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Governor's
Foreword

After two years of extraordinarily rapid change at the Bank following the granting of operational independence in 1997, the last year has provided us with a very welcome period during which we have been able to bed in the new arrangements for our twin roles of overseeing monetary and financial stability. But some of the practical policy problems with which we have had to grapple have been no less difficult than before. Indeed, one of those problems – the imbalance within the UK economy between domestically oriented businesses and sectors and those that are internationally exposed – is sadly familiar and has, if anything, become more difficult to resolve.

The recent economic performance of the UK has improved markedly since inflation targeting was adopted seven years ago. The inflation rate has averaged 2.7% on the Government's target measure – the longest period of sustained low inflation the UK has known for a generation; we have also enjoyed the longest period of uninterrupted quarter by quarter economic growth since records began some 45 years ago, with annual growth averaging 2.8%. We have had the lowest short-term interest rates in most people's memory, averaging 6.25% compared with some 11.25% over the preceding decade, while yields on 10 year Government bonds have recently been the lowest for four decades. Most welcome of all, the unemployment rate – on a claimant count basis – for the UK as a whole, at 4%, has reached its lowest level for 20 years.

Looking ahead, we see the tantalising possibility of new developments that may help to maintain our better performance. There is evidence, for example, of more intensive retail competition that could put downward pressure on the price level. The future spread of e-commerce may have a similar effect. There is also a possibility – no more than that at the moment, because of the lack of statistical evidence – that the spread of IT will raise the overall growth potential of the economy.

Any improvement in our longer term potential growth rate is in the realms of speculation, but there is no doubt that, having avoided a widely predicted recession a year or so ago, the economy has more recently been growing strongly, and above its trend growth rate. That is why the Monetary Policy Committee has raised interest rates since last autumn, by 1% to 6%, partially reversing the cuts we made a year earlier in response to the global economic slowdown.

But such encouragement as we may draw from the improvement in the performance of the UK economy as a whole over the past few years has been tempered once again by the problem of severe imbalances between different sectors of the economy. This is in part a hangover from the slowdown in global activity from the end of 1997 to the start of 1999, but the more important factor now is the persistence of the weakness of the euro against the pound, and also against the dollar and the yen. This is not a new difficulty, and it is one we have been concerned about for some time, but the impact on externally exposed companies and sectors, and on regions with a higher than average proportion of internationally exposed businesses, has been increasingly severe.

It is not easy to see what exactly is causing the euro's difficulties. Many blame it on structural weaknesses in the Eurozone, which are encouraging capital outflows to the United States and elsewhere. Whatever the cause, it has a particularly severe impact on our own economy because of the high proportion of our trade with the Eurozone.

Because the problem originates largely abroad, it is difficult to address directly through domestic policy action. But in our interest rate decisions, we do of course take full account of the fact that sterling's strength against the euro has a dampening effect upon both domestic inflation and external demand, with the result that interest rates have risen by less than would otherwise have been necessary. In effect we have been compensating for these effects of the strong exchange rate by encouraging domestic demand growth in order to keep the economy as a whole on track.

The risk is that we might have some difficult judgements to make about interest rates when the euro recovers, as most analysts expect that it will as the eurozone economies themselves continue to strengthen. But it would be unwise in the light of recent experience for any forecaster to attempt to anticipate the timing of that recovery in the euro. In the meantime, using monetary policy to drive down the exchange rate would have no more than a very short term benefit for the suffering sectors, and it would certainly destabilise the UK economy as a whole. That return to the disruptive cycles of the past is exactly what the new monetary arrangements are designed to avoid.

In the international arena over the last year, we have seen not only serious imbalances between major economies as a result of exchange rate misalignments but – in helpful contrast - a considerably more stable picture in the emerging market economies. Systemic threats to the world economy have receded. Not even the most optimistic analysts could have foreseen during the financial crisis 18 months ago quite how quickly the main economies in the Far East and Latin America would recover. But the fact that the worst fears were not realised is no reason to gloss over some of the shortcomings in the international financial framework, which became apparent in the difficult days towards the end of 1998.

The Bank has continued energetically to pursue its second core purpose of maintaining the stability of the financial system. The Bank has in particular been actively involved in the work on the reinforcement of international arrangements for preventing and managing financial crises, where there has been a great deal of progress, except in relation to the development of a new framework combining limited official financing with private sector involvement in handling systemic financial crises. We have continued to monitor financial markets and financial intermediaries worldwide, as part of macro prudential surveillance, to identify potential threats to stability, and we have been promoting improvements in the infrastructure – particularly payment and settlement systems and bank capital standards in the review of the Basel Accord - in order to strengthen the financial system's ability to stand up to shocks.

More generally, under the Memorandum of Understanding agreed in 1997 between the Bank, the Financial Services Authority (FSA) and the Treasury, the Bank has responsibility for the stability of the financial system as a whole, and within this framework our working relationship with the FSA is in very good shape. Some of the Bank's work in this area is now presented regularly to the public in the flagship publication for our second core purpose work, the *Financial Stability Review*, where we now provide a much more extensive and transparent assessment of our views of financial stability conditions, internationally and in the UK. And of particular note in the financial stability area last year was the Bank's work on preparations for the Year 2000 date change, where we concentrated on payment systems and note distribution, and publicised the issues to the markets and the public through our Blue Book. We also took steps, in our market operations, to ensure that ample liquidity was available to the financial system; and we worked with the banks to increase the availability of banknotes for the public. In the event, there was no serious disruption, but the evidence is that without the meticulous preparation which took place there could well have been serious embarrassments for the financial industry and for the public.

In the payments area, we continue vigorously to promote the reduction of systemic risk. A number of important new initiatives have been achieved or are being pursued, including the upgrading of the CHAPS domestic payment system. The Bank is also involved in planning the introduction of Delivery Versus Payment in equity, bond and money market settlement in the UK for implementation in the second half of next year. During the year, ownership of the settlement systems for gilt-edged stock and money market instruments (CGO and CMO) were transferred to CRESTCo. The Bank is working with the Bank for International Settlements, the European Commission, and others, on a range of international payment and settlement issues including Continuous Linked Settlement in the foreign exchange markets, and is in close touch with the European System of Central Banks over the TARGET cross border payment system for euros, to which the UK is linked.

In our market operations, although the Bank handed over the Government's cash management to the Treasury's Debt Management Office at the beginning of April, we have nevertheless extended our range of activities in other areas: we have taken on the Treasury's euro bill and - from next January - euro note programmes, as well as extending our reserves management operations for the Treasury through the continuing programme of gold auctions; and we have pressed ahead with our programme to modernise the structure of sterling money market instruments.

The Bank's success in co-ordinating the technical preparations in the wholesale markets for the introduction of the euro in January 1999 was not the end of that particular story. As a result of the City's efforts, London remains by far the largest and most competitive financial centre in Europe. To assist preparations for possible UK entry, the Bank continues to publish *Practical Issues Arising from the Euro* twice a year, and the Bank chairs a City Euro Group, whose job is to identify issues and ensure planning is done. The Bank is closely involved in the Treasury's National Changeover Plan and maintains extensive contacts with euro-area central banks. We continue to have a good working relationship with the ECB in areas of common interest.

On a more personal note, I would like to thank Dame Sheila Masters, who was nominated by the Chancellor in 1998 as Chairman of the sub-committee of non-executive Directors, for the excellent work she has done in guiding her sub-committee through its second annual report (published on page 56 of this report), which reviews the performance of the Bank and the procedures of the MPC. During the year we were delighted to welcome Kathleen O'Donovan and Sir Ian Gibson who joined us as non-executive members of Court in the place of Sir David Lees and Sir Colin Southgate who had earlier retired. This year, Graham Hawker has decided to retire from Court at the end of May when his term expires and Chris Allsopp has been appointed to the MPC from 1 June. I would like to thank both for their contribution to our work. In their places I am very pleased to welcome Sir Brian Moffat and Bridget Blow.

I would also like to thank Willem Buiter and Charles Goodhart, who are leaving the MPC at the end of this month, for their invaluable contributions to the first three years of the new monetary arrangements. In their places I am pleased to welcome both Chris Allsopp and Stephen Nickell who join us on 1 June.

I pay special tribute to Max Fry, Director of the Centre for Central Banking Studies, who tragically died last year, bringing to an abrupt end a distinguished and energetic career that was still in full flow until near the end. I extend a warm welcome to his successor, Peter Sinclair. And I wish to record my sadness at the death last month of John Fforde, a former Executive Director of the Bank, with whom I worked closely and for whom I had the highest regard.

My thanks also go to all the staff of the Bank, who have seen yet another year of change as the Bank continues to adapt to its new roles. In last year's Report, we said goodbye to those colleagues who left to join the FSA in Canary Wharf. Over the latest year, our staff have endured stoically the side effects of the extensive refurbishment that is allowing us to consolidate most of our now rather smaller numbers in London back into the headquarters building.

I am very grateful to my two Deputy Governors, to my fellow members of Court, to our Executive and Deputy Directors, to the members of the MPC and to the staff of the Bank for all they have done in their respective roles to help us meet our responsibilities.

Governor of the Bank of England

The Court of Directors

Members of the Court of Directors

The Rt Hon. 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.

Partner,
KPMG.
Member of Court,
Worshipful Company of Chartered Accountants.
Governor,
London Business School.
Trustee,
Reuters Founder Share Company.

Frances Heaton
Appointed March 1993.

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

Sir Chips Keswick
Appointed March 1993.

Senior Non-Executive Director,
De Beers.
Director,
Anglo American plc.
Director,
De Beers Consolidated Mines Limited.
Director,
The Edinburgh Investment Trust plc.
Director,
IMI plc.
Director,
Persimmon plc.
Director,
Investec Bank (UK) Ltd.

Sheila McKechnie OBE
Appointed June 1998.

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

Bill Morris
Appointed June 1998.

General Secretary,
Transport and General Workers' Union.
Member,
Executive Board of the International Transport Workers' Federation.
Sitting Member,
the Employment Appeal Tribunal and represents the Union on the Council of the Advisory, Conciliation and Arbitration Service.
Member,
Royal Commission for the Reform of the House of Lords.

Jim Stretton
Appointed June 1998.

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

Howard Davies
Appointed to Court as Deputy Governor in September 1995. Resigned in July 1997. Reappointed to Court in March 1998.

Chairman,
The Financial Services Authority.

Roy Bailie, OBE
Appointed June 1998.

Chairman,
W&G Baird Holdings Limited.
Director of Court,
Bank of Ireland.
Non-Executive Chairman,
Northern Ireland Tourist Board.
Non-Executive Director,
UTV (Ulster Television).

Sir David Cooksey
Appointed March 1994.

Chairman,
Advent Limted.
Chairman,
Bespak plc.
Chairman,
William Baird plc.
Director,
Advent VCT plc.
Director,
Advent 2 VCT plc.

Sir Neville Simms
Appointed March 1995.

Chairman,
Carillion plc.
Director,
National Power plc.
Chairman,
Regional Leadership Team (West Midlands), BITC.
Governor,
Stafford Grammar School, Stafford.

John Neill, CBE
Appointed March 1996.

Deputy Chairman and Group Chief Executive,
Unipart Group of Companies.
Director,
Business in the Community Limited.
Director,
Charter plc.
Chairman,
SMMT Industry Forum.
Vice President,
The Institute of the Motor Industry.
Vice President, Council Member and Executive Committee Member,
Society of Motor Manufacturers and Traders Limited Council.

Andrew Buxton
Appointed March 1997.

Advisor,
Barclays Bank plc.
President,
British Bankers' Association.
Deputy Chairman,
FI Group plc.
Chairman,
European Services Forum.
Member,
HMT Standing Committee on EMU Preparations.
Governor,
Imperial College of Science, Technology & Medicine.

Christopher Allsopp
Appointed June 1997.

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

Graham Hawker, CBE
Appointed June 1998.

Group Chief Executive,
Hyder plc.

Sir Ian Gibson, CBE
Appointed August 1999.

Senior Vice President,
Nissan Motor Co Limited, Japan.
Supervisory Board Member,
Nissan Europe NV.

Kathleen O'Donovan
Appointed August 1999.

Chief Financial Officer,
Invensys plc.
Director,
EMI Group plc.

Governance and Accountability

This is the second Annual Report prepared under the Bank of England Act 1998, which was summarised in last year's Report. This Report reflects the new governance arrangements, the main elements of which are set out below.

The Court of Directors

The 1998 Act provides for Court to consist of the Governor, two Deputy Governors and 16 Directors. The Directors are all 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 were less than three years to ensure that their terms of office did not expire all at the same time. Details of the current Court are set out on pages 6-7. During the year, the terms of Sir David Lees and Sir Colin Southgate expired and they were replaced by Sir Ian Gibson and Kathleen O'Donovan. Christopher Allsopp, Howard Davies and Sir Neville Simms were appointed for new three-year terms.

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 (MPC). 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.

Members of Court have been indemnified by the Bank against personal civil liability arising out of the carrying out or purported carrying out of his or her functions, provided he or she has acted honestly and in good faith and has not acted recklessly. These indemnities accord with the practice of the Government in relation to board members of Non-Departmental Public Bodies and their grant was approved by HM Treasury.

The Monetary Policy Committee

The Act establishes the MPC as a Committee of the Bank, subject to the oversight of NedCo, and sets a framework for its operations. 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 specifies the price stability target and its growth and employment objectives in conformity with the Act. Membership of the MPC, and an account of its procedures, are given on page 28.

NedCo

The Act provides for the creation of a sub-committee of Court consisting of all the (non-executive) Directors, with a Chairman designated by the Chancellor of the Exchequer. It is known as NedCo, and its current chairman is Dame Sheila Masters. While Court as a whole is responsible for managing the affairs of the Bank, including setting its objectives and strategy, NedCo is responsible for reviewing the Bank's performance in relation to its objectives and strategy, and monitoring the extent to which the Bank's financial management objectives are met. 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. Other functions of NedCo include reviewing the Bank's 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 MPC appointed by the Chancellor. 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 required to make a report as part of the Bank's Annual Report. This is on page 56.

Remuneration Committee

On 1 July, Sir David Cooksey became Chairman of Remuneration Committee, succeeding Sir Colin Southgate. At the same time Bill Morris joined the Committee, and Jim Stretton replaced Sir Chips Keswick. Throughout the year the other members of the Committee were Dame Sheila Masters and Frances Heaton. The Committee's approach to remuneration is set out in the Remuneration Report on page 45.

Audit Committee

On 1 July, Andrew Buxton replaced Sir David Lees as Chairman of the Audit Committee. Throughout the year Graham Hawker, John Neill and Sir Neville Simms were members, and Kathleen O'Donovan joined the Committee with effect from 18 August 1999. 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 controls in the Bank.

b/ 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/ 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.

Management structure

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.

The Bank's management structure and Heads of Function are shown on page 13. The responsibilities of each area are described in more detail on pages 10-11. 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.

The main organisational change during the past year was the creation of the Risk Analysis and Monitoring Division, described on pages 27 and 53.

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

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 and prospective developments in the UK and international economies. The MA divisions 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 to achieve the government's inflation target. 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.

Financial Market Operations

Gilt-Edged and Money Markets
Foreign Exchange
Banking Services
Market Services
Risk Analysis and Monitoring
Registrar's Department

The Market Operations divisions — Gilt-Edged and Money Markets and Foreign Exchange — 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 and they conduct the current programme of Government gold auctions. They contribute market analysis and intelligence to the Monetary Policy Committee and the Financial Stability Committee from their operational presence in the markets 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 Risk Analysis and Monitoring division is responsible for integrating management information on the risks arising from the Bank's operation in the financial markets and for analysing the balance sheet implications of those operations. The Registrar's Department provides the principal stock registration service for the Government and an execution-only postal brokerage service for retail gilt investors.

Financial Stability

Domestic Finance
Financial Intermediaries
International Finance
Market Infrastructure
Regulatory Policy

The Financial Stability divisions have the main responsibility for discharging the Bank's remit to maintain 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 covers both UK and overseas financial systems and markets, and the functioning of the international financial system. The divisions identify, analyse and carry out research into developments relevant to the structure and functioning of the financial system domestically and internationally, 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 as a member of the Monetary Policy Committee. The divisions' 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, specifically in relation to the euro. It monitors the evolution of the euro financial markets and supporting infrastructure; and provides information on this (and other euro-related matters) in the biannual Practical Issues report. It leads the Bank's involvement in HMT's National Changeover Plan work, focusing on the financial sector preparations. It co-ordinates the Bank's involvement in the main official and private sector euro fora; and provides a body of expertise on the European Central Bank. Working with the Agents, it also monitors the use of the euro in the UK.

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 senior management, 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
Legal Unit
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 legal and information services.

CCBS

The Bank of England's Centre for Central Banking Studies offers technical assistance, courses, workshops, seminars and comparative research on and for central banks throughout the world. Its primary aims are to foster monetary and financial stability world-wide, to promote the Bank's core activities, and to provide opportunities for Bank of England staff to obtain broader perspectives on their own areas of expertise. Its goal is to be recognised internationally as a leading centre of intellectual excellence for the study of practical central banking.

Printing Works

In addition to printing all the Bank's notes, the Printing Works manufactures its own inks, threads and other security components; and printing plates. Its expertise in these areas has led to commercial sales in overseas markets through Debden Security Printing Limited, 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 opened a new, purpose-built cash centre and took over physical cash operations from Head Office.

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

Management Structure

As at 1 March 2000

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 – see page 31

Philip Turnbull
Monetary and
Financial Statistics

Peter Sinclair
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

David Ingram
Risk Analysis
and Monitoring

Merlyn Lowther
Deputy Director and
Chief Cashier

Christopher Mann
Market Services

Colin Mann
Banking 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

Andy Brookes
(wef 1.10.00)
Management Services

Michael Craig
Investment Unit

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 2000/01 are set out on page 35 of this Report. The Bank Objectives for 1999/00 were 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 15-27 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

This section of the Report provides an account of the Bank's performance during 1999/00 against the Bank's Core Purposes and the Strategic Objectives set for the year by Court. These were published in last year's Annual Report, and have provided a framework for the Bank's business planning and budgets over the past year.

The Bank of England Act 1998 requires Court to determine the Bank's objectives (including objectives for its financial management) and strategy. It also requires NedCo 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 by Court for the Bank's financial management have been met. NedCo's own report is published on page 56. The objectives set for 2000/01 are shown on page 35.

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 physical note issue itself.

Meeting the Inflation Target

The monetary policy objective is set by the Bank of England Act 1998. It is **"To maintain price stability and, subject to that, to support the economic policy of HM Government including its objectives for growth and employment"**. Under the Act the Government is required to set a price stability objective each year. Throughout the year just past, the Government has defined this in terms of a target for inflation of 2.5% on the RPIX (excluding mortgage interest) measure. Should inflation move more than 1% either side of the target the Governor would be required to write an open letter to the Chancellor explaining the deviation and stating how the MPC intended to remedy the situation.

The MPC's decisions themselves, and the background to them, are recorded in the published minutes of its monthly meetings and in the Bank's *Inflation Report*, and are not repeated here. **During most of the year under review the rate of inflation was close to and slightly below the target. The MPC's latest central projection for inflation is close to the target level, although that central projection is surrounded by considerable uncertainties.**

Support for the Monetary Policy Committee

The Court's concern is with the MPC's processes, rather than its interest rate decisions, and with the support provided by the Bank to the MPC.

The MPC's own processes are described on pages 28-34. The strategic objective set by Court for the Bank was **"To improve the range and quality of information and economic analysis provided to the Monetary Policy Committee"**. 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, many of them in response to the wishes of MPC.

Full support to MPC in terms of briefing and analysis has been maintained by the Bank's Monetary Analysis and Market Operations Divisions, with assistance from the Financial Stability area (especially on emerging market issues). Among the main areas of improvement in the quality of information and economic analysis have been:

- International economic analysis: the new International Division within Monetary Analysis, which was established in the Spring of 1999 to draw together the

Bank's international economics work, has become a key contributor to the monthly briefing of the MPC and to the quarterly forecast process, where its effectiveness has been enhanced by new modelling tools.

- Analytical developments: new and more robust methods of yield curve analysis were introduced and published; further work on monetary policy strategies was undertaken and presented to MPC; additional research has been carried out on the links between labour market performance and inflationary pressure; and model development continued across many areas following the publication of *Economic models at the Bank of England* in May 1999.

- Monetary and Financial Statistics Division successfully expanded their statistics and briefing for the MPC process.

- Market developments: greater emphasis has been placed on the productive uses of market intelligence acquired through the Bank's contacts with financial market participants.

- The Agencies: the information provided to MPC via the Bank's regional Agencies, which now include an Agency in Northern Ireland, launched in January 2000, is enhanced by a targeted 'question of the month' put to business contacts of the Bank. Topics over the past year have included export prospects, skill shortages, productivity trends, stockbuilding in advance of Y2K and the outlook for pay growth in 2000.

The Bank also concluded a service level agreement with the Office for National Statistics, which strengthens the links between the two organisations and gives the MPC a formal opportunity to convey its priorities for data provision.

The Monetary Analysis area has also conducted a review of its business processes, with particular regard to IT developments. As a result of that review, a new Business Support Unit has been established.

The principal constraint on analytical support to the MPC has continued to be the difficulty of recruiting and retaining skilled and experienced economists. A major recruitment effort has been undertaken to relieve this constraint. During the year 21 economists have been recruited to Monetary Analysis (MA) from outside the Bank, but the net increase (ie allowing for departures from the Bank or to other parts of the Bank) was only 13, which falls some way short of the planned expansion to serve the MPC. By the end of the year MA was 6 under budget. Shortages of more senior economists have been especially acute.

During the year new arrangements were agreed for involving the external MPC members more closely in determining the priorities for research and analytical work in MA, and for providing them with dedicated staff of their own. These are described on page 28.

Progress has been made in the area of recruitment, and a high standard of support for the MPC process has been achieved. However staff numbers in MA remain below the number budgeted, and with lower average experience levels than planned. Looking ahead, there will be continuing emphasis on recruitment, training and retention issues over the coming year.

BUILDING SUPPORT FOR PRICE STABILITY

The Bank has long understood that monetary policy achieves its results more effectively if its processes are transparent and its objectives have wide public support. The strategic objective set by Court was **"To build public support for price stability, and public understanding of the MPC's approach to its remit"**.

Inflation Report

The Bank has developed an extensive public information programme, built around two key publications, the quarterly *Inflation Report* and the minutes of monthly MPC meetings. The *Inflation Report* explains the MPC's approach to its remit in the context of forecasts for inflation and economic growth. It complements the minutes, which are published within two weeks of each meeting, giving a detailed account of the proceedings, including the vote of each member. In May 1999, the MPC also published a paper on the transmission mechanism of monetary policy.

Parliamentary Committees

The messages of these documents are amplified and explained to Parliament, the media, business audiences and the general public in a variety of ways. The Governor, Deputy Governors and other MPC members appeared three times before the Commons Treasury Committee during the year, and also before the House of Lords Select Committee on the Monetary Policy Committee and the Commons Employment sub-committee. Dame Sheila Masters, Chairman of NedCo, appeared with a number of her non-executive colleagues before the Commons Treasury Committee and the Lords Select Committee on the Monetary Policy Committee to discuss Bank governance issues.

Speeches and media appearances

All members of the MPC undertook programmes of speeches, meetings, visits and media interviews, throughout the UK, to explain policy and exchange views with a wide variety of audiences. During the year, about 60 visits were organised by the Bank's Agencies for MPC members, typically of one or two days. Visits could involve a combination of speeches, lectures, meetings with local business groups and other interests, and visits to companies, schools and universities. The Court of the Bank also began a series of meetings outside London, in Birmingham in May and in Edinburgh in January.

While there were about two dozen major published speeches on monetary policy by the Governor and other MPC members during the year, they also gave more than 100 other private and public speeches, lectures and informal talks on the economy. The Bank's regional Agents undertook extensive speaking programmes of their own, and also organised a series of presentations by MPC members on the Inflation Report, for regional business audiences. In keeping with the MPC's policy of remaining in touch with all the regions of the UK, half of all the media interviews given by MPC members over the year were with regional newspapers, TV and radio.

Web site

The Bank has continued to develop its web site as a medium for promoting understanding of monetary policy. Total visits to the Bank's site have recently been averaging more than 175,000 a week, and have been growing at around 50 per cent a year. A substantial proportion of the visits are directed at the wide range of monetary policy and statistics content published on the site, including the *Inflation Report*, the MPC minutes, speeches and educational material. The site is being continually upgraded with the aim of staying at the technical and design forefront among central banks.

Education Programme

The Bank also continues to foster links with schools and universities. As well as a long standing programme under which nearly 20,000 visitors a year, half of them students, are given talks in the Bank, regular seminars are arranged for teachers of economics and business studies and senior staff and members of the MPC give presentations at universities, in part to help the Bank's recruitment drive.

In March 2000, to take the Bank's education work an important stage further, Mervyn King, the Bank's Deputy Governor for monetary policy, announced a new competition for schools, *Target 2 Point 5*, in which students aged 16-18 will make presentations on the economy and monetary policy in a series of regional heats, with a final in London in early 2001. In addition the Bank, in collaboration with economics teachers, is developing a "virtual Bank" web site for use as a classroom tool.

It is inevitably difficult to quantify the wider success and benefits of the Bank's efforts to build general public support for price stability. In November, the Bank began to trial a national opinion poll, designed to explore public opinion and understanding of a range of monetary policy matters. It is too early to

draw firm conclusions from this poll about changes in public understanding.

It can be said, however, that the credibility of monetary policy as measured by inflation expectations has been further enhanced over the year: survey measures and market indicators are now largely consistent with inflation expectations being anchored around the 2.5 per cent inflation target. Consistent with these expectations, outturns for inflation on the targeted RPIX measure have been near, though slightly below, the target.

MAINTAINING THE STABILITY OF THE FINANCIAL SYSTEM

The Bank's second core purpose relates to the stability of the financial system. In the framework of the Bank of England Act 1998, and of the Memorandum of Understanding between the Treasury, the Bank and the Financial Services Authority, the Bank is responsible for "the overall stability of the financial system as a whole".

In practical terms, this leads to work in three main areas: analysing and promoting initiatives to strengthen market infrastructure and the financial system's capacity to withstand shocks, and in particular the integrity and risk characteristics of payment and settlement systems; macroprudential surveillance - that is, monitoring developments in financial markets and amongst financial intermediaries worldwide to try to identify potential threats to financial stability before they become acute; and reinforcing arrangements for handling financial crises should they occur. Given London's position as a large international financial centre, the Bank's work has to address international as well as specifically domestic risks and initiatives.

The key forum within the Bank for addressing these issues is the Financial Stability Committee (FSC), which each month reviews the major policy issues and the Bank staff's assessment of current and prospective risks to stability. Issues raised in FSC are sometimes taken to the joint Treasury/Bank/FSA Standing Committee, which first met in January 1998 and which has become a useful high-level forum for the exchange of information, as well as providing a means of co-ordinating official intervention should specific problems in the financial sector need to be addressed. In the past year, the Standing Committee has considered a wide variety of issues focussing on, but not confined to, the UK. A recurrent subject was preparation for the millennium date change, which passed off in the event without material disruption (pages 21 and 25).

Internally, the Bank has made increasing use of the FSC to review policy issues related to its financial stability remit and to discuss the position that Bank representatives should take in various external discussions. This is important as the Bank's financial stability work has a strong international focus and involves the Bank in a number of international committees and working groups, including most prominently the Group of 10 Governors, of which the Bank's Governor is Chairman, and the G7 grouping itself; the G7 Deputies on which Mervyn King represents the UK; the Financial Stability Forum and the G10 Deputies, on which David Clementi sits.

Identifying threats to financial stability

The objective set by Court was **"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 FSA 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"**.

During the year, the Bank has strengthened its capacity for monitoring and analysing developments in the major international financial markets and emerging economies. It has also worked to strengthen its relationship with the FSA in reviewing developments in the UK financial system relevant to stability. The Bank has continued through its dealing and market intelligence activities to monitor risks in the markets centred on London. For the Market Operations area, a particular focus in the past year has been on factors influencing the movements of sterling and on yield curve relationships in both the short-term money markets and the bond markets. The Bank's Financial Stability area has initiated a research programme on so-called "leading indicators" of financial instability, and has been considering ways in which their usefulness in the Bank's macro-prudential surveillance could be increased. The Bank's interest here is the potential for system-level disruption. This has fitted well alongside the FSA's predominant interest in developments that may cause difficulties for the individual institutions they regulate.

International Financial Architecture

The Bank has also contributed to the policy debate on the international financial architecture. This debate, which has been stimulated by the debt-service problems in various emerging markets over the past two or three years, is directed towards improving countries' economic and financial management and strengthening their financial systems so as to integrate them more effectively and safely into global capital markets. Some of the main themes have been the introduction of greater transparency in relation both to data and to policy formulation; a strengthening of financial structures, including regulatory systems, supported by standards and codes; prudent management of external liquidity and country "balance sheets"; more orderly arrangements for the public and private sector to work together in responding to crises; and a review of the roles of the IMF and the World Bank.

Crisis Management

The Bank has been contributing to the work of several international groups to map out more clearly and comprehensively arrangements to respond to financial disturbances with a possible systemic impact – an important dimension in the debate on international architecture. In that context, the Bank has contributed to thinking on the terms of capital market contracts, on possible support facilities, and on arrangements for securing private sector involvement in resolving country crises.

International Supervisory Standards

A second and closely related area of activity has been revision of the Basel Capital Accord. The Bank sits alongside the FSA on the main Basel Supervisory Committee, where much of the discussion has taken place, and has also been involved in many of its sub-groups, especially those looking at the measurement and analysis of credit risk. The Bank also contributed to the Basel Committee's revised guidelines on bank liquidity management, which are vital to strengthening emerging market banking systems. The Bank's interest in prudential regulatory questions arises from the impact that prudential capital and liquidity standards for individual institutions can have on the stability of the financial system as a whole, and its contribution has drawn on its own research into macroprudential issues.

The Financial Stability Review

During the year, the Bank recast its *Financial Stability Review (FSR)*. Specifically, beginning with the June edition, *FSR* now contains a much more extensive commentary and assessment setting out the Bank's view of financial stability conditions and so increasing the transparency of the Bank's analysis. As the Bank's flagship publication for its second core purpose work, *FSR* also contains a wide range of analytical articles on financial stability related issues.

The Bank's financial stability work has, through the *FSR*, become increasingly transparent and, as a result of the internal Financial Stability Committee, more closely focussed and effective. It is clear that in a number of international fora Bank contributions have been making a real impact on the debate.

OVERSIGHT OF PAYMENT SYSTEMS

Within its responsibility for the stability of the financial system as a whole, one area of particular attention is the integrity of payment and settlement systems.

Domestic payment systems

The high value payment system, CHAPS, has satisfied best international practice for the control of financial risk since becoming a real-time gross settlement (RTGS) system in 1996. The technical infrastructure on which it operates is, however, no longer state-of-the-art and the Bank has been discussing with the CHAPS company ways to upgrade it and make it more flexible. Agreement was reached in February to move the sterling system onto the same platform as that currently used for payments in euro. The move will preserve the RTGS basis of the system and facilitate the introduction of full Delivery versus Payment (DVP) in central bank money for domestic securities settlement.

Payments risk in domestic settlement arrangements

The introduction of DVP will be an important step for equity, bond and money market settlement in the UK. The scale of the inter-bank exposures involved in this area has grown substantially in recent years, to the point where they are as large as the exposures in CHAPS before the introduction of RTGS. Towards the end of 1999, the Bank reconvened the DVP Steering Group, formed two years earlier during the Settlement Systems Priorities Review, to take forward the implementation of DVP in CREST. This Group comprises market and settlement bank representatives as well as CRESTCo and the Bank. It produced a report in January this year setting out principles for the design of DVP and providing guidance on the application of these principles to those directly responsible for delivering the project. These 'Project Owners' produced a *Statement of User Requirements* at the end of February for approval by the Steering Group. The Steering Group will continue to meet periodically to review progress and respond to any further issues which may emerge. Full DVP should be implemented in the second half of 2001.

Ownership of the computerised settlement systems for gilt-edged stock and money market instruments (CGO and CMO) was transferred from the Bank to CRESTCo during the year. The Bank will continue to operate the CGO system on CRESTCo's behalf until July 2000 when both gilts and equities will be settled within a single system, operated by CRESTCo. Since September 1999, when CMO operations were transferred to CREST, the Bank has provided a depository service for the safe custody of the instruments transferred within CMO.

International co-operation

The Bank has also worked closely with other central banks to promote sound payment and settlement arrangements internationally. It has participated extensively in initiatives and discussions within the European System of Central Banks (ESCB), including those related to the operation of the TARGET payment system which provides a cross-border real-time gross settlement system in *euro*. The TARGET system came into operation at the beginning of 1999 and has functioned well with availability in excess of 99% throughout the year.

The ESCB, through its Payment and Settlement System Committee, monitors the performance of TARGET and also oversees the European Banking Association's Euro 1 system. It also seeks to develop a common approach to issues such as the oversight of electronic money systems, technical standards and the standards for securities settlement systems in the EU.

S.W.I.F.T.

Through the G10 group of central banks, the Bank takes part in international efforts to oversee S.W.I.F.T. which provides messaging services to the international financial sector. The process is led by the National Bank of Belgium and involves regular discussions between technical specialists in the central banks and S.W.I.F.T. and its auditors in addition to higher-level policy discussions.

Settlement Finality Directive

The Settlement Finality Directive is intended to underpin payment system safety in the EU by making the legal framework in which it operates more certain and supportive of payment and settlement finality. The Directive was implemented in the UK in December 1999 through enabling legislation that gives the Bank responsibility for designating UK payment systems. The Bank will designate systems which, in its judgement, meet the statutory criteria; the main effect of designation is to give the rules of such systems protection against the operation of insolvency law in the EU. The FSA has similar responsibilities in respect of securities settlement systems but must consult the Bank where payment transfer orders are embedded in the securities settlement process.

International payment initiatives

As part of efforts to promote better market infrastructure, an international group established by the Basel Committee on Payment and Settlement Systems, chaired by John Trundle (Head of the Bank's Market Infrastructure Division), has been working to develop core principles for the design and operation of systemically important payment systems world-wide. The group comprises payments experts from 23 central banks in a wide variety of countries from all over the world and also includes the IMF and the World Bank. It produced a report last December which was published by the BIS for consultation. The report sets out ten core principles whose adoption will help to ensure the safety and efficiency of systemically important payment systems and four key responsibilities for central banks in applying the principles. A second part to the report will elaborate on the practical implementation of the principles. The first part is aimed specifically at policy-makers and the second at project designers. The group intends to complete its work in the second half of this year. The core principles should help central banks, as overseers of payment systems, and private sector operators assess the adequacy of existing systems and is likely to be particularly helpful to the many countries undertaking major reform of payments infrastructure.

Foreign exchange settlement risk

The Bank has remained active in international co-operative efforts to reduce foreign exchange settlement risk, which is very important to the stability of the international financial system. Payments specialists have assisted the Basel Supervisory Committee in producing guidance to encourage banks to monitor and contain the risks they run in this area. There has also been a continuing publicity and education programme in the industry. In addition the Bank, alongside other G10 central banks, has monitored the industry's own initiatives, notably the CLS (Continuous Linked Settlement) project. Progress has been made under each of the headings, but a further substantial reduction in foreign exchange settlement risk remains a high priority for the Bank's payment and settlement policy.

Y2K

Although in the event it passed off without serious disruption, one of the most obvious and foreseeable recent threats to financial stability was the millennium date change. The Bank's own preparations are described on page 25. Beginning in 1997, the Bank, in collaboration with the FSA, embarked on a programme to ensure that the financial infrastructure and major financial firms were properly prepared. While the FSA focussed on individual authorised firms, the Bank addressed mainly the preparation of significant payment systems, the arrangements for note distribution and the card payments schemes. Oversight of card schemes was a new area of activity for the Bank; these are predominantly retail and generally give rise to little systemic risk. This particular threat, however, was so pervasive that the Bank judged it should fill the gap by overseeing these schemes for this purpose. The Bank reported on all these preparations publicly in its regular so-called Blue Book publications. These also contained reports from other infrastructure providers. During 1999, the focus of these efforts shifted away from remedial action on IT systems towards the development of contingency plans to deal with any problems that might arise. Over the millennium weekend itself the Bank and the FSA maintained teams on site to monitor the transition and to respond to questions or to any emergencies. A similar, but smaller scale, process was put in place for the leap year transition which also passed off smoothly.

SEEKING TO ENSURE THE EFFECTIVENESS AND EFFICIENCY OF THE UK'S FINANCIAL SERVICES

The Bank has a long-standing interest in the way financial markets are organised both to serve the wider community and to attract and retain financial activity in the United Kingdom. The objective set by Court was **"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".

Money market instrument review

The year has seen important changes in the core sterling money markets. A working group, chaired by the Bank's Market Operations area, and comprising market participants, CREST, the Debt Management Office and other authorities, prepared a report on the future of money market instruments (MMIs) including CDs, Treasury Bills, commercial bank bills and commercial paper. Wider market consultation revealed strong support for all the main proposals, including dematerialisation of MMIs and their issuance and settlement in CREST, with the aim of promoting their trading and liquidity, and of providing secure, efficient and integrated settlement arrangements. Further work to prepare for implementation of the changes will be carried forward over the next year. One proposal was to simplify the requirements for bank bills to be eligible in the Bank's open market operations, and this change was announced in March 2000.

The Financial Services and Markets Bill

The Bank has been able to contribute to the debate on a number of issues arising from the Financial Services and Markets Bill. It has, in particular, taken an interest in the aspects of the Bill which potentially affect the functioning of wholesale markets. The Bank's Market Operations area has undertaken, at the FSA's request, to arrange for three groups of market participants to draft a Code of Conduct for dealings in "non-investment products" - that is, financial instruments such as wholesale deposits, spot and forward foreign exchange contracts and spot and forward gold contracts, which will not be covered by the FSA's new Interprofessionals Code of Conduct.

Finance for small firms

The Bank has continued to assess the relationship between banks and their small firm customers; a series of reports on the issues raised has been published over the past seven years. When this work began in the early 1990s, the emphasis was predominantly on relationships between small firms and their banks. As time has gone on, however, the emphasis has shifted more towards the availability of risk capital and also to questions about the position of particular categories of small firm (especially ethnic minority and high technology firms). Looking forward, the Bank will this year be publishing a further report on the financing of high technology firms and, following a remit given to it by the Government after the Policy Action Task Force Report on Financial Exclusion, will also be publishing a review of financial exclusion as it applies to small firms.

Guidance on share issuing good practice for listed companies

In February 1999, the Monopolies and Mergers (now, the Competition) Commission published its report on underwriting services for share offers, and asked the Bank to take forward the recommendations by preparing good practice guidance notes. After extensive consultation with relevant trade associations, market participants and finance directors, the guidance was published in October.

The Bank continues through initiatives like these to combine its analytical capacity and its market experience to support improvements in London's financial infrastructure and its service to the economy.

FINANCIAL MARKET OPERATIONS

The objective for the Bank's operational divisions was **"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"**.

Money market operations

In sterling open market operations, the range of securities eligible for use as collateral was greatly extended during 1999, to include a wide range of euro-denominated government securities. This was made possible by using the correspondent arrangements between European Union central banks. The change largely removed strains in asset markets that had arisen from occasional shortages of eligible collateral; the FSA allowed the newly-eligible instruments within its definition of sterling stock liquidity, facilitating banks' short-term asset and liability management; and as described in more detail on page 25, it also helped the Bank to ensure that ample liquidity was available to the banking system over Y2K.

Planning proceeded throughout the year for the Debt Management Office to start handling Government cash management in April 2000. This required close working contact between the Bank and the DMO.

Foreign Exchange

In managing HM Government's foreign exchange and gold reserves, the Bank complied fully with the objectives set by HM Treasury and is well on track to meet or exceed the performance targets set by HM Treasury.

Euro bill and Euro note programmes

During 1999, the Bank took over the Euro bill programme from HM Treasury, using the proceeds of the bill sales to fund the Bank's provision of euro liquidity to the London-based participants in the TARGET euro payments system. The Bank's market operations area has established an asset portfolio that achieves the twin objectives of providing the collateral for daily funding of the TARGET deposit and earning a return which exceeds the servicing cost to the Bank of the euro bills.

In March 2000, it was announced that the Bank would similarly take over the Government's rolling 3-year euro note programme, starting next January.

Gold Auctions

The Government decided in May 1999 to sell part of the UK's gold reserves through a series of auctions, which were managed by the Bank. Four auctions were held in the year ending 29 February 2000; another took place on 21 March 2000. The Bank was a signatory on behalf of HM Treasury to the announcement by European central banks on 26 September 1999 setting out their plans for future gold sales and gold lending.

The note issue

As part of its continuing programme to maintain the integrity of the note issue, the Bank introduced a new £20 note in June 1999 which included several enhanced security features, including a foil hologram and an ultra-violet feature. This was accompanied by an extensive publicity programme to explain the new features to the public. Other initiatives have been designed to improve the efficiency of note issue and distribution arrangements. A major review of the current arrangements is being undertaken in co-operation with the institutions involved in wholesale note distribution and the Bank has outlined some proposals for change in this field which are being developed further. In July, the provision of new notes to the banks was moved from the Bank's Head Office in Threadneedle Street to a new cash centre at the Printing Works in Essex.

Banking Services Review

There have been no changes to the range of banking services provided to customers but the systems and processes by which they are provided have been thoroughly reviewed during the year. As a result of this review a major change programme, lasting 2-3 years, has started, aimed at increasing the extent of straight-through processing and improving the provision of information to management and customers.

Stock Registration

Despite falling volumes, the registration function in Gloucester continued to operate within the unit cost target agreed with HMT throughout the year as a result of enhanced productivity. Maintaining this position has however required a number of redundancies.

The Bank has met all of its operational targets, including some not envisaged at the start of the year, and has embarked on a substantial change programme to improve efficiency and customer service in its banking operations.

PREPARING FOR EMU

The technical preparations in the wholesale financial markets specifically for the introduction of euro, which were co-ordinated by the Bank, were a success. As a result, notwithstanding the UK position outside EMU, London has fully maintained its market share. This year the Bank's objective was **"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 Economic and Financial Committee".**

Practical Issues Publication

The Bank has continued to publish *Practical Issues Arising from the Euro*, now on a biannual basis. Since the launch of the euro, this has begun to focus on the evolution of the euro financial markets and the supporting payments and settlement infrastructure.

Helping prepare the City

To assist the preparations for possible UK entry, a **City Euro Group** was established last year, under the chairmanship of John Townend, the Bank's Director for Europe, and with representation from across the City. Its aims are to ensure that the necessary planning is undertaken, and to serve as a communication channel through which the developing state of preparations can be explained and the right issues identified. The Group meets broadly quarterly and much of the intervening work is undertaken through a series of sub-groups.

Practical Issues sets out the state of the developing preparations for potential future EMU entry. A detailed and comprehensive statement of market practitioner views was published in the edition last June, and an update of the subsequent work of the City Euro Group was published in the December edition.

Helping prepare the wider economy

The Bank has helped to prepare the wider economy for potential EMU entry through its involvement in the Treasury's National Changeover Plan exercise. The Bank is represented at each level of the Treasury's project structure, including by the Governor on the Chancellor's Standing Committee. The City Euro Group is part of this process. The Bank has also co-ordinated discussions with the major banks on defining an optimal changeover scenario, taking into account the lead times for the preparations and the current uncertainties, since the financial sector would be at the heart of any future changeover.

Preparing the Bank

Through a Bank-wide committee, again chaired by John Townend, the Bank has considered in detail the practical and operational preparations which it would need to make to become a full member of the European system of Central Banks, if the UK Government decided the UK should join EMU. Having identified the necessary preparations, and the lead times involved, the Bank can ensure that it is in a position with a relatively short notice period to perform all the functions which would be required at the point of entry.

Bank representation in Europe

The Bank retains extensive contacts with euro-area central banks, including the European Central Bank (ECB). The Governor is a member of the ECB General Council and the Bank is represented on all of the main ESCB committees.

Over the last year, the International Economic Analysis Division in the Monetary Analysis area, which was created in March 1999, has built up nearly to full strength. It has taken on the responsibility of analysing the economic implications of EMU and as part of that task participates in discussions at the ECB and in relevant committees of the EU Council of Ministers.

The Bank has been given considerable credit for the success of the technical preparations for the euro and their subsequent contribution to maintaining London's position; and its work on the City's practical preparations for potential future EMU entry is also widely recognised.

YEAR 2000 PREPARATIONS

Although speedily forgotten once the danger was past, one of the most obvious recent threats both to the Bank's operations and to financial stability more widely was the millennium date change, where the Bank's objective was "**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"**.

Internal preparations

Testing of all critical internal systems was completed by Easter 1999 and full business continuity plans developed during the remainder of the year. All systems operated smoothly in the New Year and on 29 February, and no further problems are expected.

Meeting demand for notes

The Bank recognised that the additional bank holiday and Christmas and millennium celebrations could cause a much increased demand for cash from the public over the millennium period, quite apart from any increased demand due to concern over potential millennium related software problems. With the co-operation of the institutions involved in wholesale note distribution, the Bank put in place well-publicised arrangements to provide reassurance that sufficient notes would be available to meet the public's demands throughout the period.

Forestalling demand for liquidity

For Market Operations, Y2K work involved ensuring that an ample supply of liquidity would be available to the banking system throughout the New Year period, so as to allay widespread anxieties that fear of computer failures could lead to market disruption. The Bank introduced a facility under which the Bank's regular open market counterparties could borrow from the Bank for up to three months over the year-end, to supplement the regular two-week operations, so as to facilitate advance planning by market participants to meet liquidity needs and to reduce the need to roll borrowings over around the end of the year. In addition, the Bank undertook intensive contingency planning, in consultation with the FSA and foreign central banks, against the possibility of difficulties in individual financial institutions; and co-ordinated with institutional stock lenders and custodians to minimise withdrawals of securities from stock lending and collateral markets.

In the event, market anxiety about the possibility of an inadequate supply of liquidity diminished greatly, well before the end of the year; and the New Year came in with no disruption to the functioning of financial markets.

Co-ordinating City Preparations

Beginning in 1997, the Bank in collaboration with the FSA embarked on a programme to ensure that the financial infrastructure and major financial firms in the UK were properly prepared. During 1999, the focus of these efforts shifted away from remedial action on IT systems and more towards the formulation of contingency plans in the event that problems arose. As described in more detail on page 21, the Bank contributed to these preparations in a variety of ways, including the publication at regular intervals of its so-called Blue Book; and over the millennium weekend itself both the Bank and the FSA maintained teams on site to respond to questions or (had they arisen) to any emergencies. In the event, the transition passed off without any significant problems.

The near absence of Year 2000 problems in the financial sector was the result of much meticulous preparation and contingency planning. The individual problems that did emerge were quickly corrected, but it was clear that had large scale remedial work not been done in advance an accumulation of problems over the weekend would have been hard to manage. And steps taken by the Bank, well ahead of the date change, to reassure the market that there would be adequate liquidity over the year end, and the public that there would be adequate supplies of notes, proved successful.

MANAGING THE BANK'S HUMAN RESOURCES

The objective for the year was **"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"**.

The major concern throughout the year was recruiting a sufficient number of first class economists to support the MPC's and FSC's work, and retaining those already in place. Recruitment procedures were reviewed during the year and a number of specific recruitment drives were initiated in addition to the normal university milk round. In effect the Bank is now engaged in year round recruiting. This has been demanding of resources in the line Divisions as well as in Personnel.

The operation of the Bank's salary and job banding systems were again reviewed to ensure that they were not placing needless restraints on progression of the most promising individuals, and in the annual pay review particular attention was paid to remuneration in the key areas where retention is an issue.

During the year, the Bank proposed a new approach to non-salary benefits, as a result of which its spend on benefits will be distributed more fairly, including to those who have recently joined. An important aim of the new package is to improve the Bank's position in the recruitment market, and there is evidence that it is already achieving this purpose. For some existing staff the changes, especially the withdrawal of subsidised mortgages, proved controversial, but the Bank believed it had a strong business case for the change and that the compensation offered to those losing existing fixed benefits was fair. Following extensive consultation with staff and the three trades unions involved, the new arrangements were introduced on 1 April.

The Bank has been working hard in the recruitment market and this will continue: changes to pay and benefit arrangements will underpin that. Longer term individual and career development issues will be the priority in the coming year.

MANAGING THE BANK'S FINANCES

The Bank's financial framework is discussed in more detail in pages 36-39 of this Report. The objective set by Court was **"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, which calls for a £20 million reduction in overheads, including property costs"**.

Budgets

For 1999/00 Court set an expenditure budget of £213.2 million. The Bank's total spending for the year was £207 million. The main factors contributing to this outturn are discussed in the section of this Report on the Bank's financial framework on page 36.

The medium term spending plan within which the Bank operates includes a £20 million reduction in the annual costs of centrally-borne overheads. £20 million relates to the overhead costs that remained with the Bank when supervision transferred to the FSA in 1998. Progress against the planned reduction has been substantial with over half of the savings having been achieved, largely in the maintenance and servicing of buildings and in central personnel and finance. Relative to budgets for 1997/98, the last full year before the transfer of supervision, operating expenses in Property Services, Personnel and Finance Divisions were some £11 million less in 1999/00, accompanied by a fall in headcount in these areas from 590 to 396.

Further savings in centrally borne overheads are reflected in the budget for 2000/01 as set out on page 36.

Property

The Bank's strategy in relation to central London properties is to retrench into the main Threadneedle Street building, after first refurbishing that building in order to secure the benefits of lower maintenance costs, and a more flexible open plan style which would allow for higher densities of occupation. The refurbishment project is on track in terms of time and budget. The first phases are now either completed or close to completion. Planning for the second phases is well advanced.

Completion of the first phases allow the Bank to vacate the King's Arms Yard building.

The Bank has met its budget target and is on track to deliver the planned overhead savings.

MANAGING OPERATIONAL AND FINANCIAL RISK

The objective set by Court was **"To review the management of the Bank's balance sheets and to implement a new framework for monitoring and controlling financial and operational risks"**.

An account of the Bank's progress in this area is given on pages 53-55. Operationally, a high-level Asset and Liabilities Committee has been established to oversee the management of the Bank's balance sheet and to monitor the financial performance and risk profile of its main business activities. A separate Risk Analysis and Monitoring Division - a "Middle Office" - has been formed, with a budget for 19 staff, to monitor credit and market risks across all of the Bank's business activities.

The Bank believes that the new arrangements will provide a more integrated structure to enable management to measure and control the risks taken in its activities.

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 21 March 2000. 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.

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 review the procedures followed by the MPC and in particular whether the MPC has collected the necessary regional, sectoral and other information.

Resources for Monetary Policy

A key issue for Court during the past year has been the research and analytical support for the MPC. Court agreed and introduced in November formal arrangements for the MPC to determine collectively the priorities for research and analytical work to be undertaken by the staff of the Monetary Analysis Divisions. It was agreed that the MPC should meet six times a year to discuss these matters. Four of the meetings would follow on immediately after the publication of the quarterly *Inflation Reports*, and would focus on setting short-term priorities for analysis on issues that had arisen during the forecast round. The first of these was held in November. The remaining two meetings would respectively set and monitor priorities for long-term research. The first would identify the research strategy for the subsequent year; the second would take stock of progress made and adjust priorities as necessary at a mid-year review. The Committee met in December to set priorities for research in 2000. External MPC members direct some research projects and may act as consultants to others.

Court also agreed that the external members of the MPC would each be provided with one senior and one junior economist to support their personal research. Three of the four external members have taken up this facility; four members of staff have been appointed from within the Bank and two are being appointed from external recruitment.

These arrangements represent a significant advance, but it is too early to judge whether they will resolve all the issues raised concerning support for the MPC. They will be kept under review.

Professor Willem Buiter*

Professor Charles Goodhart**

Dr DeAnne Julius

Ian Plenderleith

John Vickers

Dr Sushil Wadhwani

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

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, Council, Royal Institute of International Affairs, Member, Governing Council, Institute of Development Studies, University of Sussex and Member, Advisory Board, Centre for the Study of Globalisation and Regionalisation, University of Warwick.

Dr Sushil Wadhwani: Member of the Clare Group, Member of the Council of Management of the National Institute of Economic and Social Research, Fellow of the Royal Society of Arts.

* Professor Stephen Nickell has been appointed to the MPC with effect from 1 June 2000. He will replace Professor Buiter.

** Christopher Allsopp has been appointed to the MPC with effect from 1 June 2000. He will replace Professor Goodhart.

Outside of this dedicated resource for the non-executive members, the MPC as a whole is primarily supported by the Monetary Analysis Divisions, though these staff also undertake non-MPC work. Additional MPC-related work is carried out in the Market Operations area, in the Monetary and Financial Statistics Division, in the Financial Stability Divisions, and in the Secretary's Department. As reported on page 16, a key issue for Monetary Analysis over the past year has been the difficulty of recruiting and retaining sufficient high-calibre economists.

An important resource for the MPC is the data produced by the Office for National Statistics (ONS). In October, the MPC's relationship with the ONS was formalised through a Service Level Agreement (SLA). In essence, the ONS will seek to supply economic statistics of sufficient quality and scope to enable the MPC to fulfil its objectives. The SLA also gives the MPC an opportunity to express its views on the ONS's work priorities.

The monthly policy round

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 meeting cycle include an extensive briefing of the MPC by Bank staff. This takes place a few days prior to the MPC policy meeting. The policy meeting itself is a two-stage meeting spread over two days, usually Wednesday and Thursday. It culminates in an interest rate announcement at noon on the second day. This is followed by a two-week period in which the minutes are prepared, agreed and published.

The pre-MPC meeting

This is the main briefing meeting for the Committee, usually held on the Friday prior to the main MPC meeting, at which senior Bank staff highlight, in a series of presentations, the main economic and financial developments during the previous month. In months when the quarterly *Inflation Report* is published, the meeting is compressed into a half-day, to allow further discussion of the *Inflation Report* forecast in the afternoon. A Treasury representative, usually the Head of the Government Economic Service, also attends the meeting. Non-executive Directors of the Bank, visitors from overseas central banks, international organisations (such as the IMF) and domestic agencies (such as the ONS), sometimes attend the meeting as invited observers.

The aim of the meeting is to provide the Committee as a whole with an opportunity to take stock of the main economic developments over the past month, and to ask questions. The Committee will already be very familiar with the data, as it receives written briefing and analysis on a continuous basis throughout the month, including the regular monthly surveys by each of the Bank's regional Agents. Committee members receive copies of all the relevant statistical press releases and business surveys. To supplement the presentations by staff, Committee members also receive a standard monthly pack of tables and charts which contains approximately 500 tables and charts covering over 1000 variables. New data and revisions are highlighted. This "Chart Pack" contains a wide range of material from official statistical sources, financial market information, business and consumer surveys, and assessments by the Agents. The Chart Pack is supplied to Committee members the day before the pre-MPC meeting – updates and revisions are circulated in advance of the policy meeting proper.

The pre-MPC presentations have usually been structured around the following headings: the International Environment; Monetary and Financial Conditions; Demand and Output; the Labour Market; an Agents' Special Topic; Prices; the Agents' Overview; Market Intelligence; and Prospects for Inflation.

The structure is flexible and extra slots can be inserted if there is a need to discuss an important issue, which is not obviously covered by one of these headings. Individual presentations can last between twenty minutes and an hour.

The Agents' Special Topic is chosen by the MPC at the preceding policy meeting. The objective is to shed additional light on a particular aspect of how the economy is behaving. Over the course of the month the Agents survey around 150 business contacts and report back at the next meeting. Recent special topics have included consumer pricing trends and pay prospects in 2000. The Agents also have a session towards the end of the meeting to provide the Committee with the latest business intelligence. Drawing on the information from their discussions with business people across the country, the Agents highlight any differences from the official data reported in the earlier presentations as well as drawing out any important regional and sectoral trends or divergences.

The Policy meeting – Wednesday afternoon

The policy meeting usually begins on the Wednesday afternoon in the first complete week of the calendar month. Following an update by the Chief Economist, John Vickers, on data and surveys received since pre-MPC, the Committee spends the Wednesday afternoon reviewing the news over the past month and debating the implications for the outlook. A short issues note is circulated by the Deputy Governor with executive responsibility for monetary policy, Mervyn King, to structure the discussion, but all Committee members are free to raise questions and topics which they consider relevant to the month's decision. The Treasury representative (again usually the Head of the Government Economic Service), offers information on

Regional Agents

Chris Bailey, South East and East Anglia

John Bartlett, West Midlands

John Beverly, South West

Chris Brown, East Midlands

Janet Bulloch, Scotland

Sue Camper, Wales

Nigel Falls, Northern Ireland[1]

Wendy Hyde, Greater London

Stuart Iles, Central Southern England

Mark Pratt, Yorkshire and the Humber

Tony Strachan, North West

Robin Webster, North East and Cumbria

1: An Agency for Northern Ireland, located in Belfast, was officially opened in January 2000. The North-West Agencies in Manchester and Liverpool were merged in March 2000: offices have been maintained in both cities.

aspects relating to government behaviour (eg fiscal trends, public sector earnings). The MPC Secretariat, comprising five senior members of the Bank staff, answer questions and provide clarification of data issues and analysis when they are able, but do not participate in the general discussion.

The Policy meeting – Thursday morning

The meeting continues on the Thursday morning. The Governor opens by summarising the previous day's discussion, drawing out any differences of interpretation and emphasis. Committee members are invited to comment on the summary and add any supplementary points. The Governor then asks each Committee member in turn for their view on the appropriate policy action. The Deputy Governor with executive responsibility for monetary policy speaks first and the Governor last. The order for the other Committee members varies from month to month. Committee members at their turn may signal a definite preference for a particular policy outcome, or alternatively present a preliminary opinion, subject to hearing the opinions of others. After each intervention, the speaker may be asked questions by other Committee members. Once all Committee members have spoken and preliminary views have been finalised, the Governor puts a proposition to the Committee which he believes will command a majority. A formal vote is then taken. Any Committee member in a minority position is asked to state what level of interest rates they would prefer.

Following the decision, the Committee then discusses whether or not it wishes to issue a press release to accompany the announcement of the Committee's decision. The announcement and any press release are issued to the financial markets and the media at 12 noon.

Minutes

There has been no change to the minutes procedures over the past twelve months. Agreed minutes are released at 9.30am on the Wednesday two weeks after the policy meeting (up to six weeks is allowed in the Bank of England Act).

The format of the minutes follows that of the policy meeting. The first sections summarise the Committee's discussion of the economic developments since the previous meeting. After reviewing any tactical considerations, the arguments underpinning the policy decision are presented, bringing out clearly where opinions differ either on the emphasis and interpretation of developments or the policy decision itself. The minutes conclude with the vote. Votes are attributed, but otherwise all comments and opinions in the minutes are unattributed in order to promote free and frank discussion at the meeting.

The quarterly Inflation Report process

The quarterly *Inflation Report* and the associated forecast are integral both to the policy process and to the transparency and accountability of the Monetary Policy Committee. Under the Bank of England Act, the Bank must publish a quarterly report, approved by the MPC, containing a review of the MPC's recent policy decisions, an assessment of developments in inflation and an indication of the MPC's approach to meeting its objective. The *Inflation Report* fulfils this obligation. The *Report* describes economic and financial developments over the quarter (Sections 1-4), reviews monetary policy decisions taken over the quarter (Section 5), and sets out the MPC's latest projections for inflation and output growth (Section 6). The Overview provides a short summary of the main points. The minutes of the monthly meetings published during the quarter are annexed to the *Inflation Report*.

The quarterly forecast round is central to the preparation of the *Report*. It provides an opportunity for the MPC to reassess the economic news over the quarter in detail, and to examine the potential implications for the inflation outlook. Given the time lags for changes in interest rates to affect output and inflation, policy must be forward looking. The forecast forms an important benchmark for the policy discussion.

The *Inflation Report* round involves 10-15 lengthy meetings of the staff and Committee over a period of around 5-6 weeks. The meetings can be grouped into six broad categories:

Stage 1 Reviewing data and assumptions, and identification of the main issues for the next forecast round. A separate meeting covers international prospects.

Stage 2 Typically three or so meetings covering the main forecast issues individually. Decisions taken by the MPC on individual assumptions.

Stage 3 Reviewing the forecast as a whole, again typically over three meetings. Agreement on any alternative assumptions and variants to be published in the *Inflation Report* if views differ.

Stage 4 Finalisation and signing off the forecast.

Stage 5 Finalisation and signing off the *Inflation Report*. The meetings focus particularly on the Overview and Prospects for Inflation section. Staff drafts of the other sections are circulated to the Committee earlier in the round and comments taken on board.

Stage 6 The Committee meets at the end of each forecast round to set priorities for analysis before the start of the next round.

Other meetings

The Committee also meets outside the regular policy and *Inflation Report* rounds to review a range of issues. As already noted, there are six meetings a year under the new arrangements to discuss priorities for analytical work and research. Other meetings are held to discuss, among other things, research results; media coverage and messages; statistical priorities of the ONS (where the Committee makes an input under the new Service Level Agreement); and responses to requests from the Treasury Select Committee.

Provision of Regional and Sectoral Information to the Monetary Policy Committee

NedCo has a statutory duty under Section 16 of the Bank of England Act to determine "whether the Monetary Policy Committee has collected the regional, sectoral and other information necessary for the purposes of formulating monetary policy". This section provides a brief summary of the material made available to the Committee on a regular basis.

Regional information

Examining regional data helps to improve understanding of how the national economy behaves, and consequently how it responds to different types of shocks and to changes in monetary policy. Although shocks affect the whole economy, some of these shocks will have a greater effect on certain regions than others reflecting in particular differences in industrial structure. For example, because of the high degree of openness of manufactured goods to international competition, the greater dependence on the manufacturing sector in the Midlands and the North increases the sensitivity of these economies to fluctuations in the exchange rate. In addition, industries such as agriculture and tourism are heavily concentrated in some regions. So shocks affecting these industries will have regional effects.

But the limits of monetary policy are also clear. The MPC has one instrument to hit one target. Monetary policy must be directed at the objective of national price stability in line with the Government's inflation target. But of course regional analysis aids the understanding of national economic developments and the transmission of monetary policy. Understanding the parts improves understanding of the whole.

In providing regional information to the Committee, the Bank's twelve regional Agents play a key role. Regular contact is maintained with around 7,000 businesses across the UK. Each Agent produces a monthly report which is circulated to Committee Members - a national summary is prepared in Head Office, covering a range of economic variables. In addition, the Agents are asked to produce a quantitative assessment for some 27 economic indicators each month.

In addition to the input from the Agents, other regional data produced by the ONS are provided to the MPC on a regular basis. For example, the monthly MPC Chart Pack contains tables on regional unemployment and regional house prices. The Bank monitors the data in *Regional Trends* and has on occasions undertaken more detailed analysis on the structure of the regional economies. Regional datasets have also been recently introduced onto the Bank's Intranet, containing a wide variety of economic information relevant to particular regions. MPC members regularly visit the regions to hear business people's views at first hand. Moreover, topical regional issues are brought to the attention of the MPC members through briefing notes.

Sectoral Information

On the broadest definition, most of the detailed analysis presented to the MPC draws on sectoral information. For example, any analysis of the role of money and credit in the economy has to take into account the differences in the behaviour of households, non-financial companies and financial institutions, and of course the behaviour of the banks and building societies themselves. Also, any study of aggregate GDP trends is underpinned by a picture for the key industrial sectors (manufacturing, services, construction, agriculture and the utilities). Moreover, an analysis of short-term inflation trends must draw on knowledge of special factors which affect individual goods or sectors.

All of the sections of the MPC Chart Pack contain sectoral data. And all of the monthly presentations at the briefing meeting draw on sectoral information in some form. Moreover, the Agents report on a wide range of sectoral information in their reports. A sectoral decomposition of most aggregate economic series is published either contemporaneously or with only a short delay.

In addition to official ONS data, a wide range of sectoral surveys are available to the Committee (eg from the CBI (Industrial Trends, Distributive Trades, Other Services, and Financial Sector), British Chambers of Commerce, British Retail Consortium, Engineering Employers' Federation, and the Chartered Institute for Purchasing and Supply which publishes separate reports on manufacturing, services and construction).

Sectoral themes have also been highlighted in the *Inflation Report* and *Quarterly Bulletin*. For example, *Inflation Report* issues in 1999 have included individual boxes relating to the UK construction, agriculture, oil and communications industries. Bank staff also attend quarterly CBI Trade Association meetings and the CBI Small and Medium Sized Enterprise Council meetings.

Other information

Apart from official ONS data and business and consumer surveys, the main 'other' information supplied to the Committee relates to trends in the international economy and to developments in financial markets. There are sections in the Chart Pack covering both areas, and presentations on both as part of the pre-MPC meeting.

The International Economic Analysis Division provides the MPC with analysis on international economic developments. Financial market trends are analysed in depth by Monetary Analysis and by the Market Operations Divisions. Key developments in foreign exchange markets, money markets, bond markets and equity prices are drawn to the attention of the Committee.

External Review

The Bank has continued to invite a wide range of central bankers and professionals from related organisations, both in the UK and abroad, to attend the pre-MPC meeting as observers, and about 30 attended during the year. The Bank actively solicits critical feedback and comment from these visitors, asking them to give overall impressions, views on the quality of the information and presentations, where appropriate comparisons with practice in their own institutions, and suggestions for improvements. The general tone of this feedback has been very encouraging and a number of useful suggestions have been made.

Objectives and Strategy
for 2000/01

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 objectives and strategy of the Bank for the purposes of the Act. The Core Purposes are set out on page 14. The Bank Objectives for 2000/01 are set out below. These Objectives provide the basis for objective setting in the local management areas of the Bank and a basis for the allocation of budgetary resources.

BANK OBJECTIVES FOR 2000/01

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

2/ To enhance the Bank's programme of economic analysis of key aspects of monetary policy

3/ Through speeches, the *Inflation Report* and other publications and other initiatives, to build public support for price stability, and public understanding of the MPC's approach to its remit.

4/ 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 FSA 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.

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

6/ 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, and to make fuller use in the Bank's monetary and financial stability roles of the intelligence gained through these operations.

7/ Without compromising its existing responsibilities, to ensure that the Bank is prepared to operate as a member of the European System of Central Banks should the UK join the European Monetary Union, to contribute to preparations in the UK financial sector, and to enhance the Bank's economic analysis of EMU.

8/ Through appropriate recruitment, pay and career development policies, to ensure that all Bank functions have staff of the right quality and experience.

9/ To maintain the Bank's overall spending within the agreed budget of £212.2 million for 2000/01 set by Court in the context of the medium term framework for its finances, which called for a £20 million reduction in overhead costs over the 5 year period to 2002/03.

10/ To implement the new framework for monitoring and controlling the Bank's financial and operational risks.

Financial Framework

for 2000/01

Budget for 2000/01

Reflecting the objectives set out on page 35, Court has agreed an expenditure budget of £212.2 million for 2000/01, a decrease of £1 million on last year's expenditure budget. As shown in the Chart on page 38, in subsequent years spending is expected to fall further as the benefits of current and planned investment projects come through.

Within total spending, operating expenses are budgeted at £191.4 million, £4.2 million less than last year, and revenue expenditure on investment projects is budgeted at £20.8 million, up £3.2 million on last year. The decrease in operating expenses reflects reductions in processing areas (bank note production, banking and market services and gilt registration), offset in part by increases in analytical areas, particularly in support for the Monetary Policy Committee, and in the creation of the "middle office" described on page 27. In addition the costs of central functions are due to fall by £3 million reflecting further progress towards the objective of a £20 million saving in overheads. The increase in spending on investment projects reflects the second year of the programme to refurbish the Threadneedle Street building and IT investments. Both include the impact of deferral in expenditures initially planned for last year. Major new IT projects starting in 2000/01 are Delivery versus Payment and those arising out of the proposals for changes to CHAPS.

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

Bank Expenditure Budget

			£m
	1999/00 Budget	**1999/00 Outturn**	**2000/01 Budget**
Business units			
Monetary Analysis and Statistics	16.5	16.9	18.9
Financial Market Operations	43.6	41.3	45.7
Financial Stability	8.1	8.4	8.9
Co-ordination Unit for Europe	1.3	1.3	1.4
Centre for Central Banking Studies	1.5	1.3	1.5
Printing Works	39.5	37.7	34.5
Registrar's Department	4.0	3.8	3.6
	114.5	**110.7**	**114.5**
Centrally-borne costs			
Personnel, Audit and Secretary's	22.7	23.7	24.8
Property Services and Security	36.2	32.6	34.0
Finance and central IT	5.9	6.5	6.3
Depreciation, VAT etc	33.8	33.5	32.6
	98.7	**96.3**	**97.7**
Total expenditure	**213.2**	**207.0**	**212.2**

Actual spending in 1999/00

Actual spending in 1999/00 was below budget, despite additional expenditure relating to the transitional arrangements for the new staff benefit scheme (page 42). The underlying shortfall relative to budget has three main components: faster progress in achieving planned savings, particularly in Property Services and Security Division; shortfalls in staffing, particularly analysts and economists; and the deferral of some investment spending. While the refurbishment of the Threadneedle Street building remains on track, the pattern of spending is different to that envisaged in the budget last year, and more will now appear later. In addition, the business process review in the banking area (page 23) caused investment there to be put on hold.

Costs of functions

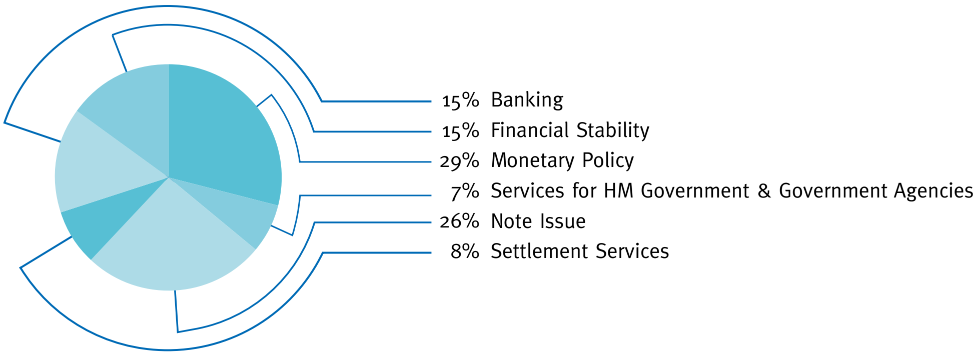
The breakdown of expenditure shown in the table is based on the organisational structure of the Bank: this is the basis on which Court manages the Bank's spending. However these figures do not show the cost of the Bank's functions, as many areas of the Bank contribute to more than one of these. For example, note issue costs, which amount to some £55 million in 2000/01, 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 shows the distribution of the Bank's budgeted costs for 2000/01 on a broad functional basis, with overheads fully allocated to functions.

Medium-term spending plans

The medium term expenditure plans continue to reflect a switch in emphasis, seeking continuous improvements in the efficiency of processing and manufacturing activities, while providing more resources for policy work. Overall though the Bank's spending is expected on balance to fall over the next three years reflecting further progress in savings in overheads and other centrally-borne costs.

One of the consequences of the change in the Bank's responsibilities under the Bank of England Act 1998 was an expectation that the Bank would reduce its overhead

Budgeted Costs of Functions 2000/01



costs by £20 million, consistent with the loss of banking supervision. 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. The Bank expects the reductions in centrally-borne costs to be fully realised by 2002/03 when building works are complete and, as is discussed on page 26, remains on course to achieve this. The chart below shows the trend in the Bank's expenditure over the past four 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.

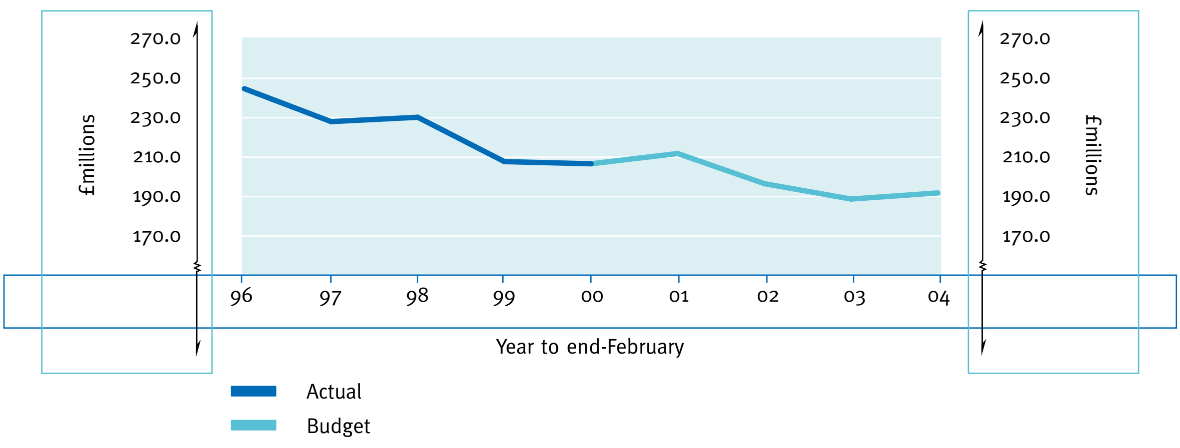
The Bank's objective in relation to its capital and reserves, agreed with Government, is to ensure a reasonable return, on an opportunity cost basis, on the Government's investment in the Bank. This is taken to be related to the return on Government bonds. When this was originally set in 1998/9 the Bank 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 continued to be lower on average than 7%. In the near term, this has only a limited impact on the Bank's income, and Court therefore is content to retain the benchmark of 7% for a further year.

Cash Ratio Deposits

Cash Ratio Deposits (CRDs) are the interest-free balances that deposit-taking institutions place with the Bank to finance its unrecovered costs associated with its monetary policy and financial stability activities. 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. In 1998, the Government 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 overhead initially retained by the Bank.

In establishing the initial level of CRDs, an interest rate of 7% was assumed to translate the required level of

Bank Expenditure 1996-2004



income (£79 million) into an initial deposit ratio of 0.15%, intended to give a level of CRDs of £1,130 million. During 1999/00, interest rates averaged 5.3% and balances £1,254 million, implying an annual income of £66 million if invested at the Bank's repo rate, substantially below the original expectation of £79 million. However the actual income was significantly higher because of the Bank's remaining holdings of high-coupon gilts. This income buffer will unwind as the gilts mature.

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. Although there continue to be upward pressures on the Bank's expenditure arising from the needs of the MPC process, changes in the Bank's total expenditure from that used in setting the inititial level of CRDs remain small, and 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

PERSONNEL

The table on page 41 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 29 February 2000, the Bank employed 2222 full-time and 202 part-time staff. Over the year, the number of staff fell by 239. Chart 1 on page 41 shows how the composition of the Bank's staff changed between 1999 and 2000. As in previous years, staff numbers fell in the Registrar's Department at Gloucester, at the Printing Works at Debden and within the Bank's central support functions. In addition, the completion of project work related to the preparation for the Year 2000 has resulted in reduced staffing levels in the Banking and Market Services area. The expanding areas of the Bank continue to be Monetary Analysis & Statistics, Financial Stability and Market Operations.

The fall in staff numbers last year continues a long-term trend illustrated in Chart 2 on page 41. In general the Bank has been steadily reducing staff in routine processing jobs, by changing processes and by using IT more intensively. Over the next few years further reductions are planned both in the central support functions and in the Banking and Market Services area, where a programme of change aimed at further improving the Bank's ability to provide high quality, responsive banking services at a competitive price has started (page 23).

Recruitment

At the clerical entry levels the Bank recruited 43 staff, (20 GCSE, 17 A-level and 6 secretaries), mainly into the operational areas of the Bank. This was slightly fewer than in 1998/99.

In the graduate recruitment area the Bank's demand increased, though the market continued to be extremely competitive. To raise the Bank's profile and attract high quality candidates, the Bank enhanced its presentations at a number of targeted Universities. The feedback has been very positive and we plan to continue to develop this approach in 2000/01. In addition, the Bank ran a summer recruitment campaign which proved successful. In all 25 new graduates joined during the year (1998/99: 18).

The demand for experienced specialist staff remained high. In response to a number of external recruitment campaigns, 33 mid-career staff were recruited (1998/99: 35). Whilst the majority were economists for the Financial Stability and Monetary Analysis areas of the Bank, a number of other areas, (e.g. the Centre for Central Banking Studies, Monetary and Financial Statistics Division, Personnel, Finance and Markets), recruited professionally qualified, experienced specialists to fill vacancies.

Training & Development

A number of initiatives were taken in 1999/00. First, induction courses were improved for new graduates and introduced for the first time for mid-career entrants who now form an increasing section of the Bank's professional work-force. Second, a range of new courses were introduced on a pilot basis for junior and middle managers, covering issues such as managing change and general management skills. The development of courses like these, together with more individual coaching support for senior managers, reflects the increasing complexity of management issues across the Bank and the need to ensure that managers are equipped with the right skills to meet these challenges.

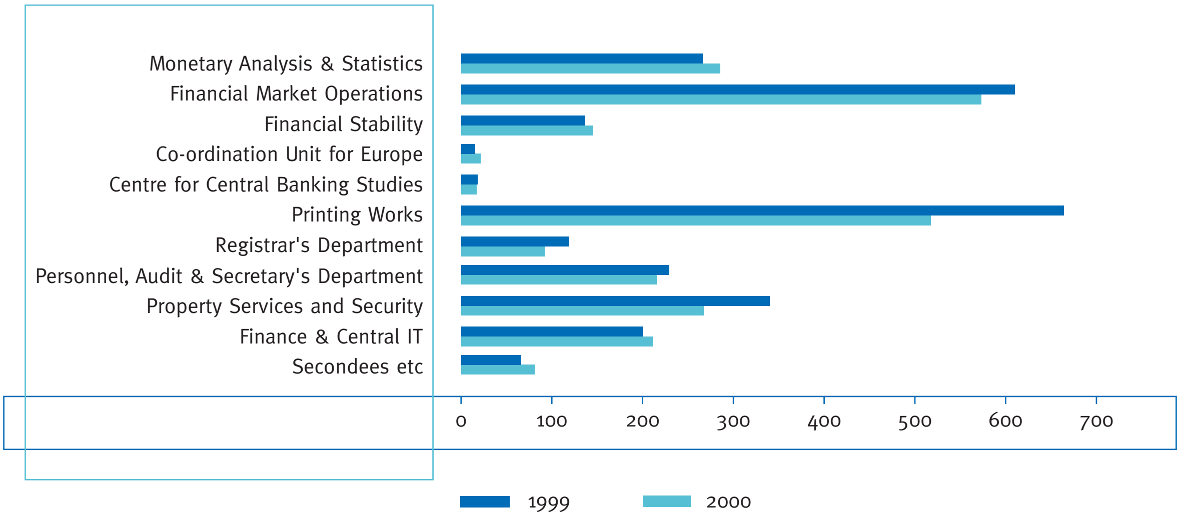
Third, a new Upward Feedback process for managers was introduced in the second half of the year and already some 120 managers have taken part. The process, which is facilitated externally, is mapped against the Bank's managerial competencies, and early feedback suggests that this is encouraging a greater focus on development on the part of managers.

In order to get the maximum return from its substantial investment in IT, the Bank has embarked on a major

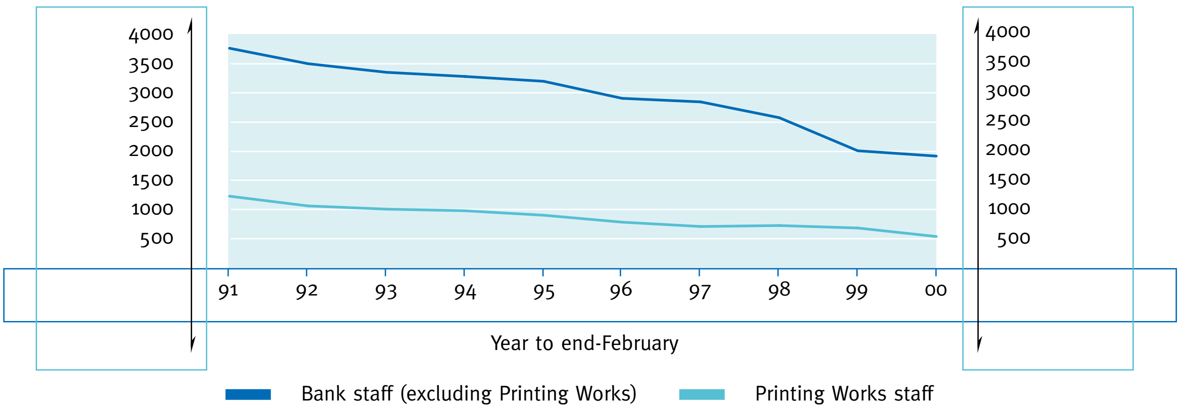
Aggregate Remuneration and Average Number of Staff

	1999/00		*1998/99*	
	Aggregate remuneration (£m)	**Average number of staff**	*Aggregate remuneration (£m)*	*Average number of staff*
Bank	**80**	**2,481**	*84*	*2,810*
Subsidiaries	**1**	**16**	*1*	*23*
Total	**81**	**2,497**	*85*	*2,833*

Numbers of Staff by Area 1999 and 2000 (Chart 1)



Bank Staff Numbers 1991-2000 (Chart 2)



programme of IT training built around the "European Computer Driving Licence" (ECDL) initiative. About 80 staff have now embarked on the courses, which are being offered both on a tutor-led and an ODL basis. The aim is that eventually all staff will qualify under the seven ECDL competencies.

A new guide, outlining the range of learning and development opportunities available to all staff, both on and off the job, was distributed in March. A quarterly newsletter will ensure staff are kept up-to-date with developments in this area.

Employment Policies

The Bank remains fully committed to diversity in the workplace and endeavours to avoid any form of discrimination. Relevant information and training is provided to staff, and this sets out their responsibilities. Staff are encouraged to raise any instances of discrimination through the Bank's internal procedures, and any complaints are investigated thoroughly. The Bank continues to support a number of targeted initiatives, including Opportunity Now, Race for Opportunity, The Employers' Forum on Disability and a similar Forum on Age.

The Bank continues to operate a range of family-friendly policies and has seen the proportion of women in managerial and analytical grades double over the past ten years or so, to the current 29%. The proportion of staff from an ethnic minority background remains at around 5%.

The Bank uses the Department of Employment's "Positive about Disabled People" symbol, which guarantees an interview to disabled candidates meeting the minimum job criteria. Where necessary the Bank provides specialist training and equipment to staff with disabilities and the needs of disabled staff have been taken into account in the current refurbishment programme.

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. This year the most significant change has been the development of new benefit arrangements, described below. In addition to the formal consultation process, briefings, notices and the Bank-wide intranet site were used to update staff on the progress of the new benefit scheme which came into effect on 1 April 2000.

The Bank is co-operating with the financial sector union UNIFI in a training initiative to provide IT skills to a group of Technical Services staff who would generally not have the opportunity to develop such skills in their day-to-day work. So far, they have concentrated on two of the seven modules required to achieve the ECDL. In view of the success of the scheme, the Bank is now expanding the IT training to additional Technical Services staff and offering further modules.

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 increasingly to bring management and press announcements to the immediate attention of staff and the Bank-wide intranet site is an expanding source of information.

Benefits

Having introduced a single integrated pay structure for Banking Staff in 1998, the Bank undertook a comprehensive review of its benefit arrangements. Following consultation with management, staff and unions, a new "flexible" benefits package was proposed. The aim was to ensure a fairer distribution of the Bank's spend in this area, so that benefits as well as pay could play a more effective role in attracting, retaining and motivating staff in the current employment market; as part of this the various subsidised mortgage and educational loan schemes were discontinued. The new scheme, which was implemented on 1 April 2000, offers a modern, equitable and consistent approach to the provision of benefits, and allows staff greater choice than before.

Replacement of existing HR system

During the year the Bank decided to replace its existing HR system and to review the current working processes. Wherever possible, centrally managed processes are being re-engineered in order to improve efficiency and reduce costs. In addition, the new IT system will allow the majority of personal HR administration to be devolved to the employee, enabling further savings in administration costs. Implementation of this new system began in January and is expected to be completed in June 2001.

COMMUNITY INVOLVEMENT

Last year the Bank contributed £568,000 in support of its community programme. This covers donations to charities and to academic research, and the cost of other contributions to community-related activities. Donations in cash totalled £416,000, while the cost of other community contributions, including time spent by Bank staff on community involvement activities, was £152,000.

The Bank's policy on charitable giving generally focuses on initiatives to enable disadvantaged people to access worthwhile employment through training and on supporting the staff's community involvement. £32,000 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, £59,000 donated by staff and pensioners to registered charities under the Give-As-You-Earn Scheme and £14,500 of staff fundraising for the Children's Promise. In addition, the Bank donates gifts in kind of surplus goods, computers and furniture.

The Bank recognises the positive impact which its community 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. These include a wide range of activities such as offering work experience placements in the Bank, and encouragement for staff to take part in various school initiatives. Staff also act as group facilitators at jobfinding skills workshops, interviewers at practice interview sessions and as mentors to pupils and partners to headteachers; a number have become school business governors. The Bank is represented on the "Partners in Leadership" steering committee which aims to find business partners for headteachers.

As a special millennium project the Bank supported the Runnymede Trust to research *Good Practices in Mentoring between Schools and Business*. In partnership with existing mentoring programmes, the Runnymede Trust has sought to highlight best practice and procedures in sustaining a successful education/business mentoring programme, particularly for ethnic minority youth.

No donations have been made for political purposes.

THE CENTRE FOR CENTRAL BANKING STUDIES

The Centre for Central Banking Studies (CCBS) continues to provide support to foreign central banks in the form of technical assistance and training on central banking matters. Comparative research relating to topical central banking issues forms an increasingly important aspect of the Centre's activities.

The range of events that the Centre runs has continued to diversify in terms both of format and of issues covered. This has ensured that the focus of CCBS activities evolves consistently with the needs of client central banks. In the year to February 2000, the CCBS ran 26 seminars/workshops in London for 531 central bankers from 98 different countries, while over 200 central bankers attended events run by CCBS staff overseas. Additionally, a number of short, specialised programmes were arranged in the UK for small teams from central banks. This diverse approach is also reflected in the range of countries seeking assistance (the Centre's resource allocation being largely demand driven). The CCBS continues to provide assistance to the transition and developing economies but there has been a growing interest in participation from a number of OECD central banks – particularly in response to the more advanced workshop events.

The Academic Workshop series continues to attract international experts from central banks, academia and the private sector. These one-week events offer the chance for participants to hear about the latest research on a key central banking topic and selected participants are invited to present papers on the approach adopted in their countries. A three-month research project follows during which a small group of central bankers work at the CCBS on an associated issue arising from the workshop. The work undertaken during this phase is presented at a subsequent conference and usually published. During 1999/00, the topic focus for these events was, respectively, the financial market data needed to enhance international financial stability; lessons for central bankers from recent financial crises; and an examination of central bank responsibilities for financial stability.

Remuneration
of Governors, Directors and MPC Members

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 the members of the Monetary Policy Committee (MPC) appointed by the Chancellor of the Exchequer. Recommendations are made by the Remuneration Committee, the composition of which is described on page 9.

REMUNERATION POLICY

The Remuneration Committee's approach is to review salaries annually, aiming to set pay and conditions of service that reflect qualifications, experience, responsibilities and performance. In addition to recommending salary levels, the Committee may recommend the payment of bonuses as a means of rewarding special services or individual performance. In proposing salary and bonuses, the Committee takes into account both internal and external salary comparators. Where appropriate, it 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 remuneration arrangements for the Governor and Deputy Governors have the following components:

Base salaries

The Governor is currently serving a second five-year term, which began on 1 July 1998. On 1 July 1999 the Governor's salary was increased from £232,675 to £238,491, in line with the Government's annual inflation target. The Remuneration Committee's intention is to continue to propose increases in line with the inflation target each year during the Governor's current term.

The Deputy Governors' salaries have been similarly increased.

Benefits

The Remuneration Committee also keeps under review other benefits available to the Governor and Deputy Governors. These benefits have generally been available on the same terms and conditions as for Bank staff, subject to any limitations on beneficial loans to directors that would apply to a banking company incorporated under the Companies Acts. During the year, as described on page 42, the range and distribution of staff benefits was reviewed, and a new flexible benefit package introduced with effect from 1 April 2000. As part of this, beneficial housing and educational loans were withdrawn. None of the Governors last year had beneficial loans, and the Remuneration Committee decided that they should not receive the full additional benefit package available to staff, but should retain medical insurance (this being the principal benefit received during the year to 29 February 2000).

The table of emoluments on page 47 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

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. The Court scheme is described on page 48. The Remuneration Committee's policy is to harmonise the value to participants of pensions that 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 scheme 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. The Governors are however 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 arising 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. 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. Non-executive Directors do not participate in the benefits package nor do they receive any post-retirement benefits from the Bank.

Remuneration of Members of Court

	Salary and Fees (Note i) £	Bonuses and other payments £	Benefits £	Total 2000 £	*Total 1999 £*
Governors					
Governor					
Mr E A J George	236,553	–	2,164	238,717	*236,344*
Deputy Governors					
Mr D C Clementi	197,106	–	1,234	198,340	*193,444*
Mr M A King	197,106	–	812	197,918	*192,810*
(from 1 June 1998)					
Non-Executive Directors					
(Notes i, ii and iii)	75,833	–	–	75,833	*59,375*
	706,598	**–**	**4,210**	**710,808**	***681,973***
Executive Directors					
(Note iv)					
Mr I Plenderleith	–	–	–	–	*45,221*
Mr T A Clark	–	–	–	–	*34,477*
Mr M D K W Foot	–	–	–	–	*37,921*
Total	**706,598**	**–**	**4,210**	**710,808**	***799,592***

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 remuneration of £5,000 due from the Bank and Mr Clementi waived remuneration of £14,000 due from the FSA.

ii/ Non-executive Directors received their salaries only from 1 June 1998 when the Bank of England Act came into effect. Prior to that they received fees of £500 per annum.

iii/ Sir David Lees and Sir Colin Southgate retired on 31 May 1999. Kathleen O'Donovan and Sir Ian Gibson were appointed on 6 August 1999. Each Director received remuneration at the rate of £5,000 per annum for their periods of office.

iv/ Under the terms of the Bank of England Act 1998, the Executive Directors ceased to be members of Court with effect from 1 June 1998. Mr MDKW Foot resigned from the Bank on the same day to take up his responsibilities at the FSA. Mr I Plenderleith and Mr TA Clark remained as employees of the Bank. The salaries of the Executive Directors were not disclosable after they ceased to be members of Court. The comparative figures for 1999 reflect the period up to 31 May 1998 when they were members of Court. As a member of MPC, Mr Plenderleith's current salary is disclosed below.

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, and the scheme 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) and allowances for spouses and dependants.

In the event of death in service, the scheme provides for the payment of a lump sum, a 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 what the Court scheme would have provided had the cap not applied. During the year ended 29 February 2000, 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)

	Age at 29 February 2000	Years of service to 29 February 2000	Accrued pension as at 29 February 2000 £	Increase in accrued pension in 2000* £
Mr D C Clementi	51	2	16,800	6,800
Mr M A King	51	9	60,400	15,100

* 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. 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 unfunded pension to reflect his service since his normal retirement date which will comprise the difference between the pension 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. At 29 February 2000 no such additional provision had been required.

ii/ Unfunded pensions are included in the above table.

REMUNERATION OF MONETARY POLICY COMMITTEE MEMBERS

The Bank of England Act 1998 requires NedCo to determine the terms and conditions of service of the four members of the MPC appointed by the Chancellor of the Exchequer. NedCo 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 £131,329 (1999 £128,125) per annum, pro rated for the number of days worked per week. The members of the MPC appointed by the Chancellor are on fixed-term contracts, normally for three years although some were initially appointed for shorter periods on the coming into force of the Bank of England Act 1998. Professor Willem Buiter's term expires on 31 May 2000, and he will be succeeded by Professor Stephen Nickell on 1 June 2000. Professor Charles Goodhart's term expires on 31 May 2000 and he will be succeeded by Christopher Allsopp. Dr DeAnne Julius's term expires on 31 May 2001 and Dr Sushil Wadhwani's on 31 May 2002. Professor Buiter, Dr Julius and Dr Wadhwani are all contracted to work full-time for the Bank, and Professor Goodhart for two days per week. On taking up their appointments in June, both Professor Nickell and Mr Allsopp will work part-time. The members of the MPC appointed by the Chancellor do not receive the standard staff benefits package. 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 not 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 £161,283 (1999 £154,263) and Mr John Vickers, whose annual salary is £144,411 (1999 £128,125). Mr Plenderleith and Mr Vickers are both eligible for the new flexible benefit package on the same basis as other members of staff.

Report from Members of Court

for the year ended 29 February 2000

PRINCIPAL ACTIVITIES AND REVIEW OF OPERATIONS

The Bank's core purposes are set out on page 14. The Governor's Foreword, the Review of Performance against Objectives and Strategy and the Financial Framework give a detailed account of the Bank's activities and operations during the year.

PRESENTATION OF THE FINANCIAL STATEMENTS

The Bank Charter Act 1844 requires that the Bank's note issue function be 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 profit of the note issue is 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 limitation 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 Bank's Income

The Banking Department's financial statements for the year ended 29 February 2000 are given on pages 60-84, and show a profit after provisions and before tax of £123 million (1998/99 £172 million). The main reason for this fall was a reduction in income, reflecting the full-year effect of the reduction in Cash Ratio Deposits referred to in last year's Annual Report, and lower interest rates. After payment in lieu of dividend of £50 million (1998/99 £70 million) and a tax charge of £23 million (1998/99 £32 million), the profit transferred to reserves amounts to £50 million (1988/99 £70 million).

The statements of account for the Issue Department (which are given on pages 85-87) show that the profits of the note issue were £1,317 million (1998/99 £1,705 million). The fall was the result of lower interest earnings on the securities backing the note issue. 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

The size of Banking Department's balance sheet is largely determined by the bilateral positions between central banks in the TARGET system. As explained last year, these balances reflect the net flows between the individual countries through the central banks and fluctuate with such payments. 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 central banks have arranged a system of transfers between themselves whereby these balances are periodically reduced.

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.

SUPPORT OPERATIONS

The NMB Group plc (NMB) was sold on 28 January. Up to its sale the NMB group had continued to recover its assets during the year. These recoveries together with a further payment on the sale had reduced NMB's loan from the Bank from £114 million at 28 February 1999 to £67 million, which was offset against the indemnity from the Bank. The Bank's loss was therefore crystallised at £67 million, compared to a maximum of £113 million in 1993. A release of £5 million of the provision has been included in profit for 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 page 76.

EMPLOYEES

Details of the Bank's employees and their involvement in the Bank's affairs and the Bank's approach to equal opportunities are given on pages 40-44.

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. Accordingly the Bank paid £32 million in April 1999 and £38 million in October 1999 in respect of the year to 28 February 1999. In April 2000 the Bank paid the first payment of £24 million in respect of the financial year ended 29 February 2000 which was based on provisional figures. The balance of £26 million will be paid on 5 October 2000.

GOVERNANCE OF THE BANK

The role of the Court of Directors and its Committees, 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 6-7.

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 13.

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 the monitoring of 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 an annual 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 by 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 endorsed by the Audit Committee. Monitoring the effectiveness of internal control is undertaken by Court (see below) and by the Audit Committee, which receives regular reports from management, from internal audit and, where appropriate, from the external auditors. The Audit Committee reviews the activities of the internal and external auditors to ensure comprehensive audit coverage.

A number of new measures have been introduced to enhance risk management, including the setting up of a monitoring committee, the Assets and Liabilities Committee (ALCO), chaired by the Deputy Governor, Financial Stability. Details of these measures are set out in the risk management section of the report on pages 53-55. Further measures have also been introduced to improve the risk reporting by Executive Management to Court. As foreshadowed in last year's Report, the effectiveness of the framework of internal control has been reviewed by Court in the context of the Turnbull guidance, which was issued in September 1999. Court intends to be in a position to report that, for the 2000/01 accounting year, the Bank has complied with the Turnbull guidance.

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 in accordance with previous guidance for reporting on internal financial controls, issued in December 1994.

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 therein, present fairly the state of affairs of the Banking Department as at 29 February 2000 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 that 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.

HEALTH AND SAFETY

Effective health, safety and risk management is recognised throughout the Bank. Appropriate policies and procedures are in place to protect employees and members of the public from workplace hazards.

POLITICAL AND CHARITABLE DONATIONS

No donation was made for any political purpose. Details of charitable donations are set out on page 43.

POLICY ON PAYMENT OF SUPPLIERS

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 96% (1998/99 95%) of its bills within these timescales.

The Bank estimates that the average trade creditor payment days for 1999/00 were 19 (1998/99 18). This is an arithmetical calculation and does not necessarily reflect our practice, described above, nor the experience of any individual creditor.

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

RISK MANAGEMENT

a/ New Developments in 1999/00

As indicated in last year's Annual Report, the Bank has continued to devote effort and resources to enhancing its risk management. In the Financial Market Operations area, where the majority of risks arise and are managed, a more centralised "middle office" function was established in October 1999, now known as the Risk Analysis & Monitoring Division. This unit brings together staff who were already working on risk issues in the individual operational Divisions in this area. Its responsibilities include monitoring and reporting on credit and market risk exposures in respect of the Bank's operations for its own account and for HM Treasury; and it oversees the procedures for introducing new financial products in the operational areas. The new unit reports to the Executive Director for Financial Market Operations. At the same time, ALCO was formed, chaired by the Deputy Governor, Financial Stability, with a membership comprising the Finance Director, the Auditor, and the Executive Director and senior management with responsibility for Financial Market Operations, including the Head of the Risk Analysis & Monitoring Division. The role of ALCO is to oversee the management of the Bank's balance sheet as a whole, and to monitor the financial performance and risk profile of its main business activities.

The following sections describe the approaches the Bank takes to different types of risk.

b/ 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 shortcomings in the effectiveness of its operations, which might impact on the implementation of policy decisions or lead to financial loss. 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.

c/ Financial Risk

The main financial risks associated with the Bank's activities are credit and market risks arising from a range of banking and market operations. These are largely undertaken in the Financial Market Operations area 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 the line management of the operational Divisions subject to limits, controls and reporting procedures established by the Governors and the Executive Director for Financial Market Operations. The risk management framework is regularly reviewed in the light of market and operational developments and is subject to oversight by internal audit and by Audit Committee on behalf of Court.

The Bank, as agent for HM Treasury, also manages the UK's official foreign currency assets and liabilities and gold reserves within a risk framework agreed annually with HM Treasury. In its foreign currency and gold operations, both for HM Treasury and on its own account, the Bank has implemented a new management information system.

d/ 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, management of the official reserves on behalf of HM Treasury, membership of the TARGET system and the operation of the Notes Held to Order scheme; and in its banking operations for the Bank's public sector, central bank 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 the Risk Analysis & Monitoring Division and reports to the Executive Director for Financial Market Operations, who is responsible for decisions on limits. This Committee is supported by a credit analysis team which also draws on the output of ratings agencies, and on relevant knowledge and experience across the Bank as a whole. In the Bank's gold and foreign exchange operations both for HM Treasury and for its own account, these exposures are monitored against credit limits on a real time basis on its management information system. 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 it deals with counterparties that meet appropriate creditworthiness and functional criteria, and wherever possible the exposures that arise are fully collateralised by high-quality, marketable securities. These exposures are also monitored on a regular basis, and additional margin is called as required.

e/ 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 note 7 of the financial statements on pages 68-74.

In relation to interest rate exposure, Cash Ratio Deposits are interest-free and the Banking Department's income on the corresponding assets is exposed to interest rate movements. The Bank minimises the variability in its income, and limits its credit exposure, by investing a significant proportion of these funds in gilts. The liquidity provided through monetary operations typically has a maturity of less than two weeks so that the interest rate exposure arising from these operations is of short maturity. Longer maturity instruments have been employed, such as the three month repos issued over the millennium period, but these were at floating rates, again limiting the Bank's interest rate exposure. Sterling deposits taken by the Bank may also be employed in the Bank's monetary operations, resulting in a slight maturity mismatch, while customer deposits in foreign currency and gold are on-placed with the market in deposits of matching maturity.

In relation to exchange rate risk, the foreign currency and gold deposits taken from customers are employed on a fully matched basis. The Bank uses foreign exchange swaps as a technique in its sterling open market operations, but no foreign exchange exposure is incurred. The Bank has used currency, foreign exchange and interest rate swaps in order to hedge its market exposures in connection with the portfolio of fixed interest euro securities and other assets acquired for the purpose of providing the UK's intra-day liquidity for the TARGET system. Other than this, the Bank does not use derivatives in its own operations. At 1 March 1999 the TARGET portfolio was funded in euro raised via cross-currency interest rate and foreign exchange swaps; from April 1999 the Bank began to fund this instead through the issue of bills denominated in euro, unwinding the corresponding foreign exchange swaps. The bill issuance programme reached its full size in September 1999, at which point the bulk of the portfolio was funded by euro bills. As these bills have matured they have been replaced by new issuance.

Under the monetary arrangements introduced in May 1997, the Bank may undertake foreign currency operations in support of its monetary policy objectives. Such operations would give rise to interest rate and foreign exchange rate exposures, but no such operations have so far been conducted. In its reserves management operations for HM Treasury, and in line with good market practice, the Bank has now introduced daily monitoring of Value at Risk (VaR), using its new management information system. Value at Risk measures the aggregate market risk of a portfolio by gauging the effect on the value of assets and liabilities of potential changes in the profile of interest rates and exchange rates.

f/ 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, procedures or legal and other documentation. Shortcomings in any of these areas could have reputational or financial consequences for the institution. Following a review by the Chief Cashier, a programme of investment is planned to further reduce operational risk in the Bank's banking activities.

Operational risks are subject to a comprehensive framework of internal controls, including contingency arrangements for both business processes and IT systems. Each business area has responsibility for detailed management of its operational risk. In the event of a serious technical failure or unavailability of systems, the Bank maintains remote contingency facilities to support its own operations and the market-wide systems run by the Bank.

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 second report under the Act and relates to the period from 1 March 1999 to 29 February 2000. The Core Purposes and Strategic Objectives of the Bank for 1999/00 are set out in the 1999 Annual 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 is 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 15-27 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 1999/00.

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 9. 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 1999/00 as reported on pages 51-52. 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 9. The report on remuneration for 1999/00 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 28-34. NedCo decided that in order to keep these procedures under review it would inter alia:

- receive a monthly report in Court on monetary stability to which all members of the Monetary Policy Committee are invited;

- 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;

- 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;

- encourage non-executive Directors to visit the Bank's Agents and to take part in their contact activities;

- 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 year. 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.

Chairman of the Non-Executive Directors' Committee

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Enquiries relating to the *Bank of England Quarterly Bulletin and Inflation Report* may be made on 020 7601 4030; *Financial Stability Review* on 020 7601 5010; and *Bank of England: Monetary and Financial Statistics* on 020 7601 5353.

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