

# Annual Report 2009



BANK OF ENGLAND





**BANK OF ENGLAND**

The Bank's Core Purposes are determined by Court as part of its role in setting the Bank's objectives and strategy. The statement opposite was endorsed by Court in May 2009.

#### **Contents**

|    |  |
|----|--|
| 2  | Foreword by the Chairman of NedCo                    |
| 4  | Foreword by the Governor                             |
| 6  | Governance and accountability                        |
| 8  | The Court of Directors                               |
| 10 | The Executive Team                                   |
| 12 | Organisation overview                                |
| 14 | Review of 2008/09                                    |
| 26 | The Bank's priorities in 2009/10                     |
| 30 | Expenditure review                                   |
| 33 | Remuneration of Governors, Directors and MPC members |
| 37 | Governance, financial statements and risk            |
| 43 | Report by the Non-executive Directors                |

#### **The Bank's Financial Statements**

|    |   |
|----|---|
| 50 | Report of the Independent Auditor                             |
| 52 | Banking Department Income Statement                           |
| 53 | Banking Department Balance Sheet                              |
| 54 | Banking Department Statement of Recognised Income and Expense |
| 55 | Banking Department Cash Flow Statement                        |
| 56 | Notes to the Banking Department Financial Statements          |
| 97 | Issue Department Statements of Account                        |
| 98 | Notes to the Issue Department Statements of Account           |
|    | Contacts  |

## The Bank's core purposes

### **The Bank of England exists to ensure monetary stability and to contribute to financial stability.**

#### Core Purpose 1 **Monetary Stability**

Monetary stability means stable prices and confidence in the currency. Stable prices are defined by the Government's inflation target, which the Bank seeks to meet through the decisions delegated to the Monetary Policy Committee, explaining those decisions transparently and implementing them effectively in the money markets.

#### Core Purpose 2 **Financial Stability**

Financial stability entails detecting and reducing threats to the financial system as a whole. Such threats are detected through the Bank's surveillance and market intelligence functions. They are reduced by strengthening infrastructure, and by financial and other operations, at home and abroad, including, in exceptional circumstances, by acting as the lender of last resort.

In pursuit of both purposes the Bank is open in communicating its views and analysis and works closely with others, including:

- Other central banks and international organisations to improve the international monetary and financial system.
- HM Treasury and the Financial Services Authority, under the terms of the Memorandum of Understanding, to pursue financial stability.

The Bank will also play its part in promoting an open and internationally competitive financial centre in the United Kingdom, using its expertise to help make the United Kingdom financial system more efficient, where such efforts would be in the public interest and provided that they do not conflict with its primary responsibilities or those of other agencies.

## Foreword by the Chairman of NedCo<sup>(1)</sup>



**Sir John Parker** Chairman

The year 2008/09 presented an unprecedented set of challenges for the Bank as it responded to the ongoing financial crisis and the significant economic downturn now affecting economies globally. It is difficult to overstate the extent of the issues that the Bank's Executive has faced. The crisis has required them to take key monetary policy decisions, design and implement innovative market facilities to improve liquidity and credit conditions, and make a substantial input into wider financial sector policy initiatives and banking reform legislation. It has been a tough year on any measure.

In such turbulent and uncertain conditions, monetary policy has never been more difficult. But, although the policy response has been challenging, the monetary policy framework and objective has always been very clear. The decisions of the Monetary Policy Committee (MPC) are not of course subject to Court's oversight, but the procedures that support those decisions are. Over such a testing period, it has been important to ensure that the MPC has had effective support and that processes and resources were able to respond flexibly to changing demands. There have been valuable discussions about the MPC's forecasting and other processes in the context of the recent crisis. More recently, Court discussed the potential use of credit and monetary easing measures as interest rates approached zero. The subsequent use of the Asset Purchases Facility for monetary policy purposes from early March has been very effectively supported by the Bank. Resources were diverted from other workstreams as priorities changed. The focus and effort evident across the Bank to meet this challenge has been extremely impressive. It will take time to observe the impact of these measures but the early signs appear positive. In due course, it will be important for the Bank to ensure it can adjust back to more normal conditions and resume the

work that has necessarily been displaced over the past year.

In contrast to the purpose and clarity of the Bank's monetary policy role, the financial crisis has crystallised a belief within the Bank, and among the Non-executive Directors, that the Bank's financial stability role needed greater clarification. The Banking Act 2009 gives the Bank the statutory objective for Financial Stability that Non-executive Directors believed was necessary, though further work will be needed to articulate precise responsibilities and powers in the context of the policy response to the financial crisis. The Act also gives the Bank responsibilities within the Special Resolution Regime (SRR) to deal with troubled institutions. This is a significant development. The Bank's powers have already been successfully used in relation to Dunfermline Building Society. I would like to acknowledge the significant contribution that has been made by Bank staff in forming the legislation and the detailed arrangements to implement it.

Although we believe that the creation of the Special Resolution Regime is a significant development, it is fair to say that there remain some concerns that the legislation may not go as far as necessary in terms of the Bank's influence in triggering the SRR and in giving the Bank timely and full access to the data it will require. Non-executive Directors agree with the Executive's view that there are important protocols on communication and information to be established among the Tripartite Authorities — especially with the Financial Services Authority (FSA) — to ensure clarity about how future arrangements and information transfer will work.

---

(1) The Committee of Non-executive Directors.

The Act also provides for a new committee of Court, the Financial Stability Committee, which will be established later this year. It will report to Court on the financial stability issues delegated to it. This will be an important development in the Bank's governance arrangements for financial stability. The new committee will play a role in contributing to the current debate and evolving policy framework in the wake of the crisis. Like others, I am convinced that one of the key lessons from the current financial crisis is the need for some form of macroprudential and systemic regulatory regime. The Bank has the skills and expertise to play a significant role in that debate. It will be important to ensure that any future responsibilities that the Bank assumes are matched by equivalent powers.

Court manages the affairs of the Bank including the setting of its strategy and objectives. This year, following his reappointment, the Governor discussed his vision for the next five years with the Non-executive Directors. The resultant strategic priorities — discussed in the *Report* — are I believe the right ones for the Bank over the coming year and beyond. Court will continue to review progress against milestones and performance indicators. We now have a very effective suite of quarterly reports covering strategy delivery, performance, finance, risk and projects. These provide the basis for constructive and challenging discussions with the Bank's Executive. This year there has been an even greater focus on the financial implications of the Bank's market operations and the effect on its balance sheet. Non-executive Directors have also been especially attentive to the extent that resources were being stretched across the organisation. Many staff have been required to work on new and additional facilities which has necessitated reprioritising other work areas. The commitment and dedication of Bank staff has been exemplary throughout. In our budget discussions this year, we were very conscious of the need to increase resources for activities such as collateral management while ensuing 'business as usual' activities are not deflected for a prolonged period. This will require careful monitoring over the year ahead.

The Audit and Remuneration Committees have, once again, made an important contribution through their delegated responsibilities. I am immensely grateful to the chairs and members of the Audit and Remuneration Committees for the significant time and commitment that has been devoted to their important work. In addition, the chair of the Audit Committee and Deputy Chair of NedCo,

along with myself, provided the core membership of the Transactions Committee. It was consulted on a number of occasions during the year on special financial transactions and the use of the Bank's balance sheet.

During the past year we welcomed Adair Turner to Court, to replace Sir Callum McCarthy. Other departures were Sir Andrew Likierman and Paul Myners who left to take up appointments in the public sector and Government respectively. Following the Banking Act, the Court of Directors will reduce to twelve members with effect from 1 June. There will be nine Non-executive Directors, including the Chair and Chairman of the FSA. This should enable Court's discussions and business to be undertaken more effectively. It is a development I fully endorse. Although some existing Non-executive Directors may serve on the new Court, many will not. I would like to extend my sincere thanks to them for their professional input, time and commitment throughout this difficult period.

A substantially new team of Non-executive Directors will take on the baton in June. I am delighted to welcome my successor, Sir David Lees. His rich corporate experience, together with his previous eight years as a Non-executive Director of the Bank during the 1990s, will provide quality leadership for Court.

The challenges facing the Bank over the past few years have been the most significant in its modern history. The Bank needs and has a strong senior team to take it forward and meet the challenges posed by recent events. I should like to place on record my admiration for the Governor who, under intense pressure, has provided dignified and dedicated leadership throughout. I have witnessed at first hand the calm analysis and clear focus that the Governor and senior members of the Bank team have displayed to devise and implement policy responses. It has been my privilege and pleasure to serve for the past five years on Court and to be Chair of NedCo. I wish the Bank and all its staff well for the future.



May 2009



## Foreword by the Governor



**Mervyn King** Governor

The past year has been the most challenging for the Bank of England since it gained independence in 1997. My predecessor, Eddie George, guided the Bank through that transition twelve years ago. It was with deep sadness that the Bank announced his death on 18 April. His memorial service will provide an opportunity for all of us to celebrate Eddie's achievements.

Over the past year, the Bank has responded decisively and comprehensively to the financial crisis that has engulfed the world.

Last summer, rising food and energy prices caused inflation significantly to overshoot its 2% target, peaking at 5.2% in September. That month I wrote a third open letter to the Chancellor. Two more letters were to follow in December and March. However, the Monetary Policy Committee (MPC) judged the pickup to be temporary, with inflation expected to fall back sharply in the medium term as output growth stagnated and the margin of spare capacity in the economy increased. The MPC judged the risks to growth to be on the downside.

Those risks materialised, and on a larger scale than anyone had expected. In September, the American investment bank, Lehman Brothers, collapsed. A panic in financial markets resulted. Our business contacts at home and abroad declared that orders and confidence, in the same telling phrase, 'fell off a cliff'.

The MPC's response was unprecedented. Bank Rate was cut from 5% to 0.5% in just five months. But the Committee judged that further, unconventional, measures were necessary.

In March, the Committee voted to use the new Asset Purchase Facility. It decided to buy £75 billion of assets from the private sector, financed by the issuance of central bank

reserves. These unconventional measures were a natural extension of the Committee's usual monetary policy operations.

Changing the price and quantity of money available is, however, only one part of the solution to the ongoing crisis. If the economy is to revive, and inflation to return to target, it is vital that normal lending to both businesses and households is resumed. This means returning banks to health. As I have said many times, this is not to protect the banks as such, but to protect the economy from the banks. That is why the measures the Bank has taken, and continues to take, were extreme and on an extraordinary scale.

In the past year, we have lent the banking sector hundreds of billions of pounds, both via extended open market operations, started in Autumn 2007, and the Bank's Special Liquidity Scheme (SLS). Introduced in April last year, the SLS was designed to finance part of the overhang of illiquid assets on banks' balance sheets by exchanging them temporarily for more easily tradable assets. The Bank lent £185 billion under the scheme against £287 billion of collateral, based on the nominal value at the end of January. It continues to remain in place for three years, thereby providing institutions with continuing liquidity and certainty.

The Bank also implemented comprehensive reforms to its money market operations. In October last year, a new, permanent Discount Window Facility (DWF) was introduced, which allows banks to swap high-quality illiquid assets for gilts, or cash under some circumstances. Initially for a period of 30 days, the DWF was extended to provide a facility for up to twelve months from January 2009. Together with changes to the facilities available for dealing with frictional payments shocks, in the form of new Operational Standing Facilities, the reformed framework puts the Bank at the forefront of global efforts to provide comprehensive liquidity insurance.

The crisis has revealed clear fault lines in the global financial structure. One of the most apparent here was the need for a proper system for resolving stressed banks. When Northern Rock failed in the summer of 2007, it became apparent very quickly that we did not have the tools necessary to effect a rapid resolution. The bank was taken into public ownership only after the Banking (Special Provisions) Act was passed in February 2008. Bradford and Bingley was also resolved under the Act in September, when its retail deposit business along with its branch network was transferred to Abbey-Santander. It was vital that a permanent resolution framework was enacted, and this was done with the passage of the Banking Act 2009, in February.

The Act implies many changes for the Bank. Formally, it gave us a statutory responsibility to contribute to protecting and enhancing the stability of the financial system of the United Kingdom. It created a Financial Stability Committee of the Court to oversee the Bank's delivery of this objective. It also made the Bank responsible for a Special Resolution Regime (SRR) to deal with distressed banks and building societies. Just six weeks after the Banking Act came into force, the SRR was triggered when the FSA determined that the Dunfermline building society no longer met its threshold conditions. Over the course of the last weekend in March, core parts of Dunfermline, including its wholesale and retail deposits and its head office and branch network, were transferred to the Nationwide.

The Act also formalised the Bank's payment system oversight role. Payment and settlement systems are vitally important to the smooth functioning of the economy. They allow financial institutions to settle market transactions, businesses to receive payments for goods and services and the general public to make purchases and receive their salaries. In 2007, the value passing through UK payment systems was around £240 trillion. Later this year, the Bank will have a statutory responsibility for their oversight, ensuring their reliability and so contributing to financial stability.

Banking crises can never be prevented; they are as old as banks themselves. But we can reduce the likelihood of them occurring, and ensure that when they do, they are orderly and contained. The Bank's new statutory responsibility for financial stability is welcome. But, as I have made clear, I regret that the new responsibility has not been accompanied by any new powers to deal with banks before they fail. Responsibilities and powers need to be aligned.

The Bank has always played a vital role at the heart of our economy and financial system. Never has that been more

apparent. The significant challenges it has faced in the past year have meant a vast increase in workload for many Bank staff and I am immensely grateful to them all for their extraordinary efforts. Each has played their part, whether it be in supporting the MPC, designing and executing the enhanced liquidity support operations, ensuring the first successful operation under the SRR or assessing the complex risks pervading the global financial sector.

The past year has been one of great change at the top of the Bank. In February, Sir John Gieve stood down as Deputy Governor for Financial Stability. Nigel Jenkinson, after almost 32 years in the Bank, the last six of which as Executive Director for Financial Stability, is retiring. I am grateful to them both for their contributions to the Bank. I am delighted to welcome Andrew Haldane as Nigel Jenkinson's replacement. I am also indebted to Tim Besley and Danny Blanchflower, both of whom leave the MPC at the end of their terms this year. I am grateful for their independent views and their contribution to the policy debate in what has been a challenging period.

I am extremely pleased that the Government has appointed Paul Tucker as Deputy Governor for Financial Stability. Paul's appointment was the first made under the new, transparent appointment process, which I welcome wholeheartedly. I am equally delighted to welcome Paul Fisher to the MPC, as the Bank's new Executive Director for Markets. I am immensely proud of the way the Bank nurtures talent; Paul is just one from a rich pool within the Bank. The Bank has a strong team to take it forward.

Sir John Parker steps down as Chairman of the Bank's Court next month. I would like to extend my warmest thanks for his tireless work and invaluable counsel over the past five years. The Bank has been extremely fortunate to have had such an exceptional Chairman. I look forward to working with Sir John's successor, Sir David Lees, in the years to come.

I have no doubt those years will see their own challenges. It is a great regret that the Bank will have to face them without Lord George. We are a richer, prouder institution because of his contribution over the past four decades. On behalf of the whole Bank, I pay tribute to him and his achievements.



May 2009

## Governance and accountability

The framework for governance and accountability is set by the 1998 Bank of England Act. In some respects the framework is modified by the 2009 Banking Act, the relevant provisions of which are expected to come into force on 1 June 2009.

### The Court of Directors

The Court is responsible for managing the affairs of the Bank, other than the formulation of monetary policy. Under the 2009 Banking Act, the Bank will have a statutory objective to 'contribute to protecting and enhancing the stability of the financial system of the United Kingdom' and the Court, consulting HM Treasury, will determine the Bank's strategy in relation to that objective. Court's responsibilities under the 1998 Act include determining the Bank's objectives and strategy, and ensuring the effective discharge of the Bank's functions and the most efficient use of its resources.

During 2008/09 Court consisted of the Governor, the two Deputy Governors and 16 Directors.<sup>(1)</sup> The Directors are all non-executive. The Governors are appointed by the Crown for periods of five years, and the Directors for three years. Details of the current Court are set out on pages 8–9. The 2009 Banking Act reduces the number of Directors to nine. The relevant provisions are expected to come into force on 1 June 2009, and the current Directors will therefore vacate their offices on 31 May 2009.

The 2009 Banking Act also provides for Court to be chaired by a Director designated by the Chancellor of the Exchequer. Previously Court was chaired by the Governor, although in practice most business has, since 2004, been discussed in meetings of NedCo (see below) under the Chairmanship of the senior Non-executive, with formal decisions taken in Court subsequently.

Members of Court have been indemnified by the Bank against personal civil liability arising out of the carrying out or purported carrying out of their functions, provided they have acted honestly and in good faith and have not acted recklessly. These indemnities were granted in 2000 and approved by HM Treasury in accordance with the practice of the Government in relation to board members of Non-Departmental Public Bodies.

### NedCo

The 1998 Act provides for a Committee of Court (NedCo) consisting of all the Non-executive Directors, with a chairman designated by the Chancellor. NedCo has responsibility for reviewing the Bank's performance in

relation to its objectives and strategy, and monitoring the extent to which its financial management objectives are met. NedCo is also responsible for reviewing the procedures of the Monetary Policy Committee (MPC) (see below), for reviewing the Bank's internal controls, and for determining the pay and terms of employment of the Governors, Executive Directors and external MPC members. NedCo is required to make a report as part of the Bank's *Annual Report*, and this is on pages 43–48.

### The Monetary Policy Committee (MPC)

The Bank of England Act establishes the MPC as a Committee of the Bank, subject to the oversight of NedCo, and sets a framework for its operations. Under the Act, the Bank's objectives in relation to monetary policy are 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. The MPC must meet at least monthly; its members comprise the Governor and Deputy Governors, two of the Bank's Executive Directors and four members appointed by the Chancellor. Membership of the MPC is given on page 16.

The MPC's decisions are announced after each meeting and minutes of their meetings are published two weeks later. The quarterly *Inflation Report* includes the MPC's projections of inflation and output.

### Financial Stability Committee

The 2009 Banking Act creates the Financial Stability Committee as a Committee of Court. Its functions are to make recommendations to Court concerning the Bank's Financial Stability strategy; to advise on actions in relation to institutions relevant to the Financial Stability objective; to advise on the use of stabilisation powers in particular cases and to monitor the Bank's use of those powers; to monitor the Bank's use of the payment system oversight powers; and to carry on other functions delegated to it by Court.

The Committee is to consist of the Governor and Deputy Governors, four Directors appointed by the Chairman of Court, and a non-voting member appointed by the Treasury. The Committee may co-opt other non-voting members.

### Remuneration Committee

The Remuneration Committee advises NedCo on the remuneration of the Bank's most senior executives, including

(1) At the time of publication of this *Report* there were thirteen Non-executive Directors, with three posts vacant.



the Governors, Executive Directors (who are not members of Court), the Advisers to the Governors and the members of the Monetary Policy Committee appointed by the Chancellor of the Exchequer (the external MPC members).

The members of the Remuneration Committee during 2008/09 were David Potter (Chairman), Peter Jay, Geoffrey Wilkinson, Arun Sarin, David Rhind and Roger Carr. The Chairman of NedCo attends meetings of the Remuneration Committee. The Committee's Report on Remuneration is on pages 33–36.

### Audit Committee

The functions of the Audit Committee are to assist Court in meeting its responsibilities for an effective system of financial reporting, internal control and risk management; and 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, their independence and their fees. It reviews the annual financial statements prior to their submission to Court, including consideration of the appropriateness of the accounting policies and procedures adopted. The Committee reports its conclusions to Court.

The members of Audit Committee during 2008/09 were Amelia Fawcett (Chairman), Sir Andrew Likierman (resigned December 2008), Paul Myners (resigned October 2008), James Strachan, Susan Rice and Robert Wigley. The Deputy Governors, the Executive Director for Central Services, the Finance Director, the Head of Internal Audit and the external auditors normally attend the meetings of the Committee, and the Chairman of NedCo may also do so. The Committee normally meets four times a year.

### Transactions Committee

The Transactions Committee is consulted about transactions outside the normal course of the Bank's business. Any decisions made by the Committee are reported to Court as soon as is practicable. The meetings in 2008/09 related to the Bank's involvement in the banking crisis, which is described on page 18.

The members are the Chairman of NedCo and two other Directors, normally the Deputy Chairman of NedCo and the Chairman of the Audit Committee.

### Management structure

The executive management of the Bank lies with the Governors and Executive Directors. The responsibilities of Governors are set out below. The responsibilities of the Executive Directors are set out on pages 10–13.

### Governor — Mervyn King

The Governor has overall executive responsibility for the management of the Bank in support of the Core Purposes. He defines the strategy for the Bank which, with the approval of Court, sets the direction for the organisation. This strategy is implemented via a detailed business plan and budget which are reviewed and agreed annually with Court. The Governor chairs the meetings of the Bank's Governors, which provide Executive oversight of the Bank's budget and authorises projects on the recommendation of the Bank's Projects Group, and of the Executive Team, which monitors delivery against the business plan and addresses key business issues. He provides leadership on both of the Bank's Core Purposes, chairing the Monetary Policy Committee and representing the Bank at the Tripartite Standing Committee. He chairs the Resolution Committee, which agrees the Bank's approach to threats to financial stability, including the exercise of the Bank's powers under the Special Resolution Regime, and is a member of the Financial Stability Board (see page 12). The Governor holds a press conference four times a year to launch the Bank's *Inflation Report*.

### Deputy Governor Monetary Policy — Charlie Bean

The Deputy Governor, Monetary Policy is a member and Deputy Chairman of the Monetary Policy Committee and is a member of the Financial Stability Board and Resolution Committee. He provides oversight of the Markets and Monetary Analysis and Statistics Directorates. He participates in the *Inflation Report* press conference.

### Deputy Governor Financial Stability — Paul Tucker

The Deputy Governor, Financial Stability chairs the Bank's Financial Stability Board and is a member of the Monetary Policy Committee and the Resolution Committee. He sits as a member of the Board of the Financial Services Authority and is the Bank's representative in the Tripartite Standing Committee Deputies. Within the Bank he oversees the Financial Stability and Banking Services Directorates, and also has specific responsibility for the oversight of the Bank's business continuity preparations.

All three Governors represent the Bank externally, including domestically through appearances in front of the Treasury Committee and internationally through membership of key international committees and groupings and regularly speak publicly on issues covering the overall economy, monetary policy and financial stability.

## The Court of Directors



**Mervyn King** Governor



**Charlie Bean** Deputy Governor



**Paul Tucker** Deputy Governor



**Sir John Parker**



**Brendan Barber**



**Peter Jay**



**Dr David Potter, CBE**



**Amelia Fawcett, CBE**



**Geoffrey Wilkinson**



**Arun Sarin**



**Professor David Rhind, CBE**



**James Strachan**



**Robert Wigley**



**Roger Carr**



**Susan Rice, CBE**



**Lord Turner**

**Sir John Parker**

Appointed to Court in June 2004.  
Appointed Chairman of the Committee of Non-executive Directors in March 2005.

- Chairman, National Grid plc
- Deputy Chairman, DP World, Dubai
- Joint Chairman, Mondi plc
- Non-executive Director, Carnival Corporation Inc. and Carnival plc
- Non-executive Director, EADS
- Member of Prime Minister's Business Council
- Chancellor, University of Southampton
- Chairman, BVT

**Amelia Fawcett, CBE**

Appointed 1 June 2004.

- Chairman, Pensions First
- Chairman, Guardian Media Group
- Non-executive Director, State Street Corporation
- Deputy Chairman of the Board, National Portrait Gallery
- Director, Business in the Community
- Chairman, London International Festival of Theatre

**James Strachan**

Appointed 1 June 2006.

- Non-executive Director, Legal and General Group plc
- Non-executive Director, Care UK plc
- Non-executive Director, Welsh Water
- Non-executive Director, Sarasin and Partners LLP
- Non-executive Director, Social Finance
- Visiting Fellow, London School of Economics

**Lord Turner**

Appointed 20 September 2008.

- Chairman, The Financial Services Authority
- Chairman, ODI
- Chairman, Climate Change Committee

**Brendan Barber**

Appointed 1 June 2003.

- General Secretary, Trades Union Congress
- Member, Executive Committee of International Trade Union Confederation
- Member, Executive Committee of European Trade Union Confederation
- Member, Council of Institute of Employment Studies
- Director, UK Commission for Employment and Skills

**Geoffrey Wilkinson**

Appointed 1 March 2005.

- Non-executive Director/Member, South West Strategic Health Authority
- Member, England Committee of the BIG Lottery Fund
- Non-executive Director, Eden Project, Cornwall

**Robert Wigley**

Appointed 1 June 2006.

- Chairman, Oxford University's Centre for Corporate Reputation Global Advisory Board
- Member of National Government Council for Education Excellence
- Member of Chancellor's High Level Group
- Deputy Chairman, Business in the Community
- Chairman, National Education Employer Partnership Task Force

**Peter Jay**

Appointed 1 June 2003.

- Executive Professor of Political Economy, Henley Business School
- Chairman, Oxford Literary and Debating Union Trust

**Arun Sarin**

Appointed 1 June 2005.

- Retired Chief Executive, Vodafone Group plc

**Roger Carr**

Appointed 1 June 2007.

- Chairman, Centrica plc
- Chairman, Cadbury plc

**Dr David Potter, CBE**

Appointed 1 June 2003.  
Appointed Deputy Chairman of the Committee of Non-executive Directors in November 2006.

- Chairman and Founder, Psion plc
- Governor, London Business School
- Trustee, China Dialogue

**Professor David Rhind, CBE**

Appointed 1 June 2006.

- Non-executive Director, UK Statistical Authority
- Chairman, Socio-Economic Committee of the Nuclear Decommissioning Authority
- Chairman, Government's Advisory Panel on Public Sector Information
- Trustee of the Nuffield Foundation
- Chairman, Portsmouth Hospitals NHS Trust

**Susan Rice, CBE**

Appointed 1 June 2007.

- Managing Director, Lloyds Banking Group Scotland
- Chairman and Chief Executive, Lloyds TSB Scotland plc
- Senior Independent Director, Scottish and Southern Energy plc
- Chairman, Edinburgh International Book Festival
- Non-executive Director, Scottish Business in the Community
- Non-executive Director, Scotland's Futures Forum

## The Executive Team



**Mervyn King** Governor



**Charlie Bean** Deputy Governor  
Monetary Policy



**Paul Tucker** Deputy Governor  
Financial Stability



**Andrew Bailey** Executive Director  
Banking Services and Chief Cashier



**Spencer Dale** Executive Director  
Monetary Analysis and Statistics



**Paul Fisher** Executive Director  
Markets



**John Footman** Executive Director  
Central Services and  
Secretary of the Bank



**Andy Haldane** Executive Director  
Financial Stability

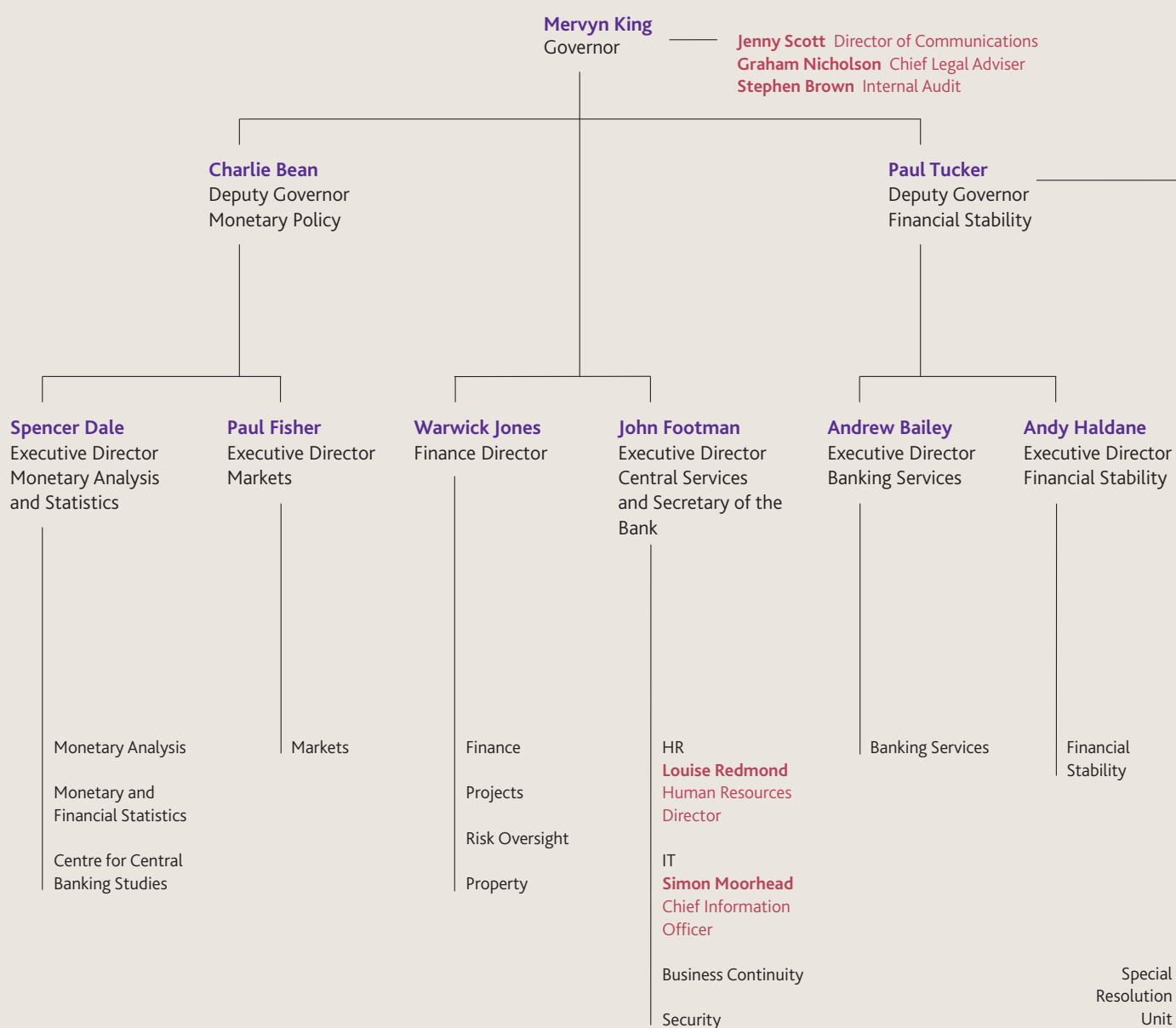


**Warwick Jones** Finance Director

The diagram on the next page shows how responsibility for individual functions is delegated within the Bank. Each major function is headed by an Executive Director. The Governors and Executive Directors form the Executive Team, the Bank's senior management group. The Executive Team meets regularly, and other senior officials (for example the Human Resources and Communications Directors) join the meetings when matters within their areas of responsibility are discussed. The Executive Directors for Banking Services, Financial Stability and Markets and, in future, the Head of the Special Resolution Unit, are also members of the Resolution Committee (see page 7).

A more detailed overview of the main operational areas, and other management, is given on pages 12–13.

## Management structure





## Organisation overview

### Monetary Analysis and Statistics

#### Spencer Dale

Martin Brooke — Conjunctural Assessment & Projections

Mark Cornelius — International Economic Analysis

Neal Hatch — Structural Economic Analysis

Jens Larsen — Monetary Instruments & Markets

Jo Paisley — Monetary & Financial Statistics

Simon Price — Senior Adviser

James Proudman — Monetary Assessment & Strategy

Gareth Ramsay — Inflation Report & Bulletin

Peter Westaway — Senior Research Adviser

Tony Yates — Senior Adviser

The Monetary Analysis (MA) 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 *Inflation Report*, which sets out the Monetary Policy Committee's assessment of the current monetary and economic situation in the United Kingdom and of the outlook for inflation and growth, and the *Quarterly Bulletin*, a publication setting out broader research and analysis supporting policy decisions.

The work of the MA divisions, including reports from the twelve regional Agencies, provides analytical information for the decisions taken each month by the 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.

### Centre for Central Banking Studies (CCBS)

#### Gill Hammond

The CCBS acts as a forum where central banks and academic experts from all over the world can exchange views on the latest thinking in central bank policies and operations. The CCBS supports the Bank of England's core purposes by promoting monetary and financial stability in the international context. CCBS provides an extensive programme of seminars, workshops and conferences both in London and abroad, attended by central bankers from more than 130 countries.

### Financial Stability<sup>(1)</sup>

#### Andy Haldane

Ian Bond — Financial Resilience

Peter Brierley — Special Adviser

Phil Evans — International Finance

Simon Hall/Nicola Anderson<sup>(2)</sup> — Systemic Risk Assessment

The Financial Stability area has the main responsibility for discharging the Bank's remit to contribute to the maintenance of the stability of the financial system as a whole. It works closely with HM Treasury and the FSA under the terms of the Memorandum of Understanding, which was revised in March 2006, and under the terms of the Banking Act 2009, which has placed the Bank's financial stability role on a statutory footing.

Internally, a high-level Financial Stability Board guides the work of the area identifying and prioritising potential risks to United Kingdom financial stability and judging which warrant follow-up action. The Board is chaired by the Deputy Governor for Financial Stability, Paul Tucker.

The area seeks to detect risks to the structure and functioning of the United Kingdom financial system and to develop measures to strengthen the financial infrastructure at home and abroad to reduce those risks. This includes its statutory responsibilities for overseeing United Kingdom payments systems. In addition it undertakes work with HM Treasury and the FSA to improve the arrangements for managing a financial crisis. The area also contributes to the monetary policy process, and promotes public understanding of issues relating to financial stability through, for instance, the regular *Financial Stability Report*.

### Special Resolution Unit<sup>(3)</sup>

The Special Resolution Unit, which was created in February 2009, reports directly to the Deputy Governor for Financial Stability. It develops and co-ordinates the Bank's response to the resolution of individual institutions, using the powers of the Banking Act 2009, and undertakes analysis to enhance the resolution regime going forward.

(1) In order to reflect the Bank's changed Financial Stability role and new statutory responsibilities under the Banking Act 2009, a new organisation structure will be put in place for the Financial Stability Directorate. This structure will consist of Divisions covering Prudential Policy, Risk Assessment, Financial Institutions, Payments & Infrastructure and International Finance.

(2) Acting Heads of Division as at 14 May 2009.

(3) As at 14 May 2009 Andrew Bailey is acting Head of Special Resolution Unit. An appointment process for a permanent Head is well advanced.

## Markets

### Paul Fisher

Sarah Breeden — Risk Management  
 Roger Clews — Special Adviser  
 Michael Cross — Foreign Exchange  
 Graeme Danton<sup>(4)</sup> — Markets Strategy and Risk Operations  
 Chris Salmon — Sterling Markets

The main functions of the Markets area include: conducting operations in the sterling money markets to implement the Monetary Policy Committee's decisions, while meeting the day-to-day demand for reserves of the banking system as a whole; managing the Bank of England's balance sheet; managing the United Kingdom's foreign exchange reserves, as the agent of HM Treasury; delivering financial market analysis and intelligence in support of the Bank's monetary and financial stability missions; and contributing to the management of financial and business continuity crises.

In delivering its functions, the area draws on a wide range of financial markets contacts in the United Kingdom and overseas, and also contributes to facilitating efficient core wholesale markets, including via practitioner committees.

The Risk Management Division is responsible for identifying, measuring and, with the front-office divisions, managing risks from financial operations. Market intelligence is co-ordinated by a dedicated team. A dedicated strategy and risk operations division provides strategic management support and risk reporting across the Markets Directorate.

## Banking Services

### Andrew Bailey

Lee Dobney — Notes  
 Joanna Place — Customer Banking  
 Alastair Wilson — Market Services

Customer Banking Division provides banking services to the Government and other customers, principally financial institutions and other central banks.

Notes Division manages the note issue, including the relationship with De La Rue, the supplier of notes to the Bank.

Market Services Division operates the Real Time Gross Settlement (RTGS) system through which payments relating to the major United Kingdom payments and securities settlement systems are settled and, from this operational role, contributes analysis to the Bank's continuing work in developing safe and efficient payment and settlement systems. It also provides the back-office functions to support the Bank's sterling and foreign currency transactions including settling the Bank's Open Market (monetary policy) Operations.

## Finance

### Warwick Jones

Peter Higgs — Facilities & Procurement  
 Simon Politzer — Projects, Risk & Performance  
 Tim Porter — Financial & Management Accounting

Finance is responsible for budgeting, financial accounting and monitoring the performance of the Bank in its attainment of its strategic priorities. In addition it provides Bank-wide project support and risk oversight, and manages the Bank's property and facilities.

## Central Services

### John Footman

Simon Moorhead — Chief Information Officer  
 Louise Redmond — HR Director  
 Stephen Collins — Business Continuity  
 Jonathan Curtiss — HR Services  
 Andrew Hauser — Private Secretary to the Governor  
 John Heath — Legal  
 Don Randall — 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 IT, personnel, business continuity, the Governors' private offices, and legal services.

## Communications

### Jenny Scott

Andrew Wardlaw — Public Communications & Information

The Public Communications & Information Division manages the Bank's public and media relations and its work to build public understanding; it includes the press office, the Bank's website, public enquiries, education and community programmes, and the Bank's museum. It also manages internal Bank-wide staff communications.

## Internal Audit

### Stephen Brown

Internal Audit assists the Court of Directors and Executive Management in protecting the Bank, and its reputation, by independently and objectively evaluating the effectiveness of internal controls, risk management and governance processes. As part of this assurance Internal Audit recommends cost-effective improvements which are agreed with management and tracked until implementation.

(4) Acting Head of Division as at 14 May 2009.

## Review of 2008/09

The strategic priorities endorsed by Court for 2008/09 and published in last year's *Annual Report* were:

**Strategic priority 1** The Bank should continue to improve the quality and efficiency of the processes supporting the Monetary Policy Committee, advance the analysis, practice and communication of inflation targeting, and enhance its understanding of the changing inflation process.

**Strategic priority 2** Money market operations should ensure stable overnight sterling interest rates and support improved banking system liquidity management, including by providing longer-term finance through open market operations.

**Strategic priority 3** Banking operations should be focused on ensuring monetary and financial stability, thus eliminating activities that do not contribute to those activities, while also being efficient and resilient, in large part to be achieved by continuing to deliver the Customer Banking Transition Programme and developing clear plans for future systems and processes required to run the remaining business.

**Strategic priority 4** The Bank should ensure that its banknotes are designed and produced in order to maintain a high level of security against counterfeiting, and that distribution of notes ensures a secure and efficient circulation that meets the Bank's objectives for integrity and quality.

**Strategic priority 5** The Bank should draw on its upgraded analytical and market intelligence capabilities to deepen its understanding of the major risks to the UK financial system, to promote wider understanding of these risks among financial market practitioners and work effectively with others to lower them.

**Strategic priority 6** The Bank should continue to manage the consequences of the recent financial crisis within the Standing Committee framework, and continue to work with others to strengthen international crisis management preparations. The Bank will contribute to work towards a special resolution scheme for banks and will contribute to a review of the Tripartite arrangements in the light of recent events in financial markets.

**Strategic priority 7** The Bank should promote safe and efficient payments and settlements systems, clarifying and implementing a revised remit for its payment systems oversight work following the conclusion of the statutory consultation process, while remaining at the forefront of best practice in operational and policy areas.

**Strategic priority 8** To deliver these strategic priorities, the Bank will aim for the highest professional standards and will continuously improve its internal business processes.

Enabling priorities for 2008/09 were:

- Delivering changes to HR services to focus on providing efficient, value-added support to business areas.
- Developing an improved system of performance measurement.
- Implementing a new business-led IT operating model.

The objectives set by Court for 2008/09, which are reproduced opposite, proved a considerable underestimate of the demands that would be placed on the Bank by the continuing financial crisis and developments in the global economy. The main lines of the Bank's responsibilities remained clear: to meet the inflation target set by the Government; and to contribute to the maintenance of financial stability through effective liquidity provision, supporting a sound payment and settlement system infrastructure, supporting the effective resolution of banks in difficulty and sound analysis of risk going forward. But the delivery of these goals required new and unconventional policy approaches; and, internally, the rapid development of new processes and systems. Staff numbers rose by 6%, the first significant increase since 1987. The Bank's balance sheet more than doubled in size. During the year a new Banking Act was passed, giving the Bank a statutory financial stability objective, and new responsibilities for bank resolution and payment system oversight.

### Monetary policy

The inflation target was reconfirmed by the Chancellor in March 2008 at 2%, measured by the twelve-month increase in the consumer prices index (CPI). The monetary policy framework requires that if CPI inflation deviates from the target by more than 1 percentage point, the Governor must write an open letter to the Chancellor explaining why, and outlining the measures being taken to bring inflation back in line with target. CPI inflation rose sharply through the first half of 2008 to a peak of 5.2% in September 2008, driven by energy, food and import prices. The increase in CPI inflation above 3% resulted in a series of four open letters from the Governor to the Chancellor in June, September and December 2008 and March 2009. From October 2008, CPI inflation fell back towards the target, in large part reflecting a reduction in energy prices and the temporary cut in VAT.

Subject to meeting the inflation target, the Monetary Policy Committee (MPC) is also charged with supporting the Government's general economic policy objective of achieving high and stable levels of growth and employment. Annual GDP growth (measured on a calendar-year basis) is estimated to have slowed in 2008, to 0.7%, and is expected to be negative in 2009, amidst a sharp and synchronised downturn in the global economy. The Labour Force Survey measure of the unemployment rate rose throughout 2008, reaching 6.3% of the workforce in the fourth quarter.

The downturn in the economy led the MPC to forecast that inflation would fall well below the 2% target in the medium term. During the latter part of 2008, and into 2009, the MPC reduced Bank Rate, from 5% in September 2008 to 0.5% in March 2009.

At the March 2009 MPC meeting, with Bank Rate close to zero, the Committee chose to use the Asset Purchase Facility (see below) to finance asset purchases through the issuance of central bank reserves. Although this changed the instrument of monetary policy, the objective was unchanged — to meet the inflation target of 2%.

The decisions of the MPC, together with its analysis and forecasts, are published in the minutes of their meetings and in the *Inflation Report*, and are not covered further here.

### Implementing MPC decisions

In its market operations the Bank aims to maintain overnight market interest rates in line with Bank Rate so that there is a flat money market yield curve and very little volatility in market interest rates out to the next MPC decision date.

During the year, to help stabilise market interest rates in line with Bank Rate, the Bank:

- held a number of fine-tuning repo operations to inject extra reserves into the banking system;
- expanded the range within which reserves were remunerated in order to accommodate the extra reserves supplied;
- held fine-tuning and scheduled operations to drain extra reserves injected through long-term repo operations, using Bank of England bills for the first time for such operations; and
- introduced Operational Standing Facilities to absorb frictions in the overnight money markets.

Other changes, intended to support bank liquidity, are described on page 17.

### Asset Purchase Facility

The Government announced on 19 January 2009 that it was authorising the Bank to purchase a range of high-quality assets as part of a package of measures to improve financing conditions in the UK economy. The first phase, which began on 13 February 2009, involved the Bank purchasing short-term commercial paper issued by

## Review of 2008/09 continued

Members of the  
Monetary Policy  
Committee

Mervyn King Governor



Charlie Bean Deputy Governor



Paul Tucker Deputy Governor



Kate Barker



Tim Besley



David Blanchflower



Spencer Dale



Paul Fisher



Andrew Sentance

corporates, financed by the issue of Treasury bills. The second phase commenced in March 2009, when the MPC began setting a target for the level of asset purchases to be financed by central bank reserves over a period of its choosing. At its March meeting, the MPC voted to undertake a programme of asset purchases of £75 billion financed by the issuance of central bank reserves. That sum covered both the continuing programme of private sector asset purchases, and the purchase of medium and long-maturity conventional gilts in the secondary market. Gilt purchases began on 11 March. On 25 March the Bank extended the Asset Purchase Facility to purchases of corporate bonds.

**Support for the MPC**

The Bank aims to provide high-quality and comprehensive analytical support to the MPC. It conducts an annual survey of MPC members' general satisfaction with the various inputs to the policy process. The latest survey suggests that MPC members remain satisfied with the conjunctural and forecast material that they receive, although the general level of satisfaction was a little lower than that found in the previous year's survey.

With the outlook for demand and output changing rapidly, the Bank's analytical support for the MPC increasingly focused on high-priority areas such as unconventional policy options and the Asset Purchase Facility. There was additionally work on the impact on the economy of banks restructuring their balance sheets, including the potential impact on demand and inflation from the tightening in the availability of credit and increased levels of uncertainty. In the Statistics area, work was undertaken to collect detailed lending statistics and information from individual financial institutions, and the first in a monthly series of *Trends in Lending* reports was published in April 2009.

Various initiatives are in train to improve the efficiency of work processes within the Monetary Analysis and Statistics area, and thus allow it to run with smaller staff numbers. For example, a project to further automate production of the statistical chart pack used by the MPC is on course to be completed in 2009. Within the Bank's Agency network, the project to relocate the regional offices to smaller premises was completed, generating significant financial savings while maintaining the Agencies' intelligence gathering and representational activities.



### Financial stability

Pressure on bank liquidity remained severe in 2008, and the global financial market turmoil intensified in the period following Lehman Brothers' failure in September 2008. During the year the Bank undertook a range of measures in the money markets, intensified its monitoring of banking sector issues, and supported action by the Tripartite Authorities to resolve individual banking problems under the Banking (Special Provisions) Act 2008. With the passage of the new Banking Act the Bank became directly responsible for operating the bank resolution regime.

### Money market operations

In addition to their role in implementing monetary policy, the Bank's market operations aim to reduce the cost of disruption to payment and liquidity services provided by commercial banks. In this context the Bank launched a number of initiatives in response to the acute pressures on financial markets and banking systems.

### Special Liquidity Scheme

In April 2008, the Bank introduced the Special Liquidity Scheme to allow banks and building societies to swap, for up to three years, high-quality currently illiquid assets for Treasury bills. Eligible assets are restricted to those on the participating institutions' balance sheets as at 31 December 2007. The aim of the Scheme is to improve the liquidity position of the banking system and contribute to confidence in financial markets. The drawdown window to access the Scheme closed (after an extension) on 30 January 2009, but the Scheme will remain in place for three years, providing participating institutions with continuing liquidity support. Use of the Scheme has been considerable, totalling £185 billion of Treasury bills, with the nominal value of securities held by the Bank as collateral amounting to approximately £287 billion at 30 January.

### Discount Window Facility

The Special Liquidity Scheme addressed the overhang of illiquid assets on balance sheets up to the end of 2007. But financing conditions remained difficult for banks and building societies and in October 2008 the Bank introduced a permanent Discount Window Facility, as part of a series of changes to its procedures for operating in sterling money markets. The Discount Window Facility provides liquidity insurance to the banking system. It allows eligible banks and building societies to borrow gilts against a wide range of collateral — wider than that

accepted in the Special Liquidity Scheme, and not limited to assets on balance sheets before a particular date. In recognition of the continued stresses in financial markets, the Bank announced in January 2009 that, for an additional fee, access to the Discount Window Facility was being extended to allow the option of a 364-day term for transactions in addition to the normal 30-day term, which would continue to be available.

### Long-term repo operations

Since December 2007, and especially since September 2008, the Bank has increased the amount and frequency of three-month lending and has extended the range of acceptable collateral. In the October consultation paper the Bank proposed a basis for making these arrangements permanent.

### Banking system monitoring and market intelligence

The Bank has undertaken heightened monitoring of conditions in the financial system and in financial markets over the past year. This has involved intensive analysis of the liquidity and capital positions of United Kingdom financial institutions on a high-frequency basis. A project has also been put in place to devise an analytical and organisational framework for enhancing the Bank's monitoring of the banking sector. This complements and supports the Bank's new statutory responsibilities under the Special Resolution Regime (SRR) (see box on page 19). It provides a systematic approach to analysing the banking sector in normal times, with particular focus on systemically important institutions. It will also ensure a basic level of information and analysis of firms subject to the SRR. This is a formalisation of some of the activities the Bank has anyway been undertaking during the course of the crisis.

In assessing risks to the UK and global financial system, and in determining appropriate responses to these stresses, timely and well-informed market intelligence has been crucial. Using its operational relationships and expertise, the Bank has established a global network of contacts in banking and capital markets. In addition to bilateral contacts, the Bank meets regularly with market participants through the Money Market Liaison Group, the Foreign Exchange Joint Standing Committee, the Securities Lending and Repo Committee and other groupings. Market intelligence is provided to the MPC and the Bank's Financial Stability Board.

## Review of 2008/09 continued

### Bank resolution

The Bank has been closely involved with the Tripartite Authorities in the resolution of a number of institutions, including Northern Rock, Bradford and Bingley and two Icelandic banks. These were conducted under the Banking (Special Provisions) Act 2008, and a key aspect of the Banking Act 2009 (see box on page 19) was the design and implementation of a permanent Special Resolution Regime (SRR). The Bank has formal responsibility for the operation of this regime and was particularly closely involved in developing the provisions governing partial property transfers under the Act and in designing the protection for creditors and counterparties, most notably the 'no creditor worse off' safeguard. The Bank contributed to the key features of the secondary legislation and to the drafting of the Code of Practice relating to the use of the SRR.

In order to fulfil its new responsibilities under the SRR, the Bank has established a Special Resolution Unit. This reports directly to the Deputy Governor for Financial Stability, and comprises a core team of Bank staff with experience of financial crisis management and resolutions, together with external experts with a background in for example law and accountancy. In steady state, the Unit will work to enhance and refine the Bank's and the United Kingdom's approach to bank resolution. It will work closely with the FSA, HM Treasury and the Financial Services Compensation Scheme, as well as with financial firms and practitioners.

On 30 March 2009 the Bank announced that it had transferred core parts of Dunfermline Building Society to Nationwide Building Society. This followed a sale process conducted by the Bank over the weekend of 28–29 March, and was the first use of the powers conferred to the Bank under the Banking Act 2009. The social housing loans of Dunfermline's customers (and related deposits) were transferred temporarily to DBS Bridge Bank Ltd, a 'bridge bank' owned and controlled by the Bank.

### System-wide measures

In order to address concerns about the stability of UK banks and building societies, the authorities have announced a range of policy initiatives over the past year. The two most important system-wide measures were in October 2008 and January 2009:

- In October 2008 the Government announced measures to invest in UK banks and building societies to help stabilise their position and support the long-term

strength of the economy, including making capital investments in RBS and, upon successful merger, in HBOS and Lloyds TSB.

- In January 2009 the Government announced a package of measures to reinforce financial stability, increase confidence and capacity to lend, and support recovery of the economy. This included offering loss protection on those assets most affected by the current economic conditions, in order to reduce banks' uncertainty about the value of past investments, hence providing them with greater confidence to lend in the future to creditworthy businesses, homeowners and consumers.

The Bank played a role in the design, assessment and implementation of both packages, alongside HM Treasury and the FSA. For example, the Bank has helped design and apply stress tests to the solvency position of UK banks and building societies, working together with the FSA. This contributed to HM Treasury decisions on the scale of the October recapitalisations. The Bank also contributed to assessing losses on different portfolios of assets submitted to the Government's Asset Protection Scheme, announced in January. The Bank's participation in these initiatives emphasised the value of the suite of financial stability models that the Bank has been developing over the past few years. More recently, these models have also been useful in assessing the implications of low interest rates for the profitability of the UK banking system.

### Payment and settlement systems

One positive factor during the crisis has been the resilience of the payments and settlement infrastructure in the United Kingdom and globally. The Bank has responsibility for the oversight of systemically important payment systems in the United Kingdom. Their resilience at a time of large increases in volumes and significant increases in market volatility underscores the importance of the improvements to the design of the United Kingdom's payment and settlement infrastructure over the past fifteen years.

During September and October 2008, there were no serious delays to payment or settlement, or major service outages, and defaults were on the whole dealt with effectively under systems' existing procedures. The Bank's Real Time Gross Settlement (RTGS) platform, introduced in 1996 to provide real-time settlement for CHAPS payments in sterling, was available for 99.8% of the time during 2008, compared with 99.7% in 2007. The average daily payment values in the two main payment and settlement

## The Banking Act 2009

The Banking Act 2009, which received Royal Assent on 21 February, aims to strengthen the United Kingdom's statutory framework for financial stability and depositor protection. It expands the 1998 Bank of England Act to provide the Bank, for the first time, with a statutory objective to contribute to protecting and enhancing financial stability in the United Kingdom. The implications for Court and for Bank governance more generally are described on page 6. Specific new responsibilities are summarised below.

### The Special Resolution Regime

The Act creates a permanent Special Resolution Regime (SRR) for dealing with distressed banks and building societies, thereby achieving one of the Bank's strategic objectives for 2008/09 (see page 14).

The SRR powers, which came into force on 21 February, enable the authorities to:

- transfer all or part of a bank to a private sector purchaser;
- transfer all or part of a bank to a bridge bank — a subsidiary of the Bank of England — pending a future sale;
- place a bank into temporary public ownership (HM Treasury's decision);
- apply to put a bank into the Bank Insolvency Procedure (BIP) which is designed to allow for rapid payments to Financial Services Compensation Scheme (FSCS) insured depositors; and
- apply for the use of the Bank Administration Procedure to deal with a part of a bank that is not transferred and is instead put into administration.

The Bank is in the lead in operating the SRR and in choosing which tools to apply in any particular case, subject to HM Treasury taking the lead if it is decided to place the bank into temporary public ownership. A decision on the choice of tool is determined on the basis of five key objectives, which are set out in the Banking Act.

The Banking Act includes provisions to protect creditors and counterparties, most notably the 'no creditor worse off' safeguard. This is intended to ensure that no creditor of the failed bank will be penalised by the application of a partial property transfer, compared with an independently evaluated assessment of what that creditor could have expected had the whole bank been placed into an immediate liquidation. These safeguards have been further enshrined in secondary legislation under the Act and a Code of Practice relating to the operation of the SRR, which was laid before Parliament on 23 February 2009.

### Payment systems oversight

The Act provides the Bank with statutory responsibility and new powers to oversee certain payment systems from Summer 2009, enhancing the system of informal oversight which previously existed. HM Treasury, with advice from the Bank, will decide which payment systems are sufficiently important to the United Kingdom that they should be recognised for oversight. The Act gives the Bank a graduated range of powers and sanctions to help it fulfil this role. The Bank will have new powers to collect information on payment systems, make and change system rules, appoint inspectors, and take a range of actions in cases of non-compliance. This brings the Bank more closely into line with the more formal approach taken to payment system oversight by most other major central banks.

### Scottish and Northern Irish banknotes

Finally, the Act modernises the existing framework for overseeing issuance of Scottish and Northern Irish banknotes by banks, with the Bank provided with new powers to ensure full protection for the holders of these banknotes.

## Review of 2008/09 continued

systems which use the RTGS platform — the CHAPS high-value sterling payment system and the CREST delivery-versus-payment system — were £284 billion and £478 billion respectively.

The Banking Act gives the Bank statutory responsibility for payment system oversight, as described in the box on page 19.

### International regulatory initiatives

The global nature of the crisis, and the problems experienced with dealing with cross-border firms, has highlighted the importance of cross-border crisis management. In April 2008, the Financial Stability Forum (FSF) recommended that a small group of supervisors and central banks be formed to address these issues.

Sir John Gieve chaired the group, which proposed a set of high-level principles for co-ordination on cross-border crises. Going forward, the Bank will work with other authorities to implement the group's proposals, under the chairmanship of Paul Tucker. These include developing a common toolkit, including an international systemic impact assessment framework, a guide that outlines possible *ex-ante* planning steps, and a list of practical lessons from recent cross-border cases.

The Bank has also contributed to various longer-term initiatives to strengthen the financial soundness of banks, working alongside the FSA. The Basel Committee's working group on liquidity, chaired by Nigel Jenkinson, published a paper with good practice standards for liquidity risk management in 2008. In 2009, the group has worked to reach international agreement on measures of liquidity risk. The Bank is also involved in efforts to strengthen the macroprudential framework. This would include the capital framework for the banking system, ensuring that banks build up buffers in good times which they can run down when needed, and is a key element in the broader debate on how to reduce cyclicalities in the financial system.

The G20 is playing a leading role in co-ordinating the international response to the current global economic problems. The United Kingdom holds the G20 presidency in 2009 and the Bank of England and HM Treasury have worked together to prepare the substance and co-ordinate the logistics for a successful Presidency. The Bank has been actively engaged in a number of the G20's work

strands which relate to Bank priorities, including reforming international financial institutions and the international monetary system, enhancing cross-border crisis management and reforming liquidity risk management. In addition, the Bank has also contributed to the G20 process through its involvement in various FSF and other international fora.

### Banking services

During 2008, the Bank continued to implement its customer banking strategy, which involves focusing on those banking activities required to enable the Bank to fulfil its responsibility as the central bank of the United Kingdom. The main focus of activity is now on the migration of retail banking activities for major government users, notably Her Majesty's Revenue and Customs (HMRC), the Government Banking Service (GBS — formerly Office of the Paymaster General) and National Savings & Investments (NS&I). RBS and Citibank will be the new banking providers and the Bank is working with them to support the migration plan. It is expected that this business will have migrated by mid-2010.

The Bank will remain an important provider of banking services to government, but with the focus on high-value activities. The Bank will likewise continue to provide custodial services to a range of customers. As of 28 February 2009 total assets held by the Bank as custodian are around £225 billion (2007/08: £220 billion), of which £102 billion are holdings of gold (2007/08: £72 billion).

### Banknotes

The Bank is responsible for issuing banknotes that the public can use with confidence. The average value of notes in circulation over the past year was £42.4 billion. Last year the Bank issued 1.1 billion new notes and, at the year end, the number of Bank of England notes in circulation was 2.5 billion. In terms of the value of notes in circulation, the £20 note accounts for the largest share, at around 63%.

Since the launch, in March 2007, of the new £20 note featuring Adam Smith, the Bank has been working with the cash industry to replace the Elgar £20 with the new design. As at end-February 2009, the Adam Smith design accounted for 69% of the £28.1 billion of £20 notes in circulation. The changeover between the two designs is expected to take at least one more year, in line with the withdrawal period of the earlier Faraday £20 design.

Over several years the Bank has observed a rise in the share of £20 notes as a proportion of total notes in circulation by value. This has risen from 49% in 1997 to 63% during 2008. Much of this increase is probably due to a gradual move by ATM owners towards stocking more £20 notes and fewer lower denomination (£10 and £5) notes. At the same time the number of ATMs has increased from around 23,000 in 1997 to around 63,000 in 2007, as ATMs have become the main channel for acquiring cash. Last year, the Bank started to work with some owners of large estates of ATMs to encourage them to ensure their machines are stocked with a sufficient proportion of lower-denomination notes. This should help ensure that the public has access to a suitable quantity and quality of lower-denomination notes for small-value transactions and as change items. This work continues.

Since 2006 the Bank has been implementing a new IT system to meet the Bank's requirements in the Notes business area. This covers matters such as warehouse management, demand forecasting, recording counterfeit and mutilated banknotes, improved electronic links to members of the Note Circulation Scheme as well as management information. The implementation of this system is due for completion during Summer 2009.

### Counterfeits

During calendar year 2008, 686,000 counterfeit Bank of England notes were taken out of circulation with a face value of £14 million. The Bank has estimated that 88% of these were taken out of circulation during machine sorting of notes by the members of the Bank's Note Circulation Scheme (NCS). In 2008 around 12 billion banknotes were machine sorted in the NCS so that the share of counterfeit notes found in this total was 0.0057%. The equivalent figures for the previous two years were 0.0037% (2006) and 0.0026% (2007).

Technical analysis reveals that organised criminal gangs are behind the vast majority of all counterfeits detected and that three major gangs have been responsible for 90% of the counterfeits passed during 2008. The number of counterfeits discovered during 2008 reached a peak during the second quarter, and was 36% below that peak by the fourth quarter. The Bank continues to work closely with law enforcement agencies to detect and stop counterfeiting. During 2008, the police successfully stopped one of the major sources; the police have also shut down a number of other smaller operations and

achieved successful convictions. The Bank is grateful for the support of the Serious Organised Crime Agency and the police forces around the country. It is important that counterfeiters are eliminated as rapidly as possible.

The Bank makes available, free of charge, to police, retailers, banks and the public, a range of banknote educational and training materials to help them identify genuine banknotes. Information is provided on the Bank's website, in leaflets and posters, in a short film guide and on a computer-based training CD Rom aimed at professional cash handlers. Further details can be found at: [www.bankofengland.co.uk/banknotes/security/index.htm](http://www.bankofengland.co.uk/banknotes/security/index.htm).

### Scottish and Northern Irish banknotes

The Banking Act 2009 (see box on page 19) updates regulation of the issue of banknotes by seven banks in Scotland and Northern Ireland. Around £5 billion of Scottish and Northern Irish notes were in circulation in February 2009. The new arrangements will ensure that these notes are backed by Bank of England liabilities (notes and a deposit at the Bank) and coin at all times, and that note holders can exchange their notes for these backing assets if an issuing bank fails. The Bank of England will also act as the regulator for note circulation in Scotland and Northern Ireland. The new regime will begin in the autumn, after Parliament has approved the necessary regulations.

### Communication

#### The policy framework

The Bank promotes understanding of its monetary policy framework, and the case of low inflation, through its publications, speeches, website and other means. The *Inflation Report* and MPC minutes explain monetary policy decisions and the MPC's judgements about the outlook for the economy and inflation, and the *Quarterly Bulletin* includes articles relevant to monetary policy and other aspects of the Bank's work. The Bank's network of twelve Agencies, located throughout the United Kingdom, continues to play an important role in explaining monetary policy objectives and decisions to businesses and other organisations, in addition to gathering intelligence about business conditions for the MPC.

The difficult external environment in 2008/09, and the related changes in monetary policy reinforced the need for the Bank to communicate effectively and build understanding of the monetary policy framework and



## Review of 2008/09 continued

### Regional Agents



**Peter Andrews**  
London



**Chris Brown**  
East Midlands



**David Buffham**  
North East



**Kevin Butler**  
South West



**Graeme Chaplin**  
West Midlands



**Phil Eckersley**  
South East & East Anglia



**Paul Fullerton**  
Yorkshire and The Humber



**Frances Hill**  
Northern Ireland



**Adrian Piper**  
Wales



**Chris Piper**  
Central Southern England



**Tony Strachan**  
Scotland



**John Young**  
North West

decisions taken by the MPC. Most recently, considerable effort was made to explain the MPC's decision to inject money directly into the economy through asset purchases, via the media, speeches, public and parliamentary appearances, and the Bank's website.

#### Financial Stability assessment

The bi-annual *Financial Stability Report (FSR)* sets out the Bank's assessment of developments and challenges facing the UK financial system. In May 2008, the *Report* discussed the difficulties the system faced as market participants sought to reprice risk and reduce leverage, against a backdrop of impaired market functioning after the collapse of Bear Stearns in mid-March. The October 2008 *FSR* explained how these financial risks had crystallised and begun to interact negatively with the slowdown in the real economy, heightening fears of an adverse spiral of falling asset prices, tighter credit conditions and slower economic growth. Interest in the

Bank's *FSRs* has increased markedly over the past two years. Media coverage has been extensive. Internet hits in the first two weeks following publication were over 276,000 in October 2008, which is a sixfold increase compared to average pre-crisis levels.

The Bank has implemented various measures to improve the communication of the messages in the *Report*. This included the inclusion of a new summary, which is sent to executive and non-executive directors of major financial institutions, and speeches by senior Bank staff at the time of publication. There have also been Q&A sessions with market participants on the date of *FSR* publication and briefings for the Bank's contacts, including banking analysts and rating agencies.

#### Speeches and hearings

Throughout the year, MPC members have continued to undertake a significant number of speeches and visits

around the United Kingdom, along with other public appearances. Formal published speeches by MPC members totalled 38 in 2008/09. These were supplemented by a large number of talks and discussions with different audiences as part of the regular programme of visits to all parts of the United Kingdom, facilitated by the Bank's Agencies. During the past year, a total of 48 such visits were undertaken outside Greater London.

The Governor, other members of the MPC and senior Bank staff attend parliamentary hearings to answer questions about monetary policy and the financial crisis. In 2008/09 the Bank provided a total of 35 witnesses at 13 hearings of the Treasury Committee of the House of Commons. The Committee held four hearings on the Bank's *Inflation Report*, five appointment hearings for MPC members, and four hearings on banking reform and the banking crisis. Bank staff also gave evidence to the Banking Bill Committee.

### Education

The Bank continues to present information and tools about monetary policy through its museum, website and schools' resources. An exhibition, *The Pound in Your Pocket*, on the topic of inflation and its control, opened in the Bank's museum in April 2008. The Bank's museum attracted over 92,000 visitors in 2008/09, an increase of 17% from the previous year. Development of the Bank's website also remains an important part of the Bank's efforts to inform the public of its role and work. In 2008/09, the site attracted over 8½ million visitors.

The Bank's schools' programme also contributes to building wider public understanding of monetary policy and the Bank's role. Over the past year, there has been increased take-up of the Bank's school resources. In total, well over 11,000 primary and secondary schools have requested the Bank's educational packs and films — up from 6,000 at the end of the previous year. The Bank's annual economics competition for schools and colleges, Target Two Point Zero, continues to be popular. In its ninth year the competition attracted 296 participants. The national final in March 2009 was won by Peter Symonds College from Winchester.

To monitor public opinion and awareness of the Bank and its role, regular opinion polls are undertaken. In the February 2009 poll, carried out by NOP, 38% of respondents said they were 'very satisfied' or 'fairly

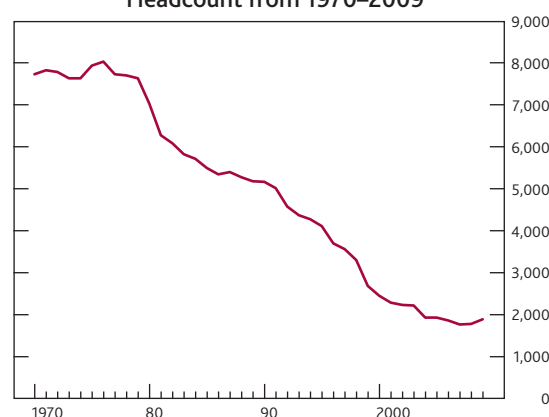
satisfied' with the way the Bank is doing its job to set interest rates to control inflation; 28% were 'dissatisfied', with the remainder neutral or undecided. The net satisfaction rating of 10% compared with 30% in February 2008. Survey results are published quarterly and in the *Quarterly Bulletin* each year.

### Resources

#### Staffing

At the end of February 2009 the Bank employed 1,642 full-time staff and 215 part-time staff; 1,666 of these staff were on permanent contracts, up from 1,579 as at end-February 2008. In total this is approximately 6% more staff than at end-February 2008; it is the first significant increase in staff numbers since 1987. During the period, 344 individuals joined the Bank and 241 left (including temporary staff). Of the staff recruited, 172 were recruited on permanent contracts, an increase from 81 in 2008. Of these new permanent staff, 38 were new graduates (up from 23 the year before), 64 were experienced hires appointed to analytical and management roles (an increase from 32 the year before) and 70 were appointed to clerical or non-technical roles (up from 26 the year before).

Headcount from 1970–2009



The increase in staff numbers was due to the extra workload brought on by the Bank's new responsibilities. In addition, many staff were temporarily reassigned during the year to work on policy initiatives such as the Asset Purchase Facility and the Special Liquidity Scheme, and on bank resolution issues. In recognition of the exceptional workload over the past year, the Bank increased its bonus and special payments budget from the usual 7% of salaries to 8.1%.

## Review of 2008/09 continued

### Employee relations and diversity

The Bank maintains its arrangements for consulting staff on matters affecting their interests including with representatives of the recognised trade union, Unite. A new flexible working framework '*Flexible Working For You*' was introduced following pilots and extensive consultation in January 2008 and has been positively received by both staff and managers; the framework has achieved improvements in quality and quantity of work in many teams as well as in staff commitment to the Bank. The next in the series of biennial staff opinion surveys will take place in the latter part of 2009 when staff will again be given an opportunity to express their views on a range of issues.

During 2008, the Bank continued to progress with the implementation of its Diversity Strategy. Andrew Bailey and James Strachan were the executive and non-executive sponsors respectively.

The proportion of women in senior roles stood at 24% at the end of February 2009, down slightly from 25% at end-February 2008. The proportion of staff from ethnic minority backgrounds has increased to just under 10% and within our graduate intake in 2008 they represented 16%. Part-time staff constitute 12% of all Bank staff and 8% of those at analyst and managerial level.

### Staff development and performance management

The Bank remains committed to the development of all staff and provides extensive training targeted at all levels.

Managers are developed through a number of coaching, mentoring and training programmes. This year has seen the introduction of new development workshops for talented senior managers. These workshops provide opportunities for delegates to compare themselves against the Bank's leadership framework and identify both their strengths and areas for further development.

The graduate intake forms a very important part of the talent pipeline, and receives a wide range of development opportunities, particularly in the first few years with the Bank. This year the Bank was awarded the prize for the Best Graduate Development Programme by the Association of Graduate Recruiters. The Association also awarded the Bank its *Best of the Best* Award which goes to the year's overall winner out of all six categories.

The Bank introduced a new performance management system in early 2009. The new system encourages staff and managers to set focused objectives based on business plans and performance measures. It also encourages staff to take greater personal responsibility for their performance and development.

### Information technology

A new IT Operating Model was implemented in 2008 to support clear focus on the main business lines of the Bank while managing the Bank's IT infrastructure as a shared service. This initiative included the appointment of IT Business Partners and a new Chief Technology Officer to improve visibility of business and IT needs in the future. Implementation of a shared service organisation to support infrastructure also netted a £1 million saving in like-for-like recurrent cost.

During the year the system development teams have been asked to move quickly to implement several special schemes to provide support to the capital markets. This has required close co-operation of project teams throughout the Bank and the creation of several new systems to help the Bank's operational functions manage new schemes in a controlled and efficient way.

IT support teams have also worked hard to maintain high levels of system availability and service through an often extended working week. This work has been managed alongside ongoing activity to ensure that the Bank's IT assets are properly secured and maintained. These initiatives will be further developed in the coming year as a project to refresh the Bank's data centres gets under way.

In November 2008 the Bank appointed its first Chief Information Officer to lead the further development of information and technology. This appointment reflects recognition of the increased importance of IT to the Bank's operations, and an understanding of the need to manage IT resources to more closely support the Bank's strategic priorities.

As part of that, a strategy has been agreed to promote new ways of working throughout the staff, using collaboration technologies and improved re-use of information. The IT Division will also be seeking to build on the IT Operating Model work to develop a 'high performing IT organisation' by improving the maturity of its solution delivery,

improving business engagement and building standard service processes to manage the Bank's IT estate.

### **Performance measurement**

During 2008 the Finance Directorate launched an initiative to improve the Bank's internal performance measurement framework. The work is aimed at better linking the processes and outputs of individual business functions to the outcomes defined by the Bank's Core Purposes and strategy. In its broadest sense, the performance measurement framework involves all of the following elements:

- Operational strategy and priority setting.
- Business planning and the budget process.
- Planning and delivery of key strategic milestones and projects.
- Design and monitoring key performance indicators and measures.
- Management of operational risks.

A business planning process is conducted annually which takes as an input the Governor's strategy, as endorsed by Court. This process feeds into the budget discussions which aim to match resources to business aims and plans for the year ahead. The business plan is approved by Court ahead of the start of the financial year. Quarterly reports on the delivery of the plan are then provided to the Executive Team and Court along with financial and risk reporting.

During the planning process for the 2009/10 financial year performance indicators and measures were included for both of the Bank's Core Purposes, and for individual Directorates and business functions. These measures will form a key part of the performance reporting to Executive Team and Court in 2009/10. Further work is planned in 2009 to refine the existing performance measures, and to add to the framework in order to reflect the Bank's redefined role in Financial Stability. As well as improving the planning and reporting process at Executive Team and Court level, the framework is designed to be used by individual business areas in their own operational management processes, and ultimately to set and measure individual staff objectives.

## The Bank's priorities in 2009/10

The strategic priorities endorsed by Court for 2009/10 are:

**Strategic priority 1** Return inflation to the 2% target, and keep it on track to meet the target, while sustaining support for the monetary policy framework.

- Enhance the contribution of the forecast process.
- Deepen analysis of monetary data.
- Review MPC communications.
- Improve efficiency of data handling and analysis.
- Enhance monitoring of bank lending and work with Government to ensure lending is adequate.

**Strategic priority 2** Enhance the sterling monetary framework to enable the Bank to provide liquidity to the system in normal and stressed conditions.

- Implement revised 'Red Book' for market operations.
- Implement the Asset Purchase Facility.
- Manage the operational and collateral management risks in the Bank's expanded market operations.

**Strategic priority 3** Discharge the Bank's enhanced role for financial stability.

- Ensure the Bank is equipped to implement the Special Resolution Regime.
- Strengthen communication on financial stability.
- Enhance the Bank's oversight of payment systems.
- Play a full role in the management of the financial crisis together with the FSA and HM Treasury.
- Integrate analysis of individual institutions and systemic risk, without becoming a shadow supervisor.

**Strategic priority 4** Strengthen co-operation and communication between central banks.

- Improve design of liquidity and capital regulation.
- Contribute to the G20 debate on reform of the international system, under United Kingdom's chairmanship.

**Strategic priority 5** Deliver efficient and effective notes issuance and banking services.

- Continue to implement the customer banking strategy.
- Ensure public demand for banknotes is met — particularly for the £5 note.

**Strategic priority 6** Enhance public understanding of the Bank's role through development of a robust communication strategy.

- Implement a revised public communications strategy.
- Enhance regular engagement with financial sector.

**Strategic priority 7** Increase accountability and efficiency across the organisation.

- Implement the new governance arrangements for the Bank.
- Strengthen the system of performance measurement.
- Improve the partnership between central services and business areas.
- Improve talent management in the Bank.
- Use IT to improve information sharing.



During the second half of 2008 the Governor set out a new strategy for his second term, which was endorsed by Court. The vision underpinning this strategy remains that the Bank should promote monetary and financial stability in the United Kingdom; retaining its focus on achieving the inflation target, and also discharge its revised financial stability responsibilities. The Bank should play an active role in the international and financial community and should aim for the highest possible standards in all it does.

The Strategic Priorities for 2009/10 reflect the immediate priorities within that strategy. This section provides an overview of the work the Bank plans to undertake to implement these priorities in the coming year.

### Monetary policy

In the area of monetary policy the objective is to return inflation to the 2% target over the medium term and to keep it on track to meet that target. In March 2009 the Monetary Policy Committee (MPC) embarked on a set of policy measures aimed at bringing inflation back in line with target over the medium and long term, including by directly targeting the supply of money to the economy. Throughout the course of the coming year the Bank will focus its analytical capabilities on supporting the MPC as the measures are implemented. This will require a continuing improvement in the quality and depth of analysis of monetary data, and further enhancement of the Bank's modelling and forecasting processes.

In order to achieve its monetary policy objectives the Bank must sustain support for the monetary policy framework, and maintain support for low inflation. This is likely to be more challenging given the adjustment required in the global economy. The Bank and MPC will need to ensure that their remit and objectives are clearly explained to all stakeholders and most importantly to the public. In 2009 the Bank expects to facilitate a full review, from first principles, of the MPC's approach to collective communications (such as through the *Minutes*, speeches and the *Inflation Report*).

Internally the Bank will also continue to improve its processes in Monetary Analysis and Statistics, aiming to improve efficiency in order to free up resources for higher value added analysis and research. A number of technology projects which support this efficiency objective are due to complete in 2009/10 including Chartpack Automation and the Data Management Loading Interface

project. 2009/10 will also see the start of a project to implement improvements to the quarterly macroeconomic model (BEQM). The project aims to increase the depth of analysis possible within the automated model and to improve the performance and usability of the toolset, allowing it to be more widely used within the Bank.

### Market operations

During 2009, the Bank will prioritise fulfilling the MPC's mandate for the new operations associated with the Asset Purchase Facility. The Bank also expects to introduce changes arising from its review and subsequent external consultation on market operations and liquidity insurance. That process began in 2008. Several important measures have already been implemented and are in use today, but a number of changes are still to be integrated into the 'business as usual' functions of the Bank. The change in scope of the Bank's market operations over the past year has also created new requirements for credit risk and collateral management processes. This year will see the start of significant investment in business processes and systems around collateral management in Markets and Banking Services in order to put these key functions onto a robust and efficient platform for the long term, reducing operational risk, and improving access to critical management information.

### Financial stability

Under the Banking Act 2009 (see page 19), Parliament has given the Bank a statutory financial stability objective. Court, consulting HM Treasury, will determine and periodically review the Bank's strategy in relation to that objective.

The main priority for the Bank under its Financial Stability Core Purpose is to discharge its new responsibilities, completing the implementation of changes which follow from the Act while also playing its role in dealing with the ongoing financial crisis.

The Bank will continue to enhance its assessment of the financial system's resilience and vulnerability. To that end, the Bank and the FSA are devising a Co-operation Protocol, which will sit below a revised Memorandum of Understanding. The protocol will set out how the two institutions plan to work together in times of both financial stability and stress.

## The Bank's priorities in 2009/10 continued

During 2009/10 the Financial Stability Directorate also aims to complete a new set of systemic risk assessment models (RAMSI) which are already providing valuable inputs to the Bank's internal assessment of risks to the United Kingdom financial system. Further investments in data and analytical tools to support Financial Stability work are also planned during 2009/10.

The Banking Act 2009 gives the Bank statutory oversight responsibility for payment systems. Internal work to prepare for this redefined role has been ongoing in the Bank in parallel with the work to draft legislation. The new regime is expected to be implemented in the summer of 2009 when the remaining provisions commence.

To carry out its new responsibilities under the Special Resolution Regime (SRR), the Bank has set up the Special Resolution Unit (SRU) and through this Unit has already successfully used the tools available for resolving banks under the Special Resolution Regime. The capabilities of the SRU will continue to be developed in the coming year under a new Head.

The recent financial crisis has demonstrated that there is scope to strengthen co-operation between central banks in relation to both monetary policy and financial stability. The Bank will continue to contribute to enhancing the effectiveness of discussions at the International Monetary Fund (IMF), the bi-monthly meetings of central bank Governors in Basel and other important international fora. A key enabler for this work is the United Kingdom's chairmanship of the Group of Twenty (G20) Finance Ministers and Central Bank Governors during 2009, and its participation in the Financial Stability Forum. Priorities for the international regulatory agenda will be to promote improvements in the design of liquidity and capital regulation, including by increasing the countercyclicality of the regulatory regime, and to strengthen the cross-border crisis resolution framework. The Bank will also play its part in contributing to the debate on macroprudential regulation more broadly, engaging with the FSA, HM Treasury and central banks around the world to improve the resilience of the global financial system.

### Banking services and banknote operations

The Bank continues to implement its customer banking strategy, which aims to ensure that the Bank's banking services are efficient and clearly focused on activities necessary to ensure monetary and financial stability.

The project to migrate the government banking business to commercial banks is well under way. The migration is expected to be completed in 2010 with account run-off activity continuing into 2011. As this work nears completion the next step is to confirm the scope of the retained business, including what the Bank may need to keep for financial stability reasons, and how the business processes and systems can best be adapted to manage those remaining functions.

The implementation of the new Notes Information Processing System (NIPS), which supports the Bank's note management and distribution activities, is expected to complete in 2009. Phase 2 of the project, due for launch in June, brings members of the Notes Circulation Scheme onto the system for the first time.

The Banking Act 2009 introduces a new framework for the issuance of Scottish and Northern Irish banknotes. Under the Act the Bank will assume regulatory responsibility for note issuance in Scotland and Northern Ireland; the provisions are expected to come into force in the latter part of 2009. The Bank will complete the set-up of all necessary systems, reporting and controls ahead of that date. The NIPS system will be extended to provide the required management information.

### Communication

In order to achieve its Core Purposes, particularly at a challenging time for the financial system and economy, the Bank must maintain a robust communication strategy. A revised strategy will be implemented during the course of 2009/10, covering all aspects of the Bank's business. It will make use of a wide variety of channels available to the Bank including through the media, the programme of speeches and visits made by senior staff, routine market and policy contacts, the Agency network, regular publications and the Bank's website.

The Governor's own programme of speeches and regional visits is an important part of the Bank's communication plan. In light of the Bank's new responsibilities under the Banking Act, the Governor's programme of regular contacts with financial sector participants will be expanded over the coming year.

### Internal management of the Bank

The Bank will continue to develop its internal management processes, building on the improvements delivered in the past five years. Central Services and Finance plan to continue improving the way in which they interact with business areas, making centralised transactional and commodity services more efficient and effective.

The second phase of the HR Services and Systems project began in early 2009, designed to improve and standardise the way HR services are provided to business areas. The project is expected to deliver a new HR system in stages through 2009 and 2010. Finance is also due to complete the Management Accounting Reporting Systems project in 2009. This will deliver more efficient management accounting data and a new set of reports to allow business areas to monitor their spend against budget in a more consistent and timely way. These projects are designed to help free up resources to focus on value-added services for the business.

A key priority for HR is to ensure the Bank retains and develops its staff across the organisation to ensure that it has the skills and capabilities it requires in the future. A review of talent management in the Bank is in progress in the first half of 2009.

Finance will continue to work with business areas to develop the Bank's performance measurement framework, linking business functions and their associated outputs to the Core Purposes and Strategy of the Bank. Improved performance measurement is designed to clarify responsibilities across the organisation and increase accountability. A full review of the use of performance measurement in the Bank is planned for November.

Technology change will underpin much of the delivery of the Strategic Priorities through new systems and infrastructure. 2009/10 sees the start of a programme of investment in improving information management across the organisation. The aim of the programme is to help staff work collaboratively and to make it easier to access, share and manage information in an efficient way. The focus for 2009/10 will be in developing new ways of working, for example through piloting collaboration tools to enable teams to share data and analysis.

## Expenditure review

The Bank draws up its medium-term spending plans within the context of its financial framework which has three main tenets:

- First, that the Bank will set a budget for spending on policy functions — monetary policy and financial stability — having regard to the figure given in the five-yearly review of the Cash Ratio Deposit (CRD) scheme. Under the CRD regime, banks and building societies are required to place a percentage of their deposit base, above a minimum threshold, at the Bank interest-free. The Bank then invests those deposits in interest-yielding assets, generating income to fund its policy functions.
- Second, that the other, remunerated, activities of the Bank will be expected to break even over the medium term. In these areas the focus will be on net spending, although the Bank will remain committed to providing value for money, without running undue risks. Any losses or gains from these activities will not flow through to the CRD-payer, but instead affect the Bank's capital.
- Third, that if spending on policy functions is in line with CRD income and other functions break even, the profit of the Bank is equivalent to the return on the assets in which its capital and reserves are invested — largely gilts and other AAA-rated sterling-denominated bonds. The Bank's post-tax profit is shared 50:50 with HM Treasury unless otherwise agreed.

Court considers the operation of the Bank's financial framework in fulfilling its responsibilities under the 1998 Bank of England Act.

### Spending in 2008/09

Net expenditure on the Bank's policy functions in 2008/09 was £113.2 million, £5 million above the budgeted amount. The Bank faced extra costs in relation to its market and banking operations and in preparation for its expanded financial stability remit.

Remunerated functions generated net income of £21.2 million, compared to a forecast breakeven position. That reflected higher income from banking services, relating to higher customer volumes.

On 2 June 2008, the CRD ratio was reduced from 0.15% to 0.11% after the review of the operation of the scheme and public consultation in 2007. CRD income in 2008/09 was £125.6 million.

**Bank expenditure by function**

| £ millions  | 2007/08<br>Actual | 2008/09<br>Budget | 2008/09<br>Actual | 2009/10<br>Budget |
|---|-------------------|-------------------|-------------------|-------------------|
| <b>Policy functions</b>                                   |                   |                   |                   |                   |
| Monetary policy   | 67.3              | 68.1              | 71.1              | 71.1              |
| Financial stability                                       | 41.9              | 42.3              | 47.2              | 52.1              |
| Contingency reserve                                       | –                 | 1.2               | –                 | 2.0               |
| Gross expenditure on policy functions                     | 109.2             | 111.6             | 118.3             | 125.2             |
| Recoveries  | -3.0              | -3.4              | -5.1              | -3.9              |
| <b>Net expenditure on policy functions</b>                | <b>106.2</b>      | <b>108.2</b>      | <b>113.2</b>      | <b>121.3</b>      |
| CRD income  | 147.6             | 127.2             | 125.6             | 107.0             |
| <b>Remunerated functions</b>                              |                   |                   |                   |                   |
| Note issue  | 59.7              | 69.3              | 69.6              | 72.9              |
| Government agency services                                | 9.5               | 9.2               | 8.9               | 9.6               |
| Payment and settlement                                    | 12.5              | 12.7              | 11.3              | 11.7              |
| Banking services  | 31.8              | 32.4              | 31.1              | 29.0              |
| Other   | 13.7              | 13.2              | 25.0              | 19.9              |
| Gross expenditure on remunerated functions                | 127.2             | 136.8             | 145.9             | 143.1             |
| Income from remunerated functions                         | 137.5             | 136.8             | 167.1             | 138.4             |
| <b>Surplus (-) / deficit (+) on remunerated functions</b> | <b>-10.3</b>      | <b>0.0</b>        | <b>-21.2</b>      | <b>4.7</b>        |
| Legacy costs <sup>(1)</sup>                               | 6.6               | 6.6               | 7.0               | 6.7               |
| <b>Total gross expenditure<sup>(2)</sup></b>              | <b>243.1</b>      | <b>255.0</b>      | <b>271.2</b>      | <b>275.0</b>      |

(1) Pensioner benefits and interest on severance provisions.

(2) From the Bank's management accounts; figures contain reporting differences to the statutory financial accounts.



## Expenditure review continued

### Budget for 2009/10

The budget for the Bank's policy functions in 2009/10 has been set at £121.2 million, higher than the amount assumed in the 2008 CRD review. That primarily reflects the cost of the Bank's new responsibilities, as well as some expenditure associated with the Bank's expanded collateral management operations and a small contingency reserve. The forecast for CRD income contained in the budget for 2009/10 is £107.0 million. As such, the Bank's policy spending is expected to exceed spending plans assumed in the 2008 CRD review and exceed CRD income. These differences are not considered to be of sufficient scale to warrant a review of the CRD scheme at this time. Court will keep the balance between the Bank's CRD income and related expenditure under review.

The net spending projection for the Bank's remunerated functions in 2009/10 is for a deficit of £4.7 million. Given surpluses in recent years, that is consistent with the Bank's objective for its other activities to be broadly self-financing.

These spending plans include proposals for just under £29 million of project-related expenditure in 2009/10, a step increase from the prior year. Around 60% of the investment budget is on building and IT maintenance or upgrade projects. Of the remainder, a substantial portion supports the Bank's policy functions directly, such as implementation of changes to the sterling monetary framework and collateral management improvements.

### Proposals for major projects supporting the strategic priorities in 2009/10 include:

| Strategic priority                      | Project   | *2009/10 cost (£ millions) | *Total cost (£ millions) | Forecast completion             |
|---|---|----------------------------|--------------------------|---------------------------------|
| 1. Monetary Policy                      | BEQM Review Implementation                              | 1.0                        | 1.1                      | 2010/11                         |
|   | Chartpack Automation                                    | 0.7                        | 1.5                      | 2009/10                         |
| 2. Sterling Monetary Framework          | Market Operations Programme                             | 2.4                        | 5.0                      | Various deliverables to 2011/12 |
| 3. Financial Stability                  | Banking Sector Monitoring                               | 2.1                        | 2.1                      | 2009/10                         |
|   | Risk Assessment Model for Systemic Institutions (RAMSI) | 0.5                        | 1.1                      | 2010/11                         |
| 4. Banking Services and Note Operations | Collateral Operations Platform                          | 1.5                        | 4.1                      | 2011/12                         |
|   | Notes security (several projects)                       | 6.4                        | 11.9                     | 2010/11                         |
| 5. Accountability and Efficiency        | HR Services and Systems                                 | 1.1                        | 1.3                      | 2010/11                         |
|   | Information Management                                  | 0.9                        | 4.2                      | 2011/12                         |

\*Non-recurrent costs.

## Remuneration of Governors, Directors and MPC members

The Committee of the Non-executive Directors of Court (NedCo) determines the remuneration of the Bank's most senior executives, including the Governors, Executive Directors, Advisers to the Governors and the members of the Monetary Policy Committee appointed by the Chancellor of the Exchequer (the external MPC members). NedCo is advised by the Remuneration Committee, the composition of which is shown on page 7. Although no executive member of Court sits on the Remuneration Committee, the Governor may be invited to attend meetings that do not consider his own remuneration. The Chairman of NedCo may also attend meetings.

### Remuneration policy

The Remuneration Committee's approach is to carry out reviews of senior Bank remuneration every five years in order to set appropriate pay, benefits and conditions of service. The Committee takes account of supply and demand, including external salary comparisons insofar as these might affect the availability of good candidates while bearing in mind the Bank's position within the public sector. Where relevant, the Committee makes use of external advice to support this. The five-yearly reviews set the rate for each job and the policy by which salaries will be increased each year and by which bonuses will operate for executive directors.

The last five-yearly review was carried out in 2006 with the assistance of Towers Perrin. The conclusions regarding the external MPC members were that their salary was appropriate for the role and that cash levels in lieu of pension and life assurance were also sufficient. However, the review for the Governors found that the salary was low for the size and responsibilities of the roles, although the benefits accrued in the Court executive pension scheme were generous. The Committee determined that in future a higher salary should be offered but lower pension benefits. Overall these changes would be approximately cash neutral. The new remuneration package for a Governor should be composed of a salary range starting at a salary between £375,000—£400,000 with automatic increases of 2.5% per annum and a pension contribution of 30% of salary. The package for a Deputy Governor would be on the same terms but starting at a salary level of £315,000 per annum. All new appointees are now offered

the new terms although those with contractual entitlements to more generous pension benefits are also offered the option of retaining these and accepting a lower starting salary.

Mervyn King was appointed for a second term as Governor starting 1 July 2008. Mr King chose not to accept the new package and has remained on his previous salary although his pension is now fully accrued. Mr Bean chose to retain his contractual pension terms on his appointment to Deputy Governor, Monetary Policy on 1 July 2008 as did Mr Tucker on his appointment to Deputy Governor, Financial Stability on 1 March 2009.

To consolidate the new remuneration package, the Court pension scheme which had been open to all new executives from outside or on promotion was closed to new members on 30 July 2007. For administrative simplicity the Court pension scheme was merged with the Staff Pension Fund at the same time. The Final Salary section of this Fund was also closed to new staff members on 30 September 2007. Existing members of both the Court and the Final Salary sections of the Fund continue to accrue benefits under the terms of the section they joined. For example, new executive appointees who are promoted from inside the Bank are able to retain pre-existing membership of the Final Salary section. New executive appointees from outside the Bank are now offered either membership of the Career Average pension section of the Fund, as are all new staff, or a salary supplement of 30% in lieu of pension.

The Court and the Final Salary sections are both non-contributory and have a normal pension age of 60. The accrual rate for the Court section allows members to achieve a maximum pension of two thirds of their pensionable salary at normal pension age after 20 years' service. The accrual rate for the Final Salary section allows members to achieve the same maximum at normal pension age after 40 years' service. Both sections provide payment of a lump sum of up to four times pensionable salary in the event of death in service, and allowances for a spouse's or civil partner's pension of 60% of the member's base pension and discretionary allowances for other dependents. Pensions and deferred pensions are reviewed annually and are normally increased in line with the rise in the retail prices index.

## Remuneration of Governors, Directors and MPC members continued

### Remuneration structure of the Governors

The remuneration arrangements for the Governor and Deputy Governors are set out below.

#### Service contracts

The Governor and Deputy Governors are each appointed by the Crown for five-year terms. The Governors have no termination provisions at the end of their appointments, other than a purdah period of three months' continued employment by the Bank when they cease to be members of the MPC.

Under the Bank of England Act, Governors are required to provide remunerated services to the Bank only. With Court's approval other directorships relevant to the Bank's work may be accepted, but any fees must be paid to the Bank. The only such directorship held during the past year has been the appointment to the FSA Board held by Sir John Gieve.

#### Base salaries

On 1 July 2008 the salary of the Governor, Mervyn King, was increased by 2.5% from £290,653 to £297,920. On 1 March 2008, the salaries of both Deputy Governors, Rachel Lomax and Sir John Gieve, were each increased by 2.5% from £240,330 to £246,338. Charlie Bean was appointed to succeed Rachel Lomax with effect from 1 July 2008 on the same salary. The Governor and the Deputy Governors do not receive bonuses.

### Pensions

Pension benefits for the current Governor and Deputy Governors are provided through the Court Pension section, supplemented in some instances by an unfunded scheme as described below. For executives serving before 2005 who are subject to the pensions earnings cap introduced in the Finance Act 1989, the Bank contracted to provide additional unfunded pensions so that their total pensions broadly match what would have been provided by the Court Pension in the absence of the cap. During the year ended 28 February 2009, unfunded entitlements were provided to Mr King, Ms Lomax and Mr Bean. Provision for these unfunded benefits is made in the Bank's financial statements. Court decided not to grant unfunded benefits to members joining after 2005, and Sir John Gieve joined the Bank after this time. Mr Tucker joined the Bank before 1989 and was never affected by the 1989 Finance Act pensions earning cap. Hence he has never received unfunded benefits.

Mr King's pension was fully accrued at the end of his first term on 30 June 2008. For his second term of office from 1 July 2008 to 30 June 2013 he earns no annual pension contribution from the Bank.

#### Other benefits

The Remuneration Committee also keeps under review other benefits available to the Governors. Medical insurances were the principal non-salary benefits received during the year to 28 February 2009.

### Pension entitlements and accruals (including unfunded entitlements)

|                                | Cash equivalent as at 29.2.08 <sup>(1)</sup> (£) | Cash equivalent as at 28.2.09 <sup>(2)</sup> (£) | Increase in cash equivalent (£) | Accrued pension as at 29.2.08 <sup>(1)</sup> (£pa) | Accrued pension as at 28.2.09 <sup>(2)</sup> (£pa) | Increase in accrued pension (£pa) | Cash equivalent of additional pension earned during year ended 28.2.09 <sup>(3)</sup> (£) |
|--------------------------------|--|--|---------------------------------|--|--|-----------------------------------|---|
| Mr M A King                    | 4,835,500  | 5,356,500  | 521,000                         | 179,200  | 198,200  | 19,000                            | 513,500   |
| Ms J R Lomax                   | 922,600  | 1,106,200  | 183,600                         | 38,100   | 43,700   | 5,600                             | 141,700   |
| Sir E J W Gieve <sup>(4)</sup> | 450,800  | 663,300  | 212,500                         | 17,600   | 25,900   | 8,300                             | 189,500   |
| Mr C Bean                      | 1,282,200  | 1,435,700  | 153,500                         | 48,400   | 55,700   | 7,300                             | 188,200   |

(1) The cash equivalent and accrued pension figures shown at the start of the year for Mr King, Ms Lomax and Sir John Gieve are taken from the Bank's remuneration report for the year ended 29 February 2008. The figures for Mr Bean are shown as at the date he became Deputy Governor.

(2) Or date pension accrual ceased, if earlier (this affects the figures for Mr King and Ms Lomax).

(3) Net of the statutory deferred pension revaluation that would apply to the accrued pension at the start of the year (this affects Sir John Gieve).

(4) At the end of Sir John Gieve's period of purdah on 1 June 2009 he will have accrued a pension of £27,772 with a cash equivalent of £727,400.

### Remuneration of Non-executive 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 2008/09 remuneration of the Non-executive Directors was £6,000 per annum; the remuneration of Non-executive Directors who chair the Remuneration Committee and the Audit Committee was £9,000 per annum; and the remuneration of the Chairman of the Committee of Non-executive Directors

was £12,000 per annum. The new Court of Directors will be constituted with effect from 1 June 2009, and these rates will go up to £15,000 per annum for directors, £20,000 for Committee Chairs and the Deputy Chair of Court and to £30,000 for the Chair of Court.

Non-executive Directors do not receive any post-retirement or medical benefits from the Bank or any additional fees for serving on Committees. The Bank does, however, meet appropriate travel and subsistence expenses.

### Remuneration of members of Court

|  | Salary<br>£    | Benefits<br>£ | Salary cost<br>of purdah<br>£ | Total<br>2008/09<br>£ | Total<br>2007/08<br>£ |
|--|----------------|---------------|-------------------------------|-----------------------|-----------------------|
| <b>Governor</b>                              |                |               |                               |                       |                       |
| Mr M A King                                  | 295,498        | 1,320         | –                             | 296,818               | 289,551               |
| <b>Deputy Governors</b>                      |                |               |                               |                       |                       |
| Sir E J W Gieve <sup>(1)</sup>               | 246,338        | 3,505         | 63,517                        | 313,360               | 241,861               |
| Ms J R Lomax — retired 30 September 2008     | 82,113         | 665           | 61,584                        | 144,362               | 241,081               |
| Mr C Bean — appointed 1 July 2008            | 164,225        | 803           | –                             | 165,028               | –                     |
| <b>Non-executive Directors<sup>(2)</sup></b> | 92,200         | –             | –                             | 92,200                | 98,458                |
| <b>Total</b>                                 | <b>880,374</b> | <b>6,293</b>  | <b>125,101</b>                | <b>1,011,768</b>      | <b>870,951</b>        |

(1) Sir John Gieve's period of 'purdah' runs from 1 March to 1 June 2009 and provision has been made in the accounts for the year ended 28 February 2009. His pension accrual for the period is set out on page 34.

(2) Sir Callum McCarthy was a member of Court from 22 September 2003 until 19 September 2008 in his capacity as Chairman of the Financial Services Authority (FSA). He was succeeded by Lord Adair Turner with effect from 20 September 2008. The Deputy Governor, Financial Stability — Sir John Gieve for 2008/09 — similarly sits on the Board of the FSA. All have agreed to waive the remuneration due from the other body. Accordingly, Sir Callum McCarthy waived remuneration of £3,317 and Lord Turner of £2,683 due from the Bank and Sir John Gieve waived remuneration of £26,500 due from the FSA.

### Remuneration of external Monetary Policy Committee members

Court determines the terms and conditions of service of the four external members of the MPC appointed by the Chancellor of the Exchequer. These members are appointed for terms of three years on a part-time basis averaging three days a week. External MPC members must not retain or accept other appointments or interests that would create a conflict with their MPC responsibilities during their term of office as determined by the Chancellor on the Governor's advice.

The external members of the MPC were paid £96,478 each in 2008/09. They do not earn bonuses. They were also paid a salary supplement of 30% of salary in lieu of membership of the Bank's pension fund. They are entitled

to cover under the Bank's group medical insurance scheme. On leaving the Bank external members are paid their salary for a period of three months during which period the Bank has the right to veto any employment that would conflict with their former MPC responsibilities.

The salaries of Executive Directors of the Bank are not disclosable under the Companies Act requirements, as they are not members of Court. However, the salaries of the Executive Directors who are members of the MPC are given here for consistency. Paul Tucker's 2008/09 annual salary was £178,160, Charlie Bean's was £186,100 until 30 June 2008 and Spencer Dale's was £164,000 from 1 July 2008. The salary range for Executive Directors is £160,000 to £190,000. Unlike Governors and Deputy Governors, Executive Directors are eligible for

## Remuneration of Governors, Directors and MPC members continued

performance-related bonuses up to a maximum of 15% of base salary dependent on the fulfilment of their executive responsibilities. Charlie Bean and Paul Tucker have been members of the Court section of the Staff Pension Fund since their earlier appointment to Executive Director whereas Spencer Dale has retained his membership of the Final Salary section. Otherwise Executive Directors receive the Bank's normal range of staff benefits.



## Governance, financial statements and risk

### 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 6–9.

### 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 of the Banking Department are properly prepared on the basis set out therein, as at 28 February 2009 and for the year to that date. The statements of account of the Issue Department are prepared in accordance with provisions agreed between the Bank and HM Treasury to implement the requirements of the Currency and Bank Notes Act 1928 and the National Loans Act 1968. The Court of Directors is responsible for ensuring that the statements of account are prepared in accordance with these requirements.

The Court of Directors is responsible for ensuring proper accounting records are kept, which disclose at any time the financial position of the Bank and enable Court to ensure that the financial statements comply with the requirements set out in note 2 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. The accounting framework adopted is set out on pages 56–63.

The directors who held office at the date of approval of this *Report* confirm that, so far as they are aware, there is no relevant audit information of which the Bank's auditors are unaware; and each director has taken all steps that they ought to have taken as a director to make themselves aware of any relevant information and to establish that the Bank's auditors are aware of that information.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### Principal activities and review of operations

The Bank's Core Purposes are set out on page 1. The Governor's Foreword, the Review of 2009/10 and the

Expenditure Review give a detailed account of the Bank's activities and operations during the year.

### Financial results

The Banking Department's financial statements for the year ended 28 February 2009 are given on pages 52–96, and show a profit before tax of £995 million (2007/08: £197 million). After a tax charge of £162 million (2007/08: £36 million) and a payment in lieu of dividend of £417 million (2007/08: £81 million), the profit transferred to reserves amounts to £417 million (2007/08: £80 million). The statements of account for the Issue Department (which are given on pages 97–99) show that the profits of the note issue were £2.2 billion (2007/08: £2.3 billion). These profits are all payable to HM Treasury.

### Banking Department balance sheet

The Banking Department balance sheet expanded during 2008/09, to £147.9 billion at 28 February 2009 (2007/08: £72 billion).

Almost all of the change in Banking Department assets can be attributed to 'loans and advances to banks', which increased to £136.8 billion at 28 February 2009 (2007/08: £62.8 billion). The Bank expanded the use of three-month reverse repos during 2008/09 and introduced US dollar reverse repos. Loans and advances to Northern Rock were repaid during the year (2007/08: £24.3 billion).

The composition of Banking Department liabilities changed during 2008/09. The Bank introduced seven-day sterling bills, with £42.2 billion outstanding at 28 February 2009 (2007/08: £ nil), and the Issue deposit with Banking Department stood at £29.2 billion at 28 February 2009 (2007/08: £19.2 billion). US dollar reverse repos were funded by borrowing from the US Federal Reserve and, in total, sterling and foreign currency deposits taken from central banks increased during the course of the year, to £24.4 billion (2007/08: £18.6 billion). During 2008/09, the Bank provided deposit facilities to Northern Rock, with £9.1 billion outstanding at 28 February 2009 (2007/08: £0.1 billion). In total, deposits from banks and other financial institutions at 28 February 2009 were £42.2 billion (2007/08: £24.9 billion) including reserve balances.

At 28 February 2009, the Banking Department balance sheet contained £3 billion of liabilities associated with the management of the Bank's foreign exchange reserves (2007/08: £3.4 billion). In March 2008, the Bank launched a \$2 billion three-year RegS/144A Eurobond; a further \$2 billion bond was issued shortly after the

## Governance, financial statements and risk continued

2008/09 financial year end. In January 2009, €3.3 billion of the Bank's three-year denominated notes (originally issued in 2005) matured. Proceeds are invested in foreign currency assets, and swaps are held to minimise exposure to interest rate, currency and liquidity risks.

The Banking Department balance sheet also contains the Bank's capital and reserves and Cash Ratio Deposits (CRDs). These are predominantly invested in gilts and supranational sterling bonds. At end-February, capital and reserves totalled £3.3 billion (2007/08: £2.3 billion). The increase on the year reflected higher retained profit, largely in relation to the long-term reverse repos, and a surplus from operations indemnified from HM Treasury, in particular the Special Liquidity Scheme. CRDs were £2.4 billion at 28 February 2009 (2007/08: £2.9 billion). The level of CRDs declined following a reduction in the CRD ratio on 2 June 2008 following the public consultation undertaken in 2007. The Banking Department's holdings of gilts securities were £2.6 billion at 28 February 2009 (2007/08: £2.5 billion) and holdings of other supranational sterling bonds were £980 million (2007/08: £1,021 million).

### Issue Department balance sheet

Banknote liabilities continued to increase year on year, and were £48.6 billion on 28 February 2009 (2007/08: £45 billion).

Gilt purchases on Issue Department, introduced in January 2008, continued, and the value of gilt securities at 28 February 2009 was £5.4 billion (2007/08: £0.8 billion); the Ways and Means advance to HM Treasury was £4.1 billion at 28 February 2009 (2007/08: £7.4 billion).

Reverse repos outstanding at 28 February 2009 were £9.8 billion (2007/08: £17.6 billion), and the Issue Department's deposit with Banking Department, netted out in the consolidated balance sheet, was £29.2 billion (2007/08: £19.2 billion).

### A combined balance sheet

The separation of Banking from Issue in the Accounts is required by statute. A summary combined Bank balance sheet as at 28 February 2009 is set out below. It is provided for information purposes only, to assist comparison with other central banks.

In summary, the combined balance sheet increased by £69.5 billion. Sterling bills in issue were £42.2 billion, sterling and foreign currency deposits taken increased by £23.4 billion and banknote liabilities increased by £3.6 billion. This funded an increase in loans and advances of £68.3 billion, increased outright gilt purchases by £4.8 billion offset by a reduction in the Ways and Means advance by £3.2 billion.

### Summary combined balance sheet

|   | 2009<br>£m     | 2008<br>£m    |
|---|----------------|---------------|
| <b>Assets</b>   |                |               |
| Ways and Means advance  | 4,142          | 7,370         |
| Loans and advances  | 148,958        | 80,684        |
| Financial assets designated at fair value through profit or loss      | 3,334          | 3,742         |
| Derivative financial instruments                                      | 287            | 122           |
| Available for sale securities   | 9,380          | 4,650         |
| Other assets  | 1,210          | 1,200         |
| <b>Total assets</b>   | <b>167,311</b> | <b>97,768</b> |
| <b>Liabilities</b>  |                |               |
| Notes in circulation  | 48,608         | 44,978        |
| Money markets instruments in issue                                    | 42,212         | –             |
| Deposits  | 68,955         | 45,552        |
| Derivative financial instruments                                      | 81             | 727           |
| Financial liabilities designated at fair value through profit or loss | 2,965          | 3,377         |
| Other liabilities   | 1,169          | 841           |
| Capital and reserves  | 3,321          | 2,293         |
| <b>Total equity and liabilities</b>                                   | <b>167,311</b> | <b>97,768</b> |

### 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 the fifth day of April and October (or prior working day), a sum equal to 25% of the Bank's post-tax profit for the previous financial year or such other sum as the Bank and HM Treasury may agree. The overall effect is that the Bank and HM Treasury will normally share post-tax profits equally. Accordingly, the Bank paid £39 million in April 2008 and £42 million in October 2008 in respect of the year to 29 February 2008. On 3 April 2009, the Bank paid the first payment of £203 million in respect of the financial year ended 28 February 2009, based on provisional full-year figures. The balance will be paid on 5 October 2009.

### Risk management

In order to effectively and efficiently deliver its Core Purposes and Strategy the Bank is required to identify, assess and manage a wide range of risks to its business. The Bank's risks are managed through an overarching framework in order to apply consistency and transparency across the organisation. The framework identifies the roles and responsibilities of key parties in the risk management process, the policies for how risks are managed, the tools and processes used and the reporting outputs that are generated.

### The Bank's risk framework

The Bank's risk management framework is designed to facilitate the identification, assessment, mitigation and management of risks which may impede the Bank's achievement of its Core Purposes and Strategy. This includes ensuring that suitable risk management processes are implemented across the Bank, and that management develop suitable mitigating actions for those exposures deemed unacceptable.

Risks are divided into three high-level categories, although there can be overlap between these:

- **Strategic:** Policy risks, governance issues or external factors which directly impact the Bank's ability to meet its Core Purposes.
- **Operational:** Risk arising as a result of weaknesses in business processes, systems, or through staff or third-party actions which have an impact on the delivery of the Bank's key business functions or on its reputation.

- **Financial:** Risks to the Bank's capital that may arise through crystallisation of market, credit or liquidity risks in the Bank's balance sheet.

The risk framework is designed to ensure that the above risk types are managed in a consistent and efficient way, and that decisions to accept or mitigate risks are taken expediently and transparently. This includes ensuring risk tolerance levels are set, exceptions and incidents are monitored and that decisions and actions are taken where necessary.

The Bank's process for identifying, evaluating and managing significant risks is in accord with the guidance contained in the Combined Code issued by the Financial Reporting Council. An annual review of the effectiveness of the Bank's system of internal control is undertaken by the Executive Directors, and its findings are reported to Audit Committee and Court.

### Risk policy

The Bank's risk policy and appetite is articulated in a set of eleven Risk Standards. The Standards are a high-level articulation of how key categories of risk are identified, assessed, controlled and monitored within the Bank. The existing Risk Standards are designed to cover the risk categories of most significance to the Bank's risk profile. This assessment will be updated regularly, and changes to the population of Standards may be proposed in future. Each Risk Standard is owned by a member of the Executive Team. The Standards are reviewed on an annual basis, and updated accordingly.

### Risk governance

The key elements of the risk framework governance structure are listed below:

**The Court of Directors:** Court's overall responsibilities include determining the Bank's objectives and strategy, and ensuring the effective discharge of the Bank's functions and the most efficient use of the Bank's resources. Within this Court takes responsibility for the overall governance framework of the Bank, including the Bank's risk framework and system of internal controls.

**The Audit Committee:** The Audit Committee assists Court in meeting its responsibilities for an effective system of financial reporting, internal control and risk management. It has responsibility for reviewing the findings of internal

## Governance, financial statements and risk continued

and external auditors and monitoring outstanding actions for timely completion. It is supported by the Bank's Internal Audit function. Audit Committee receives reports on the operation of the risk framework and the risk management processes and systems in place in the Bank.

**The Executive Team (ET):** ET members are responsible for managing the risks within their Directorates, and ET itself is responsible for managing overarching issues and risks faced by the whole institution, particularly strategic and policy risks.

**The Business Risk Committee (BRC):** The BRC ensures that the risk framework provides the risk information required by the Bank's senior management to manage the Bank's risk profile, and that the risk profile fully articulates those risks which may impact the Bank's ability to achieve its objectives. This includes ensuring that the framework delivers risk profile reports, that associated exception items are cleared, and that action plans are implemented by the risk owners on timely basis. BRC responsibilities can be summarised in three areas:

- Risk framework oversight — ensuring that the risk framework is fit for purpose and operates effectively.
- Operational risk profile oversight — ensuring that the Bank's operational risk profile is managed within the Bank's risk appetite. This includes responsibility for reviewing plans for key Bank-wide risk mitigants, such as insurance.
- Risk reporting — ensuring that the appropriate operational risk profile issues are reported to ET and Court. This includes significant risk issues, incidents, out of tolerance items (such as Key Risk Indicators) and past due action plans.

**Risk Oversight Unit (ROU):** The Risk Oversight Unit, in the Finance Directorate, is responsible for providing senior management with the Bank-wide risk profile; the two key reporting outputs being the Quarterly Risk Report to BRC and the Quarterly Risk Report to Executive Team and Court. ROU supports BRC, acting as a secretariat function and reporting to BRC on the implementation and operation of the risk framework throughout the Bank.

The ROU designs and implements risk management methodologies to fulfil the activities in the risk management life cycle; identification, assessment, mitigation and monitoring. This includes initial statements of risk appetite, operational risk assessment and

quantification methodologies, and (in conjunction with risk owners) Key Risk Indicator (KRI) thresholds. ROU manages the Bank-wide risk information systems (the central risk register system, and the incident management system) and associated reporting structures.

**Assets and Liabilities Advisory Committee (ALCO):** ALCO supports and advises the Executive Director, Markets on the management of the Bank's balance sheet under the terms of the Balance Sheet Remit from the Governor. In the context of the Remit and risk framework, it monitors the financial performance and risk profile of the Bank's main financial activities, and of the balance sheet as a whole.

**Risk Management Division (RMD), Markets:** RMD is responsible for analysing the financial risks faced by the Bank in its operations in financial markets, whether on behalf of HM Government or on the Bank's own account. RMD is responsible for the development of the appropriate framework, and articulation of appetite, for the management of financial risks, as set out in the three financial risk standards. This includes analysis of the creditworthiness of counterparties, issuers and central bank customers to whom the Bank and/or EEA may have credit exposures and the establishment of eligibility criteria for assets taken as collateral.

**Markets Strategy and Risk Operations (MSRO), Markets:** MSRO is responsible for the implementation of the agreed risk framework, including reporting on credit, market and liquidity risk. It is also responsible for operational risk management processes across the Markets Directorate and for preparations for contingencies with respect to financial operations.

### Governance of operational risk management within Directorates

Each Directorate has staff that are given responsibility for co-ordinating risk management activities for that business area. In the case of Banking Services and Markets there are dedicated organisational units set up to deliver the risk framework locally; for Markets this responsibility lies with Markets Strategy and Risk Operations Division (see above), in Banking Services the Banking Risk Unit (BRU) is responsible for developing and implementing a framework to ensure that Banking Services risks are effectively managed. The responsibilities of BRU cover:

- Operational Risk and Control (including Compliance);

- Credit and Regulatory Risk (including Anti-Money Laundering); and
- Business Continuity (including Financial Crisis management).

BRU liaise with Risk Oversight Unit and Risk Management Division on an ongoing basis in its performance of these functions.

#### Other risk management committees

The executive committees and organisational units described above are in place to provide assurance to Court on the management of operational, financial and strategic risks. A number of additional committees have been established within business areas, or across the organisation, to manage specific risk types. Outputs from all of these committees feed into the overarching framework described above — either through BRC (for operational risks) or through ALCO (for financial risks).

Markets Directorate has established additional committees to oversee specific risks arising as a result of new market operations undertaken during the past financial year, including the Special Liquidity Scheme and the Asset Purchase Facility.

#### Collateral management

The range of collateral eligible under the Bank's market operations has expanded significantly in the past year. The Risk Management Division in Markets Directorate is responsible for the risk management of non-sovereign collateral accepted under the Special Liquidity Scheme, Discount Window Facility, Asset Purchase Facility and extended long-term repo operations. The headcount for this team has increased in the last year to reflect the increased workload. Investment has also been made in new systems to manage collateral, and further projects to improve systems and processes are planned for 2009/10.

The management of financial risk is discussed in note 33 to the Financial Statements.

#### Exchange Equalisation Account

The Bank acts as agent for HM Treasury in managing the United Kingdom's foreign currency assets and gold reserves, and its foreign currency liabilities. These funds are not held on the Bank's balance sheet, but in HM Government's Exchange Equalisation Account (EEA).

The risks incurred in conducting this business are similar to those in relation to the Bank's own business, namely credit, market, liquidity and operational risk; and the controls applied parallel those applied in respect of Bank business. The management of the EEA is conducted within a framework agreed annually with HM Treasury, which is described in the *EEA Report and Accounts* published by HM Treasury.

#### Employees

Details of the Bank's employees, employee relations, development and performance management and the Bank's continued work on equal opportunities are given on pages 23–24.

#### Health and safety

Effective health, safety and risk management is a priority for the Bank. The Bank's safety management system delivers a safe working environment by continuous and effective assessment. Health and safety issues and incidents are monitored by the Bank's Safety, Health and Environment Committee.

#### The environment

The Bank monitors the impact of its operations on the environment, which is mainly through the use of power and the generation of waste. The Bank tries to minimise its impact through better use of its premises, using increasingly power-efficient equipment and by improved waste management. 10% of the electricity used in the Bank's premises is from renewable (green) sources. Although the Bank's Head Office building is accredited under the Carbon Trust's Energy Efficiency Accreditation Scheme, in 2008 the building received a Display Energy Certificate rating in Band G. The building was constructed in the 1930s and has substantial heating and cooling challenges for modern occupation, including high electricity consumption by energy-intensive information technology equipment. The Bank's Head Office building was awarded the Corporation of London's Clean City Gold award (with special commendation) for waste management in 2008. More than 98% of waste produced by the Bank at its two main sites in London and Essex is recycled or re-used in some form. The Bank's publications, including this *Report*, are printed on paper which contains 50% recovered waste and 50% virgin fibre and is certified as a Forest Stewardship Council mixed sources product.



## Governance, financial statements and risk continued

### Political and charitable donations

No donation was made for any political purpose. The Bank allows staff to take part in local political and community activity and may grant time off for such activity. No such time was granted for political interests in 2008/09 (2007/08: nil).

The Bank continued to play an active role in community initiatives and supported voluntary work undertaken by its staff. During 2008/09 the Bank contributed £582,000 in support of its community programme (2007/08: £587,000). Donations in cash totalled £331,000 (2007/08: £343,000), this included £15,000 via the Bank of England Court Awards through which donations are made to community organisations in recognition of outstanding volunteering commitment by members of staff; £5,000 for the David Sharp School Governor Awards; £55,000 to community organisations via the Staff Volunteering Award Scheme, and £32,000 matched funding under the payroll Give-As-You-Earn scheme. The cost of other community contributions, including time spent by staff on community involvement, was £251,000 (2007/08: £244,000), and donations to academic research amounted to £61,000 (2007/08: £93,000).

### Policy on payment of suppliers

The Bank subscribes to the principles and practices of the Better Payment Practice Code.<sup>(1)</sup> The Bank estimates that the average trade creditor payment days for 2008/09 was 10.9 working days (2007/08: 11.1).

---

(1) For details about the Code, see [www.payontime.co.uk](http://www.payontime.co.uk).

## Report by the Non-executive Directors

This section contains the Report from 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 Committee of Non-executive Directors — NedCo — and how it has discharged them. The Report relates to the period from 1 March 2008 to 28 February 2009, referring where relevant to other sections of the Annual Report which cover Non-executive Directors' responsibilities as members of Court.

The Bank of England Act confers a number of specific responsibilities on the Non-executive Directors. The requirements are to review the performance of the Bank in relation to its strategy and objectives as determined by Court; to monitor the extent to which its objectives in relation to financial management have been achieved; to review the Bank's internal financial controls; and to review the procedures of the Monetary Policy Committee (MPC). The Non-executive Directors also have delegated responsibilities for the remuneration of the executive members of Court, which are undertaken by the Remuneration Committee.

### The operation of NedCo

The role of the Non-executive Directors in the governance arrangements of the Bank is similar to that of any commercial organisation and they have similar responsibilities to any board. They are not involved with day-to-day decision-making but they do provide an independent and critical challenge for the management of the Bank.

Directors have continued to receive quarterly reports on implementation of the Bank's strategy, finance, project management, risk management and progress against the Bank's high-level outcomes. These reports have proven to be helpful monitoring mechanisms for NedCo and have provided the basis for discussion with management across a wide range of issues.

A performance evaluation and review of the operation of Court and NedCo was undertaken in 2008 (the previous such exercise was in 2006). The efficiency problems that were brought to light by that exercise are mostly being addressed by structural changes to Court arising from the new Banking Act — described below. Indeed, the results of

that and previous reviews helped to shape Non-executive Directors' contributions to Government consultations about the new legislation. Additionally, the chairman of NedCo has held regular meetings with HM Treasury as the Bank's shareholder and has participated in the interview panels for the selection of new Non-executive Directors. NedCo has had the opportunity to comment on senior appointments at the Bank, and they welcome the change whereby HM Treasury appoints members of the MPC through open competition. One of the Deputy Governor members and one external member has already been appointed through this new process.

### Revised governance arrangements

Some concerns about current governance arrangements arising from the 1998 Banking Act had been recognised and voiced by Non-executive Directors for some time. These included the large size of Court — which at times had limited effective debate — and the Act's requirement that the Governor chaired Court. However, arrangements put in place in 2003 have meant that the Bank's business has been processed through NedCo under the chairmanship of the Senior Non-executive Director. The Banking Act 2009, which received Royal Assent earlier this year, was primarily focused on financial stability and bank resolutions (discussed below). However, it also introduced a number of reforms to Court that addressed the key issues of concern highlighted above. The number of Non-executive Directors will be reduced from 16 to no more than nine, and Court will be chaired by the Senior Non-executive Director. There will also be a new sub-Committee of Court created to oversee the Bank's financial stability work. The Act removes the requirement for monthly meetings of Court, specifying a minimum of seven meetings in each calendar year.

The new governance arrangements come into effect on 1 June. Prior to that, existing Non-executive Directors will have resigned and a new team appointed. Existing members were able to apply for reappointment to serve the remainder of their term. At the time of this Report no announcements have been made by HM Treasury about the composition of the new Court other than the appointment of Sir David Lees as Chairman. It will be crucial that the transition is managed effectively to ensure continuity, effective support and challenge to the Bank's management. The existing body of Non-executive Directors will work to ensure a smooth transition. However, an important early task for the new Court will be

## Report by the Non-executive Directors continued

to review its delegated powers and to establish the matters that are reserved for its approval. Importantly, terms of reference for the new Financial Stability Committee will also need to be debated and agreed quickly.

### Banking Act and financial stability oversight

The Non-executive Directors believe that Parliament has acted promptly in legislating to create powers to resolve failing banks. The Bank now has specific responsibilities within the Special Resolution Regime (SRR) — used for the first time in March in relation to Dunfermline Building Society. The limitations of the previous arrangements were highlighted by the Governor and others in the aftermath of bank support operations in Autumn 2007 and 2008. The Bank's Non-executive Directors worked with the executive management to shape the banking reforms that received the Royal Assent in February 2009. The full implications of the Act for the Bank are discussed elsewhere in the *Annual Report*.

The Non-executive Directors believe that the new Act goes a long way to provide the necessary machinery and powers for future bank resolutions. In addition, the establishment of a statutory definition of the Bank's Financial Stability objective meets a need to which the Non-executives have been pointing for a number of years. It is good to have plugged this gap in the law. Nonetheless, the Non-executives recognise that much of the associated operational detail still needs to be settled among the members of the Tripartite — mainly between the FSA and the Bank. NedCo will monitor that process. Given recent experience, it is essential now to define clearly, for all to see, who among the Tripartite does what and how they interact.

Directors had expected that the legislation would give the Bank statutory powers to obtain information directly from banks rather than through the FSA. This has not been the outcome. The Non-executive Directors believe the absence of this authority weakens the position of the Bank in determining both the timing and the type of intervention necessary when the health of a financial institution falls into question. Similarly, NedCo felt strongly that the Bank should have at least equal rights to trigger the SRR in the case of a failing bank or financial institution to guard against 'regulatory forbearance'. In these circumstances it will be especially important that co-operation between the Bank and the FSA is fully

effective and Non-executive Directors will need to monitor the process carefully.

The new Act requires the Court of Directors to establish a subcommittee called the Financial Stability Committee, consisting of four Non-executive Directors and the three Governors and to be chaired by the Governor. The new Committee's functions will be (i) to make recommendations to Court about how the Bank should implement its Financial Stability objective; (ii) to provide advice on actions in relation to specific institutions where so required by the Bank's Financial Stability objective; (iii) to advise on the Bank's use of its Special Resolution Regime powers and subsequently to monitor the use of those powers; and (iv) to monitor how the Bank oversees payments systems. The new arrangements are a step forward; but there is still much to be done. We expect the new Non-executive Directors will want to give this high priority in 2009.

### Financial market developments and the Bank's operations

Over the past year, the widening and deepening financial and economic crisis has affected all aspects of the Bank's work. NedCo has continued to receive regular reports on financial market developments and the Bank's responses. Where the Bank itself has acted — for example, by providing liquidity to the banking system — Non-executive Directors have been informed and have discussed the Bank's approach at length. They have also discussed the Bank's part in wider proposals such as the recapitalisation of the banking system. With respect to material transactions with individual financial institutions, the Transactions Committee has been consulted in each instance.

The introduction of market-wide facilities such as the Special Liquidity Scheme in April 2008 and the Asset Purchase Facility in January 2009, along with financing to support individual institutions such as Bradford and Bingley (by way of temporary funding for the Financial Services Compensation Scheme), has raised important issues for the Bank which have been the subject of review by the Non-executive Directors. The impact of these operations on the Bank's objectives and its risk, financial and wider resource management have all been discussed and assessed.

In particular, the Bank's processes for collateral management have needed to be expanded to accommodate a greatly increased scale and a wider range of assets that go beyond the Bank's normal market operations and experience. Non-executive Directors have monitored continually the development of processes, the management of risks and the effectiveness of controls — including risks to the Bank's balance sheet. The Bank's budget has had to support this work, increasing resources where they were needed. We have been concerned about the pressures on staff, particularly on key individuals in the Markets and Banking areas. We have had regular reporting from senior management and have questioned whether, and sought re-assurance that, actions were being taken to recruit and redeploy staff and to manage the risks associated with the exceptional level of stress in many parts of the organisation. This is still a challenge, affecting discussions and decisions on the Bank's budget and resources for the coming years (see below). Non-executive Directors are satisfied that the present situation is being effectively managed and that the executive management is fully alive to the issues.

### **The Bank's strategy and its implementation**

The Bank's performance is reviewed on pages 14–25 of this *Annual Report*. In NedCo's opinion this evaluation is a fair statement of the Bank's performance against its objectives and strategy for 2008/09.

Debating and agreeing the Bank's strategic priorities and associated programmes of work has again been a key aspect of NedCo's responsibilities. Over the past year, an important emphasis has been the extent to which new policy and operational developments have been managed alongside the implementation of the Bank's strategic priorities and associated planned work.

This year, after the Governor's reappointment in June, Non-executive Directors had an opportunity to discuss his second five-year term vision and strategic priorities for the Bank. This enabled Court to debate the implications for resources and the shape of the Bank and its priorities in the years ahead. The regular reporting to NedCo has allowed Non-executive Directors to review competing demands and pressure points in order to challenge the Bank's management on priorities, timescales and resources. Reprioritisation and rescheduling inevitably has been a feature of the past year. Non-executive Directors are satisfied that the decisions taken have been appropriate

and are keeping the overall strategy on track. The monitoring of progress towards milestones will be equally crucial in the years ahead. Key elements of the Bank's strategy are discussed below.

### **Monetary policy**

A year ago we noted that the MPC was facing its stiffest challenge so far. During 2008/09, the MPC has had to address a dramatic and profound change in the economic outlook and, latterly, to adapt its policy response in radically new ways — through the injection of money into the economy. Non-executive Directors are responsible for reviewing the processes and procedures of the MPC, which are discussed on pages 47–48 below.

### **Market operations**

During the financial crisis, the Bank's money market framework has been reformed to meet changing liquidity requirements. Elements of the existing framework were well designed, but the standing facilities did not prove adequate and their use became stigmatised. The new facilities — including a Discount Window Facility — are better designed to provide additional liquidity in both normal and stressed conditions. Non-executive Directors will continue to review the Bank's money market operations to ensure they remain at the forefront of central bank practice. Beyond the present difficult market conditions, it will be important for the Bank to reflect on, and to review, its operations further and to apply any lessons from the past two years.

The strategy in this area inevitably has been overtaken by the major expansion of market operations as new liquidity facilities have been created to deal with the financial crisis. Managing these operations, and the collateral the Bank has acquired, is a major extension of the Bank's work which will need continued investment in people, processes and systems.

### **Financial stability**

A major focus of the past year has been the Bank's contribution to the new Banking Act as discussed earlier. Within the Financial Stability area of the Bank, a substantial team identifies and analyses risks to the financial stability of the economy as a whole. Over several years, Non-executive Directors have pressed management on the efficacy of this work, its impact through communications and other actions the Bank can take to mitigate threats. With responsibility for macroprudential

## Report by the Non-executive Directors continued

risk management but without authority at the institutional level, the Bank has had limited powers to influence events and attitudes.

The new Banking Act and Financial Stability Committee provide a constructive framework for the Bank to exercise its responsibilities. In addition, Non-executive Directors welcome the ongoing debate among policymakers on further measures to enhance systemic financial stability. Whatever the outcomes, a key role for the Bank — as for any central bank — must be to alert markets and authorities to the threats of growing systemic risks.

The Banking Act makes the Bank responsible from 1 June for statutory oversight of payment systems. It will be important to ensure that the Bank has the additional systems and processes needed for this and that effective internal and external accountability is established. The Bank's extended responsibilities need to be clearly understood in and outside the Bank and, as NedCo has indicated in the past, it will be equally important for clarity about where it does not have responsibility.

### Customer banking

Non-executive Directors have continued to monitor the migration of the Government's banking business from the Bank to the commercial sector. Good progress has been made, but NedCo has noted that the project timescale has been extended into 2010. It also recognises that an element of customer banking business may need to remain with the Bank for financial stability reasons. It will need to keep this issue under review.

### Projects

Some major projects have been delayed during the past year because of changing priorities and the strains on resources, particularly senior management time. Non-executive Directors have been kept informed of slippages and related risks and costs, and have been satisfied, on balance, that the right priorities have been set. However, it is recognised that conditions may remain stretched (in terms of resourcing) beyond the short term. We are therefore concerned that some projects that are important to the effective and efficient operation of the Bank, but are not critical to the Bank's handling of the immediate financial crisis, may be deferred for a prolonged period, with related implications for operational risk and resource stretch at the Bank. Accordingly, the

Non-executive Directors have been provided with a comprehensive Bank-wide assessment of what has been deferred, which will be kept under review.

### Human resources

Non-executive Directors have taken a very close interest in staff resourcing issues associated with the developing financial crisis. There has been an ongoing dialogue with management, in both NedCo and the Audit Committee, about the extent to which key staff are being relied upon, and the associated risks involved. We have urged the Executive to provide a range of indicators to properly assess how stretched staff are. Staff redeployment has been regularly reported and Non-executive Directors have been informed how staff resources are to be matched to the Bank's expanded responsibilities under the Banking Act 2009.

In addition to current staffing and organisational issues, NedCo has explored with the Bank's executive management how to nurture the level of expertise required to conduct future special resolution operations when lengthy periods of more benign economic conditions may dissipate experience in the practical issues. The Non-executive Directors have also discussed how to manage talent effectively. NedCo continues to believe, especially in light of the recent financial crisis, that the Bank needs to continue to increase the depth of senior management expertise in execution and project management. While NedCo recognises the value of a Bank-wide policy, they judge that it is especially important to set up individual development programmes for members of the Executive Team.

### Business resilience

The financial crisis has delayed some business continuity projects. While recognising the reasons, Non-executive Directors have considered revised timetables and their implications. Even so, good progress was made on co-operation with other central banks. NedCo had previously asked how the Bank's arrangements ranked against external benchmarks. In response, management had demonstrated that the Bank's preparations measured positively against recognised best practice. While scenario planning has progressed well, the Non-executive Directors have urged management to plan for a business continuity incident during a financial crisis.



## Financial management

The Non-executive Directors have continued to take a particularly close interest in the financial management of the Bank's operations during the year. NedCo has focused on the budgetary and expenditure implications of the Bank's enhanced responsibilities as well as on the effect on the Bank's balance sheet of the exceptional market operations undertaken this year.

The Bank's budgetary and financial reporting processes provide the link between its financial management and its business operations and strategic priorities. Court agrees the strategy and key objectives for the year ahead and provides the oversight of the budgetary position to ensure that those objectives are achieved within the Bank's financial framework. We are pleased with the improvement in the Bank's financial processes and systems. Reporting to Court on these matters is now high quality and supports well-directed debate on the main issues.

The budget for 2009/10 to 2011/12 is discussed on page 32. The Bank has been successful in containing costs over the past five years but Non-executive Directors recognise that there will be challenges in the future given the enhanced responsibilities under the new Banking Act and any future changes in the Bank's remit. Non-executive Directors approved the planned additional costs that arise from the delivery of the Bank's new responsibilities, as well as the need for some expenditure on the Bank's expanded collateral management operations. However, as current spending on policy functions will exceed projected CRD income, the Bank will need to discuss its financing with HM Treasury in due course. This will be an important matter for Non-executive Directors to consider in 2009/10 and beyond. NedCo endorses the proposals to constrain nominal spending growth and welcomes the permanent commitment to value for money.

Non-executive Directors have been kept apprised of the effect that the greatly expanded market operations have had (and will have) on the Bank's balance sheet, and the related indemnity arrangements with HM Treasury. In addition, Directors have discussed the Bank's capital position while recognising that there is no indisputable standard for a central bank's level of capital. Non-executive Directors expect discussions with HM Treasury to start on the appropriate capital position of the Bank once more normal conditions have returned.

## Audit and Remuneration Committees

Certain of the functions of Court are delegated to the Audit and Remuneration Committees. The terms of reference of each of the committees have been reviewed again during the year — a more substantive review and verification will be undertaken when the new Court and its subcommittees are formed after 1 June. Non-executive Directors consider that the Audit and Remuneration Committees have operated effectively during the year.

Awareness of risk within the organisation and risk reporting have improved further, helped by a new incident reporting framework which has evolved into a valuable tool.

Directors welcome the work that is being undertaken to ensure that themes and issues detected in incident reports transfer into the management of risk and the Bank's internal control system.

The Audit Committee assists Court in meeting its responsibilities for ensuring that the Bank has an effective system of financial reporting, internal control, risk and value for money management. Over the past year it also has focused on the demands on the Bank's balance sheet and resources arising from its increased market operations, and the need for new or strengthened controls. The Committee has reviewed the effectiveness of the system of internal financial controls which operated during 2008/09 and this is reported in the internal controls section of the *Annual Report* (pages 39–41) which, so far as appropriate, forms part of NedCo's report.

The Remuneration Committee assesses the remuneration of the executive members of Court and the Bank's Executive Directors. It also recommends to Court the terms and conditions of service of the members of the Monetary Policy Committee appointed by the Chancellor of the Exchequer. The report on remuneration for 2008/09 is set out on pages 33–36 and, so far as appropriate, forms part of this report.

## MPC procedures

Non-executive Directors are responsible for keeping the procedures followed by the MPC under review and to ensure that it has adequate resources to do its work. This includes reviewing the regional, sectoral and other information used by the MPC for the purposes of formulating monetary policy.

## Report by the Non-executive Directors continued

As required under Schedule 3 of the Bank of England Act, Non-executive Directors receive a monthly report from the MPC. Every three months, following publication of the Bank's *Inflation Report*, MPC members are invited to attend NedCo to discuss both the *Inflation Report* and MPC procedures. As well as receiving the minutes of the monthly MPC meetings, the Bank's quarterly Inflation Report and summaries of other meetings, Non-executive Directors also periodically attend pre-MPC meetings and visit the Bank's Agencies. They also see examples of the regional, sectoral and other information collected by the MPC during the year.

The intelligence gathered by the Bank's Agencies remains an important part of the information used by the MPC. This has been especially true at a time of increased uncertainty and divergent economic trends.

Non-executive Directors note that MPC members value the help of the Agencies in arranging their own visits around the United Kingdom to hear first-hand about business and economic conditions and to explain their own views about the economy and interest rate decisions.

Aside from receiving periodic presentations to Court on MPC processes, NedCo formally reviews procedures for setting monetary policy by way of a questionnaire completed each year by MPC members. These provide the basis for a private discussion between the Senior Non-executive Director and individual members of the MPC on a one-to-one basis.

In 2008/09 Non-executive Directors were pleased to note that work on streamlining the pre-MPC processes was completed early. However, there were some delays to model development work and further process automation as a result of resources having to be diverted to other priorities — for example, the implementation of unconventional monetary policy measures (quantitative easing). Non-executive Directors had valuable discussions with MPC members on a range of process-related issues, including the way in which the scale of Bank Rate changes was assessed in a severe downturn and how money could be injected directly into the economy when interest rates were close to zero. Additionally, they discussed how the Bank and the MPC communicate with the financial community and how key messages could be better transmitted.

Non-executive Directors have welcomed improvements in the planning for MPC appointments and succession. In that regard, they supported the Treasury Committee's proposal for a confidential pool of experts to be maintained to help fill vacancies in a timely fashion. The recent appointment of David Miles showed that effective procedures are now in place.

In NedCo's opinion, based on its review and notwithstanding adverse economic conditions, the MPC's procedures, including those relating to the collection of regional, sectoral and other information, operated well during the year and provided valuable input to MPC debate and decisions. The Bank continues to improve and adapt processes to address specific issues raised by MPC members and NedCo.

The table overleaf sets out attendance by the Bank's 16 Non-executive Directors at meetings of Court, NedCo, the Audit and Remuneration Committees.

The figures in brackets refer to the total number of meetings during the financial year. Attendance by other members of Court is also listed.



| Attendance   | Court (12) | NedCo (10) | Audit (3) | RemCo (6) |
|--|------------|------------|-----------|-----------|
| Sir John Parker  | 10         | 10         | 1         | 5         |
| — Attendance as an observer at Audit Committee and RemCo |            |            |           |           |
| Mr Barber  | 8          | 9          |           |           |
| The Hon Peter Jay  | 10         | 10         |           | 6         |
| Dr Potter  | 9          | 9          |           | 6         |
| Sir Callum McCarthy                                      | 5 of 7     | 5 of 6     |           |           |
| — Resigned from Court 19 September 2008                  |            |            |           |           |
| Ms Fawcett   | 7          | 7          | 3         |           |
| Sir Andrew Likierman                                     | 8 of 10    | 8 of 9     | 1 of 2    |           |
| — Resigned from Court 12 December 2008                   |            |            |           |           |
| Mr Wilkinson   | 10         | 10         |           | 5         |
| Mr Myners  | 5 of 7     | 5 of 6     | 2 of 2    |           |
| — Resigned from Court 3 October 2008                     |            |            |           |           |
| Mr Sarin   | 9          | 9          |           | 2         |
| Professor Rhind  | 10         | 10         |           | 6         |
| Mr Wigley  | 8          | 8          | 3         |           |
| Mr Strachan  | 10         | 10         | 3         |           |
| Mr Carr  | 10         | 10         |           | 6         |
| Ms Rice  | 10         | 10         | 3         |           |
| Lord Turner  | 4 of 5     | 4 of 4     |           |           |
| — Appointed to Court 20 September 2008                   |            |            |           |           |
| Mr King  | 11         | 9*         |           |           |
| Ms Lomax   | 3 of 4     | 3 of 4*    |           |           |
| — Retired from Court 31 May 2008                         |            |            |           |           |
| Sir John Gieve   | 9          | 10*        |           |           |
| Mr Bean  | 6 of 8     | 6 of 6*    |           |           |

\* Attendance by invitation.

# Report of the Independent Auditor

## Independent Auditor's Report to the Governor and Company of the Bank of England

We have audited the financial statements of the Banking Department ('financial statements'), which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, Statement of Recognised Income and Expenses and the related notes, and the statements of account of the Issue Department ('statements of account') for the year ended 28 February 2009. These financial statements and statements of account have been prepared under the accounting policies set out therein.

This report is made solely to the Governor and Company of the Bank of England and its Shareholder in accordance with Section 7 of the Bank of England Act 1998. Our audit work has been undertaken so that we might state to the Governor and Company of the Bank of England and its Shareholder those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Governor and Company of the Bank of England and its Shareholder for our audit work, for this report or for the opinions we have formed.

## Respective responsibilities of the Members of Court and the auditor

The responsibilities of the Members of Court for preparing the *Annual Report*, including the financial statements and statements of account, in accordance with applicable law and International Financial Reporting Standards as adopted by the EU are set out in the Statement of the Responsibilities of the Court of Directors in relation to the Financial Statements on pages 37 to 42.

Our responsibility is to audit the financial statements and statements of account in accordance with relevant legal and regulatory requirements and having regard to International Standards on Auditing (United Kingdom and Ireland).

We report to you our opinion as to whether the financial statements of the Banking Department and statements of account of the Issue Department have been properly prepared in accordance with the bases of preparation set out in note 2 on pages 56 to 63 and note 1 on page 98 respectively. We also report to you whether, in our opinion, the information given in the Remuneration report; the Governance, Financial Statements and Risk report; and the Report by the Non-executive Directors on pages 43 to 48 is consistent with the financial statements and statements of account.

In addition we report to you if, in our opinion, the Bank has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding remuneration to Members of Court or other transactions are not disclosed.

We read the other information contained in the *Annual Report* and consider whether it is consistent with the audited financial statements and statements of account. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements or statements of account. Our responsibilities do not extend to any other information.

## Basis of audit opinion

We conducted our audit having regard to International Standards on Auditing (United Kingdom and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and statements of account. It also includes an assessment of the significant estimates and judgements made by the Members of Court in the preparation of the financial statements and statements of account, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and statements of account are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements, the basis of which is described in note 1 on page 56, and in the statements of account, the basis of which is described in note 1 on page 98.

## Opinion

In our opinion:

- The financial statements of the Banking Department on pages 52 to 96 for the year ended 28 February 2009 have been properly prepared in accordance with the basis of preparation set out in note 2 on pages 56 to 63.
- The statements of account of the Issue Department on pages 97 to 99 for the year ended 28 February 2009 have been properly prepared in accordance with the basis of preparation set out in note 1 on page 98.
- The information given in the Remuneration report, the Governance, Financial Statements and Risk report and the Report by the Non-executive Directors is consistent with the financial statements and statements of account.

KPMG Audit Plc  
London  
Chartered Accountants  
Registered Auditor  
14 May 2009