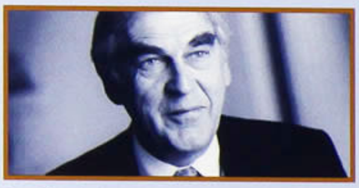
The Executive and Senior Management

Governor's Committee

Eddie George, Governor

David Clementi, Deputy Governor, Financial Stability

Mervyn King, Deputy Governor, Monetary Stability



Ian Plenderleith, Executive Director, Financial Market Operations

Alastair Clark, Executive Director, Financial Stability

John Vickers, Executive Director, Monetary Analysis and Statistics

Management Committee

David Clementi, Deputy Governor, Financial Stability

Bill Allen, Deputy Director, Market Operations

John Footman, Director of Personnel

Nigel Jenkinson, Deputy Director, Monetary Analysis and Statistics

Merlyn Lowther, Deputy Director, Banking and Market Services and Chief Cashier

Gordon Midgley, Finance Director

Paul Tucker, Deputy Director, Financial Stability

Under the Court of Directors, the Bank's senior policy-making body is Governor's Committee comprising the Governors and Executive Directors. The internal management of the Bank is the responsibility of Management Committee, comprising the Deputy Governor (Financial Stability), the Deputy Directors, the Finance Director and the Director of Personnel.

During the year, there have been a number of executive and senior management appointments, which have resulted in changes in the membership of the Committees. Current membership is shown opposite. Following the implementation of the Bank of England Act, John Vickers succeeded Mervyn King as an Executive Director when the latter took up his appointment as a Deputy Governor. Michael Foot, the Executive Director responsible for Supervision and Surveillance, and Oliver Page, the Deputy Director responsible for Supervision and Surveillance, left Governor's Committee and Management Committee respectively when they took up their responsibilities at the Financial Services Authority.

John Townend was appointed Director for Europe, reporting directly to the Governors. He was succeeded by Bill Allen as Deputy Director, Market Operations. Nigel Jenkinson was appointed Deputy Director, Monetary Analysis and Statistics in place of Bill Allen. Following Graham Kentfield's retirement at the end of 1998, Merlyn Lowther was appointed Chief Cashier and Deputy Director, Banking and Market Services. John Footman was appointed Director of Personnel and Paul Tucker was appointed Deputy Director, Financial Stability in place of John Footman.

Management structure

The Bank's management structure and Heads of Function are shown in the organisation chart on page 18. The responsibilities of each area are described in more detail on pages 16-17. This structure, based on three main operational areas - Monetary Analysis and Statistics, Financial Market Operations and Financial Stability - supported by Central Services, was introduced in June 1998 to reflect the Bank's new responsibilities following the commencement of the Bank of England Act.

Since the Act came into force, the Bank has been working to strengthen its capabilities in a number of areas and this has led to some refinements to the management structure. In Monetary Analysis, an International Economic Analysis Division was created in March 1999. It brought together the economists who are responsible for the analysis of global economic developments and of EMU developments insofar as they impact on UK monetary policy. Also in March, the economists from the Inflation Report Division transferred to the divisions within Monetary Analysis which have greatest responsibility for the individual sections of the *Inflation Report*, with a view to strengthening the synergies between the work of the divisions and the Report; the Inflation Report Division ceased to exist as a separate division. In the Financial Stability area, the International Finance Unit, which was created in July 1998 to analyse developments in the emerging market economies and the functioning of the international monetary system, became a full division in January 1999 reflecting the importance of its work and the increased resources devoted to it. At the same time, the work of the Market and Trading Systems Division on the structure of trading systems was merged with the work of Payment and Settlement Policy Division, including its work on the structure of clearing and settlement systems, and with City Group, to form a new Market Infrastructure Division. Finally, the work of Business Finance Division was expanded to include analysis of personal sector developments relevant to financial stability. The Division was renamed Domestic Finance Division to reflect its broader scope.

Following the launch of the euro, much of the work of the Euro Preparation Division has come to fruition. It has been superseded by the Co-ordination Unit for Europe under the newly-appointed Director for Europe.

Organisation Overview

Monetary Analysis and Statistics

International Economic Analysis
Structural Economic Analysis
Monetary Instruments and Markets
Monetary Assessment and Strategy
Conjunctural Assessment and Projections
Regional Agencies
Monetary and Financial Statistics
Centre for Central Banking Studies

The Monetary Analysis divisions are responsible for providing the Bank with the economic analysis it needs to discharge its monetary policy responsibilities. Its economists conduct research and analysis of current developments in the UK and international economies. They produce the *Quarterly Bulletin* and the quarterly *Inflation Report*, which sets out the Monetary Policy Committee's assessment of the current monetary and economic situation in the UK and of the outlook for inflation and growth. The work of the divisions, including reports from its 12 regional Agencies, provides the analytical information for the interest rate decisions taken each month by the Bank's Monetary Policy Committee. The Monetary and Financial Statistics Division compiles, publishes and briefs on financial statistics; in particular the monetary aggregates and banking statistics. Special studies directed at international harmonisation and improvements to the statistics are also a feature of the work. The Centre for Central Banking Studies provides technical assistance and training to overseas central banks.

Financial Market Operations

Gilt-Edged and Money Markets
Foreign Exchange

Banking Services
Market Services
Registrar's Department

The Market Operations divisions plan and conduct the Bank's operations in the core financial markets, in particular the money market, to establish short-term interest rates at the level required by monetary policy. They also manage the UK's foreign exchange and gold reserves as agent for HM Treasury. They contribute market analysis and intelligence to the Monetary Policy Committee and the Financial Stability Committee and, in line with the Bank's core purposes, they seek to promote efficient structures in these markets.

The Banking and Market Services divisions provide banking services to the Government and other customers, principally banks and other central banks. They manage the note issue. They also play a key role in the provision of safe and efficient payment and settlement services for the UK markets and for the country as a whole. The Registrar's Department provides the principal stock registration service for the Government.

Financial Stability

Financial Intermediaries
Domestic Finance
International Finance
Regulatory Policy
Market Infrastructure

The Financial Stability divisions discharge the Bank's responsibility for maintaining the stability of the financial system as a whole. The Financial Stability Committee acts as a focus for the Bank's work in this area. The Committee is chaired by the Governor. Its other members are David Clementi, Mervyn King, Alastair Clark, Ian Plenderleith, John Vickers, Professor Richard Brealey and Paul Tucker. The work of the Financial Stability divisions primarily relates to the UK markets, but also embraces international perspectives. The divisions identify, analyse and carry out research into developments relevant to the structure and functioning of the financial system and make policy proposals and encourage changes designed to increase its safety and effectiveness. The divisions also contribute to the monetary policy process, for example through the Bank's Deputy Governor for Financial Stability, and provide input to international policy issues such as payments systems and business finance. Their analysis is used to promote public understanding of issues in financial stability through, for instance, the regular *Financial Stability Review.*

Co-ordination Unit for Europe

The Co-ordination Unit for Europe is responsible for co-ordinating the Bank's work on Europe, which is carried out by each of the Bank's main operational areas. It takes a lead on the issues that affect the Bank as a whole but which do not fall within the ambit of any of the operational areas. It is also responsible for co-ordinating the Bank's involvement with the European Central Bank, other EU central banks and the EU Economic and Financial Committee. It maintains contact with, and provides technical information to, financial institutions operating in euro markets and with responsibility for euro infrastructure.

Audit

Internal Audit is an independent function empowered by the Court of Directors to review the adequacy of the internal control systems within the Bank and to test compliance with agreed procedures. It aims to provide an independent view for Directors and senior managers, to assist in the effective discharge of their responsibilities and to provide a service to the organisation as a whole.

Central Services

Personnel
Secretary's Department
Finance and Resource Planning
Investment Unit
Management Services
Property Services and Security

The Central Services divisions encompass a range of support functions that underpin the Bank's activities and help to ensure that the Bank's reputation is maintained. These include finance, IT, personnel, the Governors' private offices, press and public relations and information services.

Legal Unit

The Legal Unit provides legal advice to the Governors, Directors and other officers of the Bank on the discharge of their responsibilities and of the Bank's functions under the Bank of England Acts 1998 and 1946 and the Bank's constitution generally. It also advises on specific Community law and Economic and Monetary Union legal issues, and may provide legal advice or counsel in relation to legal advice, to line management on business matters when its assistance is sought.

Printing Works

In addition to printing all the Bank's notes, the Printing Works manufactures its own inks, security threads and printing plates. Its expertise in these areas has led to commercial sales in overseas markets through Debden Security Printing Limited (DSP), the Bank's wholly-owned commercial subsidiary. The Printing Works' site also includes a Returned Note operation which, using high-speed sorting machines, authenticates used notes returned by the commercial banks prior to destruction. In the summer of 1999, the Printing Works will open a new, purpose-built cash centre to take over physical cash operations from Head Office.

Kevin Butler
Auditor

Eddie George
Governor

Mervyn King
Deputy Governor
Monetary Stability

David Clementi
Deputy Governor
Financial Stability

Alex Jarvis
General Manager
Printing Works

Monetary Analysis and Statistics

John Vickers
Executive Director

Nigel Jenkinson
Deputy Director

Andrew Bailey
International Economic Analysis

Ian Bond
Structural Economic Analysis

Roger Clews
Monetary Instruments and Markets

Spencer Dale
Monetary Assessment and Strategy

Neal Hatch
Conjunctural Assessment and Projections

Agencies

Philip Turnbull
Monetary and Financial Statistics

Maxwell Fry
Centre for Central Banking Studies

Financial Market Operations

Ian Plenderleith
Executive Director

Bill Allen
Deputy Director

Peter Andrews
Gilt-Edged and Money Markets

Clifford Smout
Foreign Exchange

Merlyn Lowther
Deputy Director and Chief Cashier

John Bartlett
Banking Services

Christopher Mann
Market Services

Geoff Sparkes
Registrar's Department

Europe

John Townend
Director for Europe

Co-ordination Unit for Europe

Financial Stability

Alastair Clark
Executive Director

Paul Tucker
Deputy Director

Alex Bowen
Financial Intermediaries

Peter Brierley
Domestic Finance

Andy Haldane
International Finance

Patricia Jackson
Regulatory Policy

John Trundle
Market Infrastructure

Central Services

Gordon Midgley
Finance Director
Finance and Resources

Michael Craig
Investment Unit

Colin Mann
Management Services

David Pennington
Property Services and Security

John Footman
Director of Personnel

John Matheson
Personnel

Peter Rodgers
Secretary of the Bank

Advisers to the Governors

Len Berkowitz
Legal

Professor Richard Brealey
Financial Stability

Sir Peter Petrie
European and Parliamentary Affairs

The Bank's Core Purposes

The Bank's Core Purposes now form a part of the objectives and strategy of the Bank determined by the Court of Directors under Section 2 of the Bank of England Act 1998. They are reviewed each year and supplemented by an annual statement of Bank Objectives. The Bank Objectives for 1999/00 are set out on page 36 of this Report. The Bank Objectives for 1998/99 are set out in last year's Annual Report and the Bank's performance in relation to them and its Core Purposes is reviewed on pages 20-29 of this Report.

The three 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 Bank as a whole.

1/ Maintaining the integrity and value of the currency

Above all, this involves maintaining price stability, as defined by the inflation target set by the Government, as a precondition for achieving the wider economic goals of sustainable growth and employment. The Bank pursues this core purpose through its decisions on interest rates taken at the monthly meeting of the Monetary Policy Committee; by participating in international discussions to promote the health of the world economy; by implementing monetary 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

This the Bank seeks to achieve through monitoring developments in the financial system both at home and abroad, including the links between individual institutions and between financial markets; and through analysing the health of the domestic and international economy; through close co-operation with financial supervisors both domestically and internationally; and through promoting sound financial infrastructure including efficient payment and settlement arrangements. In exceptional circumstances, in consultation with the Financial Services Authority and HM Treasury as appropriate, the Bank may also provide, or assist in arranging, 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 Bank wants 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. It 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 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 United Kingdom. But 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.

Review of Performance
against Objectives and Strategy

The Bank of England Act 1998 requires the Court of the Bank to determine the Bank's objectives (including objectives for its financial management) and strategy. It also requires the sub-committee of non-executive Directors of the Bank to keep under review the Bank's performance in relation to its objectives and strategy and to monitor the extent to which the objectives set for the Bank's financial management have been met.

The objectives and strategy for 1999/00, together with the objectives for financial management, are set out on page 19 and page 36 of this Report. Next year's Annual Report will provide an assessment of the Bank's performance against them.

The Bank's Core Purposes and Strategic Objectives for 1998/99 were set by Court in November 1997, before the Bank of England Act 1998 had come into force, and were published in last year's Annual Report. Following the coming into force of the Act, the new Court decided that the Core Purposes and Bank Strategic Objectives as published in last year's Report, taken together, should be adopted as the Bank strategy and objectives for 1998/99 for the purposes of the Act.

This section of the Report provides an account of the Bank's activities during 1998/99 by reference to the Core Purposes and those Objectives, which are highlighted in the text.

MAINTAINING THE INTEGRITY AND VALUE OF THE CURRENCY

The Bank's first Core Purpose relates to the integrity and value of the currency. Relevant functions include the interest rate decisions taken by the Monetary Policy Committee (MPC) in pursuit of the inflation target set by Government, the implementation of monetary policy decisions through market operations and other dealings with the financial system, participating in international discussions to promote the health of the world economy, and maintaining confidence in the note issue.

The inflation target

The monetary policy objective is given by the Bank of England Act 1998 - **to maintain price stability and, subject to that, to support the economic policy of HM Government including its objectives for growth and employment**. The Government has defined the price stability objective in terms of a target for inflation of 2.5% on the RPIX measure. Should inflation move more than 1% either side of the target the Governor would be required to write an open letter explaining the variance and stating how the MPC intended to remedy the situation.

The MPC's processes are described on pages 30-35 of this Report and the background to the MPC's decisions are provided in the published minutes of their monthly meetings and in the *Inflation Report*. **During most of the year under review the rate of inflation has been very close to the target. The MPC's central projection for inflation, published in the May 1999 *Inflation Report*, is also around the target level, although that central projection is surrounded by considerable uncertainties.**

Building public support for price stability

Beyond the Government's remit, Court set the Bank two specific objectives, both reflecting an awareness that the task of maintaining price stability would be achieved more easily, and at a lower cost, if the Bank could enlist the widest possible public understanding and support for its objectives and actions. These objectives were **to build public support for low inflation and monetary stability;** and **to increase public awareness of the Bank's analysis of the economy**.

The Bank's *Inflation Report* has continued to identify and explain key issues affecting monetary policy; it is one of the means by which monetary policy is made transparent. Another is the publication of the minutes of the MPC, and during the year the MPC decided to bring forward publication to within two weeks of each policy meeting.

The Governors and other members of the MPC have undertaken substantial programmes of speeches and interviews. The Governor and other members of the MPC gave evidence to the Treasury Committee of the House of Commons on five occasions and to the new House of Lords Committee on the Monetary Policy Committee of the Bank of England on three occasions. The Bank also has a programme for developing links with Members of Parliament based on briefing sessions for small groups of MPs hosted by the Governors and other senior executives.

During the year the Bank announced its intention to publish its suite of economic models, with the aim of making the process of policy formulation even more transparent. Publication of a book, *Economic Models at the Bank of England*, took place in April 1999. In addition, Bank staff under the guidance of the MPC have published a paper on the transmission mechanism of monetary policy, in response to suggestions by the two Parliamentary Select Committees mentioned above.

The Bank continues to support the teaching of Economics and Business Studies in schools and universities. Economists from the Bank have run further regional seminars to keep secondary school teachers up to date on developments in monetary policy. Close links are also maintained with academic economists.

The Bank's Internet site carries the main material published by the Bank, including the *Inflation Report*, the minutes of the MPC and other key documents, speeches and announcements. During the year the site was accessed by an average of 1,500 visitors per day. In addition, the Bank has received an increasing number of requests for general information from the public and has dealt with over 53,000 telephone calls, 7,000 Internet messages and 1,300 letters during the year.

It is not easy to judge the effect of this activity. Much is investment for the long term and positive benefits will be slow to materialise. There are, however, some encouraging signs. As regards the credibility of policy, it is worth recording that financial market measures of inflation expectations have come down during the year to levels close to the inflation target. Those who follow the monetary policy debate have welcomed the transparency of the Bank's processes, and publication of the models will enhance that. The Bank's core message about price stability - that it is a necessary condition for sustainable growth in output and employment - is increasingly echoed in the media. But in this area of public perceptions it is much easier to measure activity than results. Mervyn King, the Bank's Deputy Governor for Monetary Stability, is leading an internal working party on "building a constituency for low inflation" and as part of this is reviewing possible means of assessing wider public awareness of the Bank's objectives and activities.

Supporting the Monetary Policy Committee

The MPC draws on support from the Bank - primarily from the Monetary Analysis and Statistics divisions but also from the Financial Market Operations and Financial Stability areas. The objective set by Court was **to provide the Monetary Policy Committee with the economic analysis required to set interest rates, and to strengthen further the Bank's understanding of the dynamics of the inflation process and the techniques of inflation control**.

The Bank's support for the MPC is described on pages 30-35 of this Report. The adequacy of this support, and the way it is delivered, has been kept under constant review, and the Bank has made a number of changes, including changes in response to the wishes of the MPC. These have included systematising the Agents' input to the MPC process, and increasing the amount of international analysis provided to the Committee. As described on page 32, a new International Economic Analysis Division was created in the Monetary Analysis area at the beginning of March 1999, and the new International Finance Division, created in the Financial Stability area to monitor emerging market problems, has been regularly involved in providing briefing to the MPC.

The pressures of the monthly MPC cycle have been intense and resources have been stretched. Budgeted analytical resources in Monetary Analysis have been increased, but recruitment of suitably-qualified people has been a relatively difficult process. Between May 1997 and February 1999, the number of staff in Monetary Analysis was targeted to rise by 20 but in the event rose by only 13, or 10%. One effect of this has been to divert resources from research work, which is needed to support policy in the longer term. For the current budget year a further increase in staffing is planned and considerable effort is being put into recruitment.

MAINTAINING THE STABILITY OF THE FINANCIAL SYSTEM

Responsibility for the regulation of banks, wholesale market institutions and netting systems passed to the Financial Services Authority (FSA) on 1 June 1998. The Bank now has no statutory powers of supervision. The Bank's continuing role in ensuring financial stability was described in the Memorandum of Understanding (MoU) published in October 1997. While the FSA is responsible for the regulation of all individual financial institutions and for regulatory action in respect of them, the Bank remains responsible for the overall stability of the financial system as a whole.

The Bank seeks to achieve this through monitoring developments in the financial system both at home and abroad, including the links between individual institutions and between financial markets; through analysing the health of the domestic and international economy; through promoting sound financial infrastructure including efficient payment and settlement arrangements; and through close co-operation with overseas central banks and the International Financial Institutions. Over the past year the last of these areas has been particularly active and the Bank was closely involved in discussions leading up to the formation of the international Financial Stability Forum, which met for the first time in Washington on 14 April. The Forum, which evolved from a proposal by the Chancellor of the Exchequer at the 1998 IMF autumn meetings, is intended to identify and keep under review many of the issues which contributed to last year's financial crisis and ways of preventing them recurring.

Relations with the FSA and other supervisory authorities

Achieving the Bank's objective in this area requires close co-ordination with the FSA and an objective for the year was **to maintain a close relationship with the Financial Services Authority and with central banks and other financial authorities overseas, and thereby to contribute to the debate on financial supervision and regulation from the point of view of the Bank's responsibility for systemic stability.**

An important focus of the new arrangements is the joint Treasury/Bank/FSA Standing Committee. This first met in March 1998 and has become a useful high-level forum for the exchange of information, as well as providing a means of co-ordinating intervention should specific problems in the financial sector need to be addressed.

Practical arrangements to encourage and manage the exchanges of information between the Bank and the FSA, provided for in both the Act and the MoU, were taken during the year with the agreement of a code of conduct for Bank and FSA staff.

The Bank has also co-operated closely with the FSA on the assessment of City exposure to the Year 2000 problem, described on page 24.

The Bank has participated alongside the FSA in the work of the Basle Supervisors Committee and in a number of its sub-groups.

David Clementi, the Bank's Deputy Governor for Financial Stability, is a member of the FSA Board, and

Howard Davies, Chairman of the FSA, is a member of the Bank's Court.

The relationship with the FSA is of critical importance to the Bank. It has got off to a good start with a clear statement of respective roles in the MoU and a willingness on both sides to work together.

Public awareness of financial stability issues

An objective set by Court was **to build public, political and market understanding of the systemic aspects of financial stability and the Bank's responsibility for the overall stability of the financial system as a whole**.

The Bank has pursued this aim through a series of speeches and publications, including the *Financial Stability Review*, two issues of which were published during the year. Systemic risks - which are key to the Bank's financial stability role - have been at the forefront of the debate, both in the context of immediate risks such as the euro weekend and the millennium changeover, more generally in the context of payment system reform, and especially in the international groups set up in the wake of the emerging market crises. The Bank for International Settlements has established a Financial Stability Institute to reflect the growing interest among central banks worldwide in these issues.

As with monetary stability, the impact of the Bank's work on public awareness of financial stability issues is hard to measure. Developing a clear and widely-understood definition of the brief will remain a priority.

Monitoring risks to financial markets

The Bank's objectives were **to monitor and analyse market and institutional developments both in the UK and overseas, which could pose a threat to monetary or financial stability, or impede the development of effective financial markets in the service of the wider economy; and to identify market failures in the functioning of the financial system and, where the Bank has relevant expertise, contribute to their resolution**.

This work has been overseen by the Bank's Financial Stability Committee (FSC), which was formed at the beginning of 1998 and has met monthly. The membership of the Committee is given on page 16. The year has seen severe pressures in financial markets, arising largely from problems in emerging markets, and during the year the Bank created a small International Finance Division to monitor emerging market countries and issues. The Bank was represented on all three of the "Willard" groups, which reviewed the international financial architecture during the year, and made a large contribution to their work. One of the groups was co-chaired by Mervyn King, the Deputy Governor for Monetary Stability. When market pressures reached their peak in September and October 1998, an internal working group examined the international and domestic evidence for a "credit crunch". The Bank has been involved in international discussions on the impact of hedge funds' activities on financial stability.

The new Financial Stability Committee is working well, and the Bank has made a substantial contribution especially to the analysis of international financial problems.

Payment and settlement systems reform

The Bank has an operational involvement in payment systems and has, in recent years, driven forward a number of initiatives aimed at increasing efficiency and competitiveness and reducing risk. The objective for 1998/99 was **to continue to push forward with the reform of payment and settlement systems in the UK and abroad, and participate in the development of such systems for EMU**.

The Bank has taken a lead in three key payment systems issues. First, the Bank has sought to push forward international work to reduce foreign exchange settlement risk (sometimes called "Herstatt risk") by implementing the strategy set out in the G10 report on the subject in 1996. That has involved surveys of the extent to which banks understand, monitor and control foreign exchange settlement risk; close liaison with the major industry initiatives which are designed to reduce the risk -

notably with the CLS (Continuous Linked Settlement) Services project; and an extensive publicity and education programme in the industry, for example through participation in specialist conferences. The detailed work with banks is now increasingly being undertaken by banking supervisors in the UK and overseas, but the central bank work on monitoring progress overall, on working with industry initiatives like CLS, and on publicity and encouragement will continue throughout 1999 and in 2000.

Second, John Trundle, Head of the Bank's Market Infrastructure Division, was invited during the year to chair an international group to devise core principles for payment systems worldwide. The work was initiated by G10 central banks but involves 11 other central banks both from developed and emerging market countries as well as the European Central Bank (ECB), IMF and World Bank. The project seeks to set out general principles for the design and operation of payment systems which would be widely applicable and to give examples of how they can be met in different countries and institutional environments. The group hopes to achieve consensus on these issues and is expected to publish a report before the end of 1999.

Third, the Bank conducted the Securities Settlement Priorities Review, which sought views from market participants about the development of securities settlement systems in the UK. A consultation paper was issued in March 1998 and comments were sought from market participants. The results were published in September 1998. The report recommended the merger of the separate systems at present used to settle gilts, equities and money market instruments, and that the Delivery versus Payment process in those systems should be improved as soon as possible after 2000, with much of the planning undertaken in 1999.

The Bank's expertise in this area, which is internationally-recognised, has enabled it to make a very substantial contribution, in the interests both of the UK financial sector and of risk reduction globally.

SEEKING TO ENSURE THE EFFECTIVENESS OF THE UK'S FINANCIAL SERVICES.

The Bank's objective is **to take a leading role in promoting efficient structures in the UK financial markets, to ensure that they keep pace with international best practice and serve the needs of the wider economy**.

The Bank has continued to monitor closely the relationship between banks and their small firm customers. The sixth annual report on small firm finance was published in January 1999 and a special report was also prepared on the position of ethnic small businesses.

The Bank has also monitored closely the plans of LIFFE, the London Clearing House and the London Stock Exchange, particularly as they relate to strategic alliances.

Year 2000 and the financial sector

In close collaboration with the FSA, the Bank has monitored preparations in the financial sector for the millennium date change, which has required substantial remedial work on the IT systems on which the financial system and the economy at large depend. A liaison group involving all the key UK financial infrastructure providers was formed in November 1997 and the first issue of the Bank's Year 2000 Blue Book was published in February 1998. Two further issues were published during the year, and a fourth in March 1999. The Blue Book has become a key source of information on Year 2000 preparedness in the UK financial sector.

Through the Infrastructure Group and the Blue Books the Bank has sought to ensure that information on remedial, testing and risk mitigation work was widely shared within the financial sector, and also to encourage co-ordination, where possible, between those working on similar problems. The Bank has joined the Government's National Infrastructure Forum and contributed to its work, and has also contributed to international initiatives through the Committee on Payment and Settlement Systems and the Basle Joint Council. During this year this work will intensify with a particular focus on contingency planning.

The Bank's Year 2000 Blue Book has been widely welcomed in the financial sector and has helped not only to promote awareness of the issue and co-ordination of testing plans, but also to increase confidence in other markets about the UK's preparedness for the Year 2000 date change.

PREPARING FOR EMU

Although it was clear from October 1997 that the United Kingdom was not to be a member of EMU at the outset, the Bank had long recognised the need to participate fully in the discussions leading up to EMU and this was reflected in the objective set by Court - **to participate in the preparatory work for EMU in order to exert as much influence as possible on the design of the system**.

The Bank continued to make a substantial contribution to the work of the European Monetary Institute (EMI) both through membership of its Council and through participation in a number of its working parties. Since 1 June, when the EMI was replaced by the ECB, the Bank has contributed to the ECB's General Council.

The new International Economic Analysis Division, created on 1 March 1999, will be responsible for the analysis of the economic implications of EMU, and for assessing the likely economic impact on the UK of joining. A new unit, the Co-ordination Unit for Europe, has been created under John Townend to oversee and co-ordinate all the Bank's preparations for EMU and representation in European groups.

Preparing the financial sector for EMU

A further EMU-related objective was **to assist the UK financial sector in its practical preparations for EMU**.

The Bank has contributed to the Treasury's outline National Changeover Plan for possible UK entry to EMU, and to its working party on the retail financial sector. The Governor is a member of the Standing Committee on the changeover and John Townend, the Director for Europe, serves on the Business Advisory Group chaired by Lord Simon of Highbury, Minister of State for Trade and Competitiveness in Europe.

The Bank has played a major role in ensuring that the UK financial sector was prepared for EMU, and its work culminated this year in the smooth transition of the key wholesale markets. The Bank continued to chair a number of groups of market practitioners to help reach a consensus where a common approach was needed. Where gaps were identified the Bank played a role in seeking missing information and pressing for key decisions to be taken both at the European level and in the London market. The Bank prepared contingency plans for the euro-weekend itself and monitored progress over the weekend, remaining in close touch with about 40 key practitioners as the conversion went forward.

The Bank was closely involved in the design of the TARGET system to achieve cross-border real-time gross settlement (RTGS) payments in euro within the EU. In particular, the Bank sought to ensure that EU countries which were not taking part in EMU in the first wave ("outs") had full access to the system and to the associated intra-day liquidity provision. This would encourage wider use of the system by banks, thereby reducing interbank payment risk, and contribute to the system's efficiency. Agreement was reached with other central banks in the European System of Central Banks during 1998 and TARGET began operating successfully as planned on 4 January.

A key element of the Bank's euro work was the quarterly *Practical Issues Arising from the Introduction of the Euro* (PIQ). Four issues were published during the year. The PIQ has been widely used, not only in the UK but also across Europe and beyond, as an authoritative guide on the mechanics of the transition to the euro. The Bank's mailing list for the PIQ reached 42,000, and a number of firms paid for bulk supplies - in one case ordering thousands. The Bank's euro web pages were the most heavily visited part of the Bank's web site, recording 200,000 hits in the second half of 1998 alone. Parts of the PIQ have been reproduced in a variety of technical publications, including those of the European Commission.

The Bank held the third in its series of euro symposia in October 1998, bringing together some 250 people from leading market firms and institutions in the UK, including (for the final session) their chairmen and chief executives.

The Bank has also taken many opportunities to emphasise to overseas audiences the City's readiness to play a key role in the new currency. David Clementi, the Deputy Governor for Financial Stability, led two series of "roadshows" to key overseas centres and members of the Euro Preparation Division gave over 30 presentations abroad.

External feedback on the Bank's approach to preparing the markets in London, to negotiating a satisfactory outcome for the UK on TARGET access, and to promoting London's future role in the euro area has been extremely positive. The PIQ, in particular, has been regarded, in the UK and beyond, as an indispensable and authoritative guide to euro conversion and to euro issues more widely.

FINANCIAL MARKET OPERATIONS

The objectives directed at the market side of the Bank were **to deepen the Bank's financial market expertise as an input to its responsibilities for monetary policy and financial stability and its role in enhancing the effectiveness of the UK financial system;** and **to conduct the Bank's financial market operations with a high degree of professional competence and risk management**.

Market analysis

In response, the Bank's markets area has developed a more structured approach to monitoring and analysing market developments, for example building on the links between analysts and dealers, improving the flow of information to other areas of the Bank, setting up markets pages on the Bank-wide intranet service and providing detailed material to the MPC and the FSC meetings.

Sterling money market operations

The Bank has continued with a programme of reforms in its sterling market operations. Following the introduction of gilt repo operations and a wider range of counterparties in 1997, the timetable for daily operations was revised in 1998 and the range of collateral against which the Bank provides liquidity was extended. A market liaison group has been set up to consider the next step - a review of the structure of sterling market instruments aimed at achieving greater fungibility and thus depth and liquidity in the markets.

Transfer of debt management and cash management

Responsibility for the management of the Government's funding programme was transferred to the new Debt Management Office (DMO) in April 1998. Prior to the final transfer, the Bank provided large-scale support to the DMO in building up its capability, including seconding five staff. The DMO started operations inside the Bank before moving to its own premises making the transfer virtually seamless. The Bank provides settlement services to the DMO.

The Bank maintains an operational presence in the gilt market on its own account and, since December 1998, on behalf of customers. The customer service (mainly for other central banks) has been actively marketed.

The Bank's government stock registration service at Gloucester completed its restructuring in 1998, implementing new work processes and going live with a new IT system. Staff numbers have fallen from 280 before the restructuring to 117 now, and the cost per account managed has fallen to £4.26, below the level agreed with the Treasury, despite volumes being lower than forecast. During the year the Registrar's Department successfully absorbed the work of the National Savings Stock Register with its associated low-cost dealing service for the general public.

Foreign exchange operations

When the Bank was given operational independence for monetary policy, the Chancellor of the Exchequer indicated that the Bank could also hold foreign exchange reserves for use in monetary operations should the MPC judge it appropriate. This is not reflected in the Bank of England Act as no new power was needed to enable the Bank to hold, borrow or deal in foreign exchange; and in practice the Bank has not intervened on its own account in foreign exchange markets. However the necessary systems for reporting any exposures have been put in place.

Other foreign exchange operations planned or executed during the year have included foreign exchange swaps against sterling as an adjunct to sterling money market operations, management of intra-day euro liquidity in TARGET, and adjustments in the distribution of Exchange Equalisation Account assets.

Banking services

The Bank has continued to seek out and implement steps to improve the quality and reduce the cost of the core banking services that it provides to the Government and the financial system. Facilities have been set up to enable government departments that bank with us to make and receive payments in euro. The wholesale note handling operation is being moved to the Printing Works site at Debden to increase efficiency and reduce costs. In parallel, negotiations are in train with the banks to economise on the stock of used notes awaiting reissue in the Notes Held to Order scheme.

The integrity of the note issue

Aside from safeguarding its value in terms of what it will buy, the Bank has a responsibility for the physical integrity of the currency of which it is a monopoly supplier. A major consideration is counterfeiting. The Bank keeps the security and design features of its notes under continuous review to ensure that they remain as secure as possible against counterfeiting. The Bank announced in December that a new variant of the £20 note would be issued in 1999 with enhanced security features.

Settlement services

The Bank's Securities Settlement Priorities Review revealed a clear consensus amongst market participants to merge gilt and equity settlement within a single system, and strong support for full integration of money market instruments into gilt/equity settlement arrangements. Accordingly, in September 1998, the Bank and CRESTCo Ltd reached agreement for CRESTCo to assume responsibility for the settlement of transactions in gilts and money market instruments.

Subject to implementation of the necessary statutory and regulatory changes and the conclusion of a number of new contractual arrangements, CRESTCo will assume responsibility for the Central Gilts Office (CGO) and the Central Money Markets Office (CMO) services in the second quarter of 1999.

Both services will initially continue to be operated by Bank staff under CRESTCo's management, from the Bank's premises and using the Bank's equipment. CRESTCo aim to relocate the CMO service to its own premises and equipment in the third quarter of 1999. The CGO service will remain in the Bank until gilt settlement is absorbed into the CREST system itself.

Internal preparations for the euro

The year saw the culmination of some 30 euro-related projects that needed to be completed before the transition on 1 January 1999. All were completed on time and all have functioned without problems. They included a complex project to provide real-time cross-border payments in euro across the EU, which entailed contributing to the creation of CHAPS euro as the UK system, linking it to the 14 other EU national systems comprising TARGET and developing arrangements to provide intra-day liquidity in euro for members of CHAPS euro.

Internal Year 2000 preparations

Work on testing systems for successful operation in the Year 2000, which began in 1996, has gathered pace in the last year. The Bank had set itself the target of demonstrating internally that all its critical systems were 'millennium compliant' by the end of 1998. This allowed a substantial period of contingency. In the event, some Year 2000 testing work carried on into the first quarter of 1999 in order to allow completion of internal euro testing, which had to be finished by the end of 1998. This work has been successfully completed and all the Bank's critical systems are now compliant and ready for the millennium. In co-ordination with other City institutions and central banks, contingency plans are being drawn up for the period immediately ahead of the date change and for the date change weekend itself, in which the Bank is preparing to play a City-wide co-ordinating role. The Bank's wider Year 2000 work is described on page 24.

Risk management

During the year the Bank commissioned a report from external consultants on the financial control and risk management framework. Following the recommendations of this report, risk monitoring arrangements have been reviewed and the Bank's financial control framework is to be placed on a more integrated basis in a unified Middle Office within the Financial Markets Operations area. In addition, completion of the first stage of the Open-link project now provides management with real-time information on foreign exchange operations.

The Bank's risk control framework is described in more detail on pages 53-59.

Against a background of rapid change the Bank has continued to provide a professional and effective market operations function, and to provide market input to the MPC and the FSC processes. The transition of Bank systems to operating in euro was successful. The Year 2000 remediation and testing programme was delayed by the euro launch, but is now substantially complete. Considerable progress has also been made in upgrading risk management systems and this will continue in the current year with the establishment of a Middle Office.

MANAGING THE BANK'S FINANCES

The general objective set for the year was **to manage the Bank's resources responsibly so as not to burden either the Government or the private sector with unnecessary costs, and to satisfy the Bank's shareholder, HM Treasury, that effective use is made of the Bank's capital**.

The Bank's financial framework is discussed in more detail in pages 37-40 of this Report.

Transfer of supervision to FSA

The year was dominated by the coming into force of the Bank of England Act 1998 and the associated transfer of supervision responsibilities to the FSA. Direct costs associated with banking supervision amounted to £30 million per annum, but the Bank also had centrally-borne overhead costs associated with premises and support services of £20 million per annum. The direct costs were transferred to the FSA on 1 June 1998, but the related centrally-borne overhead costs remained with the Bank and are being eliminated as part of the current medium-term spending plan (page 38).

The Bank of England Act required the Bank to make a scheme for the transfer of assets to the FSA. This was brought into effect on 1 October 1998 by an order made by the Treasury. The Bank continued to provide services and accommodation to the FSA for a period after the transfer, and the last FSA staff left the building in December.

Review of internal management information processes

Following a review by external consultants, the financial management information supplied both to senior management and to Court was reviewed and improved. To assist Court oversight further, area business aims and performance indicators have been incorporated into the budget process.

Property

The Bank's strategy for properties was reviewed in the light of the transfer of supervision to the FSA, and the opportunity that was provided, while the two floors occupied by the supervisors were vacated, to modernise the office areas in Threadneedle Street to secure the benefits of lower maintenance costs, and a more flexible open-plan style which would allow for higher densities of occupation. The total cost of the project is £40 million, with offsetting savings arising from the retrenchment into a single site of the bulk of the Bank's London activities.

Budget

For 1998/99, Court approved an expenditure budget of £210 million. The Bank's total spending for the year was within budget. Although the transfer of supervision to the FSA happened slightly later than expected, which increased the Bank's costs, there were offsetting reductions elsewhere, partly reflecting difficulties in recruitment and retention of staff.

The Bank has continued to exert downward pressure on its central costs despite the additional costs of monetary policy work. As described in the section of this Report on the Bank's financial framework for 1999/00 (pages 37-40), this process will continue as the Bank reaps the benefit of consolidation into a single building.

Monetary Policy Committee

Processes

Eddie George

Mervyn King

David Clementi

Members of the Monetary Policy Committee

In respect of monetary policy, the Bank's objective is to maintain price stability and, subject to that, to support the economic policy of the Government, including its objectives for growth and employment. Throughout the period covered by this Report, the Government defined the price stability objective in terms of an inflation target of 2.5% (measured by RPIX); this was most recently confirmed by the Chancellor in the Budget Statement on 9 March 1999. The Bank pursues this objective through the interest rate decisions taken by the Monetary Policy Committee (MPC).

The MPC is a Committee of the Bank constituted by the Bank of England Act 1998, with responsibility within the Bank for formulating monetary policy.

The policy work of the MPC - in terms of the judgments it reaches on the state of the economy, the assessments it makes of the prospects for inflation and the decisions it takes on interest rates - is reported in the published minutes of its monthly meetings, in the quarterly *Inflation Reports* and in the MPC's policy announcements. The MPC is also required to report monthly to the Court of Directors.

This section of the Bank's Annual Report deals with those aspects of the MPC which are relevant to the Directors of the Bank in fulfilling their responsibility under Section 16(1) of the Act to keep under review the procedures followed by the MPC and in particular whether the MPC has collected the necessary regional, sectoral and other information.

The MPC process

The MPC meets monthly to decide interest rates; the dates of its scheduled meetings are announced up to a year in advance. The Act makes provision for emergency meetings but none has so far been called.

The key elements of the regular monthly cycle include an extensive briefing of the MPC by Bank staff during the week prior to the MPC meeting; a two-stage meeting during "MPC week" culminating in an interest rate announcement usually at noon on the Thursday; and then a two-week period in which the minutes are prepared and agreed in advance of publication on the Wednesday of the second week. This is usually the day of the monthly meeting of the Bank's Court of Directors, which holds a discussion with MPC members present. Most non-executive Directors have attended as observers at the monthly "pre-MPC" briefing meeting (described below), but they do not attend the Committee's decision-taking meetings.

The pre-MPC meeting

The pre-MPC briefing meeting normally takes place on the Friday prior to "MPC week" and, outside *Inflation Report* months, lasts the whole day. (Once a

Sir Alan Budd*

Professor Willem Buiter

Professor Charles Goodhart

Dr DeAnne Julius

Ian Plenderleith

John Vickers

The principal external activities of the MPC members appointed from outside the Bank by the Chancellor of the Exchequer are:

Sir Alan Budd: Non-Executive Director, Information Sciences Limited; Member Advisory Board, European Economic Research Limited; Member, Council of International Advisers, NEC Corporation

Professor Willem Buiter: Professor of International Macroeconomics, University of Cambridge.

Professor Charles Goodhart: Norman Sosnow Professor of Banking and Finance and Deputy Director, Financial Markets Group, London School of Economics.

Dr DeAnne Julius: Member, Skills Task Force.

* Dr Sushil Wadhwani has been appointed to the MPC with effect from 1 June 1999. He will replace Sir Alan Budd.

quarter, prior to publication of the *Inflation Report*, the pre-MPC meeting is confined to the morning because the afternoon is taken up with discussion of the inflation and growth projections.) It is a large meeting and, in addition to the MPC members themselves, up to 50 staff attend from the policy areas of the Bank and the regional Agencies. Observers from overseas central banks and international organisations (including the IMF) attend on occasions, as do non-executive members of Court. Assessments of the process have been sought from external observers, and these have been very positive.

The central purpose of the pre-MPC meeting is to present the latest official data, financial market information and surveys, together with the staff's interpretation of them, and reports from the Bank's regional Agents (whose role is described more fully on pages 32-34). Special factors that may have affected the recent data are highlighted. Where relevant, the data are also assessed against the Committee's most recent quarterly projections.

Typically, the presentations at the pre-MPC meeting cover monetary conditions, the international economy, demand and output, the labour market, prices, the Agents' assessments of conditions across the economy, financial market developments and the prospects for inflation. The timetable has been adapted when necessary, for example in the autumn of 1998, to allow full discussion of emerging market economy issues and financial market turbulence. The format of the pre-MPC meeting is periodically reviewed to ensure that the best use is made of the time and the resources that necessarily go into such a meeting.

Following the pre-MPC meeting, further analysis may be requested ahead of the Committee's main policy meeting the following week.

Information provided to the MPC

Ahead of the pre-MPC meeting, Bank staff circulate an extensive standardised chart pack and an "issues" note. The chart pack is substantial, covering up to 1,000 variables, but does not contain any commentary. The "issues" note contains a series of short notes by staff addressing specific questions of relevance to the Committee's assessment. Examples during the past year have included: possible explanations of sterling's strength; the implications of the weak yen; an examination of the money holdings of non-bank financial institutions; public sector pay; the growth of temporary employment; the value of surveys in predicting consumer spending and investment; and the evidence for a "credit crunch".

Neither the data in the chart pack nor the material in the "issues" note will be wholly new to MPC members. They will have received, and had staff briefing notes on, all significant data and surveys as they are released during the month. A summary of the main international developments is circulated weekly and market information is provided daily with updates and analysis available on the Bank's intranet. Analytical papers are also sent to MPC members, and are frequently commissioned by them.

Apart from the main series produced by the Office for National Statistics (ONS), and the input from surveys and from the regional Agents (described below), the MPC receives information on financial market developments and on overseas economies. Both are the subject of presentations at the pre-MPC meeting and, partly at the request of the MPC, emphasis on international developments has increased over the year. In 1998, an International Finance Division was established in the Financial Stability area of the Bank, and that has provided briefing to the MPC; in March 1999, an International Economic Analysis Division was created in Monetary Analysis to draw together work on developments in the major economies (North America, Japan, Western Europe), and in the world economy as a whole, and their likely impact on the UK. It will also be responsible for assessing prospective developments in the major economies and in world trade as an input to the *Inflation Report* projections.

The wide range of data sources available to the MPC provides a more robust basis for policy analysis than would a limited set of data. For example, when the ONS Average Earnings Index was suspended in November 1998, the MPC still had available a number of other sources of data on pay growth.

Regional information

Assessing regional influences is important for understanding the economy and the dynamics of the transmission mechanism.

A number of regional data series are provided on a regular basis, as well as survey information across regions. However, since much of the regional data produced by the ONS is published with a considerable lag after the national data, the Bank's 12 regional Agents are an invaluable source of much timely information on regional trends as well as on the economy as a whole.

The Agents maintain contact with some 7,000 businesses across the UK. Each Agent produces a monthly report on conditions in his or her region and a national summary is prepared in Head Office. The reports cover a range of economic conditions: in addition the Agents are asked to produce a judgmental, quantified assessment for some 27 economic indicators on a scale of +5 to −5. (A quarterly summary of the Agents' reports is published with the *Inflation Report*.)

As well as providing written reports, three Agents (in rotation) attend the pre-MPC meeting and provide a commentary on economic conditions from their regional perspectives. Moreover, the Agents normally report on a survey of a key issue of the month commissioned by the

Regional Agents

Neil Kemsley, North West (Liverpool) and Northern Ireland

Stuart Iles, Central Southern England

Wendy Hyde, Greater London

John Beverly, West Midlands

Robin Webster, North East and Cumbria

Sue Camper, Wales

Mark Pratt, Yorkshire and the Humber

Tony Strachan, North West (Manchester)

Janet Bulloch, Scotland

Nigel Falls, South West

Robin McConnachie, South East and East Anglia

Chris Brown, East Midlands

MPC. Recent examples have included trends in stockbuilding, credit conditions, evidence on retail sales growth and wage pressures.

MPC members have themselves made a number of visits to the regions, meeting contacts of the Agents and giving speeches and presentations to local businesses.

Sectoral information

A wide range of sectoral information is reported in the chart pack and is monitored by the MPC. The Agents also provide commentary on sectoral trends in their reports. The ONS provides a sectoral decomposition of their main series, and there are a number of sectoral surveys, all of which the Bank monitors. Sectoral data have provided the basis for several special presentations to the MPC: for example, in October 1997, there was an assessment of the construction sector; the May 1998 *Inflation Report* carried a section on the UK car market; and the November 1998 *Quarterly Bulletin* carried the report of an extensive study led by DeAnne Julius, an MPC member, on the services sector. This will be continued during the coming year.

During the year the Agents have extended their coverage of private sector services industries to reflect better their weight in national GDP.

The MPC's policy meeting

The policy meeting, starting usually on the Wednesday afternoon, is attended by MPC members and the Treasury representative. There is also a small secretariat, which does not participate in the discussion.

The Treasury representative attends and speaks at the MPC's meetings, although does not vote. The Treasury representative plays an important role in ensuring that the MPC is fully briefed on fiscal developments and other aspects of the Government's economic policies. This includes, at Budget time, briefing the MPC on the fiscal stance. Involvement of the Treasury representative provides a proper interchange of information between the MPC and the Treasury and this ensures sound co-ordination between monetary and fiscal policy. In the past year, Gus O'Donnell, Director of Macroeconomic Policy and Prospects has acted as the Treasury representative, except on those occasions when Sir Andrew Turnbull, Permanent Secretary, has attended the MPC's meetings.

The meeting will have an updated chart pack and starts with an update on key data and financial market developments since pre-MPC. The MPC then identifies a series of issues for discussion on the basis of a list proposed by Mervyn King, the Deputy Governor for Monetary Stability. In *Inflation Report* months, the meeting also agrees the final projections for inflation and output growth.

On the following morning, the Governor summarises the previous day's discussion, and MPC members individually explain their views on the desirable policy stance. The Governor will then put to the meeting the policy proposition which he believes will command a majority, and the Committee takes a vote. Any member in a minority is asked to say what level of interest rates they would have preferred, and this is recorded in the minutes. The Committee then agrees the text of its announcement, which is released at noon.

Publication of the minutes

Under Section 15 of the Bank of England Act, the Bank is required to publish minutes of MPC meetings within six weeks. Since October 1998, the minutes have been published within two weeks of each meeting. They comprise a minute of the policy meeting and an Annex summarising the analysis presented by Bank staff to the pre-MPC meeting. Individual votes are recorded, but otherwise views are not attributed to individual members of the Committee so that in the discussion members can explore different points of view before coming to a decision.

Preparation of the quarterly inflation forecast and the Inflation Report

The Bank is obliged by Section 18 of the Bank of England Act to prepare and publish, with MPC approval, a quarterly report reviewing the monetary policy decisions taken, assessing developments in inflation in the UK and indicating the Bank's expected approach to meeting its price stability objective.

The Bank meets this requirement through the *Inflation Report*, which includes the MPC's latest projections for inflation and output growth.

The projections are important because monetary policy operates with a lag. The MPC must take account of this in setting policy.

The Bank does not rely on a single forecasting model, but rather there is a suite of models. The economy is complex and difficult to capture in a single model. Different models help the Bank to analyse and explore different aspects of the economy and their inter-relationships. This is important, because models cannot be used mechanically to produce forecasts. Key to forecasting are the judgments made; and in the Bank's process the key judgments are made by the MPC in a way that is informed by modelling tools.

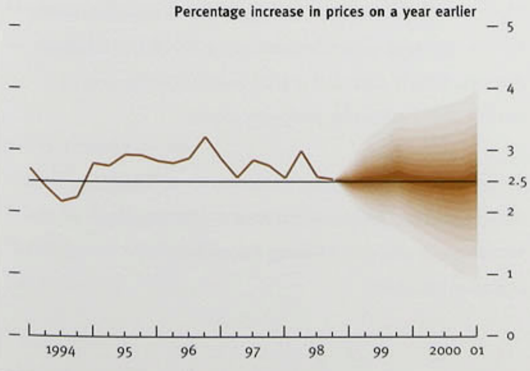
The quarterly forecast round involves the MPC in anything up to seven meetings each lasting up to three hours. It starts about a month ahead of publication with a meeting to identify the key issues. News since the last forecast is assessed and the starting assumptions discussed. The first draft of the new central projections are presented by staff approximately two weeks ahead of publication, and there is then a further opportunity to debate the assumptions and to assess the degree of uncertainty attaching to the projections and the balance of upside and downside risks.

At the same time drafts of the *Inflation Report* are circulated to MPC members for comment.

There is a further detailed discussion of the projections following the pre-MPC meeting. The MPC reviews the projections again prior to its policy meeting and again at its policy meeting: the projections will then incorporate its interest rate decision.

The *Inflation Report* containing the projections is published in the week following the MPC meeting. The projections are published in the form of "fan-charts" which show the balance of risks surrounding the central projection. An example (taken from the February *Inflation Report*) is given below (Fig. 1).

RPIX Inflation Projection (Fig. 1)



The fan-charts show graphically the uncertainty surrounding any economic projection; the spurious accuracy of a point forecast is avoided. The fan-charts also provide useful information on how the MPC view the degree of uncertainty and the balance of risks. The judgments of individual MPC members may differ materially from the Committee's best collective judgment, in which case that is stated in the Report.

The modelling tools used to help the MPC make its projections were published in April 1999.

Resources

The resources available to the MPC include the staff of Monetary Analysis (MA) and Monetary and Financial Statistics Division (MFSD), as well as other areas of the Bank, and the data provided by a variety of sources, notably the ONS.

In respect of ONS data, the Review of the Average Earnings Index, which was commissioned by the Chancellor in November 1998, recommended that a Service Level Agreement be negotiated between the Bank and the ONS to cover the Bank's data needs. The Bank is pursuing this recommendation with the ONS.

As regards internal resources, the number of staff in MA was budgeted to increase by 20, to 136, between May 1997 and the end of February 1999. In practice the number rose by only 13 because of difficulties in recruitment. Of MA's staff, 85 are analytical or managerial staff, almost all having at least a masters degree in economics or related subjects. There are in addition 50 staff in the regional Agencies. The monthly policy process and quarterly Inflation Report round, together with shortfalls on budgeted staff numbers, has put staff under considerable pressure and a priority for the coming year is to re-emphasise research work which will be necessary to support policy in the longer term. The Bank plans to recruit a further 20 staff for MA during the course of 1999/00.

A substantial investment in IT systems has also been made, including the replacement of MA's database system, and further investment in information sharing and workflow systems is planned for the coming year.

Objectives and Strategy
for 1999/00

Under the Bank of England Act 1998 the Court of Directors is required to determine the Bank's objectives, including its objectives for financial management, and strategy.

The Court has decided that the Core Purposes of the Bank, which are reviewed but usually not changed each year, taken together with the annual statement of Bank Objectives, should constitute the strategy and objectives of the Bank for the current year. The Core Purposes are set out on page 19. The Bank Objectives for 1999/00 are set out below. These objectives provide the basis for objective setting in the local management areas of the Bank and for the allocation of budgetary resources.

BANK OBJECTIVES FOR 1999/00

1/ To improve the range and quality of information and economic analysis provided to the Monetary Policy Committee.

2/ To build public support for price stability, and public understanding of the Monetary Policy Committee's approach to its remit.

3/ To deepen the Bank's analysis of market and institutional developments in the UK and overseas which could pose a threat to financial stability, and in collaboration with the Financial Services Authority to play a leading role in developing policy responses to domestic and international financial stability problems, and to encourage measures aimed at reducing risk in financial systems.

4/ To take a leading role in the development of structures in UK financial markets which are competitive internationally and effective in supporting business at home.

5/ To conduct the Bank's financial market and banking operations with a high degree of professional competence, to execute the Bank's policy decisions and to meet customer requirements cost-effectively.

6/ To assist the preparations, in both the financial sector and the wider economy, for the possible introduction of the single currency; and to remain close to, and seek to influence, the policy debates at the European Central Bank and in the EU Economic and Financial Committee.

7/ To ensure that all the Bank's systems are millennium compliant and to contribute to the co-ordination of UK financial sector preparations for the millennium.

8/ To ensure that all Bank functions have, and through appropriate recruitment, retention and career development policies continue to have, staff of the right quality and experience to fulfil their tasks efficiently.

9/ To maintain the Bank's overall spending within the agreed budget of £213.2 million for 1999/00 set by Court in the context of the medium-term framework for its finances described on page 38 of the Annual Report, which calls for a £20 million reduction in overheads, including property costs.

10/ To review the management of the Bank's balance sheets and to implement a new framework for monitoring and controlling financial and operational risks.

Financial Framework

for 1999/00

Budget for 1999/00

Reflecting the objectives set out on page 36, Court has agreed an expenditure budget of £213.2 million for 1999/00, an increase of £3.6 million on last year's expenditure budget, or £6.4 million if FSA costs are excluded from the comparison. The largest single reason for the increase is the introduction of the new bank note series; and, as shown in the chart on page 39 (Fig. 3), in subsequent years spending is expected to fall substantially as the benefit of current investment projects comes through.

Within total spending, operating expenses are budgeted at £195.6 million, £6.6 million more than last year, and revenue expenditure on investment projects is budgeted at £17.6 million, down £3 million on last year. In addition to the bank note costs, which amount to £4.7 million, the increase in operating expenses reflects the provision of more resources for the policy areas, particularly Monetary Analysis in support of the Monetary Policy Committee, and, in the operational areas, for the operation of TARGET. These increases are partly offset by reductions in the costs of Personnel and other central functions. The fall in spending on investment projects reflects the completion of the Bank's preparations for the introduction of the euro. Major projects in 1999/00 are the completion of the Bank's millennium compliance work and the start of the refurbishment of the Threadneedle Street building. Some of this spending, which is included in centrally-borne costs, was deferred from last year, as the FSA transferred from Bank premises later than initially planned.

A summary of the Bank's budget for the current year is given in the table below (Table 1).

Bank Expenditure Budget (Table 1)

	1998/99 Budget	1998/99 Outturn	£m 1999/00 Budget
Business units			
Monetary Analysis and Statistics	13.5	14.1	16.5
Financial Market Operations	42.3	42.5	43.6
Financial Stability	6.8	7.1	8.1
Co-ordination Unit for Europe	1.3	1.3	1.3
Centre for Central Banking Studies	1.5	1.4	1.5
Printing Works	34.8	33.8	39.5
Registrar's Department	5.2	5.1	4.0
Banking Supervision	2.8	6.2	–
	108.0	**111.4**	**114.5**
Centrally-borne costs			
Personnel, Audit and Secretary's Department	23.6	24.4	22.7
Property Services and Security	38.8	35.6	36.2
Finance and central IT	5.3	4.8	5.9
Depreciation, VAT	33.8	31.9	33.8
	101.6	**96.7**	**98.7**
Total expenditure	**209.6**	**208.1**	**213.2**

Due to roundings, the individual figures do not sum to the rounded totals.

Actual spending in 1998/99

Actual spending was below budget. Although responsibility for banking supervision remained with the Bank for longer than assumed in the budget, the impact of this on total spending was more than offset by lower spending on the rest of the Bank's activities. In part this reflected shortfalls in staffing, but some was the deferment of spending on premises.

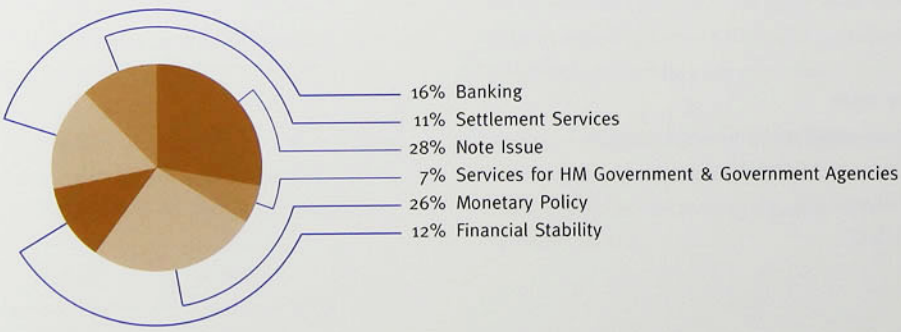
Costs of functions

The breakdown of expenditure shown in the table is based on the organisational structure of the Bank: this is the basis on which Court manages the Bank's spending. However these figures do not show the cost of the Bank's functions, as many areas of the Bank contribute to more than one of these. For example, note issue costs, which amount to some £60 million in 1999/00, arise partly at the Printing Works (note production) and partly in Financial Market Operations (distribution and overall policy). Similarly, the Bank's expenditures directly stemming from monetary policy analysis and its implementation include contributions from Financial Market Operations and from the Press Office and Information Services in Secretary's Department, as well as those recorded against Monetary Analysis and Statistics. The chart below (Fig. 2) shows the distribution of the Bank's budgeted costs for 1999/00 on a broad functional basis, with overheads fully allocated to functions.

Medium-term spending plans

1999/00 is the first full-year budget to reflect the change in the Bank's functions following the Bank of England Act. As described on page 28, the FSA took over the Bank's direct costs of supervision from 1 June 1998 - these amounted to about £30 million per annum - but the Bank has retained overhead costs previously allocated to supervision amounting to some £20 million per annum, and the objective is to eliminate these as quickly as possible. To a large extent achieving this is dependent upon the necessary changes to the Threadneedle Street building to allow nearly all London-based staff to be accommodated on a single site, rather than in five buildings as at present. In the short run, the refurbishment of the Threadneedle Street building adds to centrally-borne costs.

Budgeted Costs of Functions 1999/00 (Fig. 2)



The Bank expects the reductions in centrally-borne costs to be fully realised by 2002/03 when building works are complete. Elsewhere, within the overall decline in spending in the medium term, the Bank is projecting a continuing switch in emphasis, seeking continuous improvements in the efficiency of processing activities, while providing more resources for policy analysis. The chart below (Fig. 3) shows the trend in the Bank's expenditure over the past eight years and the expected trend four years ahead.

The financial framework

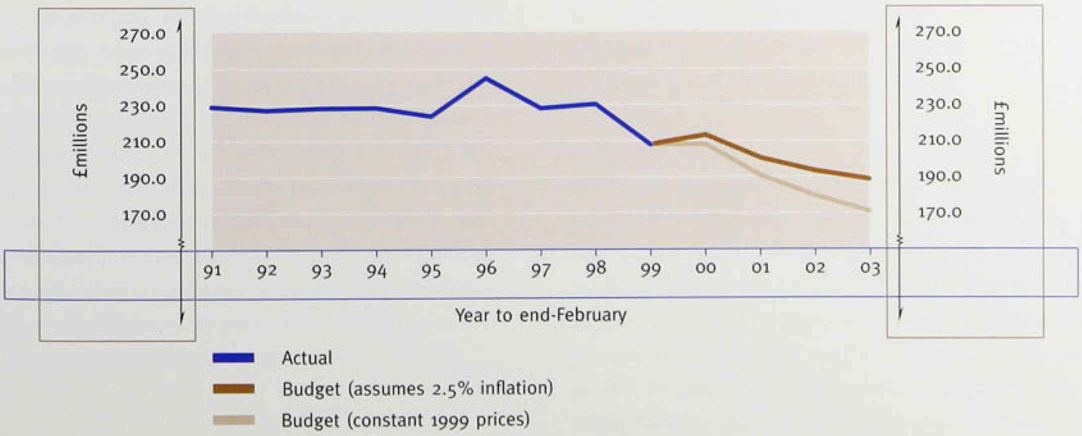
In planning its finances in the medium term, the Bank takes into account the return on its capital and reserves and the implications for Cash Ratio Deposits.

The Bank's objective in relation to its capital and reserves, agreed with Government, is to ensure a reasonable return, on an opportunity cost basis, on the Government's investment in the Bank. This is taken to be related to the return on Government bonds. For 1998/99, the Bank agreed with the Government that it would plan its finances on the basis of a benchmark return of 7%, the return on gilts in mid-1997. Market yields have fallen substantially since then but, because the Bank has a substantial portfolio of gilts, which will be held to maturity and which yield more than 7%, this has not yet materially affected the Bank's earnings on the investment of its financial capital.

Cash Ratio Deposits

Cash Ratio Deposits (CRDs) are the interest-free balances that deposit-taking institutions place with the Bank to finance monetary policy and financial stability activities, the costs of which cannot otherwise be recovered. The Bank of England Act provided the Government with powers to set the level of CRDs, after consultation with the Bank and others, and having regard to the financial needs of the Bank. The Government subsequently set CRDs to deliver income to the Bank of £79 million in a full year. This reflected the Bank's estimate of its prospective average unrecovered costs associated with its monetary policy and financial stability activities, but excluding any share of the £20 million supervision overhead retained by the Bank. Currently this estimate is expected to be exceeded, reflecting the planned increase in resources to support the monetary policy process, and also an increase in the cost to the Bank of providing settlement services caused by a reduced offset from the banks' settlement balances.

Bank Expenditure 1991-2003 (Fig. 3)



In establishing the initial level of CRDs, an interest rate of 7% was assumed to translate the required level of income (£79 million) into an initial deposit ratio of 0.15%, intended to give a level of CRDs of £1,130 million. Between June 1998, when CRDs were set, and the end of February 1999, interest rates averaged 6.9% and balances £1,167 million, implying an annual income close to the required level of £79 million if invested at the Bank's repo rate. By the end year, though, interest rates were 5.5% and the level of CRD balances was £1,206 million, which would yield annual income of only £66 million at the repo rate although actual income will depend on the composition of the Bank's portfolio.

The CRD scheme itself is to be reviewed in 2003, at the end of the initial five-year period, but the Government has said that the level of CRDs will be kept under review in the light of changing circumstances and in consultation with the Bank. Despite the fact that short-term interest rates are now lower than when the level of CRDs was first set, and the costs of monetary and financial stability higher, the Court sees no need this year to seek a change in the CRD ratio. However Court will continue to keep the adequacy of CRD income under review.

Personnel, Community Activities and Technical Assistance

Staff of the Bank

The table on page 42 (Table 2) 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.

Staff numbers

At the end of the financial year, on 28 February 1999, the Bank employed 2,443 full-time and 220 part-time staff. Over the year, the number of staff fell by 615. 460 staff left the Bank as part of the transfer of responsibility for banking supervision to the newly-created Financial Services Authority (FSA), and further efficiency savings were made at the Registrar's Department in Gloucester, at the Printing Works at Debden and within the central support function. Offsetting these reductions has been an increase in the number of short-term contract staff engaged in project work related to the introduction of the euro and preparation for the Year 2000, and the increase in staff in Monetary Analysis and Financial Stability.

The chart on page 42 (Fig. 4) shows how the composition of the Bank's staff changed between 1998 and 1999, mainly reflecting the transfer of supervision to the FSA.

The fall in staff numbers last year continues a long-term trend illustrated in the chart on page 42 (Fig. 5). In general, the Bank has been steadily reducing staff in routine processing jobs and using IT more intensively; and it has also been outsourcing functions that can more economically be provided by contractors. With the departure of supervision (which was a rapidly expanding area) the Bank will be able to fit nearly all its London staff into the Head Office building. This will involve a critical examination of the Bank's building maintenance and security operations and how these can be managed most efficiently in the future. To this end, the Bank has been engaged in consultation with members of Banking Insurance and Finance Union and the staff on how to improve efficiency and achieve cost savings.

Recruitment

The departure of supervision has had a significant effect on the Bank's recruitment. In 1997, 57 new graduates were recruited to the Bank: last year only 18 joined, and the Bank aims to recruit around this number in 1999. The Bank has however continued to recruit experienced specialist staff to fill specific gaps: last year 35 mid-career staff were recruited, mainly for the Financial Stability and Monetary Analysis areas. One aim of this recruitment has been to rebuild the Bank's capacity for international economic analysis: the bulk of the Bank's former international teams had been attached to the supervisors and were transferred to the FSA.

Career development and training

Last year, the Bank completed its work on creating a single integrated pay structure for all banking staff, underpinned by common job evaluation, largely unified performance assessment systems and performance related pay and bonus arrangements. This new structure allows greater flexibility and more local accountability in setting individuals' salaries.

The training and development of staff at all levels continues to be a high priority. The content and focus of training and development programmes for all Bank staff have been revised to meet the Bank's operational needs. These programmes are now based on agreed competencies at all levels and they form part of a more integrated and committed approach to performance management. Particular emphasis is being placed on skills training for more junior staff and, throughout the organisation, on achieving improved levels of professional and technical qualifications.

Employment policies

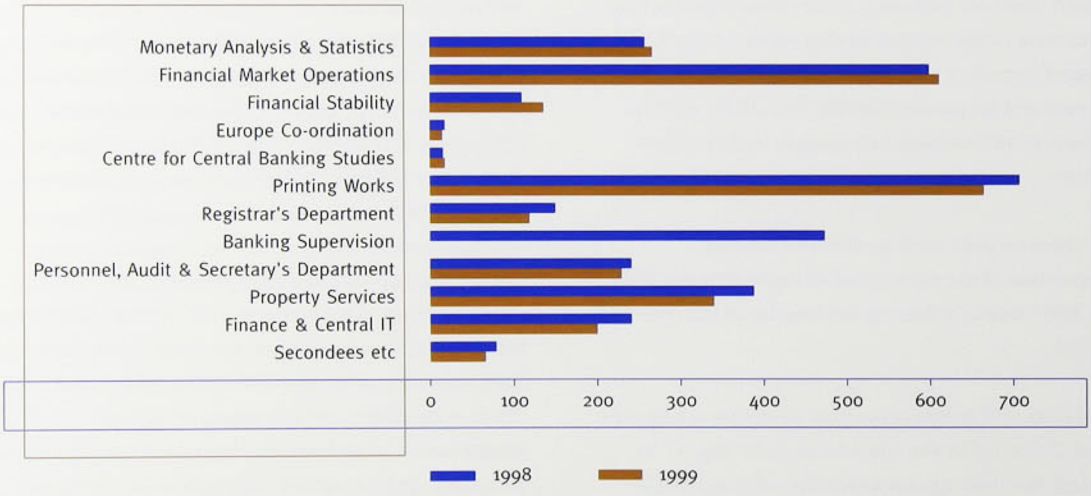
The Bank is committed to equal opportunities and endeavours to avoid any form of discrimination. Relevant information and training is provided to staff, which sets out their responsibilities. They are encouraged to raise any instances of discrimination through the Bank's internal procedures. The Bank continues to support a number of targeted initiatives, including Opportunity 2000, Race for Opportunity, the Employers' Forum on

Aggregate Remuneration and Average Number of Staff (Table 2)

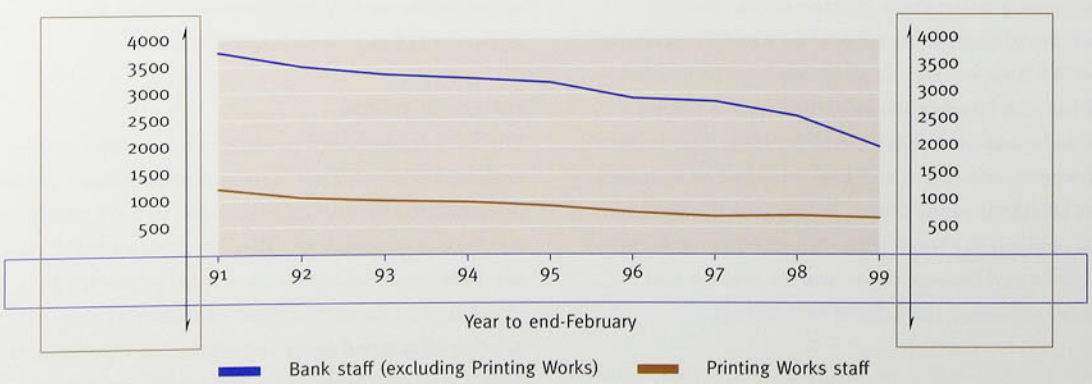
	1998/99		*1997/98*	
	Aggregate remuneration (£m)	**Average number of staff**	*Aggregate remuneration (£m)*	*Average number of staff*
Bank*	**84**	**2,810**	*97*	*3,400*
Subsidiaries	**1**	**23**	*1*	*31*
Total	**85**	**2,833**	*98*	*3,431*

* Includes subsidiaries whose functions are directly related to the operations of the Bank.

Numbers of Staff by Area 1998 and 1999 (Fig. 4)



Bank Staff Numbers 1991-1999 (Fig. 5)



Disability and a similar forum on Age. The Bank's family-friendly policies continue to help staff, particularly women, to combine home and work responsibilities: the proportion of women in managerial and analytical grades has nearly doubled since 1991 and now stands at 28%. The proportion of ethnic minority staff in the Bank remains largely unchanged at 5%. The Bank uses the Department of Employment's 'Positive about Disabled People' symbol, as part of which it operates a Guaranteed Interview scheme for any disabled applicant meeting the minimum job criteria. Support for disabled employees includes provision of specialist training and equipment as well as adjustments to working practices and premises.

Employee involvement

The Bank has well-established arrangements for consulting staff on matters which are likely to affect their interests. Formal and informal discussions are held on a regular basis with representatives of the recognised trade unions on matters relating to employment conditions. Focus groups continue to be a vehicle for consulting staff and, this year, were used in connection with plans for new catering facilities and a study on fringe benefit arrangements. The Bank is also co-operating with the Banking Insurance and Finance Union in a training initiative which is directed to the Technical Services grouping of the Bank where employment opportunities are declining. Through this partnership, staff will be able to pursue learning and skills development outside their present areas of expertise.

Staff are kept fully informed about a wide range of issues including the objectives, performance and day-to-day activities of the Bank, through regular briefings, seminars and publications such as the fortnightly staff newspaper. Electronic mail is used to bring management and press announcements to the immediate attention of staff and a Bank-wide intranet site continues to expand.

Community involvement

Last year the Bank contributed £1.4 million in support of its community programme. This covers donations to charities and to academic research, the cost of certain secondments and contributions to other community-related activities. £580,000 was donated to registered charities and £373,000 to other organisations, whilst the cost of community secondments and subsidised accommodation totalled £467,000.

The Bank's policy on charitable giving focuses on initiatives to enable disadvantaged people to access worthwhile employment through training and on supporting the staff's community involvement. £41,000 was donated to charities and schools in recognition of the funds raised or time given by staff. The Bank also matched, on a £1 for £1 basis, £58,100 donated by staff and pensioners to registered charities under the Give As You Earn Scheme and £9,200 of staff fundraising. In addition, the Bank donates gifts in kind of surplus goods, computers and furniture.

The Bank recognises the positive impact which its community involvement programme can have in terms of the benefits to the staff involved, to the community projects in which they are active and to its own reputation. Because of its position, it can also give a lead to City and other organisations. Apart from the financial support described above, the Bank encourages a range of Education Business Partnership activities, particularly in areas close to the Bank such as Tower Hamlets, Hackney and Islington. These include a wide range of activities such as offering work experience placements in the Bank and staff taking part in various school initiatives. Staff listen to children read in primary schools during the lunch hour. They also act as group facilitators at job-finding skills workshops, interviewers at practice interview sessions and as mentors to both pupils and headteachers. Staff are encouraged to become school business governors. The Bank is represented on the "Partners in Leadership" steering committee.

No donations have been made for political purposes.

THE CENTRE FOR CENTRAL BANKING STUDIES

The Centre for Central Banking Studies (CCBS) continues to provide training and technical assistance to developing central banks but has also introduced a series of analytical workshops and research projects which are of interest to a growing number of OECD central banks.

The Academic Workshop series began in January 1998. Some twenty central bankers are invited for a one-week workshop in order to discuss a particular central banking issue in an analytical context. The workshops have attracted high-quality speakers - both from central banking and academia - and are becoming a forum for exchanging state-of-the-art ideas among central bankers. As a result, the demand to take part in them has been strong, including from Bank of England staff. The research projects that follow each workshop typically last for three months, with a small group of central bankers, including Bank of England staff, looking at some of the issues raised in the workshop in more depth. The research is presented at a London-based conference, with a view to publication. This has proved to be a unique opportunity for central bankers to work together on a research topic and has been a good developmental opportunity for the Bank staff who have been involved. The projects enable Bank staff to work closely with central bankers from different backgrounds and environments, so broadening their own expertise in a specific project subject. The CCBS hosted three such workshops/projects last year.

In addition, the CCBS continues to provide other London-based courses on a range of central banking topics. These have become increasingly participative, as visiting central bankers are expected to prepare papers beforehand and make a presentation during the workshop. This ensures more senior and experienced candidates and an increased focus. CCBS staff also visit overseas central banks in order to provide “hands on” assistance. During 1998, the CCBS provided help to over 140 countries, through workshops, seminars, study visits and technical assistance.

Report on Governors' and Directors' Remuneration

REMUNERATION POLICY

Court determines the remuneration of the Bank's most senior executives, including the Governors, Executive Directors (who are not members of Court), advisers to the Governors and members of the Monetary Policy Committee (MPC) appointed by the Chancellor of the Exchequer. This role has been delegated to the Remuneration Committee whose policy is to set remuneration and conditions of service to reflect adequately qualifications, experience, responsibilities and performance. The policy is to review salaries annually. In addition to recommending salary levels, the Remuneration Committee may recommend the payment of bonuses as a means of rewarding special services. In proposing salary and bonuses, the Committee takes into account both internal and external salary comparators. Where appropriate, the Committee commissions external professional advice on the levels of pay and benefits in comparable public institutions and in the private sector. However, in advising Court on remuneration at senior levels within the Bank, the Committee also bears in mind the Bank's position within the public sector. Although no executive member of Court sits on the Committee, the Governor may be invited to attend meetings that do not consider his own remuneration.

REMUNERATION STRUCTURE FOR THE GOVERNORS.

The Bank of England Act 1998 provides for the remuneration of the Governor and Deputy Governors. The sub-committee of Court made up of the 16 non-executive Directors (NedCo) is responsible under the Act for determining the process by which their remuneration and pensions are set. NedCo has invited the Remuneration Committee to recommend the salaries and pensions of the Governor and Deputy Governors, for adoption by Court.

The remuneration arrangements for the Governor and Deputy Governors consist of the following components:

Base salaries

The Governor was reappointed for a second five-year term which began on 1 July 1998. On commencement of this second term, the Governor's annual salary was increased from £225,000 (which had been at the same level throughout his previous term) together with Court fees of £2,000, a total of £227,000, to £232,675. This increase matches the Government's inflation target.

The Deputy Governors' salaries have been set in line with the policy described above.

Benefits

The Remuneration Committee also keeps under review other benefits available to Governors, including medical insurance and beneficial loans for housing and other purposes. The latter are available to the Governor and Deputy Governors on the same terms and conditions as for Bank staff, subject to any limitations that would apply to a banking company incorporated under the Companies Acts. The principal benefits received during the year were beneficial loans and medical insurance. The table of emoluments on page 47 (Table 3) also includes payments of tax in respect of notional benefits of travel on Bank business. These arise because of the Inland Revenue's practice of treating travel by spouses accompanying a Governor or Deputy Governor on official business as a taxable benefit. The presence of the spouse on certain official business is regarded by the Bank as necessary and accordingly the Bank meets any tax liability that may arise in respect of such occasions.

Post retirement benefits

Court, via the Remuneration Committee, is also responsible for reviewing the pension arrangements for current and former executive members of Court. The Governor and Deputy Governors are eligible for post retirement benefits. These are generally provided through the Court Pension Scheme, which is separate from the scheme for staff. This scheme is described on page 48. The Bank's policy is to seek to harmonise the value to participants of their pensions which may be provided through a variety of different arrangements reflecting individual service with the Bank, arrangements with previous employers and with external pension providers. Generally the Bank aims to provide a pension of two-thirds salary based on at least 20 years service with the Bank at a retirement age of 60.

Service contracts

The Governor and Deputy Governors do not have service contracts with the Bank. Governors are required to provide services only to the Bank. With Court's approval other directorships relevant to the Bank's work may be accepted, but any fees must be paid to the Bank.

REMUNERATION OF DIRECTORS

The Bank of England Act 1998 provides for the remuneration of the non-executive Directors to be determined by the Bank with the approval of the Chancellor of the Exchequer. A sub-committee of Court, comprising the Governors, has determined that with effect from 1 June 1998 the remuneration of the non-executive Directors is £5,000 per annum and the remuneration of the Chairman of the sub-committee of non-executive Directors is £7,500 per annum. The Chancellor has approved this remuneration.

The Act, which came into force on 1 June 1998, made changes to the Court of Directors. Court now comprises the Governor, two Deputy Governors, and 16 Directors, all of whom are non-executive. The 16 non-executive Directors include the 11 non-executive Directors who served during the period to 31 May 1998, plus five new Directors appointed from 1 June 1998.

A total of 16 non-executive Directors served during the year ended 28 February 1999 (1998 12). In accordance with the Bank's Charter of 1946, a fee of £500 per annum was payable to each Director until the Bank of England Act came into force on 1 June 1998. For the year ended 28 February 1999, £125 (1998 £500) was paid on this basis to each of the 10 non-executive Directors who served during the period from 1 March 1998 to 31 May 1998. Mr Davies waived fees of £125.

Of the Executive Directors who served during the period to 31 May 1998, Mr King was appointed a Deputy Governor with effect from 1 June 1998 and Mr Foot resigned from the Bank on the same date to take up his responsibilities at the Financial Services Authority (FSA). The remaining two Executive Directors, Mr Plenderleith and Mr Clark, ceased to be members of Court on 1 June 1998.

Non-executive Directors do not receive any post-retirement benefits from the Bank.

Remuneration of Governors and Directors (Table 3)

	Salary and Fees (Note i) £	Bonuses and other payments (Note iii) £	Benefits £	Total 1999 £	*Total 1998 £*
Governors					
Governor					
Mr E A J George	230,617	–	5,727	236,344	*232,272*
Deputy Governor					
Mr D C Clementi	192,298	–	1,146	193,444	*95,750*
Mr M A King	192,048	–	762	192,810	*154,443*
(from 1 June 1998)					
Mr H J Davies	–	–	–	–	*96,826*
(resigned 31 July 1997)					
Non-Executive Directors					
(Notes i, iii)	59,375	–	–	59,375	*19,959*
Executive Directors					
Mr I Plenderleith	37,625	–	7,596	45,221	*148,074*
Mr T A Clark	31,375	–	3,102	34,477	*131,183*
Mr M D K W Foot	31,375	–	6,546	37,921	*144,260*
(resigned 1 June 1998)					
(Note ii)					
Total	**774,713**	**–**	**24,879**	**799,592**	***1,022,767***

Notes

i/ Mr Davies is a member of Court in his capacity as Chairman of the FSA. Mr Clementi as Deputy Governor, Financial Stability, also sits on the Board of the FSA. Each has agreed to waive the remuneration due from the other body. Accordingly, Mr Davies waived fees of £125 and remuneration of £3,750 due from the Bank and Mr Clementi waived remuneration of £14,000 due from the FSA.

ii/ For the year ended 28 February 1998, a non-pensionable bonus of £10,000 was paid to Mr Foot.

iii/ Sir David Scholey, (who retired on 28 February 1998), received a fee of £14,000 in respect of his service as a member of the Board of Banking Supervision. No similar fees were paid to any Bank Director for the year ended 28 February 1999. With effect from 1 June 1998, the Board of Banking Supervision became a committee of the FSA.

PENSIONS OF THE GOVERNOR AND DEPUTY GOVERNORS

The Court Pension Scheme, in which the Governors participate, is non-contributory and is governed by an independent trust. Executive Directors are also members of the scheme. The normal retirement age is 60, which allows members to achieve a maximum pension of two-thirds of their pensionable salary at normal retirement age after 20 years service. The scheme also provides for early retirement in certain circumstances (including ill-health), payment of a lump sum in the event of death in service, and allowances for spouses and dependants.

In the event of death in service, the scheme provides for the payment of a lump sum, surviving spouse's pension of 50% of the member's base pension (55% from age 80), and discretionary allowances for dependants. With the agreement of Court, members may retire at any time after age 50 and receive an immediate pension. This pension may be reduced to reflect early payment. Pensions and deferred pensions are reviewed annually and are normally increased in line with the rise in the Retail Prices Index.

For members subject to the pensions earnings cap introduced in the Finance Act 1989, the Bank offers additional unfunded pensions so that their total pensions broadly match those provided by the Court scheme. During the year ended 28 February 1999, there were two capped members - Mr Clementi and Mr King. Provision for these unfunded benefits is made in the Bank's financial statements.

Pension Entitlements (Including Unfunded Entitlements) (Table 4)

	Age at 28 February 1999	Years of service to 28 February 1999	Accrued pension as at 28 February 1999 £	Increase in accrued pension in 1999* £
Mr D C Clementi	50	1	9,800	6,500
Mr M A King	50	8	44,700	8,700

* The increase in accrued pension during the year excludes any increase for inflation.

Notes

i/ The Governor, Mr George, is not shown in the above table having reached the age of 60 on 11 September 1998, the normal retirement age under the Court Pension Scheme, after 38 years service. At normal retirement age, the Governor's pension entitlement was £167,000 per annum. Excluding inflation, the net increase in the Governor's pension entitlement between 1 March 1998 and normal retirement age was £6,800. Under the Court Pension Scheme, the Governor's remuneration became non-pensionable on his 60th birthday and, accordingly, no further pension entitlement under this scheme will accrue, although the pension will increase each year until drawn, to reflect deferment. The death in service provisions described above remain in force for the duration of his service.

Court has granted the Governor an additional ex-gratia pension to reflect his service since his normal retirement date which will comprise the difference between the £167,000 referred to above and two-thirds of his final salary on retirement. This further entitlement will accrue over his second term of office and provision for its cost will be made over this period.

ii/ Unfunded pensions are included in the above table.

REMUNERATION OF MONETARY POLICY COMMITTEE MEMBERS

The Bank of England Act 1998 requires the sub-committee of 16 non-executive Directors to determine the terms and conditions of service of the four members of the MPC appointed by the Chancellor of the Exchequer. The sub-committee of the 16 non-executive Directors has agreed that the Remuneration Committee should recommend the salaries and pensions of these members of the MPC.

The four members of the MPC appointed by the Chancellor are paid £128,125 per annum, pro rated for the number of days worked per week. This salary includes an increase of 2.5% awarded from 1 January 1999, on the advice of the Remuneration Committee. The members of the MPC appointed by the Chancellor are on fixed-term contracts which all run from 1 June 1998. Sir Alan Budd was appointed to the MPC for one year, Professor Willem Buiter and Professor Charles Goodhart for two years and Dr DeAnne Julius for three years. Sir Alan Budd is contracted for four days a week and Professor Goodhart for two days. Professor Buiter was contracted for three days a week until he became full time on 1 July 1998 and Dr Julius has been full time since joining the MPC in 1997. The members of the MPC appointed by the Chancellor do not receive housing or personal loan benefits. They are entitled to death-in-service benefits on the same terms as Bank staff and are eligible to join the Bank's group medical insurance scheme. Their pension arrangements depend on their individual circumstances.

As a result of the Bank of England Act 1998, Executive Directors are no longer members of Court, so their remuneration is no longer disclosable under the Companies Act requirements. However, the salaries of the two Executive Directors who are members of the MPC are given for consistency with other members.

The two Executive Directors of the Bank who are members of the MPC are Mr Ian Plenderleith, whose current annual salary is £154,263 and Mr John Vickers, whose annual salary is £128,125. Mr Plenderleith and Mr Vickers are eligible for the Bank's normal range of benefits, including non-contributory pensions.

Report from Members of Court

for the year ended 28 February 1999

PRINCIPAL ACTIVITIES AND REVIEW OF OPERATIONS

The Bank's Core Purposes are set out on page 19. The Governor's Foreword on pages 2-6, the Review of Performance against Objectives and Strategy on pages 20-29 and the section on Personnel, Community Activities and Technical Assistance on pages 41-44 give a detailed account of the Bank's activities and operations during 1998/99. Details of the Bank's financial statements are given below.

PRESENTATION OF THE FINANCIAL STATEMENTS

The Bank Charter Act 1844 requires that the Bank's note issue function is separated from its other activities. Accordingly, for accounting purposes, the Bank is 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 comprises all the other activities of the Bank.

Neither the Issue Department nor the Banking Department is an organisational unit of the Bank.

Banking Department

Under the Bank of England Act 1998, the Bank, in preparing the financial statements of the Banking Department, is subject to requirements corresponding to the Companies Act requirements relating to a banking company. The Bank may, however, disregard a requirement to the extent that it considers it appropriate to do so having regard to its functions. Accordingly the financial statements of the Banking Department follow, insofar as is appropriate having regard to its functions, in particular with the limitations described below, the accounting requirements for banks as laid down in the legislation or in applicable Accounting Standards. This basis for preparing the financial statements has been followed for a number of years.

In exceptional circumstances, as part of its central banking functions, 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 Department's financial statements in the year in which they occur, these financial statements may not explicitly identify the existence of such support. However, the existence of such support will be disclosed in the Annual Report when the need for secrecy or confidentiality has ceased.

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

Issue Department

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

FINANCIAL RESULTS

The Banking Department's financial statements for the year ended 28 February 1999 are given on pages 64-83, and show a profit after provisions and before tax of £172 million compared with £179 million in 1997/98.

The Bank's finances and balance sheet have changed significantly during the year. During the first three months of the year supervision was part of the Bank. On 1 June 1998, supervision was transferred to the

Financial Services Authority and the Cash Ratio Deposit (CRD) regime changed as described on pages 39-40. Overall, CRDs were around £1,350 million lower at 28 February 1999 than at the previous year end. The reduction in CRDs resulted in a fall in the Bank's income. However, the Bank's costs also fell significantly on the transfer of supervision.

The introduction of TARGET (see below) brought new income and outgoings and thus changed the pattern of the Bank's income.

After payment in lieu of dividend to HM Treasury (see page 52) of £70 million (compared with £70 million in the previous year) and a tax charge of £32 million (1997/98 £39 million), the profit transferred to reserves amounts to £70 million which compares with £70 million last year.

The statements of account for the Issue Department (which are given on pages 84-86) show that the profits of the note issue were £1,705 million compared with £1,528 million in 1997/98. 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.

Balance sheets

As mentioned above the Banking Department's balance sheet has changed over the year. The footings at 28 February 1999 had increased by £7 billion over the previous year as a result of a number of different factors.

The balance sheet footings at 28 February 1998 were exceptionally high for reasons explained last year, relating to market conditions, the Government's funding position and the extent and nature of market operations by the Bank, which may be carried out in both the Banking and Issue Departments. After the end of the Bank's 1997/98 financial year, the Banking Department's balance sheet returned to a more normal size of between £5 and £7 billion footings. The reductions in CRDs in April and June 1998 reduced this total by around £1 billion overall.

The Bank is providing €3 billion as a float of liquidity for the UK financial sector's use of TARGET. This float comprises securities and deposits denominated in euro and is included on the Bank's balance sheet, together with the corresponding funding.

The Bank started to acquire the assets for the float in December 1998 purchasing securities and placing deposits, initially in currencies that would on 1 January 1999 convert to the euro. These assets were then redenominated into the euro. This portfolio was financed by swaps and an increase in the deposit from the Issue Department.

The TARGET system involves the creation of bilateral positions between central banks in the member countries. These balances reflect the net flows between the individual countries through the central banks. Although the net position is what matters for most operational purposes, the individual balances are with different legal entities and must therefore be shown gross under UK accounting rules. The existence of these balances has resulted in a significant increase of around €12 billion (£8 billion) in the Bank's balance sheet footings at the balance sheet date.

The Issue Department balance sheet remains as in previous years, but the footings have increased due to a rise in the note circulation. The matching assets remain similar to previous years and include reverse repo transactions used in the Bank's market operations and the Ways and Means advance to HM Treasury. HM Treasury plans changes to the use of the Ways and Means advance during 1999/00.

PROVISIONS FOR SUPPORT OPERATIONS

The NMB group has continued to realise its assets over the year. The history of the Bank's involvement with this company has been referred to in previous reports and is given in note 12 on pages 76-77. The Bank has been able to release £11 million of its provision for support operations. These provisions amounted to £74 million at 28 February 1999, down from £85 million in 1998 and compare with a maximum of £115 million in 1993.

PAYMENT IN LIEU OF DIVIDEND TO HM TREASURY

The Bank of England Act 1946, as amended by the Bank of England Act 1998, requires the Bank to pay to HM Treasury, in lieu of dividend on the Bank's capital, on 5 April and 5 October, a sum equal to 25% of the Bank's post-tax profit for the previous financial year or such other sum as the Bank and HM Treasury may agree. The overall effect is that the Bank and HM Treasury will normally share post-tax profits equally.

The first payment under the new regime was made in October 1998 being the second payment of £35 million in respect of the financial year ended 28 February 1998. The second payment under the new regime was made in April 1999 being the first payment of £32 million in respect of the financial year ended 28 February 1999 and was based on provisional figures. The balance of £38 million will be paid on 5 October 1999.

The new statutory provisions correspond to the arrangements for such payments agreed between the Bank and HM Treasury before the coming into force of the 1998 Act.

GOVERNANCE OF THE BANK

The role of the Court of Directors and the names of the members of the Court of Directors, together with the principal outside appointments of the non-executive Directors are given on pages 8-13.

The role and functions of the sub-committee comprising the non-executive Directors of the Bank is explained on pages 60-61.

The functions and membership of the Remuneration Committee are given on page 13.

The functions and membership of the Audit Committee are given on page 13.

Internal controls

The Court of Directors is responsible for the system of internal control in the Bank and its subsidiaries. The responsibility for day-to-day operations is delegated to the executive management. The system of internal control is based on what the Governors and 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 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 the 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 18.

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 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 Management Committee and the Audit Committee. Monitoring the effectiveness of internal 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.

During 1998, the Stock Exchange introduced a requirement for companies to report on the effectiveness of their whole system of internal control and not just on internal financial control. However, guidelines on this have not yet been issued by the relevant bodies and in the interim the requirement is only to review internal financial control. The Bank is looking at the whole system of internal control so as to be able to report in future when the guidelines are available. In the meantime, and 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.

STATEMENT OF THE RESPONSIBILITIES OF THE COURT OF DIRECTORS IN RELATION TO THE FINANCIAL STATEMENTS

The Court of Directors is responsible for ensuring that the financial statements, as prepared on the basis set out in the financial statements, present fairly the state of affairs of the Banking Department as at 28 February 1999 and of the profit for the year to that date. The statements of account of the Issue Department are prepared 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 prepared 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 Court to ensure that the financial statements comply with the requirements set out in note 1 thereto. The Court of Directors is also responsible for safeguarding the assets of the Bank and its subsidiaries, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

RISK MANAGEMENT

Reputational risk

The Bank needs to maintain a high level of public confidence across the full range of its activities in order to operate effectively. Risks to the Bank's reputation may arise, for example, from weaknesses in the quality of analysis underlying policy assessments or in the effectiveness of the Bank's operational activities. These risks are managed by rigorous procedures for the selection and development of staff, by setting annual objectives and performance measures for staff at all levels and by a structured process for the management and oversight of the work of the Bank.

Financial risk

The main financial risks associated with the Bank's activities, in both the Banking and Issue Departments, are credit risk, market risk and operational risk arising from a range of banking and market operations. These operations are largely undertaken in the Financial Market Operations area of the Bank in pursuit of the Bank's responsibilities for monetary and financial stability. The Bank has in place a framework of controls to identify, monitor and manage the risks arising from these operations. The framework is established by Court and is implemented by line management of the individual operational Divisions under limits, controls and reporting procedures established by the Governors and the Executive Director for Financial Market Operations. The risk management framework is continuously upgraded in line with market and operational developments and is subject to review by internal audit and by the Audit Committee on behalf of Court.

The Bank, as agent for HM Treasury, also manages the UK's official foreign currency and gold reserves within a risk framework agreed with HM Treasury.

Credit risk

The Bank incurs credit risk in the monetary operations through which it implements interest rate decisions taken by the Monetary Policy Committee; in other core central banking activities, notably provision of intra-day liquidity to members of the sterling and the euro wholesale systems, membership of the TARGET system and the operation of the Notes Held to Order scheme; and in banking operations conducted for the Bank's public sector, overseas central banks and other customers. Where feasible, credit limits are set for individual counterparties on the basis of continuous review conducted by a Credit Risk Advisory Committee, which is chaired by the Head of Market Services Division and reports to the Executive Director for Financial Market Operations. This Committee draws on relevant knowledge and experience across the Bank as a whole. Where the Bank, as a central bank, cannot set credit limits because the scale of its operations is determined by the liquidity needs of the financial system as a whole, credit risk is contained by structuring the Bank's operations so that, wherever possible, the resulting credit exposures are collateralised by high-quality, marketable securities.

Market risk

As a result of its operations, the Bank incurs market risk, principally in the form of exposure to changes in the relative interest rates received on its assets and paid on its liabilities; limited exposure may also be incurred to changes in exchange rates and to shifts in general market conditions such as liquidity. The Bank has adopted policies to minimise its exposure to these risks to the extent consistent with the underlying purposes for which its operations are conducted. Details of the Bank's interest rate and foreign currency exposures are given in the tables on pages 56-57 (Tables 5 and 6).

In relation to interest rate exposure, CRDs are interest free and so the Bank's income is automatically exposed to interest rate movements. The Bank manages this by investing a significant proportion of its funds in gilts, thereby fixing much of its income for the medium term. The liquidity provided through monetary operations typically has a maturity of around two weeks so that interest rate exposure arising from these operations is of short maturity. Deposits taken by the Bank in its banking operations are predominantly employed in deposits of matching maturity.

In relation to exchange rate risk, foreign currency and gold deposits taken by the Bank for customers are employed on a currency-matched basis. Foreign exchange swaps are on occasions undertaken to support the Bank's sterling open market operations, but no foreign exchange exposure is incurred. The Bank holds a portfolio of fixed-interest euro securities and other assets for the purpose of providing the UK's intra-day liquidity for the TARGET system. At the year end, the portfolio was funded in euro raised via cross-currency interest rate and foreign exchange swaps; later this year the portfolio will be funded instead by bills denominated in euro, which the Bank began to issue in April 1999.

Under the monetary policy arrangements introduced in May 1997, the Bank may undertake foreign currency operations in support of its monetary policy objectives. Such operations could give rise to foreign exchange rate exposure, but no such exposure has so far been incurred.

Operational risk

Like any financial institution, the Bank incurs operational risk, in the form of exposure to unexpected losses attributable to human error, systems failures, fraud or inadequate internal controls and procedures. Each business area has responsibility for detailed management of operational risk. The Bank maintains contingency facilities to support its own operations and market-wide systems run by the Bank.

Current developments

The Bank is devoting effort to the continued improvement in risk management. Current developments include updating of the risk matrix and implementation of recommendations made by an external review of controls undertaken in 1998. The Financial Market Operations area, where the majority of the risks arise and are managed, is increasing the resources devoted to risk management issues through, amongst other things, the establishment of a Middle Office and a Risk Committee. A new Front and Middle Office system has been introduced in Foreign Exchange Division for the real-time monitoring of credit and market risk limits.

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 95% of its bills within these timescales compared with 96% last year.

The Bank supports the aims and principles of the Better Payments Practice Group but is not a member.

AUDITORS

Coopers & Lybrand merged with Price Waterhouse on 1 July 1998. The new firm of PricewaterhouseCoopers will continue as auditors of the Bank.

The following table summarises the Bank's interest rate exposure in the form of an interest rate repricing table. This table can be used as the basis for an assessment of the sensitivity of the Bank's net income to interest rate movements.

Interest Rate Repricing Year-ended 28 February 1999 (Table 5)

	Not more than 3 months	More than 3 months but not more than 6 months	More than 6 months but not more than 1 year	More than 1 year but not more than 5 years	More than 5 years	Non-interest bearing	Total
	£m	£m	£m	£m	£m	£m	£m
Assets:							
Treasury and other eligible bills	18	–	–	–	–	–	18
Due from central banks in respect of TARGET	7,949	–	–	–	–	–	7,949
Loans and advances to banks, the money market and customers	7,100	530	39	3	3	98	7,773
Debt securities & equity shares	142	20	28	2,863	662	26	3,741
Other assets:-							
financial	–	–	–	83	–	437	520
non - financial	–	–	–	–	–	392	392
Total assets	**15,209**	**550**	**67**	**2,949**	**665**	**953**	**20,393**
Liabilities:							
Due to central banks in respect of TARGET	7,349	–	–	–	–	–	7,349
Deposits by central banks	1,594	530	37	–	–	26	2,187
Deposit by banks	657	–	–	–	–	1,233	1,890
Customer accounts	7,238	–	–	–	–	42	7,280
Other liabilities:-							
financial	–	–	–	–	–	222	222
non - financial	–	–	–	–	–	176	176
Shareholder's funds	–	–	–	–	–	1,289	1,289
Total liabilities	**16,838**	**530**	**37**	–	–	**2,988**	**20,393**
Off-balance sheet items	1,405	–	–	(1,405)	–	–	–
Interest rate repricing gap	(224)	20	30	1,544	665	(2,035)	
Cumulative gap	(224)	(204)	(174)	1,370	2,035		

Currency Exposure Year-ended 28 February 1999 (Table 6)

	Net foreign currency monetary assets and liabilities				
	US dollar	**Gold**	**Euro**	**Other**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
Functional currency of operations: Sterling					
Assets:					
Due from central banks in respect of TARGET	–	–	7,949	–	7,949
Loans and advances to banks, money market and customers	3,767	561	721	43	5,092
Debt securities	–	–	2,363	–	2,363
Equity shares and participating interest	–	–	25	1	26
Other asset	–	–	83	–	83
	3,767	**561**	**11,141**	**44**	**15,513**
Liabilities:					
Due to central banks in respect of TARGET	–	–	7,349	–	7,349
Deposits by central banks	636	561	627	40	1,864
Deposits by banks	–	–	596	–	596
Customer accounts	131	–	46	2	179
	767	**561**	**8,618**	**42**	**9,988**
Net	**3,000**	**–**	**2,523**	**2**	**5,525**
Off-balance sheet items	**(3,000)**		**(2,497)**		**(5,497)**

Fair Values of Financial Assets and Liabilities Year-ended 28 February 1999 (Table 7)

	Book value £m	Fair value £m
Primary financial instruments held to finance the Bank's operations:		
Assets		
Cash	8	8
Items in course of collection	217	217
Treasury and other eligible bills	18	18
Due from central banks in respect of TARGET	7,949	7,949
Loans and advances to banks, the money market and customers	4,722	4,722
- hedged items	3,051	3,051
Debt securities	1,352	1,668
- hedged items	2,363	2,363
Equity shares and participating interest	26	97
Other assets:-		
financial	295	295
non-financial	392	392
	20,393	**20,780**
Liabilities		
Deposits by central banks	2,187	2,187
Due to central banks in respect of TARGET	7,349	7,349
Deposits by banks	1,890	1,890
Customer liabilities	7,280	7,280
Other liabilities:-		
financial	222	222
non-financial	176	176
Shareholder's funds	1,289	1,676
	20,393	**20,780**
Derivative financial instruments held to hedge interest rate and currency exposure:		
Off-balance sheet items		
US dollar currency swaps	3,000	3,000
Euro securities		
-Cross currency interest rate swaps	1,405	1,405
-Foreign exchange swaps	1,092	1,092
	5,497	**5,497**

Notes:

i/ Market values have been used to determine the fair values for debt securities and Treasury and other eligible bills.

ii/ Debt securities denominated in euro and foreign currency swaps are translated into sterling at the rates ruling at the balance sheet date.

iii/ The forward leg of the transactions, which hedge the currency exposure, are also translated at the same exchange rates.

iv/ The fair value for equity shares and participating interest is equal to the valuation as disclosed in note 11 of the financial statements.

Report by the Non-Executive Directors of the Bank of England

This section of the Bank's Annual Report contains the report of the non-executive Directors required by Section 4(2)(a) of the Bank of England Act 1998. It describes the responsibilities under the Act of the sub-committee of non-executive Directors and how it has discharged them. In order to avoid repetition, the report refers where possible to other sections of the Annual Report, for which the non-executive directors, as members of Court, are also responsible.

Under the Bank of England Act 1998 certain functions of Court are delegated to a sub-committee comprising the non-executive Directors of the Bank. This sub-committee is known as NedCo.

The delegated functions are:

a/ keeping under review the Bank's performance in relation to its objectives and strategy for the time being determined by Court;

b/ monitoring the extent to which the objectives set in relation to the Bank's financial management have been met;

c/ keeping under review the internal financial controls of the Bank with a view to securing the proper conduct of its financial affairs;

d/ determining how the remuneration and pensions of the executive members of Court should be fixed;

e/ keeping under review the procedures followed by the Monetary Policy Committee, including determining whether the Monetary Policy Committee has collected the regional, sectoral and other information necessary for the purposes of formulating monetary policy;

f/ determining the terms and conditions of the members of the Monetary Policy Committee who are appointed by the Chancellor of the Exchequer.

NedCo is required by Section 4(2)(a) of the Act to make a report in respect of the matters for which it is responsible for inclusion in the report required to be made by the Bank as soon as practicable after the end of each of its financial years. The Act came into force on 1 June 1998. This is the first report under the Act and relates to the period from 1 June 1998 to 28 February 1999.

The Core Purposes and Strategic Objectives of the Bank for 1998/99 set out in the 1998 Annual Report have been adopted as the objectives and strategy of the Bank for the purposes of the Act and this report.

In discharging its functions, NedCo decided that it would, as far as practicable, rely on processes established for and work done for or in Court. Certain of the work required to fulfil NedCo's delegated functions was already carried out by the Audit and Remuneration Committees of Court. The work of these Committees is considered in Court. The terms of reference of these Committees were modified where necessary in order to align them with the Act and to facilitate the discharge by NedCo of its responsibilities. In addition, various reports on particular issues were prepared by the Bank at the request of NedCo. NedCo met regularly during the year to satisfy itself that the delegated functions were being satisfactorily discharged.

The Bank's performance in relation to its strategy and objectives (including the extent to which the objectives in relation to financial management have been met) was reviewed by Court and is evaluated by the Bank on pages 20-29 of this Annual Report. In NedCo's opinion this evaluation is a fair statement of the Bank's performance in relation to its objectives and strategy for 1998/99.

The Bank's internal financial controls were kept under review as a part of the responsibilities of the Audit Committee, which comprises non-executive Directors as set out on page 13. The Audit Committee, on behalf both of Court and of NedCo, has reviewed the effectiveness of the system of internal financial control which operated during 1998/99 as reported on pages 52-53. So far as appropriate, that forms part of this report.

Matters relating to the remuneration of the executive members of Court and of the terms and conditions of service of the members of the Monetary Policy Committee appointed by the Chancellor of the Exchequer were dealt with by the Remuneration Committee, which comprises non-executive Directors as set out on page 13. The report on remuneration for 1998/99 is set out on pages 45-49 and, so far as appropriate, forms part of this report.

The Monetary Policy Committee's procedures are described on pages 30-35. NedCo decided that in order to keep these procedures under review it would, inter alia:

- receive information provided to Court by senior executives of the Bank and discuss particular aspects of the procedures;
- encourage periodic attendance by non-executive Directors at the pre-Monetary Policy Committee meetings at which the Bank's staff present their latest analysis of relevant economic data to the members of the Monetary Policy Committee;
- hold discussions with Monetary Policy Committee members (both collectively and individually) and with HM Treasury's representative at Monetary Policy Committee and others, including senior representatives from the International Monetary Fund;
- review the minutes of the monthly Monetary Policy Committee meetings (at which the Monetary Policy Committee makes its decisions on interest rates) and summaries of other meetings;
- review the Bank's quarterly *Inflation Report* which is approved for issue by the Monetary Policy Committee;
- review examples of the regional, sectoral and other information collected by the Monetary Policy Committee during the year.

In NedCo's opinion, based on its review, the Monetary Policy Committee's procedures, including those relating to the collection of regional, sectoral and other information, operated satisfactorily during the part of the year under consideration. Although non-executive Directors did not attend meetings of the Monetary Policy Committee itself NedCo has no reason to believe that had they done so it would have altered its opinion.