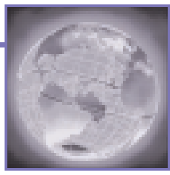
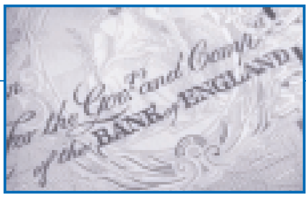
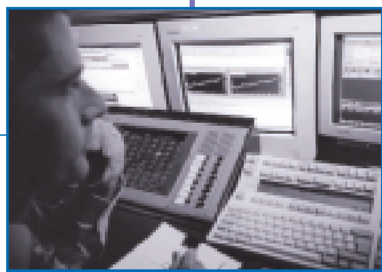






Bank of England

Annual Report 2001

Contents

Sir Edward George, Governor

Governor's

Foreword

The past year has seen further steady progress for the UK economy as a whole. By the first quarter of 2001, output was some 2½% higher than a year earlier, leaving the annual average rate of growth at around 3% since the recovery from recession began some nine years ago. Employment has continued to rise, to over 28 million on the latest LFS data – the highest number of people in work on record; and the rate of unemployment has continued to decline, to 3.3% on the claimant count – the lowest rate since August 1975. The target measure of inflation, which averaged 2% over the year to March, was a little below the Government's target of 2½% for the second consecutive year.

Looking ahead, the question is whether this steady progress can be maintained. The likelihood is that it can. The most likely prospect over the next year or two is for continuing growth in output, a continuing high level of employment and with inflation remaining close to target. But there are undoubtedly downside risks to that prospect associated with developments in the global economy. In particular, there is a significant risk that the slowdown in the US economy might be deeper or more protracted than currently seems likely, and there is a risk of continuing related weakness in financial asset prices. Elsewhere, there is little sign of a sustained upturn in the Japanese economy; and while output growth in the Euro-area – the UK's largest export market – is likely to remain reasonably robust, it, too, could be affected by much weaker growth in the US. These developments, together with the puzzling weakness of the euro, if that persists, may prolong the imbalance between the domestic and internationally-exposed sectors of the UK economy which has been an uncomfortable characteristic of our situation in recent years. And we have more recently become exposed to a new downside risk from the outbreak of Foot and Mouth disease.

This outbreak has, of course, had a devastating effect on many of the farmers affected and on large parts of the rural community more generally. The direct macroeconomic consequences of the disease are nevertheless likely to be limited, although the possible knock-on impact to industries such as tourism or to confidence more generally could be greater.

In response to these risks, and given the continuing subdued pressures on domestic costs and prices, the Monetary Policy Committee twice reduced interest rates in the early months of 2001, taking the Bank's repo rate down from 6% – where it had been for a year – to 5½%, in order to remain on track to hit the inflation target looking further ahead. The Committee will continue to monitor developments in the economy very carefully for any evidence that the downside risks we have identified are beginning to materialise.

Turning to financial stability, there have been sector-specific issues, such as the sharp correction in the stock prices of new technology companies and the high level of borrowing by telecoms companies. And some individual countries, notably Turkey and Argentina, have also experienced problems. The slowdown in the world economy has not, however, so far given rise to any serious general threat to domestic or international financial stability although problems could emerge if the downside macroeconomic risks came through.

In relation to international financial stability, the Bank has further strengthened its surveillance capability this year, both of G10 and emerging market economies. The Bank has been an important contributor in a number of international forums to the drive to improve the architecture of the financial system, and in particular to the efforts to strengthen the presumptive arrangements for crisis management.

Another area where the financial stability work of the Bank has been a force for improvement has been the revision of the Basel capital accord, where we have had an important input to the process. And the Bank has further developed its work on the basic infrastructure of the financial system, by promoting the improvement of payments and settlements systems of all kinds, both in the UK and internationally. The Bank's work on these and other financial stability issues has been reported in the *Financial Stability Review*, published twice a year.

On many of these issues the Bank has worked in close co-operation with the Financial Services Authority and I should like to thank them for their contribution.

In our financial market operations, I can report a smooth hand over of cash management to the Debt Management Office last year, and a successful take-over by the Bank of the Treasury's 3-year euro-denominated note programme, which like the euro-bill auctions have, since January, been conducted electronically. It was also pleasing that the National Audit Office report on the Treasury's gold sales programme, which is implemented by the Bank, concluded that the sales were conducted in a transparent and fair manner, with value for money, and that the Bank's work had been generally applauded by the market. In our banking and payments activities, we have introduced a new £10 bank note with enhanced security features; and we are well advanced with a number of important market-wide projects that will come on stream in the coming year, notably the introduction of Delivery-versus-Payment for securities settlement.

Our work in monitoring London's position as an international financial centre has confirmed our view that the broadening and deepening of euro financial markets resulting from the introduction of the new currency has so far been a benefit for the City, while the City has in turn played an important role in the process of euro market integration. So in that practical sense, both the City and the euro area have gained. London has nevertheless fully maintained its market share and remains by far the largest and most competitive financial centre in Europe. In the meantime, we have continued twice a year to publish *Practical Issues Arising from the Euro*, which covers the development of the euro markets, particularly in London, and sets out progress on preparations, including those by the Bank itself, for possible UK entry. The Bank chairs a City Euro Group whose job is to plan the potential changeover of the sterling financial markets, as part of the Treasury's wider exercise preparing for a possible UK national changeover.

In the wider area of the effectiveness of the UK's financial services as a whole, the Bank published the first in a series of reports commissioned by Treasury ministers on the financing of small businesses in deprived areas, which concluded that the difficulties were a product of the environment in which such businesses operated rather than particular problems in securing finance. The report reflected concerns that the number and diversity of groups providing help to small firms in these areas was itself a problem. Our longer-established work on small firms continued, and we revisited the theme of our 1996 report on the financing of hi-tech small firms. Our new report found some improvements from the earlier study but emphasised the importance of the availability of equity finance and the role of "business angels." As part of our work on the promotion of the City, the Bank was involved in the relaunch of *British Invisibles* as *International Financial Services, London*, increasing our support for the organisation.

I would like to pay tribute to Baroness Noakes, who was nominated by the Chancellor in 1998 as Chairman of the sub-committee of non-executive Directors, and who leaves Court in May at the end of her term of office, for the excellent work she has done in setting up the sub-committee and guiding it through its third annual report. This is published on page 54, and reviews the performance of the Bank and the procedures of the MPC. Her place as chairman of the sub-committee is to be taken by Sir David Cooksey. I would also like to thank Andrew Buxton, most recently Chairman of the Audit Committee; Frances Heaton, Chairman of the Trustees of the Staff Pension Fund; and Sir Chips Keswick, Chairman of the Court Pension Scheme, for their very great contributions as non-executive Directors. Their terms also expire at the end of this month. I am pleased to welcome, in place of the retiring non-executive Directors, Sir John Bond, Mary Francis and Graham Hall, and also DeAnne Julius who is stepping down as a member of the Monetary Policy Committee. In that role she has made an invaluable contribution to the work of the Committee since she joined in September 1997. On behalf of all her MPC colleagues I should like to express our gratitude to her. We welcome Kate Barker as a new member of the Committee with effect from 1 June.

We are very conscious of the cumulative impact on staff over recent years of externally driven changes to the Bank itself, modification of pay arrangements, the programme of overhead cuts following the departure of banking supervision, the benefits changes, the refurbishment of head office and most recently the project to reorganise Banking and Market Services. Over the last year, there has been very little let up in the pace of change, and inevitably morale in some parts of the Bank has been affected. We of course have a public responsibility to ensure on a continuing basis that the Bank remains an effective institution and maintains the highest standards of efficiency. However, we should now be able to look forward to a period of consolidation, and in that newer and more stable environment we very much hope that where morale has suffered there will be a significant improvement in the coming year – indeed, we are determined to see that happen.

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 especially to our staff for their dedicated contribution to helping us continue to meet our responsibilities.

Governor of the Bank of England
May 2001

The Court of Directors

Members of the Court of Directors

The Rt Hon. Sir Edward George
Governor

David Clementi
Deputy Governor

Mervyn King
Deputy Governor

The Baroness Noakes, DBE
Appointed to Court in March 1994. Appointed Chairman of the sub-committee of Directors in June 1998.

Director,
Carpetright plc.
Director,
English National Opera.
Director,
Solutions in Staffing and Software plc.
Governor,
Marlborough College.
Governor,
Eastbourne College.
Trustee,
Reuters Founder Share Company.

Frances Heaton
Appointed March 1993.

Director,
Lazard Brothers & Co., Limited.
Non-Executive Deputy Chairman,
W S Atkins plc.

Sir Chips Keswick
Appointed March 1993.

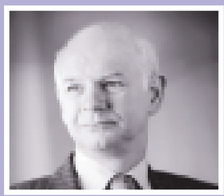
Non-Executive Director,
De Beers.
Director,
Anglo American plc.
Director,
De Beers Consolidated Mines Limited.
Director,
The Edinburgh Investment Trust plc.
Director,
IMI plc.
Director,
Persimmon plc.
Director,
Investec Bank (UK) Ltd.

Bill Morris
Appointed June 1998.

General Secretary,
Transport and General Workers' Union.
President,
Trades Union Congress
Member,
Executive Board of the International Transport Workers' Federation.
Sitting Member,
the Employment Appeal Tribunal.
Chancellor,
University of Technology, Jamaica.
Member,
Commission for Integrated Transport.

Jim Stretton
Appointed June 1998.

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



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

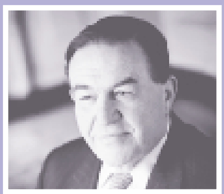
Chairman,
The Financial Services Authority.

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 Ian Gibson, CBE
Appointed August 1999.

Senior Vice President,
Nissan Motor Co Limited.
Supervisory Board Member,
Nissan Europe NV.
Director,
Centre for Life Trust.



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.
Director,
ITouch plc.
Chairman,
Small Business Investment Taskforce.

Sir Neville Simms
Appointed March 1995.

Chairman,
Carillion plc.
Chairman,
International Power plc.
Chairman,
Business in the Community (West Midlands).
Member,
CBI Presidents Committee.
Member,
New Deal Task Force.
Governor,
Ashbridge Management College.
Governor,
Stafford Grammar School.

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.
Director,
SMMT Industry Forum.
Vice President,
The Institute of the Motor Industry.
President,
Society of Motor Manufacturers and Traders Limited.

Andrew Buxton
Appointed March 1997.

Advisor,
Barclays Bank plc.
President,
British Bankers' Association.
Deputy Chairman,
FI Group plc.
Chairman,
European Services Forum.
Chairman,
Heart of the City.
Governor,
Imperial College of Science, Technology & Medicine.

Sheila McKechnie OBE
Appointed June 1998.

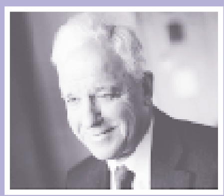
Director,
Consumers' Association.
Chief Executive,
Which? Limited.
Director,
International Consumer Research & Testing Limited.
Trustee,
Architecture Foundation.

Kathleen O'Donovan
Appointed August 1999.

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

Bridget Blow
Appointed June 2000.

Chief Executive,
ITNET plc.
Council Member,
Industrial Society.
Member,
British Computer Society.
Chair,
Macmillan Cancer Relief Birmingham Development Board.
Companion,
Institute of Management.
Member,
CBI Education and Training Affairs Committee.



Sir Brian Moffat, OBE
Appointed June 2000.

Chairman,
CORUS Group plc.
Non-Executive Director,
Enterprise Oil plc.
Non Executive Director,
HSBC Holdings.

Governance and Accountability

This is the third Annual Report prepared under the Bank of England Act 1998, which was summarised in the 1999 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 term of Graham Hawker expired and he was replaced by Sir Brian Moffat. Christopher Allsopp took up his appointment on the MPC from 1 June 2000 and Bridget Blow was appointed to Court in his place for the balance of his term through to 31 May 2002. Roy Bailie, Sheila McKechnie, Bill Morris, John Neill and Jim Stretton 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 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 Baroness Noakes. 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 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 54.

Remuneration Committee

The members of the Remuneration Committee during 2000/01 were Sir David Cooksey (Chairman), Frances Heaton, Baroness Noakes, Bill Morris, Jim Stretton and John Neill, the latter having joined in June 2000. The Committee's approach to remuneration is set out in the Remuneration Report on page 43.

Audit Committee

The members of the Audit Committee during 2000/01 were Andrew Buxton (Chairman), Sir Neville Simms, Kathleen O'Donovan, Bridget Blow and Sir Brian Moffat. The latter two members replaced Graham Hawker and John Neill. 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 pages 12-13. 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.

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 the 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
Customer Banking and Notes
Market Services
Risk Analysis and Monitoring
Registrar's Department

The Market Operations divisions – Gilt-Edged and Money Markets and Foreign Exchange – conduct the Bank's operations in the core financial markets, to establish short-term interest rates at the level required by monetary policy. They manage the Bank's foreign currency balance sheet, taking deposits from central bank customers and managing the issue of Bank of England euro bills and notes. They also manage, as agent, HM Treasury's foreign exchange and gold reserves and 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 Customer Banking & Notes 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. The Risk Analysis and Monitoring Division is responsible for integrating management information on the Bank's 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 Industry and Regulation
G10 Financial Surveillance
International Finance
Market Infrastructure

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, Charlie Bean, Alastair Clark, Ian Plenderleith 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

The Internal Audit Division is an independent function authorised by the Court of Directors to review the adequacy of the Bank's internal control systems and periodically to test compliance with agreed procedures for managing risks. It aims to provide an objective view to senior management to support their own control assurance procedures, giving advice where appropriate to ensure the Bank follows good practice in internal control.

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 purposes, 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

The Bank of England Printing Works is located on a purpose built high security site in Debden in Essex. It employs over 450 people and is responsible for the printing of over 1 billion notes annually, together with the manufacture of its own inks, printing plates and threads. In addition the Printing Works provides technical and specialist security advice to a number of central banks worldwide.

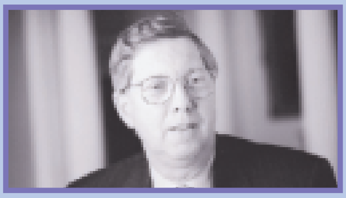
The notes are produced in a highly developed printing process which combines high technology and quality craftmanship, making the Bank one of the most cost effective note producers worldwide.

The Printing Works' expertise has led to commercial sales in overseas markets through Debden Security Printing Limited, the Bank's wholly owned commercial subsidiary.

The Executive and Senior Management

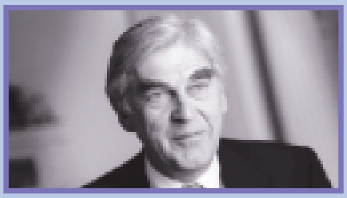
Governor's Committee

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

Charlie Bean, 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

Kevin Butler
Auditor

Eddie George
Governor

Mervyn King
Deputy Governor
Monetary Stability

David Clementi
Deputy Governor
Financial Stability

Mike Thompson
General Manager
Printing Works

Monetary Analysis and Statistics

Charlie Bean
Executive Director

Nigel Jenkinson
Deputy Director

Peter Andrews
Monetary Assessment and Strategy

Andrew Bailey
International Economic Analysis

Ian Bond
Structural Economic Analysis

Roger Clews
Monetary Instruments and Markets

Spencer Dale
Conjunctural Assessment and Projections

Agencies – see page 31

Joanna Place
Monetary and Financial Statistics

Peter Sinclair
Centre for Central Banking Studies

* reports to Charlie Bean and Bill Allen

Financial Market Operations

Ian Plenderleith
Executive Director

Bill Allen
Deputy Director

Merlyn Lowther
Deputy Director and Chief Cashier

Neal Hatch
Gilt-Edged and Money Markets

Clifford Smout
Foreign Exchange

David Ingram
Risk Analysis and Monitoring

Christopher Mann
Market Services

Colin Mann
Customer Banking and Notes

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
G10 Financial Surveillance

Peter Brierley
Domestic Finance

Andy Haldane
International Finance

Patricia Jackson
Financial Industry and Regulation

John Trundle
Market Infrastructure

Central Services

Gordon Midgley
Finance Director
Finance and Resources

John Footman
Director of Personnel

Andy Brookes
Management Services

Michael Craig
Investment Unit

Peter Higgs
Property Services and Security

John Matheson
Personnel

Peter Rodgers
Secretary of the Bank

Advisers to the Governors

Malcolm Glover
(w.e.f. 1.6.01)
Legal

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 2001/02 are set out on page 33 of this Report. The Bank Objectives for 2000/01 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 2000/01 against the Bank's Core Purposes and the ten 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 pages 54-55. The objectives set for the year 2001/02 are shown on page 33.

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 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. Throughout the year under review the rate of inflation was a little below the target. The MPC's latest central projection sees inflation moving up towards the target level over the next two years, although that central projection is surrounded by considerable uncertainties.

SUPPORT FOR THE MONETARY POLICY COMMITTEE

The MPC's own processes are described on pages 28-32. For the Bank itself, the strategic objective set by Court was **"to maintain the range and quality of information and economic briefing provided to the Monetary Policy Committee"**.

Full support to MPC in terms of briefing and analysis has been maintained by the Bank's Monetary Analysis, Market Operations and Monetary and Financial Statistics Divisions, with assistance from the Financial Stability area. And the Agencies (page 31) continue to make an important direct input into the policy process. The adequacy of this support, and the mode of delivery, continues to be kept under constant review. Where issues have been identified the Bank, in consultation with the Committee, has made a number of changes, including:

- Streamlining the pre-MPC meeting, at which the staff present to the Committee the key economic developments over the preceding month. The meeting now lasts just half a day and is more sharply focused.

- Simplification of the forecast round. The staff now provide the Committee with a 'benchmark update' of the previous forecast in light of new data. This benchmark forecast is then amended by the Committee after analysis and discussion of the key judgments. The new arrangements have shortened the process, and have helped to concentrate discussion to just the major issues and risks.

- A quarterly meeting is held with the Committee after the publication of each *Inflation Report* to agree priorities for additional short-term analysis on puzzles and issues that had arisen during the round.

- As agreed in November 1999, the four non-Executive Members of the MPC have each been provided with a dedicated postgraduate and graduate economist to support their personal research.

Links between the Bank and the Office for National Statistics (ONS) have become closer over the last year. The ONS have run a number of courses for Bank staff to explain how various statistics are constructed; and Bank staff have given a number of seminars on how statistics are used. The MPC continues to specify its priorities for data provision and improvement under the Service Level Agreement with ONS.

Recruitment and retention of high calibre staff remains a major challenge. During 2000, a total of 26 economists were recruited to Monetary Analysis, while only 13 economists left the area, and further efforts are being made to widen the recruitment net. To support retention of more junior economists, salary levels have been increased. And to retain more senior staff, a new category of 'senior economist' has been established to recognise higher experience levels in Monetary Analysis. Under this scheme, economists can obtain promotion without taking on staff management responsibilities.

Looking ahead, plans to increase support for the Monetary Policy Committee through increased resources come under three main strands:

- An increase in the numbers of economists in Monetary Analysis, with extra staff to be employed on model development, as identified in the Kohn Report (page 28).

- Continued development of the senior economist scheme.

- Additional resources applied to data management and programming support in Monetary Analysis.

Research Programme

The staffing shortfalls of earlier years constrained the Bank's ability to pursue its research agenda and an objective set by Court for 2000/01 was **"to enhance the Bank's programme of economic analysis of key aspects of monetary policy"**.

Bank staff have produced research on a wide variety of policy relevant themes. A partial list of topics researched includes: exchange rates and their impact on inflation; the determinants of consumers' expenditure; the effect of information and communication technology on productivity and growth; and the impact of structural changes on the link between activity and inflation.

Much of this work is being, or has already been, subject to peer review outside the Bank and will appear in the Bank's *Working Paper* series in 2001.

New arrangements for the setting and monitoring of long-term research projects were agreed by MPC in November 1999, and these are now fully in place. The research programme for 2000 was set by the Committee at a meeting in December 1999 and reviewed in July 2000. The Committee met in January 2001 to set priorities for the coming budget year. In advance of that meeting, research proposals were put forward by staff and reviewed in a series of meetings with senior management. Ideas were also put forward by MPC members themselves.

The results of the research are reviewed informally by members of the Committee at a series of "Research Awaydays", which examine the main findings and conclusions of three or four papers in a two hour meeting. Five Awaydays, covering 19 papers in total, took place over 2000/01. The findings are often drawn on in the monthly and quarterly rounds.

BUILDING SUPPORT FOR PRICE STABILITY

Monetary policy achieves its results more effectively if its processes are transparent and its objectives have wide public understanding and 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 an extensive public information programme, built around the MPC's two key publications, the quarterly *Inflation Report* and the minutes of the monthly policy 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.

Parliamentary committees

The messages of these two documents are explained to Parliament, the media, business audiences and the general public in a variety of ways. The Governor and other MPC members appeared three times before the Commons Treasury Committee to answer questions about the *Inflation Report*. There were two other Treasury Committee hearings for MPC members, the first for Christopher Allsopp and Stephen Nickell and the second for Charles Bean, and there was also a hearing attended by Baroness Noakes and other non-executive directors, to discuss issues related to Bank governance and MPC procedures. MPC members appeared at the House of Lords Select Committee on the Monetary Policy Committee five times, including two attended by the Governor.

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, more than 50 formal visits, organised by the Bank's Agents, were made to the regions by MPC members, typically of one or two days. Visits involve a combination of speeches, lectures, meetings with local business groups and other bodies, and visits to companies, schools and universities. In January the Court of the Bank held the third of a regular series of meetings outside London, on this occasion in Leeds.

While there were about 25 major published speeches on monetary policy by the Governor and other MPC members, executive and external, 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, for regional business audiences, a series of presentations on the *Inflation Report* given by MPC members. Well over 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 200,000 a week, compared with 175,000 a year ago. 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 was redesigned and restructured and a new version launched this spring as part of a programme of continual upgrading to stay at the design and technical forefront among central banks.

Education programme

The Bank also continues to foster links with schools and universities. The main development during the year was the successful launch of the schools competition, *Target 2 Point 5*, in which A-level and Scottish Highers students of economics and business studies made presentations on monetary policy in regional heats in November and February, with the final in London in March. The winning team was from the Harry Carlton School, Loughborough. The feedback from participating schools was enthusiastic and supportive and the Bank intends to continue the competition on an annual basis.

It believes that the competition itself, including the extensive briefing material the Bank produced for A-level students, will encourage interest in the study of economics and help improve understanding of monetary policy and of the Bank's role.

Among other activities, there is a long-standing programme in which about 17,500 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 effort.

Opinion polls

It is difficult to quantify the wider success and benefits of the Bank's efforts to build general public support for price stability. However, the Bank has been trialling a national opinion poll, designed to explore the evolution over time of public opinion and understanding of a range of monetary policy matters.

Using feedback from the first year's trials, the Bank agreed a final version of the poll at the beginning of this year. The Bank will carry out quarterly surveys, with one longer survey each year in February containing a larger sample and some additional questions (whose answers are not likely to vary much quarter to quarter.) The first of the annual February surveys has been carried out, and the results will be reported in the Bank's Summer *Quarterly Bulletin*, with the full data available on the web site. Quarterly surveys will be published in a press release and on the web site.

The five annual questions cover perceptions of the relationship between interest rates and inflation and knowledge of who sets interest rates. The nine quarterly questions cover expectations of price and interest rate changes, perceptions of the impact of inflation and interest rate changes on both the economy and on the individual, and satisfaction/dissatisfaction with the way the Bank of England is doing its job of setting interest rates in order to control inflation.

The proportion satisfied with the way the Bank "is doing its job to set interest rates in order to control inflation" has climbed to 55 per cent in February 2001 from 41 per cent a year earlier. This is not unexpected, because interest rates remained stable and then fell slightly over the period. The Bank believes that approval ratings for its actions are likely to be affected quite strongly in the short term by the direction of movements in interest rates, so this part of the survey will be most valuable when studied over a number of cycles.

The credibility of monetary policy as measured by inflation expectations has been consolidated over the year: survey measures and market indicators are largely consistent with inflation expectations being firmly 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 is to promote the stability of the financial system. In the framework of the Bank of England Act 1998, and of the 1997 Memorandum of Understanding (MoU) 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 requires work in three main areas: analysing, and promoting initiatives to strengthen, the financial system's capacity to withstand shocks, including market infrastructure and regulatory policies; macroprudential surveillance – that is, monitoring developments in financial markets and amongst financial intermediaries 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 domestic developments.

The key forum within the Bank for addressing these issues is the Financial Stability Committee (FSC), which each month reviews major current policy issues and Bank staff's latest assessment of actual and potential risks to stability. Besides updating Committee members, the discussions help to establish a Bank position on questions which are under consideration externally, within the UK or in international groups. In particular, issues raised in the FSC are regularly 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. Over the past year the Standing Committee has considered papers on a wide variety of subjects, including trading, clearing and settlement arrangements, issues concerning highly-leveraged institutions, input to the EU "Wise Men" exercise, telecom exposures, and potential or actual problems in a number of individual countries.

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 further strengthened its surveillance capability, especially in the analysis of developments in global financial markets but also, selectively, in individual economies. This has meant, for example, paying close attention to developments in Argentina, Korea and Turkey; to the situation in the US; and to trying to understand more fully the links between macroeconomic performance and financial vulnerabilities in Japan. In parallel, the Bank has sought to improve its analysis of pressures on, or threats to, the domestic UK financial system, as a complement to the FSA's role in relation to individual firms. Identifying incipient problems before they become acute is a key objective of surveillance and is a task which no-one – in the public or private sectors – can claim to have mastered. One of the Bank's aims has therefore been to use analytical and research work within central banks, finance ministries and academic institutions so as to improve the Bank's diagnostic capabilities. Another has been to calibrate risks, rather than simply identify them, so that some scheme of priorities can be established.

International Financial Architecture

Reappraisal of the so-called "financial architecture" has been a major theme in international discussion over the past three years. The immediate spur was the experience of financial crises in a number of countries, which at times threatened to spill over into more general systemic disruption. But behind this has been the broader concern that, with closer international economic and especially financial integration, misguided or badly-executed policies can have damaging effects outside the country immediately concerned, as can poor risk management and misaligned incentives for lenders or investors.

The Bank has contributed to debate on these issues in a number of ways. It has, in collaboration with the Bank of Canada, sought to sustain and extend discussion on the role which private sector creditors can play in the orderly resolution of country debt crises. It has participated in several international groups, in particular under the auspices of the IMF/World Bank and the Financial Stability Forum, looking at ways to increase the awareness of and encourage the implementation of a range of standards and codes on good practice in various aspects of economic and financial policy. It has continued to emphasise the importance of country balance sheet, liquidity and foreign currency exposure data as indicators of potential vulnerability to external shocks.

The architecture agenda is now putting considerable emphasis on crisis management; there are, for example, a number of groups examining, from different points of view, the practical issues involved in handling problems in major, internationally active, firms. The Bank, along with the FSA, is making a significant input to this work.

The Centre for Central Banking Studies (page 41) has continued to offer training and technical assistance to emerging country central banks, and to provide a forum for discussion of state-of-the-art techniques and current issues among central bankers.

The new Basel Capital Accord

Despite the transfer of responsibility for operational banking supervision to the FSA, the Bank retains a close interest in prudential regulation, and especially in capital and liquidity requirements, given their importance in maintaining the overall stability of the financial system and in influencing its efficiency.

Although in one sense part of the architecture debate, the revision of the Basel Accord on bank capital – which aims to take better account of credit risk - stands as a major exercise in itself. The UK is represented on the Basel Committee jointly by the Bank and the FSA; and both institutions have made substantial contributions to the development of the new proposals, both analytically and through chairing or participating in various working groups. The Bank has had a particular input in the modelling of credit risk and in the statistical analysis of default and loss data, drawing on elements of the internal Financial Stability research programme. The Basel Committee's proposals are out for comment until the end of May; the objective is to finalise them by the end of the year.

During the year the Bank has also participated actively in the ECB's Banking Supervision Committee, which has a financial stability focus, and in various sub-groups. And again in the area of prudential requirements, the Bank has sought to promote debate on dynamic (ie forward-looking) provisioning and on the pros and cons of Fair Value Accounting for banks.

Payment systems and market infrastructure

Several initiatives designed to enhance the effectiveness of UK payment and settlement systems were started last year, in particular updating the technical infrastructure on which the domestic high value payment system (CHAPS) operates and reforming the CREST securities settlement system through the introduction of Delivery versus Payment (DvP) in order to eliminate intra-day credit exposures amongst settlement banks. Both projects involve the Banks' Banking and Market Services area, alongside private sector system operators and market participants. Inauguration of the new technical infrastructure for CHAPS is scheduled for August 2001 and of the CREST system reforms for November 2001. The latter will be an important step for securities settlement in the UK: the inter-bank exposures generated in the payment system supporting CREST are now of the same order as the exposures in CHAPS before the introduction of real-time gross settlement (RTGS) in 1996.

In the foreign exchange settlement area the Bank, alongside other G10 central banks, has supported the industry's own initiatives to reduce settlement risk, notably the CLS (Continuous Linked Settlement) project. Testing of this service is now taking place prior to commencement of live operations scheduled for October 2001. The Bank will be providing sterling settlement for CLS payments.

In 1998 the G10 Committee on Payment and Settlement Systems (CPSS) launched an exercise to establish core principles for the design and operation of systemically important payment systems, with the intention that these principles might be a helpful guide to countries in setting up such systems and might also provide a 'good practice' benchmark against which existing systems could be judged. The work, which covered both the principles of design and practical implementation issues, was completed during 2000 and the report was published by the CPSS in January. The task force responsible for producing the report was chaired by the head of the Bank's Market Infrastructure Division.

As a counterpart to the work on payment systems, there has been a similar review of good practice in the design and operation of securities settlement systems, sponsored jointly by the CPSS and the International Organisation of Securities Commission (IOSCO). The Bank has participated actively in this work, which remains in progress. A draft report was published for consultation in January. Meanwhile, the G30, a private sector group of senior practitioners and officials, has also initiated a review of certain aspects of securities settlement to which the Bank will be contributing.

Analysis of risk in central counterparty arrangements

Many markets, particularly those in derivatives, already clear through a central counterparty as a way of clarifying and managing the associated risks. The behaviour of, and the risk management techniques applied by, such counterparties are a matter of considerable interest for central banks and regulators. The Bank, in conjunction with the FSA, has been conducting its own analysis of the issues involved and will be drawing on the conclusions in its discussions with existing central counterparties and prospectively in considering plans for new central counterparty arrangements.

Reporting on Payment Systems Oversight

In November 2000, the Bank published a paper on the *Oversight of Payment Systems*[1] to explain its role in this area and to follow best practice by being transparent about its objectives and methods. The Bank's oversight responsibilities are part of its general responsibilities for financial stability set out in the 1997 MoU. The Bank has undertaken to give an account each year of the way in which it has carried out its oversight role.

The Bank receives a great deal of information about the structure and operation of payment systems through its own operational involvement in several of them. The Bank supplements this with requests to the system operators for specific additional information, through regular meetings with the management of the systems and sometimes discussions with the internal or external auditors. The Bank has begun a structured review of the main UK payment systems based on the Core Principles described above. In addition, as part of its general oversight of payments infrastructure, the Bank takes a close interest in the payments processes supporting CREST and the London Clearing House (LCH).

The Bank does not monitor day-to-day operational aspects of payment systems or seek to resolve day-to-day operational problems (except where it is directly involved). Nor does the Bank monitor systematically relations between banks or others providing payment services and their customers. Primary responsibility for the reliable functioning of payment systems lies with operators and system members. The Bank's main aim is to establish that operators have taken reasonable steps to ensure the robustness of their systems.

Some of the Bank's oversight functions are carried out collectively with other G10 central banks, notably the oversight of CLS (where the US Federal Reserve is in the lead) and SWIFT (which is led by the National Bank of Belgium).

The Bank also has a responsibility arising from the EU Settlement Finality Directive as designating authority for payment systems in the UK. The CHAPS sterling and CHAPS euro payment systems applied for designation under the Settlement Finality Directive in March 2000 and were designated in May. CLS plans to apply to the Bank for designation later this year.

The Financial Stability Review and research

The Bank has continued to develop the *Financial Stability Review* (FSR) as the main channel for reporting publicly on its financial stability work. The *Review* is distributed in both printed and electronic form: in the month after publication of the December issue, the FSR section of the Bank of England website recorded over 100,000 hits and the various sections of the opening article, *The Financial Stability Conjuncture and Outlook*, registered over 65,000 downloads. FSR summarises the Bank's broad assessment of financial stability conditions, both internationally and in the UK. It also contains articles summarising the background analysis on which the Bank's views are based, and is one vehicle for reporting on the Bank's research work in this area. Over the past year, some of the main areas of research effort have been:

- dynamics of country crises;
- bank capital requirements;
- the costs of financial instability; and

1: http://www.bankofengland.co.uk/fsr/payment.htm.

– indicators of banking system weakness, for example in the run up to the UK's early-1990s small bank crisis.

Significant progress has been made in deepening the Bank's analysis of systemic risk, and based on this work the Bank has been able to contribute to a number of international initiatives including the new Basel Capital Accord, the Core Principles for systemically important payment systems and the debate on private sector involvement in country crisis resolution. Operationally, work on CHAPS and DvP is on course and will reduce settlement risk. The Bank has also begun to report on its payment system oversight work.

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

The Bank's third core purpose relates to the effectiveness and efficiency of the UK's financial markets. This is one aspect of its interest in financial stability; but it also derives from a concern to ensure that the UK financial system provides effective support to the rest of the UK economy and that the UK remains an attractive location for the conduct of international financial business. 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 all types of business at home"**.

The euro and London

The Bank has continued to monitor developments in the euro-denominated financial markets and in the supporting financial infrastructure. This has shown continuing integration in the euro money market, a deepening of the euro capital market and some increase in cross-border diversification of investment. It has also highlighted remaining disparities in regulation and supervision, in aspects of the tax system and obstacles more generally to completion of the single market in financial services. On the basis of this monitoring, the Bank has been able to make a significant input to policy discussions on these issues.

Money market instrument review

Preparation for the changes agreed in the Money Market Instrument Review (conducted last year) has continued over the past year. Implementation requires legislative changes and is not expected before 2002.

Financial exclusion

In 1998 the Government initiated a series of studies by the "Policy Action Teams" into the question of social exclusion. In the light of their findings, the Bank was asked by Treasury ministers to prepare periodic assessments of the provision of finance to small businesses in deprived communities.

The Bank conducted the first such review last summer and published its findings in November. The main conclusions were that current or potential entrepreneurs in deprived areas did face special difficulties but that these difficulties were by and large a product of the environment generally rather than a result of any particular problems in securing finance. The report also highlighted the wide range of groups which had, exclusively or in part, a role in helping to provide financial and technical support to small businesses in deprived areas, and reflected concerns that the number and diversity of these groups was itself a problem. The Bank has reported these findings to Treasury ministers and to other interested parties and will be discussing possible follow-up action.

Finance for small firms

For the past seven years the Bank has produced an annual report assessing the climate for the financing of small firms generally, and specifically reviewing the evolution of relationships between small firms and their bankers. From a situation in the early 1990s in which these relationships had all but broken down, the position is now much improved. But it has become clear that provision of bank loans, or debt finance more broadly, is only part of the picture. Even for very small firms there can be a demand for equity finance and, over time, the Bank has paid increasing attention to this issue, especially for technology-based firms. In 1996, the Bank produced a first report on financing of technology-based small firms; and in February this year it produced a second. This suggested some easing of the constraints identified in the earlier study and emphasised the potential role of "business angels" in the supply of small amounts of equity finance.

Promotion of the City

In 1968, the Bank launched the Committee on Invisible Exports. Since then it has taken a general interest in arrangements for the international promotion of the City. In the course of last year, and with the Bank's support, British Invisibles (the successor to the COIE) undertook a review of its activities, precipitated partly by changes in the structure of the financial services industry in the UK, especially the large-scale consolidation and the growing international reach of individual firms. One of the re-launched organisation's main objectives – it has been renamed International Financial Services, London – will be to help achieve greater coherence in the City's promotional effort in a number of areas.

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

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

Money market operations

The aims of sterling open market operations are to implement the interest rate decisions made by the Monetary Policy Committee and to provide sufficient sterling funds to the banking system to enable end-of-day payment transfers to be completed smoothly. These objectives were satisfactorily achieved during 2000/01.

In April 2000 the Debt Management Office (DMO) took over from the Bank the responsibility for the Exchequer's cash management. In preparation for the takeover, there had been close working contact between the Bank and the DMO, which ensured a smooth transition. The effectiveness of open market operations has been unaffected.

During the year, the Bank expanded the range of sterling deposit facilities which it offers to foreign central bank customers.

Foreign currency operations

The Bank has also increased the scale of its foreign-currency deposit-taking activity from foreign central bank customers. The proceeds are placed in unsecured deposits with commercial banks, within limits set by the Bank's credit risk management process, or in repo. The Bank continues to provide foreign exchange transaction services to foreign central bank customers.

The Bank maintained during the year its programme of monthly auctions of euro-denominated 1, 3 and 6-month bills; in addition, as announced in March 2000, the Bank took over the Treasury 3-year euro-denominated note programme. The first auction of €500 million of Bank of England euro notes maturing in January 2004 was held in January and three further quarterly auctions, each of a further €500 million of the 2004 note, are planned. The euro note and euro bill auctions have, since January 2001, been conducted electronically, in order to reduce the elapse of time between submission of bids and announcement of the results.

The proceeds of the euro-denominated bill issues are invested in order to generate the intra-day liquidity needed to secure access to intra-day credit in the TARGET payments system for banks located in the UK. The proceeds of the euro-denominated note issue are being invested in high quality securities. The euro bill and euro note programmes involve no foreign exchange risk, and the interest rate risk is tightly limited and closely monitored (page 52).

Management of the Exchange Equalisation Account and HMG foreign currency liabilities

The Bank manages HM Government's foreign exchange and gold reserves in line with the objectives set by HM Treasury in its annual Remit. This governs the level of the reserves, benchmarks and limits for the investment of the reserves, the framework for managing credit and market risks, and the financing of the reserves.

As part of the Government's programme announced in May 1999 to sell part of the UK's gold reserves through a series of auctions, six auctions were held in the year ending 28 February 2001; another took place on 14 March 2001. The National Audit Office report on the gold sales programme, published on 12 January, concluded that the Government's objective to sell in a transparent and fair manner while achieving value for money had been met, and that the Bank's work in keeping the gold market well informed and in securing a technically successful sales programme had been generally applauded by the market.

Market intelligence

The Market Operations divisions have over the past two years shifted resources towards interpreting and disseminating intelligence received from market contacts as an adjunct to the trading activities of the divisions. Information about current market developments, updated in real time, is disseminated electronically throughout the Bank; and, at a lower frequency, market intelligence is reviewed and interpreted for use in the Bank's monetary policy and financial stability functions.

Domestic securities settlement

The Bank continued to operate the computerised settlement system for gilt-edged stock (CGO) system on CRESTCo's behalf until July 2000 when both gilts and equities were settled within a single system operated by CRESTCo. The Bank also provided depositary facilities throughout the year to CRESTCo for the money market instruments lodged within the computerised settlement system for such instruments (CMO). These depositary facilities will no longer be needed once the changes agreed in the Money Market Instrument Review have been implemented.

The note issue

In November 2000 the Bank introduced a new £10 note which included the same enhanced security features as the new £20 note introduced in 1999. The new £10 note featured Charles Darwin on the reverse. Towards the end of the year the Bank announced that it was withdrawing from circulation the older £20 note, featuring Michael Faraday on the reverse; legal tender status was formally withdrawn at the end of February.

Work has continued throughout the year with the institutions involved in wholesale note distribution on the initiative to improve the efficiency of note issue and distribution arrangements. The main elements of the new arrangements are now agreed and a phased transition started in April 2001.

Banking services change programme

This programme, which followed from a thorough review of the systems and processes by which the banking services are provided to customers, has proceeded according to schedule. IT packages have been selected and a re-organisation has taken place which aligns the structure more closely to the underlying business processes.

Stock registration

The number of accounts on the gilt-edged stock register maintained by the Registrar's Department in Gloucester continued to fall, as did the overall volume of work. By making further cuts in operating costs (including a further round of redundancies) the Department nevertheless remained within the unit cost target agreed with HMT throughout the year.

In addition to stock registration, the Department continues to operate the Bank's retail postal brokerage service, developed from that transferred from National Savings in 1998, which enables holders to purchase or sell gilt-edged stock as well as facilitating the re-investment of redemption and dividend payments.

The Bank has continued to deliver policy objectives through its market operations, and to meet its customers' requirements. It has expanded its own foreign exchange activities to the benefit of the London markets, and the quality of the note issue has been enhanced. Intelligence from market operations is more widely shared within the Bank and is contributing to the Bank's monetary policy and financial stability work. The change programme in banking operations is on track.

PREPARING FOR EMU

This year the Bank's objective was: **"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"**.

Economic Analysis of EMU

The Bank has an ongoing programme of analytical work on EMU. This includes the operation and implementation of monetary policy within the eurozone, and how the introduction of the euro has affected the transmission mechanism of monetary policy. This work both informs the Bank's quarterly conjunctural analysis of international economic prospects, and also allows the Bank to play an active role in discussions with the ECB and other EU institutions.

Preparing the Bank

As part of the Government's 'prepare and decide' policy, the Bank has continued to make internal preparations for possible UK entry into EMU, with the aim of putting the Bank in a position to go ahead should Parliament decide to do so. Individual projects, which are co-ordinated by John Townend, the Bank's Director for Europe, have been broken down into those going ahead anyway (like new CHAPS and DvP); those requiring few resources or short lead times; and a small number with long lead times.

Preparing the UK financial sector

More generally, the Bank has continued to assist HM Treasury in its broader planning of a UK national changeover, in the event of UK entry. The Bank is represented at each level of the Treasury's project structure, including by the Governor on the Chancellor's Standing Committee. In particular, the Bank has responsibility for co-ordinating the preparations necessary for the City's wholesale financial markets to change over from sterling to euro, which would largely take place immediately on entry. The focus has continued to be on planning, in order to minimise the time which would ultimately be required for implementation if the decision to join were taken.

The Bank has worked with market practitioners primarily through the City Euro Group, which meets in the Bank roughly three times a year, with a membership of some 60 market and trade association representatives. With members' help, there is now as fully articulated a plan as possible, detailing how sterling transactions and the underlying financial instruments would become redenominated into euro, subject to decisions from Government and market authorities.

Representing the Bank in Europe

The Governor is a member of the ECB General Council and the Bank is represented on the ESCB committees. Over the past year, the Bank has continued to devote considerable effort to sustaining its relationship with the Eurosystem, (the collective term for the ECB and the 'in' national central banks (NCBs)).

The Bank is also learning as much as possible from the 'in' NCBs and the wider banking sector in the euro area about the issues they are facing, and the solutions they are adopting, in completing their own transition to the euro.

Communicating through "Practical Issues"

The Bank has continued to publish *Practical Issues Arising from the Euro* on a biannual basis, to a very large audience. Besides describing preparations for possible UK entry, *Practical Issues* has focused on the evolution of the euro financial markets and the supporting trading, clearing and settlement infrastructure. Notwithstanding the UK's current position outside EMU, London has continued fully to maintain its market share.

The Bank has retained a close practical involvement in the evolution of euro business in London and has kept close to the issues surrounding the introduction of the euro in the EMU area. The Bank's own internal preparations for possible euro entry have been maintained, and all of these issues have been shared with the markets through the *Practical Issues* series of publications.

MANAGING THE BANK'S HUMAN RESOURCES

The objective for the year was **"Through appropriate recruitment, pay and career development policies, to ensure that all Bank functions have staff of the right quality and experience"**.

The Bank has continued to work hard at recruitment, focussing in particular on the needs of the monetary analysis and financial stability areas for qualified analytical staff. Last year 40 graduates and 30 mid-career entrants joined the Bank. 17 of the new graduates had Masters degrees; and the Bank introduced new arrangements to offer non-Masters graduates the chance to work in the Bank for two years before undertaking a suitable economics masters course sponsored by the Bank.

Retention remains an issue though there has been some improvement over the past year. The operation of the Bank's salary and job banding systems have been kept under review, the major concern being to ensure that they are sufficiently flexible to accommodate the wider range of staff now joining the Bank and to address retention issues where necessary.

New arrangements for non-salary benefits were introduced on 1 April 2000, following extensive consultations with staff and Unions. Under the new package the Bank's spend on benefits is distributed more fairly than before, and individual staff have considerably more flexibility about how to apply it. The changes were nevertheless controversial and six members of staff chose not to accept the new arrangements. It was not practical to continue the previous benefits package for this small group, and after extensive consultations with the individuals concerned and their Union, their employment was terminated and they left the Bank in September. This was a matter of considerable regret to the Bank.

The pace of change in the Bank's operations, the reduction in central service and processing functions and the increased emphasis on analytical work, have all contributed to a sense of insecurity among some groups of staff and this, together with the recent changes in traditional pay and benefit arrangements, has clearly had an impact on their morale and motivation. A small-scale survey of staff views was undertaken during the year and the Bank intends to build on this, addressing specific issues where it can and working with the staff to find solutions to others. For the coming year an objective for management in the Bank will be to build the morale and motivation of the staff.

The Bank has had considerable success in the recruitment market and changes to pay and benefit arrangements have helped to underpin that. Morale and motivation issues will be a particular priority in the coming year.

MANAGING THE BANK'S FINANCES

The Bank's financial framework is discussed in more detail on pages 34 to 37 of this Report. The objective for the year was: **"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 is finances which called for a £20 million reduction in overhead costs over the five-year period to 2003"**.

Budgets

For 2000/01 Court set an expenditure budget of £212.2 million. The Bank's total spending for the year was £210 million. The main factors contributing to this outturn are discussed on page 34.

The medium term spending plan within which the Bank has operated for the last two years 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 was transferred to the FSA in 1998. At the beginning of the current year, the Bank was more than half way to achieving the £20 million reduction in overheads. It is now three quarters of the way.

The remaining £5 million saving in centrally borne overheads will be achieved through the continuing rationalisation of the Bank's occupancy of its remaining properties, in particular on the completion of the refurbishment of the Ground Floor of the Threadneedle Street building which will then permit the Bank to vacate Bank Buildings.

Property

The Bank's strategy in relation to central London properties is to retrench into the main Threadneedle Street building. The refurbishment of the upper floors of that building has been completed on time and within budget. Work on enabling the refurbishment of the Ground Floor has now commenced. The first stage is the creation of a new dealing room and this should be complete by the end of this year.

Outside central London, a new computer centre has been created at the Debden site which will permit further reductions in building occupancy in central London.

The Bank sold Number 1 New Change in November and the Kings Arms Yard building in March this year.

IT Strategy Review

Over the past year the Bank has with the assistance of external consultants reviewed its approach to setting IT strategy. The outcomes of the review are a greater emphasis on cross-organisational projects and increased IT training. Both these developments are reflected in the budget for 2001/02 discussed on page 34.

At any time a large number of IT projects are in train within the Bank. Progress is monitored closely and for all major projects is reported to Court. During the year most projects have proceeded on time and within budget. One project, aimed at improving the system for processing monetary and financial statistics, has proved to be a more complex undertaking than originally envisaged, leading to unexpected delays in completion. The status of the project is under review.

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

MANAGING OPERATIONAL AND FINANCIAL RISK

The objective set by Court was **"to implement the new framework for monitoring and controlling the Bank's operational and financial risks"**.

A detailed account of the financial and other risks run by the Bank, and the way in which they are now managed, is provided in the sections on Governance of the Bank on page 8 and in the Report from Members of Court on page 47.

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 $2^1/_2$% (measured by RPIX). That was most recently confirmed by the Chancellor in the Budget Statement on 7 March 2001. 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 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: that is, to review the procedures followed by the MPC and in particular whether the MPC has collected the necessary regional, sectoral and other information.

In terms of MPC processes, the main developments over the past year have been an external peer review by Don Kohn of the Federal Reserve Board, and the implementation of new arrangements for external MPC members.

THE KOHN REPORT

At the suggestion of the Bank's non-executive Directors, the Bank decided to commission an informed expert to undertake an external review of the procedures of the MPC, and its analytical support in the Bank of England. The Bank invited Don Kohn, Director of the Division of Monetary Affairs at the Federal Reserve Board in Washington. Mr Kohn spent six weeks visiting the Bank of England in the Spring of 2000, and he returned to present his findings and discuss them with both the non-executive Directors of Court and the MPC in October 2000. Mr Kohn's Report[1] provided a thorough review of MPC procedures, and made a number of suggestions for further improvement. The MPC found the Report very helpful and agreed with most of its suggestions.

The Forecast Process

A major section of the Kohn Report was devoted to the forecast process. There were two main strands. The first focussed on the transparency of the process and the interpretation of the forecast. The second concentrated on the efficient production of the forecast.

Mr Kohn highlighted the challenge of how best to present the Committee's views, noting the tensions

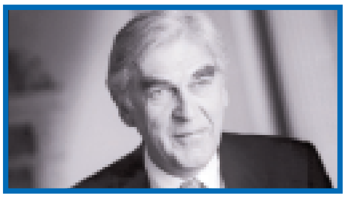
1: http://www.bankofengland.co.uk/kohn.pdf.

Christopher Allsopp

Charlie Bean

Dr DeAnne Julius*

Professor Stephen Nickell



Ian Plenderleith

Dr Sushil Wadhwani

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

Mr Christopher Allsopp: Fellow in Economics, New College, Oxford. Reader in Economic Policy, Oxford University. Editor and Director, Oxford Review of Economic Policy.

Dr DeAnne Julius: Member of the National Learning and Skills Council. Chairman of the Banking Services Consumer Codes Review Group. Vice Chairman of the Institute of Development Studies, University of Sussex. Member of the governing councils of Chatham House and the Centre for the Study of Globalisation and Regionalisation, University of Warwick.

Professor Stephen Nickell: School Professor of Economics, LSE (part-time). President of the European Association of Labour Economists. President of the Royal Economic Society. Fellow of the British Academy and of the Econometric Society. Member of the International Board of Advisers of the Tinbergen Institute (Amsterdam). Member of the Council of the European Economic Association.

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. Visiting Professor at the City University Business School and the London School of Economics.

*Kate Barker has been appointed to the MPC with effect from 1 June 2001. She will succeed Dr DeAnne Julius.

between individual and collective responsibility. He concluded that there was no single best way. The Committee has discussed these issues on a number of occasions and will continue to review its approach.

Mr Kohn made a number of suggestions for improving the efficiency of the forecast process, in particular by concentrating the attention of the Committee on the major issues and by encouraging a greater input from Monetary Analysis staff. These suggestions were implemented successfully in the August and November forecast rounds.

Briefing arrangements

The Committee has implemented Mr Kohn's suggestion that the regular monthly staff briefings (known as "Pre-MPC") should be shorter and more focussed. The staff presenting at Pre-MPC are being encouraged to be more analytical in their presentations in order to improve the focus further.

NEW ARRANGEMENTS FOR EXTERNAL MPC MEMBERS

In November 1999, new formal arrangements were agreed for the external MPC members' access to research resources. These included the provision of two economists to provide research support to each external MPC member. At the same time new arrangements were introduced to identify the priorities for longer-term MPC-related research, with one meeting to set the annual programme, supplemented by a mid-year meeting to review progress; and quarterly meetings are held after each *Inflation Report* to identify the immediate priorities for additional analysis and research to be undertaken in advance of subsequent forecast rounds.

These arrangements have been implemented successfully.

THE MAIN MPC PROCESSES

A short summary of the main procedures is provided in this section. Although there have been changes during the year, the broad structure remains the same as in last year's Annual Report. The processes of the Committee can be grouped into three broad categories:

- The monthly policy round;
- The Quarterly forecast and Inflation Report round;
- Other tasks.

The monthly policy round

The Bank of England Act 1998 stipulated that the Committee must meet (at least) monthly to review and if necessary change interest rates to achieve the target set by the Government. The MPC satisfies this mandate by holding a regular monthly meeting – typically on the Wednesday afternoon and Thursday morning of the first full week of each month – announcing the policy decision at noon on the Thursday. The first afternoon of the meeting is devoted to a discussion of the key economic news over the previous month and the implications for the inflation outlook. On the morning of the second day, following a summary of the economic discussion by the Governor, Committee members are invited to outline their assessment of the main developments over the past month and to give a preliminary indication of their judgement on the appropriate level for interest rates. After all the Committee members have spoken, the Governor puts a proposition to the Committee, which he judges will command majority support and calls for a vote. Committee members preferring alternative policy settings to the majority view are asked to state their preferred level of interest rates. The nature of the debate and the range of members' views are set out clearly in the Minutes.

The policy meeting itself is the focus of the monthly round, which starts with the half-day pre-MPC briefing meeting by staff on the Friday before the policy discussion and concludes with the publication of the Minutes of each meeting at 9.30am on the Wednesday two weeks after the first day of the policy meeting.

The quarterly forecast and Inflation Report

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. The *Inflation Report* fulfils the obligations under the Act for the Bank to provide a quarterly report approved by the MPC, which reviews monetary policy decisions, assesses developments in UK inflation and provides an indication of the expected approach to meeting the objectives set by the Government. Given the time lags for changes in interest rates to affect output and inflation, policy must be forward looking. Hence a forecast is essential for the policy process.

The core sections of the *Inflation Report*, which provide the analysis of the economy and describe the MPC's forecast, have changed little over the past twelve months. But the *Report* does now incorporate the Agents' quarterly summary of business conditions, which was previously published separately. From February 2001, the MPC Minutes were dropped from the *Inflation Report*, and printed as a separate publication.

Other Tasks

The Committee also meets outside the regular policy rounds to review a range of issues, which include: internal procedures such as the forecast process; media coverage and messages; research and priorities; statistical priorities of the ONS; and responses to requests from the Treasury Select Committee. Committee members

Regional Agents

Chris Bailey, South East and East Anglia

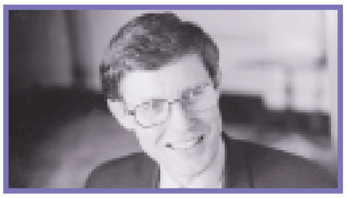
John Bartlett, West Midlands

John Beverly, South West

Chris Brown, East Midlands

Janet Bulloch, Scotland

Sue Camper, Wales



Nigel Falls, Northern Ireland

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

undertake an active programme of regional visits and speaking arrangements to explain the role of the MPC and the analysis underlying the policy decision. Members are also called regularly to appear before Parliament.

REGIONAL AND SECTORAL INFORMATION

Regional information

The limits of monetary policy are 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. Regional analysis can, however, aid the understanding of national economic developments and the transmission of monetary policy.

The Bank's 12 Agents play a fundamental role in providing regional information to the Committee. Regular contact is maintained with around 7,000 businesses across the UK. Agents produce monthly reports on economic conditions as seen from the perspective of businesses in their areas. These are circulated to Committee Members, and a national summary is prepared in the Bank's Head Office.

As well as the written reports, four Agents (including one from the north, the centre and the south of England and one from either Scotland, Wales or Northern Ireland) attend the pre-MPC briefing meetings. They provide an overview of economic developments as seen by the Agents, as well as focusing on a particular key issue of interest to the MPC.

In addition to the input from the Agents, the MPC is provided with regular statistical information and ad hoc notes on various official and survey data on the UK's regions. In recognition of the importance of this regional information for the monetary policy process, a regional economist was employed by the Bank in October 2000 to monitor and analyse the main regional macroeconomic developments in the UK. The introduction of this regional economist will ensure an expanded coverage of regional analysis available to the MPC. The Bank has also undertaken liaison with representatives from central banks in other countries (eg the US Federal Reserve System and the Reserve Bank of Australia) with regard to their coverage and use of regional data.

The Bank has on occasion undertaken more detailed analysis on regional developments. For example, topics examined have included whether activity in the southern regions of the UK leads the rest of the country, an analysis of differences in the industrial mix of the regions, and how best to measure regional unemployment dispersion.

Sectoral Information

On the broadest definition, most of the detailed analysis presented to the Monetary Policy Committee draws on sectoral information. For example, any analysis of the role of money 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 analysis of aggregate GDP trends is underpinned by a picture for the key industrial sectors. And any analysis of short-term inflation trends must draw on knowledge of special factors, which affect individual goods or sectors. The Agents have made further efforts to improve the sectoral mix of their regular contacts, and they report on a wide range of sectoral information in their reports.

In addition to official ONS data, numerous sectoral surveys are made available to the Committee (eg from the Confederation of British Industry and British Chambers of Commerce). Members of the Monetary Policy Committee also have meetings with national and local trade associations which represent sectoral interests.

Some of the sectoral analysis done for the MPC has been published in the *Inflation Report* and *Quarterly Bulletin*. For example, recent *Inflation Report* issues have included individual boxes relating to the UK housing market, utility prices and consumer spending on vehicles.

Objectives and Strategy

for 2001/02

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 2001/02 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 2001/02

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 such as the launch of the Schools Competition, to build public support for price stability, and public understanding of the MPC's approach to its remit.

4/ Drawing on an increased research effort, to enhance the Bank's assessment of the nature and scale of (domestic and international) risks to financial stability, and to step up the Bank's oversight of payment systems.

5/ To enhance the Bank's contribution to international and domestic initiatives which could significantly affect the efficiency and effectiveness of UK financial markets.

6/ To conduct the Bank's financial market and banking operations with a high degree of professional competence, in order to execute the Bank's policy decisions and meet customer requirements cost-effectively, and to make full 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 policies for recruitment, rewards, training and career development, to ensure that the Bank recruits, retains and develops staff with relevant skills and experience; and to build strong staff motivation and morale.

9/ To maintain the Bank's overall spending within the agreed budget of £209.4 million for 2001/02 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 five-year period to 2002/03.

10/ To improve the Bank's use of IT in pursuit of its objectives and to provide timely and cost-effective management information.

Financial Framework

for 2001/02

Budget for 2001/02

Reflecting the objectives set out on page 33, Court has agreed an expenditure budget of £209.4 million for 2001/02, a decrease of £2.8 million on last year's budget Most of the fall is in depreciation and unrecovered VAT which are both lower as a consequence of lower capital expenditure, down from £24.9 million in last year's budget to £16.2 million this year.

Within total current spending, operating expenses are budgeted at £190.7 million, £0.7 million less than budgeted for last year, and revenue expenditure on investment projects is budgeted at £18.7 million, down £1.9 million on last year. The decrease in operating expenses includes the impact of VAT and depreciation and excluding this, operating expenses are higher (by £4 million). The main increases in the underlying budget for operating expenses are in training, including IT training, developmental secondments and study leave, particularly the finance of post graduate economics training; in staff numbers in Monetary Analysis in support of the MPC process and in Financial Stability; and in IT resources in order to meet a skills deficit identified in a review of IT Strategy undertaken last year.

The reduction of £2.1 million in the contribution of investment spending to the total expenditure budget reflects the profile of spending on the refurbishment of the Threadneedle Street building. IT investment continues at a similar rate to the previous year's budget. A summary of the Bank's budget for the current year is given in the table below.

Bank Expenditure Budget

			£m
	2000/01 Budget	**2000/01 Outturn**	**2001/02 Budget**
Business units			
Monetary Analysis and Statistics	18.9	17.9	20.7
Financial Market Operations	45.7	43.9	45.4
Financial Stability	8.9	8.5	9.7
Co-ordination Unit for Europe	1.4	1.2	1.4
Centre for Central Banking Studies	1.5	1.4	1.5
Printing Works	34.5	32.4	34.2
Registrar's Department	3.6	3.3	3.5
	114.5	**108.5**	**116.6**
Centrally-borne costs			
Personnel, Audit and Secretary's Department	24.8	25.2	26.1
Property Services and Security	34.0	32.9	30.6
Finance and central IT	6.3	6.2	7.8
Depreciation, VAT, etc	32.6	37.1	28.2
	97.7	**101.5**	**92.8**
Total expenditure	**212.2**	**210.0**	**209.4**

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

Actual spending in 2000/01

Actual spending in 2000/01 was slightly below budget. There were shortfalls in staffing, particularly economists and analysts, and there were shortfalls in spending at the Printing Works mainly because more demand was met out of running down stocks. Some planned IT investments were deferred until this year. The variance against budget in depreciation and unrecovered VAT arises in part from changes in timing to the sequence of the Head Office refurbishment project, but also includes additional expenditure relating to transitional arrangements to the new staff benefits scheme (discussed in last year's report).

Costs of functions

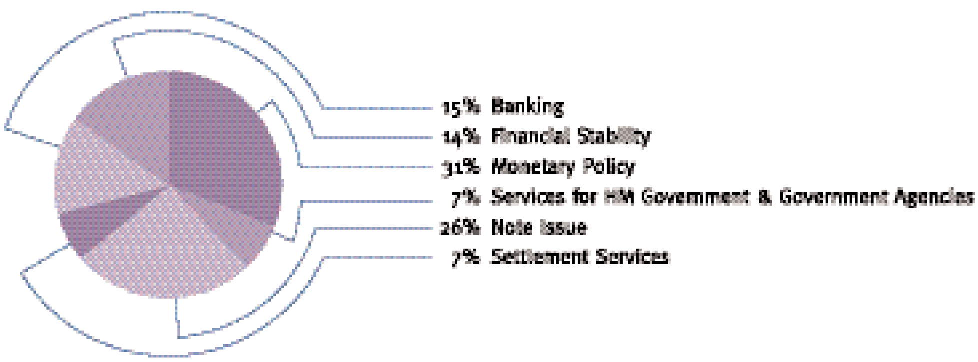
The breakdown of expenditure shown in the table is based on the organisational structure of the Bank, which is the basis on which Court agrees the Bank's spending. These figures do not show the cost of each of the Bank's functions, as many areas of the Bank contribute to more than one of these. For example, note issue costs, which amount to some £53 million in 2001/02, 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 2001/02 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, the Bank's spending is still expected 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 costs by £20 million, consistent with the transfer of banking supervision to the FSA. The Bank is now three

Budgeted Costs of Functions 2001/02



quarters of the way to achieving the £20 million reduction in overheads. Headcount in overhead functions has fallen by 240 since 1997/98, an annual staff cost saving of £8.5 million. Building occupancy has fallen and this has reduced costs by a further £4.7 million annually. Other related savings amount to a further £1.6 million a year. The Bank has now sold two of the five buildings it occupied in London. The Bank expects the reductions in centrally-borne costs to be fully realised in 2003, when refurbishment of the Threadneedle Street building is complete and the remaining buildings in London can then be vacated. The chart below shows the trend in the Bank's expenditure over the past eight years and the expected path four years ahead.

The financial framework

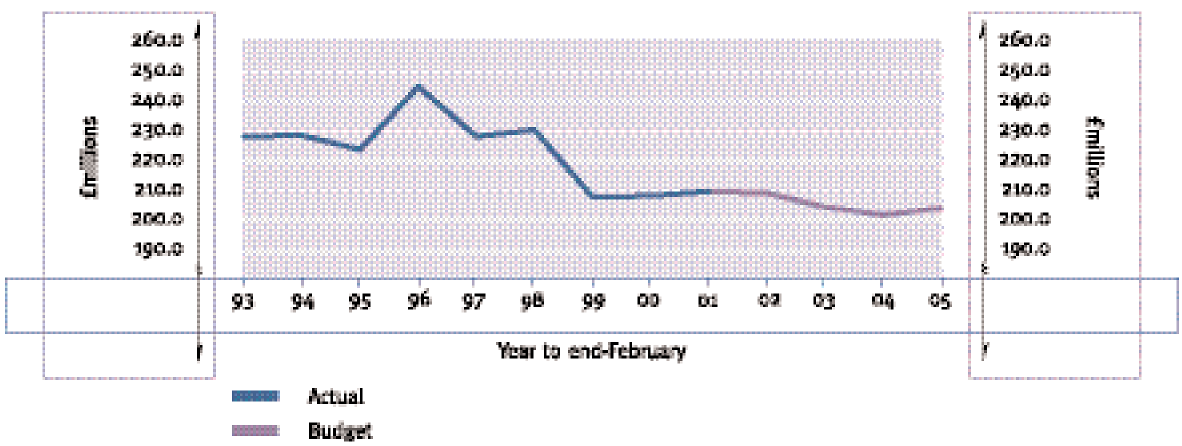
In planning its finances in the medium term, the Bank takes into account the return on its capital and reserves and the implications for Cash Ratio Deposits.

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 significantly lower than 7%, but in the near term this has only a limited impact on the Bank's income. Court is therefore content, as last year, to retain the benchmark of 7% for the year ahead.

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 1998 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 subsequently set CRDs at a level intended 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.

Bank Expenditure 1993-2005



In establishing the initial level of CRDs, an interest rate of 7% was assumed to translate the required level of income (£79 million) into an initial deposit ratio of 0.15%, intended to give a starting level of CRDs of £1,130 million. During 2000/01, interest rates averaged 6.0% and balances £1,350 million, implying an annual income of £81 million if invested at the Bank's repo rate. In fact, actual investment income was higher overall because of the Bank's remaining holdings of high-coupon gilts, but this buffer is unwinding 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 meantime, 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 principally from the needs of the MPC process, changes in the Bank's total expenditure from that used in setting the initial 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

STAFFING

The table on page 39 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 February 2001, the Bank employed 2,052 full-time staff and 206 part-time staff. Over the year, the number of staff fell by 166. Chart 1 on page 39 shows how the composition of the Bank's staff changed between 2000 and 2001. As in previous years, staff numbers fell in Registrar's Department at Gloucester, at the Printing Works at Debden and within the Bank's central support functions. The introduction of the C21 project in the Banking and Market Services area (page 24) has also led to reductions in staffing levels. The expanding areas of the Bank continue to be the policy divisions.

The fall in staff numbers last year continues a long-term trend illustrated in Chart 2 on page 39. In general the Bank has been steadily reducing routine processing jobs, by changing processes and by using IT more intensively.

Recruitment

In total (and across all categories), the Bank recruited 175 staff. This included 19 staff to work in IT. In line with a number of other employers, the Bank has launched a dedicated recruitment web-site[1]. This facilitates the initial screening of candidates and allows for the electronic submission of application forms. In fact, all the candidates for graduate entrant positions in the 2001 round submitted electronic applications.

The Bank recruited 66 clerical staff, mainly to the operational areas of the Bank. Of these, 44 joined at the clerical entrant level (17 GCSE, 27 A-level), and 22 as experienced hires. This was slightly more than in the previous year. (1999/2000: 59 clerical recruits, of which 43 were at entrant level).

In terms of graduate recruitment, the Bank's demand for high quality candidates increased further, while the market remained very competitive. 37 new graduates joined during the year. (1999/2000: 25). Major efforts have been made to raise the Bank's profile in the market and to attract the best candidates. In addition to the introduction of the new web site, selection processes were reviewed during the year.

The demand for experienced specialist staff remained high. In response to a number of external recruitment campaigns, 33 mid-career staff were recruited, the same outcome as in the previous year. The majority were economists for the Financial Stability and Monetary Analysis areas of the Bank. Others areas (including Audit, Personnel and Banking and Market Services) recruited professionally qualified, experienced specialists to fill specific vacancies.

Training and development

Following a successful pilot exercise, the Bank has launched a major bank-wide programme of IT training, built around the European Computer Driving License (ECDL). This internationally recognised computing qualification establishes a tangible IT benchmark across a number of applications as well as improving the productivity of staff. So far, 76 staff have successfully completed all seven modules of the programme. A further 597 are registered for the programme. After an initial assessment of skills, most of the training needs are met by use of computer based training, supplemented by tutor-led sessions as necessary.

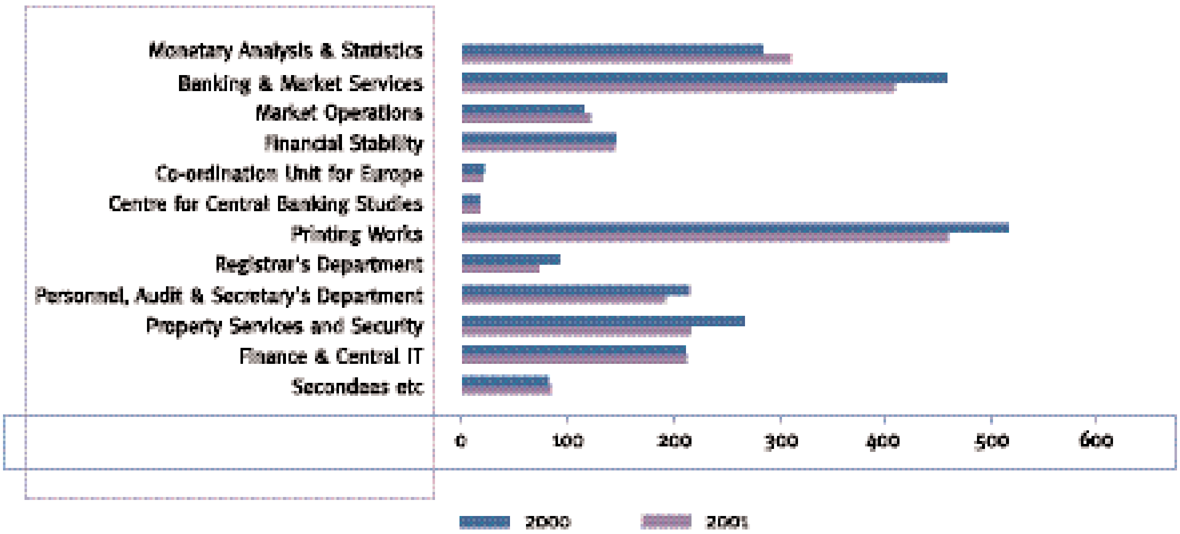
In order to reflect the changing demands on employees in the Bank, a review of the Bank's competency framework was undertaken. The result is a matrix of clearly defined performance standards encapsulating the required behaviours and skills for all levels of staff. Further work is now being undertaken to devise a revised on-line appraisal process that utilises the revised competency framework.

1: http://www.bankofengland.co.uk/jobs

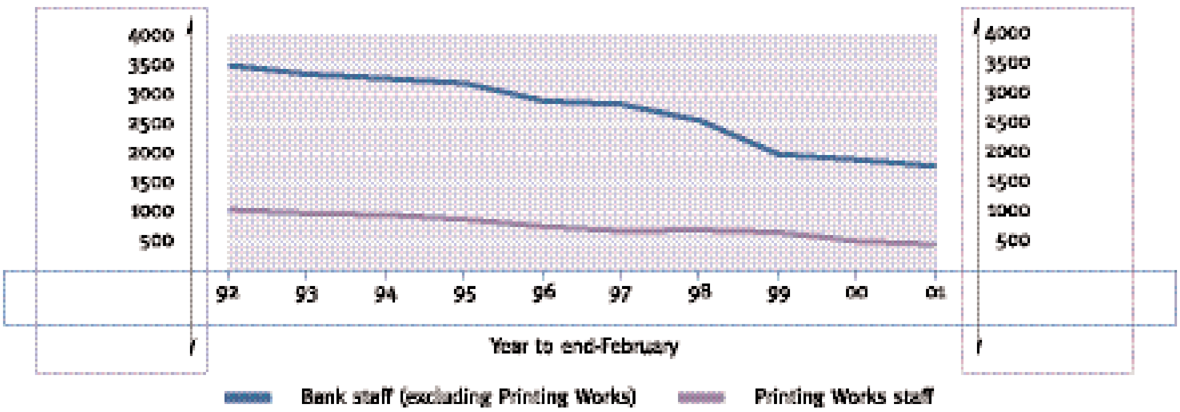
Aggregate Remuneration and Average Number of Staff

	2000/01		*1999/00*	
	Aggregate remuneration (£m)	**Average number of staff**	*Aggregate remuneration (£m)*	*Average number of staff*
Bank	**79**	**2,344**	*80*	*2,481*
Subsidiaries	**–**	**1**	*1*	*16*
Total	**79**	**2,345**	*81*	*2,497*

Numbers of Staff by Area 2000 and 2001 (Chart 1)



Bank Staff Numbers 1992-2001 (Chart 2)



A number of initiatives were undertaken involving the development of the Analyst Career Training Programme for new graduate entrants. A review of the induction programme has ensured that a broader range of topics is covered. This helps these staff become better versed not only in the Bank and its role in the City but also in the range of skills (both technical and interpersonal) required to be a successful analyst. To complement the induction, the 3-year programme of training that the graduates subsequently receive has been re-defined to include both core and optional elements that will support their development during this key time in the Bank. In addition a new Development Workshop has been introduced for graduates which gives them an opportunity at the mid-point in their training to review their performance and set their own development plans.

A career development adviser was appointed during the year to help staff in and approaching the management grades to make the maximum use of the development opportunities the Bank offers, to encourage greater job mobility and to support succession planning.

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 they are encouraged to raise any instances of discrimination through the Bank's internal procedures: 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 policies to help people balance work and family responsibilities, including flexible and part-time working. Over the past year both the number and proportion of women managers in the Bank grew slightly, to around 20%. The proportion of staff from an ethnic minority background also rose slightly, to nearly 6%, though the proportion in management grades was much smaller.

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.

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. In addition to the formal consultation process, briefings, notices and the Bank-wide intranet site are used to update staff on developments in this area.

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 communicate management and press announcements promptly to staff and the continuing development and expansion of the Bank-wide Intranet site is designed to give quick and easy access to information across a wide range of subjects.

During the year the Bank undertook a formal staff consultation using externally-facilitated focus groups. This highlighted a number of specific concerns, including the operation of new leave arrangements, management, communication, career development and the pace and direction of change in the Bank. Some immediate steps have been taken in response to the findings, and the Bank's management will be working over the coming year to address others: building the morale and motivation of staff has become a key objective of management at all levels in the organisation. There will be further staff consultations on a regular basis.

COMMUNITY INVOLVEMENT

Last year the Bank contributed £634,000 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 £400,500, while the cost of other community contributions, including time spent by Bank staff on community involvement activities, was £233,500.

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, £70,400 donated by staff and pensioners to registered charities under the Give-As-You-Earn Scheme and £8,400 of staff fundraising for the National Asthma Campaign and the Samaritans. The Bank provides office space for a charity, Opportunities for People with Disabilities, and hosted receptions for various community organisations. In addition, the Bank donates gifts in kind of surplus goods, computers and furniture.

As well as giving financial support, the Bank encourages a range of Education Business Partnership activities particularly in areas close to the Bank such as Tower Hamlets and Hackney. These include 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 and a number have become school business governors. The Bank offers its staff Civic Duties and Volunteering Leave, which enables staff reasonable time away from work to undertake volunteering commitments.

The Bank recognises the positive impact that its community programme can have not only on the projects that benefit, but also in terms of the development of its own staff. During the year the Governor emphasised this point in a letter to all staff. The Bank can also help to focus the efforts of other City organisations. In September 2000 the Governor, together with the Lord Mayor and the Chairman of the Financial Services Authority, launched the "Heart of the City" initiative which aims "to research, inform and promote community involvement and charitable giving by companies and individuals in the City of London". This will be achieved through collecting and publishing data on community involvement by firms in the City and Docklands, sharing experience and publishing a good practice guide, and an annual celebratory event based at the Guildhall. It is hoped that "Heart of the City" will give prominence to the efforts of those firms and members of their staff who are already involved, and encourage others who are less actively engaged, to recognise the benefits of such activity to the firms themselves as well as to the surrounding community.

As a special millennium project the Bank supported the Runnymede Trust to research Good Practice in Mentoring between Schools and Business. In partnership with existing mentoring programmes, the Runnymede Trust has sought to highlight good practice and procedures in sustaining a successful education/business mentoring programme, particularly for ethnic minority youth. The research briefing and the good practice mentoring guide for business will be published in 2001.

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 issues. 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 broaden both in format and in issues covered. This has ensured that the focus of CCBS activities evolves with the changing needs of overseas central banks.

In the year to February 2001, the CCBS ran 30 seminars or workshops in London for 757 participants, most of them central bankers drawn from 110 countries. 164 central bankers attended events run by CCBS staff overseas. In addition, 70 short specialised programmes were arranged in the UK for a total of 296 visitors from central banks. There were also 33 technical assistance visits abroad. The Centre's resource allocation is largely driven by demand. 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. A highlight of the year was the Central Bank Governors' Symposium, held in June, which was devoted this year to the issue of financial stability and central banks' role in sustaining and enhancing it.

The Academic Workshops attract international experts from central banks, academia and the private sector. These one-week events offer participants the chance 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 ten-week research project follows; 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. In 2000, the subjects covered in these events were the Transmission Mechanism of Monetary Policy, and Extracting Information from Financial Market Data.

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), the 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 remuneration and conditions of service to reflect adequately 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 consist of the following components:

Base salaries

The Governor is currently serving a second five-year term, which began on 1 July 1998. On 1 July 2000 the Governor's salary was increased from £238,491 to £244,454, 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 set in line with the policy described above.

Benefits

The Remuneration Committee also keeps under review other benefits available to Governors. Until 1 April 2000 these benefits were generally available on the same terms and conditions as for Bank staff, subject to any limitations on beneficial loans that would apply to a banking company incorporated under the Companies Acts. As described last year, the benefits available to Governors were reviewed along with those available to the staff, and some benefits, in particular housing and educational loans, were withdrawn. The Governor and Deputy Governors do not receive the full additional benefit allowance available to staff, but retain medical insurance together with pension, and these were the principal benefits received during the year to 28 February 2001.

The table of emoluments on page 44 includes payments of tax in respect of notional benefits of travel on Bank business. These arise because of the Inland Revenue's practice of treating travel by spouses accompanying a Governor or Deputy Governor on official business as a taxable benefit. The presence of the spouse on certain official business is regarded by the Bank as necessary and accordingly the Bank meets any tax liability that may arise in respect of such occasions.

Post retirement benefits

Court, via the Remuneration Committee, is also responsible for reviewing the pension arrangements for current and former executive members of Court. The Governor and Deputy Governors are eligible for post retirement benefits. These are generally provided through the Court Pension Scheme, which is separate from the scheme for staff. This scheme is described on page 45. The Bank's policy is to seek to harmonise the value to participants of their pensions which may be provided through a variety of different arrangements reflecting individual service with the Bank, arrangements with previous employers and with external pension providers. Generally the Bank aims to provide a pension of two-thirds of 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. Under the Bank of England Act, Governors are required to provide services only to the Bank. With Court's approval other directorships relevant to the Bank's work may be accepted, but any fees must be paid to the Bank.

REMUNERATION OF DIRECTORS

The Bank of England Act 1998 provides for the remuneration of the non-executive Directors to be determined by the Bank with the approval of the Chancellor of the Exchequer. 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 receive any post-retirement benefits from the Bank.

Remuneration of Members of Court

	Salary (Note i) £	Benefits £	Total 2001 £	*Total 2000 £*
Governors				
Governor				
Sir Edward George	242,467	2,516	244,983	*238,717*
Deputy Governors				
Mr D C Clementi	202,034	915	202,949	*198,340*
Mr M A King	202,034	316	202,350	*197,918*
Non-Executive Directors				
(Note i)	77,500		77,500	*75,833*
Total	**724,035**	**3,747**	**727,782**	***710,808***

Notes

i/ Sir Howard 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, Sir Howard Davies waived remuneration of £5,000 due from the Bank and Mr Clementi waived remuneration of £14,000 due from the FSA.

PENSIONS OF THE GOVERNOR AND DEPUTY GOVERNORS

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

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

For members subject to the pensions earnings cap introduced in the Finance Act 1989, the Bank offers additional unfunded pensions so that their total pensions broadly match those provided by the Court scheme. During the year ended 28 February 2001, there were two capped members – Mr Clementi and Mr King. Provision for these unfunded benefits is made in the Bank's financial statements.

Pension Entitlements (Including Unfunded Entitlements) (Table 4)

	Age at 28 February 2001	Years of service to 28 February 2001	Accrued pension as at 28 February 2001 £	Increase in accrued pension in 2001* £
Mr D C Clementi	52	3	24,100	6,700
Mr M A King	52	10	68,700	6,400

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

Notes

i/ The Governor, Sir Edward 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 £167,000 referred to above and two-thirds of his final salary on retirement. This further entitlement will accrue over his second term of office and provision for its cost will be made over this period. At 28 February 2001 no such additional pension entitlement had arisen.

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 £134,613 (2000 £131,329) per annum, pro rated for the number of days worked per week. They are appointed for terms of three years. Professor Willem Buiter's term expired on 31 May 2000 and he was succeeded by Professor Stephen Nickell. Professor Charles Goodhart's term also expired on 31 May 2000 and he was succeeded by Christopher Allsopp. Dr DeAnne Julius's term expires on 31 May 2001 and Dr Sushil Wadhwani's on 31 May 2002. Both Dr Julius and Dr Wadhwani work full-time in the Bank. Professor Nickell works in the Bank on a four day a week basis, and Mr Allsopp works in the Bank for three days a week, and they are paid respectively four-fifths and three-fifths of the basic MPC rate. In addition Mr Allsopp pursues in Oxford a programme of research on MPC-related issues and his remuneration for that is equivalent to a further one-fifth of the basic MPC rate. The members of the MPC appointed by the Chancellor do not receive the normal staff benefits. They are however 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.

The salaries of Executive Directors would not be disclosable under the Companies Act requirements, as they are not members of Court. However, the salaries of the two Executive Directors who are members of the MPC are given here for consistency with other members. Mr Ian Plenderleith's current annual salary is £169,348; and Mr Charles Bean's is £140,000. Both are eligible for the Bank's normal range of benefits, including non-contributory pensions.

Report from Members of Court

for the year ended 28 February 2001

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 Review 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.

In preparing this year's financial statements the Bank has adopted two new accounting standards, Financial Reporting Standards 15, on Tangible Fixed Assets, and 16 on Current Taxation, but these have no material impact on the financial statements. The Bank has also decided to have a full professional revaluation of its properties this year and will do so every 3 years in future. Previously the Bank had a revaluation every 5 years with the last one being in 1997.

Issue Department

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

FINANCIAL RESULTS

The Banking Department's financial statements for the year ended 28 February 2001 are given on pages 58-84, and show a profit after provisions and before tax of

£156 million (1999/2000 £123 million). The 2001 result includes a profit of £22 million on the sale of one of the Bank's properties, New Change. This disposal is part of the retrenchment programme, announced 2 years ago, under which the Bank will move all its City based staff into one building. Excluding this item, profits were slightly higher than last year, mainly due to increased interest income. After payment in lieu of dividend of £68 million (1999/2000 £50 million) and a tax charge of £20 million (1999/2000 £23 million), the profit transferred to reserves amounts to £68 million (1999/2000 £50 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 £1,584 million (1999/2000 £1,317 million). The increase was the result of more notes in circulation and slightly higher interest rates. 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 has, for the past two years, been largely determined by the bilateral positions between central banks in the TARGET system. As explained in previous years these balances reflected the net flows between the individual countries through the central banks and fluctuated with such payments. Although the net position was what mattered for most operational purposes, the individual balances were with different legal entities and had therefore to be shown gross under UK accounting rules. A netting arrangement was implemented from 30 November 2000, under which the bilateral balances that arise intra-day between the central banks are netted into a single position with the European Central Bank. Therefore only this position is shown in the balance sheet for the year ended 28 February 2001 and consequently the balance sheet footings are very much reduced.

The size of Banking Department's balance sheet is also affected by the allocation of open market operations between Banking and Issue Departments. This is determined by market conditions on the day. When market operations are conducted on Banking Department's balance sheet, they may be funded by an increase in the Issue Department's Deposit with Banking Department. At 28 February 2001 the level of market assistance provided by Banking Department was around £2.2 billion, approximately £300 million lower than at the previous year end.

The Bank issued 3 year euro-denominated securities, euro notes, during the year. The initial tranche of some €500 million out of €2,000 million was auctioned on 29 January and it is expected that further tranches of the same amount will be sold by auction every quarter. The proceeds of the issue have been invested in foreign currency assets so as to minimise market risk exposures, particularly interest rate and currency exposures.

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, which has been fixed at £13.4 billion since April 2000.

Support operations

A dividend of £5 million (1999/2000 £250,000) was received from Minories Finance Limited (formerly Johnson Matthey Bankers Limited). The company continues to realise its remaining assets.

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 38 to 40.

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 50% 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 £24 million in April 2000 and £26 million in October 2000 in respect of the year to 29 February 2000. In April 2001 the Bank paid the first payment of £33 million in respect of the financial year ended 28 February 2001 which was based on provisional figures. The balance of £35 million will be paid on 5 October 2001.

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 Court considers 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 is designed to manage rather than eliminate the risk of failure to achieve business objectives and, as such, provides reasonable, but not absolute, assurance against material mis-statement and loss.

In accordance with the Internal Control Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales, Court has reviewed the effectiveness of the system of internal control and confirms that an ongoing process of identifying, evaluating and managing the Bank's significant risks has operated throughout the year covered in this Annual Report, and up to the date of its approval.

The key features of the control system are set out as below:

i/ An organisational structure, as shown on page 13, that is closely aligned to the Bank's Core Purposes in order to provide a framework for the control of its various activities

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/ The appointment of experienced and suitably-qualified staff. Annual objective setting and appraisal procedures for all staff enable standards of performance to be monitored by management. A Bank-wide programme of training and development enables continuing improvement in relevant skills and knowledge.

iv/ 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 strategic, including financial, objectives.

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

vi/ Oversight of the management of the Bank's balance sheet as a whole and monitoring of the financial performance and risk profile of its main business activities by the Assets and Liabilities Committee (ALCO), which is chaired by the Deputy Governor, Financial Stability, and meets quarterly. A Risk Analyssis and Monitoring Division (RAMD) is responsible for monitoring risk controls in the Bank's banking and market operations. It provides a regular report for ALCO on balance sheet changes and developments. The financial risks and associated controls are separately reported on pages 51-53, as required under FRS 13.

vii/ A procedure, supported by the maintenance of a Bank-wide risk and controls matrix, under which the

Executive report to Court once a year on risk management in each of their areas of responsibility. In particular, such reports, which were made for the first time for the year under review, cover the nature and scale of the risks, how they are managed and monitored and, taking into account the control framework, the likelihood of risks materialising. In addition, the reports include any weaknesses or failures in controls during the year, which have not been previously reported to Court or to the Audit Committee on behalf of Court. The system of internal control is subject to scrutiny by the Executive and by internal audit, the head of which reports to the Governor. A risk-based internal audit programme is prepared annually and is approved by the Management Committee and endorsed by the Audit Committee. Monitoring the effectiveness of internal control is undertaken by Court 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.

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 28 February 2001 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 those requirements.

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

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

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 41.

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 showed that the Bank paid 95% (2000 96%) of its bills within these timescales.

The Bank estimates that the average trade creditor payment days for 2000/01 were 21 (1999/2000 19). 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

This section covers the management of risks arising from the Bank of England's financial operations, including its use of derivatives. As indicated in previous Annual Reports, the Bank runs various types of financial risk, whether in managing its own capital; in its banking business; through its involvement in payments and settlements systems; in implementing monetary policy; or in acting as agent for HM Treasury in managing the UK's official reserves. These risks are managed and corresponding controls monitored in the context of the Bank's internal control framework, described on pages 49-50.

New Developments in 2000/01

The past year has seen a number of changes to the business profile of the Bank. Existing customer business has expanded, notably in the area of fixed term deposits taken from other central banks. In addition, as described on page 23, the Bank took over the Government's 3-year euro note programme from January 2001. New product review and assessment procedures have been carried out, to ensure that the credit and market risks involved in the new business as well as operational issues such as accounting, settlement and legal documentation, have been addressed

Other initiatives that will reduce the Bank's balance sheet exposures have been under way in 2000/01. First, as a result of an agreement between the central bank members of the TARGET euro payments system, daily netting by novation was introduced system-wide from 30 November 2000. This eliminated the large gross bilateral claims and liabilities that arose between national central banks, which are now represented by a small single claim on the European Central Bank. The effect of this development in reducing the size of the balance sheet is mentioned on page 48. Second, following a major review of the Notes Held to Order scheme, new arrangements began to be phased in from April 2001, aimed inter alia at reducing the Bank's intra-day exposure to the institutions responsible for wholesale banknote distribution. Third, the moves towards Delivery versus Payment (DvP) in CREST later in 2001 will eliminate the intra-day exposures incurred by the Bank as a result of its role as a settlement bank.

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

Reputational Risk

To operate effectively, the Bank needs to maintain a high level of public confidence across the full range of its activities. Risks to the Bank's reputation may arise, for example, from shortcomings in the effectiveness of its market operations, which might impact on the implementation of policy decisions, the services provided to customers, or lead to financial loss. Potential risks are identified and evaluated by line management (using, for example, the risk and controls matrix referred to on pages 49-50, which facilitates a systematic re-assessment of the various risks to which the Bank is exposed, the potential impact of these and the controls in place to mitigate these risks). This enables line management to keep the control environment under review and to take whatever steps are needed to strengthen it. Risks are also managed by procedures for the selection and development of staff, by defining their key responsibilities, by setting annual objectives and performance measures for staff at all levels, and by a structured process for the management and oversight of the work of the Bank.

Financial Risk

The main financial risks associated with the Bank's activities are credit, market and operational risks arising from a range of banking and market operations. These are described in more detail below. They are largely undertaken in the Financial Market Operations area in pursuit of the Bank's responsibilities for monetary and financial stability.

The Bank, as agent, also manages HM Government's foreign currency assets and gold reserves, and its foreign currency liabilities, 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 continued to develop its management information systems.

Credit Risk is incurred by the Bank in the monetary operations through which it implements interest rate decisions taken by the Monetary Policy Committee; in other core central banking activities, notably through its participation in the major sterling and the euro wholesale systems (CHAPS, BACS, CREST, TARGET, etc); in the management of the official reserves on behalf of HM Treasury; in the operation of the Notes Held to Order scheme; and in its banking operations for its public sector, central bank and other customers. Credit and settlement 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 RAMD and reports to the Executive Director for Financial Market Operations, who is responsible for decisions on limits. This Committee is supported by a credit risk analysis team which also draws on the output of ratings agencies, and wherever possible 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, exposures are monitored against credit limits on a real time basis. Where the Bank, as a central bank, cannot set 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 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.

Market Risk is also incurred by the Bank, 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 manage its exposure to these risks, 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 67 to 73.

In relation to interest rate exposure, Cash Ratio Deposits are interest-free, while the Banking Department's income on the corresponding assets is exposed to short-term interest rate movements. The Bank reduces the variability in its income, and limits its credit exposure, by investing a significant proportion of these funds in gilts. Similarly, the liability corresponding to the Note Issue is interest-free, and the assets acquired by the Bank in providing liquidity to the Bank's system through open market operations typically have a maturity of two weeks or less, so that the interest rate exposure arising from these operations is of short maturity. Longer maturity instruments have been employed on occasion (eg over the millenium), but these have been at floating rates, again limiting the Bank's interest rate exposure. Sterling deposits taken by the Bank may be employed in its monetary operations, resulting in a slight maturity mismatch; such sterling deposits may also be placed in the market, via foreign exchange swaps, in the form of foreign currency deposits of matching maturity. Finally, customer deposits taken in foreign currency and gold are on-placed with the market, in either deposits or reverse repos 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 may also use foreign exchange swaps as a technique in its sterling open market operations, but no foreign exchange exposure is incurred. The Bank has used cross-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 and in relation to the new portfolio of securities funded by the euro-denominated medium term note programme which began in January 2001. The bulk of the TARGET portfolio is funded by eurobills. 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 intervention in support of its monetary policy objectives. Such operations would give rise to interest rate and foreign exchange rate exposures on the Bank's balance sheet, but no such operations have so far been conducted. In its reserves management operations on behalf of HM Treasury the Bank does take exchange rate and interest rate risk; it also employs the swap products described in the previous paragraph, as well as futures and forward rate agreements. In line with good market practice, the Bank now monitors Value at Risk on a daily basis for its reserves management operations, and where necessary on its own balance sheet, in order to monitor the effectiveness of its hedging operations. VaR 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. The Bank recognises that the VaR methodology cannot be guaranteed to predict the maximum loss that may be suffered in any trading period, particularly in the event of extreme market turmoil. Therefore stress testing is used to simulate the effect of extreme adverse market movements on the outstanding positions.

Operational or other related risks may arise directly or indirectly through inadequate internal processes, human error, systems or business continuity failures, fraud, or inadequate legal and other documentation. These are the types of risk faced by any institution active in banking and financial markets. Shortcomings in any of these areas could have reputational or financial consequences for the institution.

Such 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 and the monitoring of associated controls. As with other kinds of risks, these are included in the Bank's risk matrix referred to above. As noted above, any new product (defined as an instrument, transaction type or service that requires changes to the systems and procedures needed to transact, monitor, settle or account for it) is subject to a detailed new products procedure before senior management can authorise its introduction. 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 following 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 Bank's Annual Report. This report relates to the period from 1 March 2000 to 28 February 2001. The Core Purposes and Strategic Objectives of the Bank for 2000/01 are set out in the 2000 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. 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 2000/01.

The Bank's internal controls were kept under review as 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 2000/01 as reported on pages 49-50. So far as appropriate that forms part of this report.

Matters relating to the remuneration of the executive members of Court and to 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 2000/01 is set out on pages 43-46 and, so far as appropriate, forms part of this report.

The Monetary Policy Committee's procedures are described on pages 28-32. As provided for under Schedule 3 of the Act, Court receives a monthly report from the Monetary Policy Committee and all members of the MPC are invited to attend Court for that discussion and other relevant discussions of the MPC's procedures. Additionally, NedCo has decided that, in order to keep the MPC's procedures under review, it would *inter alia:*

- 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;

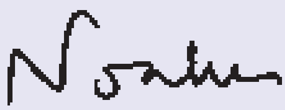
- Encourage non-executive Directors to visit the Bank's Agents and take part in their contact activities;

- Review examples of the regional, sectoral and other information collected by the Monetary Policy Committee during the year.

During the year, at the suggestion of NedCo, a review of MPC procedures was conducted by Don Kohn of the US Federal Reserve Board. Mr Kohn's findings (summarised on page 28) were discussed with NedCo in October.

NedCo also kept under review the new arrangements under which dedicated research and support staff are provided to external MPC members, as described on page 29.

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