BANK OF ENGLAND

Annual Report 2014

The contents of this Report encompass the requirements of Section 4 of the Bank of England Act 1998, which include (1) a report by the Oversight Committee on the matters for which it is responsible (S4(2)(a)), including a review of the Bank's performance in relation to its objectives and strategy (S4(3)); (2) a report by the Court of Directors on the activities of the Financial Policy Committee of the Bank (S4(2)(aa)); (3) a statement of the Bank's objectives and strategy for the next year, as determined by the Court (S4(4)(b)); and (4) a statement of the rates at which Non-executive Directors of the Bank have been remunerated (S4(4)(a)).

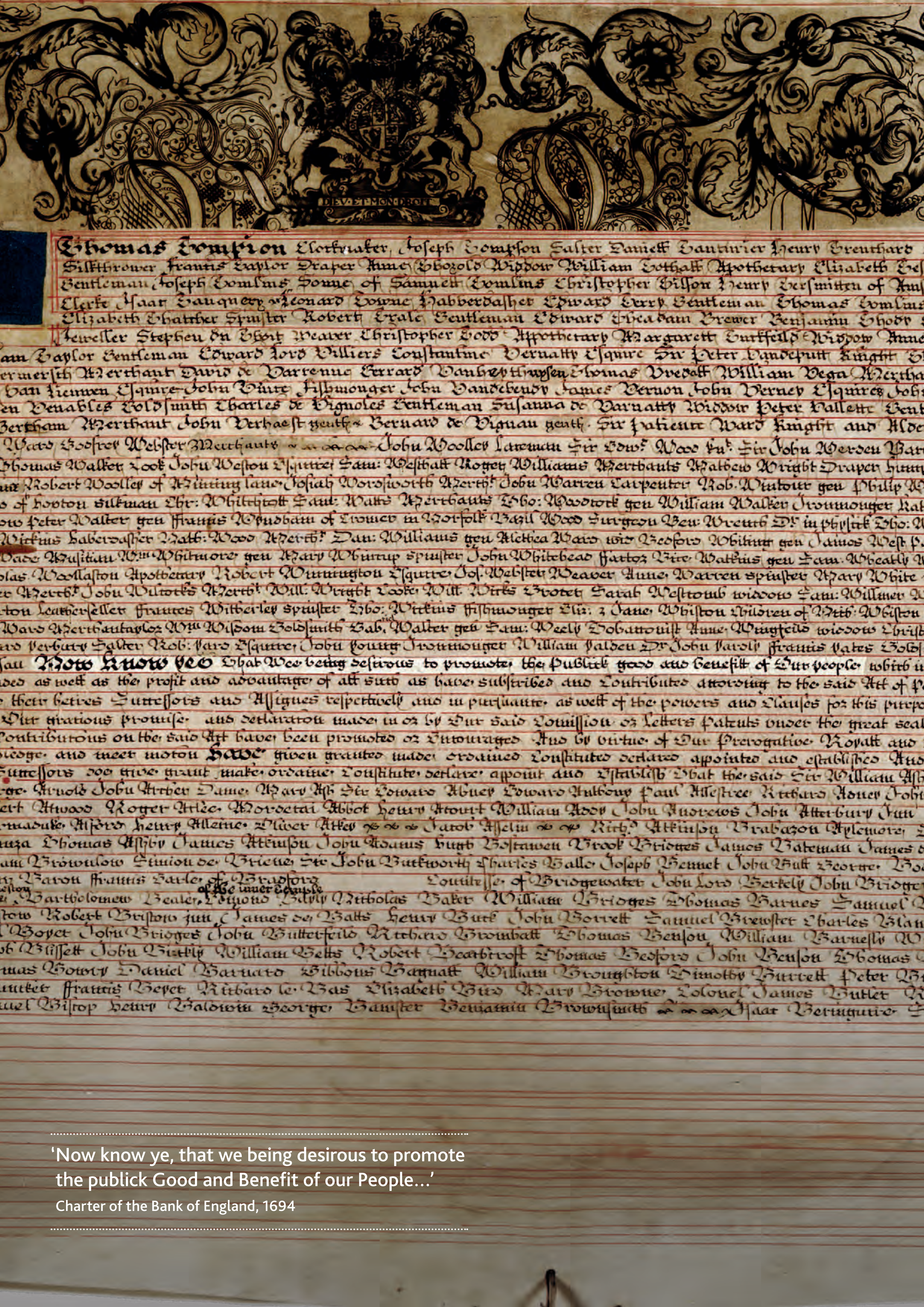
The Prudential Regulatory Authority has published a separate report as required by Paragraph 19 of Schedule 1ZB of the Financial Services and Markets Act 2000, and in accordance with the requirements of the Companies Act 2006.

The Bank has also published a separate report, as required by the Banking Act 2009 and the Financial Services and Markets Act 2000, on its supervision of financial market infrastructures.

Bank of England
Annual Report 2014

1 March 2013 to 28 February 2014

Presented to Parliament by the Chief Secretary to the Treasury
by Command of Her Majesty



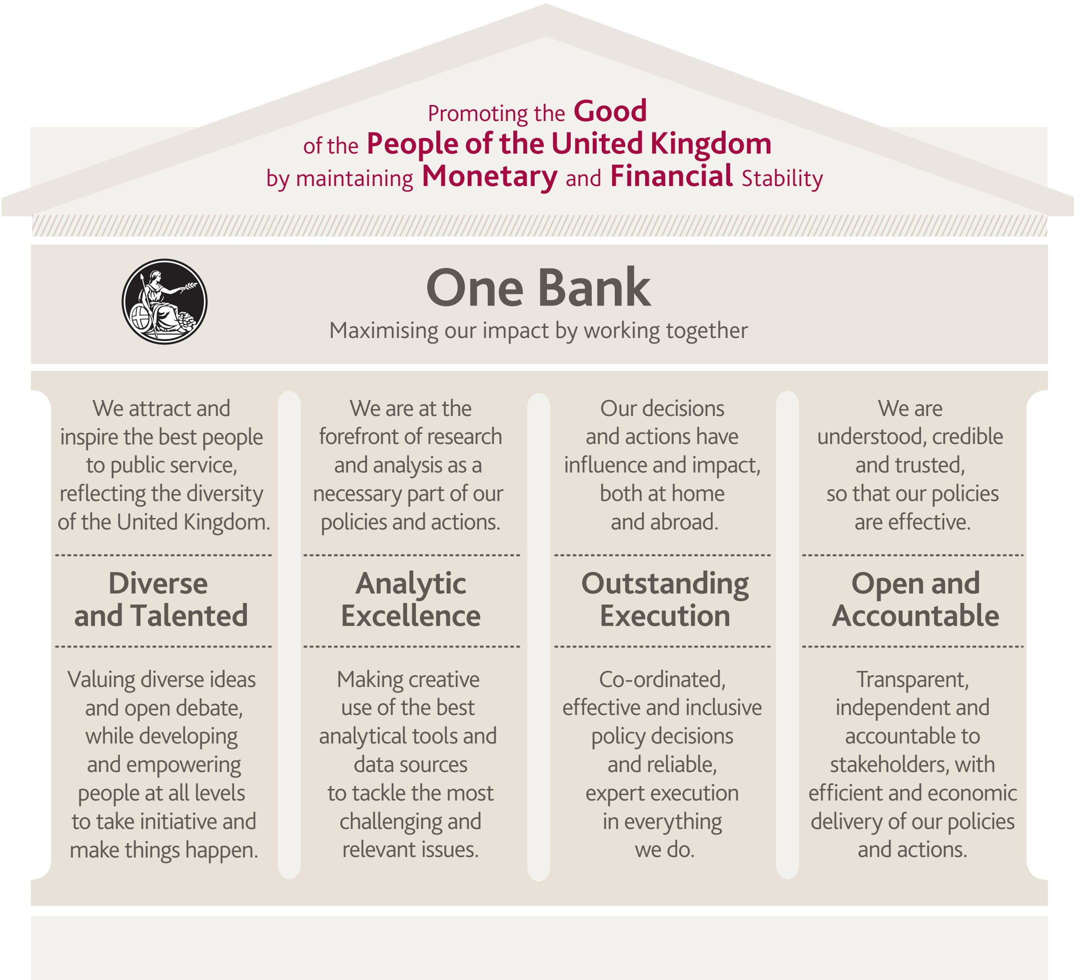
'Now know ye, that we being desirous to promote the publick Good and Benefit of our People…'

Charter of the Bank of England, 1694

Interactive contents

One Mission, One Bank

The Bank of England's mission is to promote the Good of the People of the United Kingdom by maintaining Monetary and Financial Stability.



Foreword by the Chairman of Court

Sir David Lees
Chairman of Court

This is my final Report as Chairman of the Bank's Court. The five years since I was first appointed, in 2009, have been eventful but also rewarding.

The position of Chairman was created by the 2009 Banking Act. At that stage the Bank was dealing still with the immediate aftermath of the financial crisis, and had been given additional responsibilities for bank resolution and payment systems oversight – these turned out to be only the first of a series of new challenges. Since then the Bank has acquired responsibilities for macroprudential policy and for prudential regulation, as well as for the supervision of financial market infrastructures. The Bank I leave is a very different place to the Bank I joined in 2009. To take one simple metric, when I joined there were about 1,900 staff. Now there are about 3,600.

Membership of Court was reduced in size in 2009 – from 19 to 12 – and there were six new members. An initial task was to make it an effective, modern board with good governance which the reduction in size facilitated. The Bank's massive Court Room was abandoned and meetings were, and are, held in more appropriate surroundings. This encourages discussion and debate rather than speeches. Clarity was needed about Court's role in relation to the Executive of the Bank, and about the role of the Court Committees. That has been achieved and is clearly documented. A code was introduced to cover ethics, including conflicts, conduct and personal financial transactions. These were important considerations as Non-executive Directors progressively acquired the right to observe the policy committees at work and to see their papers. Following good practice in the corporate sector, annual Board effectiveness reviews were introduced and a series of improvements in the operational and financial reports made to Court were initiated. This provided executives as well as non-executives with a clearer picture of the Bank's performance and risk position.

Achieving clarity outside the Bank has been more of a challenge. Renaming Court a 'Board' would have helped given the word Court does not suggest modernity. Although Court is different from a company board in that it neither appoints nor has the capacity to dismiss the executive, it does set the strategy, controls the Bank's resources, determines remuneration and is greatly interested in succession planning. It is unambiguously supreme in the management of the Bank. And the non-executives – now grouped as the Oversight Committee – have a wide range of statutory responsibilities which includes keeping the Bank's performance under review, and reviewing the procedures of the FPC and MPC.

That much is straightforward. The complexities in the Bank's governance arrangements lie rather in the accretion of overlapping management and policy committees. The MPC was created as a committee of the Bank, acting under a remit from HM Treasury to secure monetary stability. The FPC, on the other hand, is a statutory sub-committee of Court, exercising macroprudential powers in support of a Financial Stability Objective given by Parliament, within a Financial Stability Strategy set by Court, and subject also to 'recommendations' made by HM Treasury. And the PRA, as a subsidiary of the Bank, has a Board that both sets supervisory policy and is the governing body of the PRA, which in practice is managed as part of the Bank. The effect of all this has been to blur, for outside observers at least, the important distinction between management and policy. It is however clear internally that the policy bodies have the primary responsibility for policy matters and that Court is concerned with management of the organisation as a whole. That is the form of presentation in this Report.

The role of Chairman of Court was first established in 2009. The first Governor of the Bank was appointed in 1694 and Mark Carney is the 120th. It has been a pleasure to work with him in his first year. He has already made a significant impact in the Bank, and the new Strategic Plan described in this Report sets exactly the right course for the Bank – bringing all the policy functions together as part of a single unified institution that is clear about its objectives and agile in execution. Delivery of the 'One Bank' strategy will do much to clarify the Bank's governance. And operationally, it will make the Bank more effective, give it a clearer voice, and reduce the risk of management silos developing under the policy bodies.

I am grateful to many members of the staff at the Bank, whose deep knowledge and expertise I have come to admire and who have been uniformly helpful and resourceful throughout this period of rapid change. Despite external competition, and the impact of a two-year pay freeze, the Bank has immense reserves of talent, and is committed in the Strategic Plan to manage that as fruitfully as possible.

I have greatly enjoyed my time at the Bank which is in no small part due to the support I have received from my non-executive colleagues on Court.

They are a hardworking and effective group and I thank them for their many contributions. In addition to the work in the Audit and Risk and the Remuneration and Nomination Committees, they have worked on ad hoc committees – to examine the new banknote contract, to assess the business case for the new property in Moorgate – and have supported the Bank's work on diversity and in the wider community. I have never lacked support in forming selection panels for the numerous appointments in which Court is involved. In particular the Bank owes a debt of gratitude to Susan Rice and Roger Carr, as Chairmen of the Audit and Risk and Remuneration Committees, who leave the Court at the end of May.

The Bank is fortunate in my successor. Anthony Habgood comes to the Bank with a reputation as a strong and effective chairman of some very successful companies. I wish him – and the Bank – every success in the future.

4 June 2014

Foreword by the Governor

Mark Carney
Governor

I would like to begin my first *Annual Report* as Governor by paying tribute to my predecessor, Lord King, for his enormous contributions to the Bank of England, to economic thought and to global policy formation.

It was an extraordinary pleasure to work with him as part of the community of central bankers and it has been an extraordinary honour to succeed him.

With this privilege comes responsibility: the responsibility to build on the outstanding work that the Bank has performed under extremely difficult circumstances and to make the new enlarged Bank of England fulfill its potential.

In April 2013, the Bank took on enormous new powers and responsibilities, including the responsibility for prudential regulation of banks and insurers and the design and operation of macroprudential policy. Our task has been to create a single, unified institution – One Bank – that fully exploits the synergies from co-ordinating across our policy functions.

To achieve that, we have launched an ambitious three-year Strategic Plan under the joint leadership of myself and Charlotte Hogg, the Bank's first Chief Operating Officer. The first steps to implement the plan have now been taken with a restructuring of the Bank's management. Our divisional and management structure has been rationalised. Senior officials are being moved across functions to encourage the building of synergies and barriers have been broken down.

A unified approach – in which we use all of our policy tools in concert – is especially important at a time when the UK faces great challenges that cut across our policy areas. The clearest of those challenges has been to turn the nascent recovery into strong, sustainable, balanced growth. All of our policy functions have contributed.

The forward guidance introduced by the Monetary Policy Committee is working. Expected interest rates have remained low even as the economy has recovered strongly. Most importantly, UK businesses have understood the message, and in many cases guidance is encouraging businesses to hire and spend. UK output is now growing at the fastest rate in the advanced economies, jobs are being created at the quickest pace since records began, and after four years above target the inflation rate has fallen to 1.8%.

We are fully aware that the environment of low and predictable interest rates necessary to nurture the recovery could encourage excessive risk taking in financial markets and by households. In November, the Bank's Financial Policy Committee announced initiatives to reduce the stimulus being provided by the authorities to the housing market. We will not hesitate to take further proportionate and graduated action as warranted. That will allow monetary policy to remain focused on providing the stimulus the economy needs for as long as it is needed to secure a strong, sustained recovery.

The Prudential Regulation Authority and the Financial Policy Committee have worked closely together to bring clarity both to banks' existing capital positions and the standards expected of them. The resulting increase in capital ensured the core of the financial system was on a sound footing and made an important contribution to securing economic recovery. We are now building on that success with the first of the Bank's annual stress-testing exercises, bringing together the microprudential assessment of banks with a macro perspective of the risks to which they must be resilient.

In an era of renewed globalisation, securing monetary and financial stability requires more than a purely domestic focus. Policymakers must re-build an open, integrated and resilient global financial system. As the leading global financial centre, the UK will be central to this task.

The Bank's actions will help shape the functioning of core markets and we have introduced a new framework building on the lessons learned throughout the financial crisis and drawing on the recommendations made by Bill Winters in his review of our system. Changes must also be made to the hard and soft infrastructure of core markets to ensure they are fair, effective and efficient. These are massive issues which require focus, discipline and innovation, and I am thrilled that Minouche Shafik has accepted the new and important role of Deputy Governor for Markets and Banking.

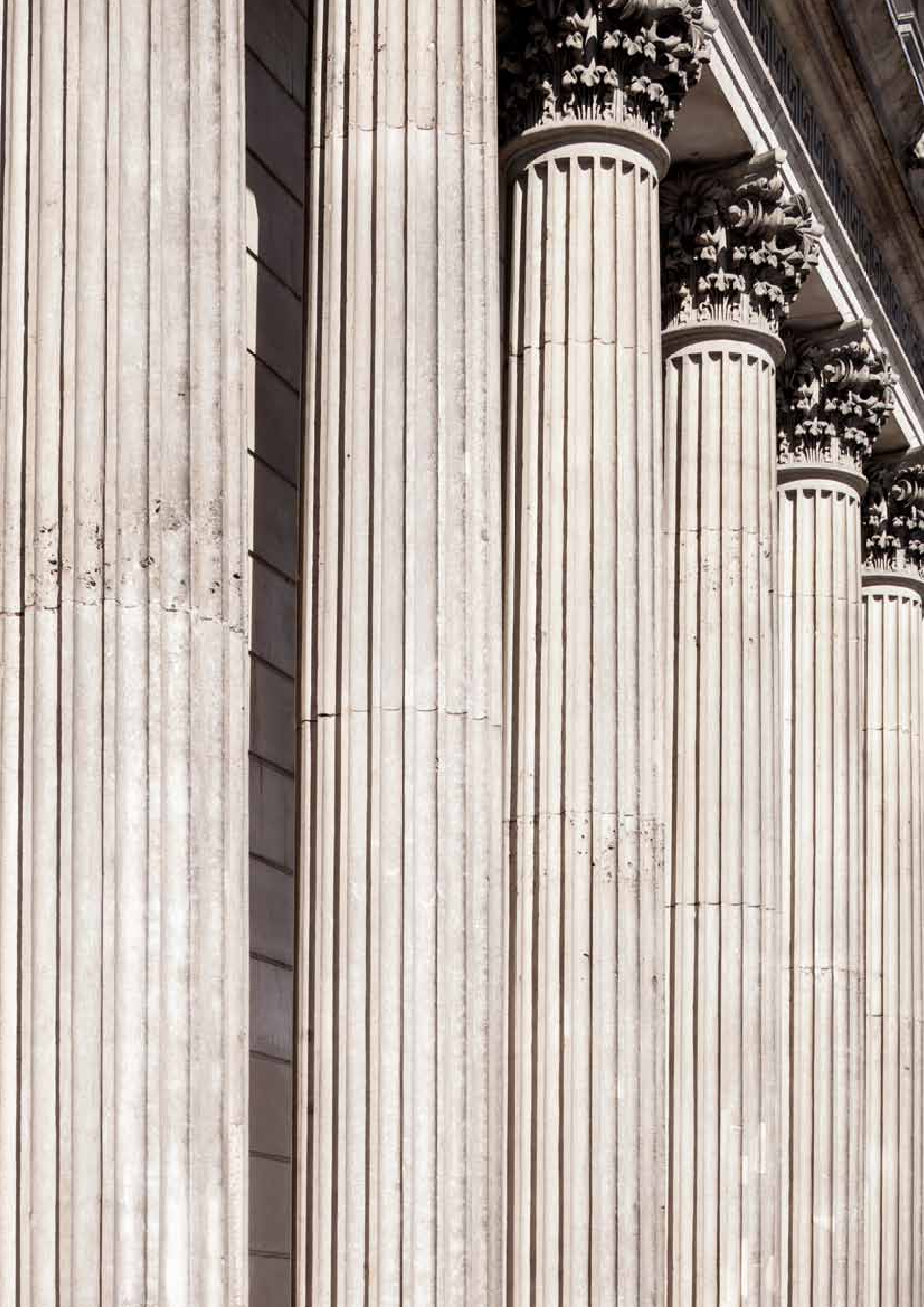
Through its intellectual leadership and international relationships, the Bank can help complete the G20's ambitious programme of financial reform. We are privileged that Sir Jon Cunliffe, one of the original architects of the Financial Stability Board, is leading not just the Bank's domestic financial stability work, but also our engagement with this important international agenda. He will build on the immense contribution made by Sir Paul Tucker to critical reforms in the UK and at the global level during an exceptional career of public service.

I would also like to take this opportunity to record my immense thanks to Charlie Bean and Sir David Lees, who will retire in June. I have benefited greatly from their wise counsel and support during the early stage of my Governorship. I look forward to working with Ben Broadbent as he succeeds Charlie as Deputy Governor for Monetary Policy and with Anthony Habgood as he succeeds Sir David as Chairman of the Court of the Bank of England.

Since arriving at the Bank in July, I have been hugely impressed by the dedication, expertise and talent of those who work across the organisation. I am very grateful to them for their support and hard work. Much has been accomplished in the past year, but the coming years will be crucial in delivering a strong, sustainable, balanced recovery; in reforming the domestic and international financial systems to ensure financial stability; and in transforming the Bank of England itself. I am confident that in the period ahead we can meet these challenges.

By doing so, we will be pursing the goal first given to the Bank of England in its founding charter in 1694 but still relevant today: to promote the good of the people of the United Kingdom.

4 June 2014



Court, and the Bank's policy committees

The Bank's framework for governance and accountability is set by the Bank of England Act 1998. The Court of Directors acts as a unitary board with executive and non-executive members and an independent non-executive chairman: it sets the Bank's strategy and budget and takes key decisions on resourcing and appointments.

The members of Court also meet separately, as the Oversight Committee, to keep the Bank's performance and financial management under review. The major policy committees, all of which are chaired by the Governor and have external members, are the Monetary Policy Committee (MPC), the Financial Policy Committee (FPC), and the Board of the Prudential Regulation Authority (PRA).

The Court of Directors

The Court of Directors is responsible for managing the affairs of the Bank, other than the formulation of monetary policy. Court's statutory responsibilities include determining the Bank's objectives and strategy, including its Financial Stability Strategy, and ensuring the effective discharge of the Bank's functions and the most efficient use of its resources.

Members of Court are appointed by the Crown, for periods of eight years in the case of the Governor, five years for the Deputy Governors, and up to four years for the Non-executive Directors. One of the latter is designated by the Chancellor of the Exchequer to chair Court.

Court delegates the day-to-day management of the Bank to the Governor and through him to other members of the executive. But it reserves to itself a number of key decisions, including:

- The Bank's strategy and objectives;
- The Bank's and the PRA's expenditure budget;
- Major capital projects;
- The Bank's financial framework;
- The Bank's risk management policies;
- Approval of the accounts and the appointment of auditors;
- The remit for managing the Bank's balance sheet;
- Senior appointments within the Bank;
- Major changes in staff remuneration and pension arrangements;
- The Bank's succession plan; and
- The establishment of sub-committees of Court, their terms of reference and membership.

These 'matters reserved to Court' are reviewed annually and are published on the Bank's website.[1] Court minutes since April 2013 have also been published.[2]

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 first 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.

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Court meetings

Court met eight times during the year. Attendance at Court and Committee meetings is given on page 66

1,2 www.bankofengland.co.uk/boe-ar2014/links

The Court of Directors
as at 28 February 2014

Non-executive Directors

Sir David Lees
Chairman of Court

Appointed
1 June 2009
Term expires on
31 May 2015[3]

- Member of the Panel on Takeovers and Mergers
- Director, Royal Opera House Enterprises Limited
- Trustee, Royal Opera House Endowment Fund
- Governor, Shrewsbury International School in Bangkok

Sir Roger Carr
Deputy Chairman of Court and Senior Independent Non-executive Director

Appointed
1 June 2007
Term expires on
31 May 2014

- Chairman, BAE Systems plc
- Senior Adviser, KKR
- Fellow of the Royal Society for the Encouragement of the Arts
- Companion of Institute of Management
- Visiting Fellow of the Saïd Business School
- Honorary Fellow of the Institute of Chartered Secretaries and Administrators

Lady (Susan) Rice CBE

Appointed
1 June 2007
Term expires on
31 May 2014

- Managing Director, Lloyds Banking Group Scotland
- Non-executive Director, J Sainsbury plc
- Non-executive Director, Scottish and Southern Energy plc
- Non-executive Director, Big Society Capital
- Chairman, Edinburgh International Book Festival
- Regent, Royal College of Surgeons, Edinburgh
- Fellow, Royal Society of Edinburgh
- President, Scottish Council for Development and Industry

John Stewart

Appointed
1 December 2009
Term expires on
30 November 2015

- Chairman, Legal and General Group plc
- Chairman, The Guide Dogs for the Blind Association
- Chairman, Southern Cross Stud
- Non-executive Director, Board of the Financial Reporting Council (wef 5 March 2014)

Michael Cohrs

Appointed
21 June 2011
Term expires on
31 May 2015

- Advisor, EQT
- Advisory Board, British Airways
- Fellow, Cambridge University
- Non-executive Director, SurfCast Inc

Bradley Fried

Appointed
1 June 2012
Term expires on
31 May 2015

- Managing Partner, Grovepoint Capital LLP
- Non-executive Director, Investec plc and Investec Limited
- CEO in Residence at Cambridge University's Judge Business School
- Fellow of Magdalene College, Cambridge

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3 Sir David Lees will retire from Court on 30 June 2014.

Tim Frost

Appointed
1 June 2012
Term expires on
31 May 2014

- Non-executive Director, Cairn Capital
- Member of Court and Council, London School of Economics
- Non-executive Director, LSE Enterprise
- Non-executive Director, Markit

Dave Prentis

Appointed
1 June 2012
Term expires on
31 May 2015

- General Secretary of UNISON
- Member of the Trades Union Congress Executive Council
- Member of the Labour Party Joint Policy Committee
- Vice-President of the European Public Services Union
- President of Public Services International
- Commissioner of UK Commission for Employment and Skills
- President of Unity Trust Bank

Governor/Deputy Governors

Mark Carney
Governor

Charlie Bean
Deputy Governor, Monetary Policy

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Andrew Bailey
Deputy Governor, Prudential Regulation and CEO of the PRA

→ **Find out more online**
www.bankofengland.co.uk

Policy committees

Monetary Policy Committee (MPC)

Members as at 28 February 2014
Top row, left to right

Mark Carney
Governor

Charlie Bean
Deputy Governor, Monetary Policy*

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Spencer Dale
Executive Director, Monetary Analysis and Statistics*

Paul Fisher
Executive Director, Markets*

Bottom row, left to right

Ben Broadbent
External member*
Term: 1 June 2011 – 30 June 2014

Ian McCafferty
External member
Term: 1 September 2012 – 31 August 2015

David Miles
External member
Term: 1 June 2009 – 31 May 2015

Martin Weale
External member
Term: 1 August 2010 – 31 July 2016

The Bank of England Act 1998 establishes the MPC as a committee of the Bank and sets a framework for its operations. The Bank's monetary policy objectives under the Act 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 its price stability target and its growth and employment objectives. The MPC is responsible for achieving those objectives. In March 2013, the Chancellor of the Exchequer re-confirmed the inflation target – '2 per cent as measured by the 12-month increase in the Consumer Prices Index'. The economic policy objective of the Government was 'to achieve strong, sustainable and balanced growth shared more evenly across the country and between industries'.

The MPC consists of nine members. Five are Bank of England staff and four are external members appointed by the Chancellor. The Committee meets at least once a month to set policy. The MPC's decisions are announced after each meeting and the minutes are published two weeks later. The Bank's quarterly *Inflation Report* includes the MPC's projections for inflation and output.

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* Responsibilities from 1 June 2014 are shown on pages 18–19.

Financial Policy Committee (FPC)

Members as at 28 February 2014
Top row, left to right

Mark Carney
Governor

Andrew Bailey
Deputy Governor, Prudential Regulation and CEO of the PRA

Charlie Bean
Deputy Governor, Monetary Policy*

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Andy Haldane
Executive Director, Financial Stability*

Bottom row, left to right

Dame Clara Furse
External member
Term: 1 April 2013 – 31 March 2016

Donald Kohn
External member
Term: 1 April 2013 – 31 March 2015

Richard Sharp
External member
Term: 1 April 2013 – 31 March 2016

Martin Taylor
External member
Term: 1 April 2013 – 31 March 2015

Martin Wheatley
Chief Executive, Financial Conduct Authority (*ex officio*)

The Bank has an overarching statutory Financial Stability Objective to 'protect and enhance the stability of the financial system of the United Kingdom'. The FPC contributes to the achievement of this objective by:

– identifying, monitoring and taking action to reduce risks to the financial system; and, subject to that,
– supporting the Government's economic policies, including its objectives for growth and employment.

The FPC also advises Court on the Bank's Financial Stability Strategy.

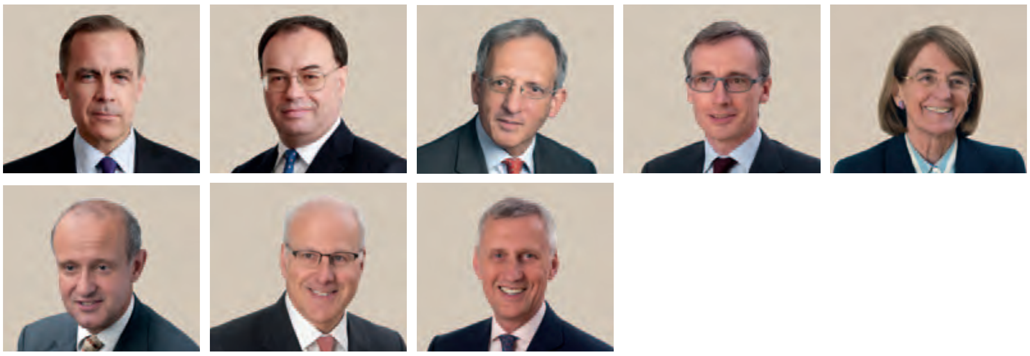
At least once a year, the Government must make recommendations about the FPC's responsibilities for financial stability and also about its growth and employment objectives. The FPC must respond formally to these, and provide reasons if it proposes not to follow the recommendations. In April 2013, the Chancellor of the Exchequer provided recommendations covering the interaction of the FPC's objectives, monetary and macroprudential policy, the use of public funds, the location of the regulatory perimeter and accountability.

The FPC is a statutory sub-committee of Court. It consists of ten members, plus a non-voting member from HM Treasury. Five are Bank of England staff and five are external members – the Chief Executive of the Financial Conduct Authority and four members appointed by the Chancellor. The Committee meets at least quarterly. It may give Directions to the PRA and the Financial Conduct Authority in relation to macroprudential measures prescribed by secondary legislation under the Bank of England Act 1998. The FPC also has powers to make Recommendations to any other body. It publishes a record of its formal policy meetings and is responsible for producing the twice-yearly *Financial Stability Report*.

* Responsibilities from 1 June 2014 are shown on pages 18–19.

→ **Find out more online**
www.bankofengland.co.uk

Board of the Prudential Regulation Authority (PRA)



Members as at 28 February 2014
Top row, left to right

Mark Carney
Governor

Andrew Bailey
Deputy Governor, Prudential Regulation and CEO of the PRA

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Iain Cornish
Independent member
Term: 20 February 2013 – 19 February 2016

Rosalind Gilmore
Independent member
Term: 20 February 2013 – 19 February 2015

Bottom row, left to right

Nick Prettejohn
Independent member
Resigned wef 5 March 2014

Charles Randell
Independent member
Term: 20 February 2013 – 19 February 2017

Martin Wheatley
Chief Executive, Financial Conduct Authority (*ex officio*)

The PRA is a subsidiary of the Bank. In April 2013, it became the UK's prudential regulator for banks, building societies and credit unions (collectively known as deposit-takers), insurers and major investment firms.

The PRA's objectives are set out in statute, principally the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012, and include:

- a general objective to promote the safety and soundness of the firms it regulates; and
- an objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for those who are, or may become, insurance policyholders.

In addition to its primary statutory objectives, the final report of the Parliamentary Commission on Banking Standards recommended a secondary competition objective for the PRA, which was accepted by the Government in July 2013. The new objective was introduced in the Financial Services (Banking Reform) Act 2013, and requires that 'the PRA must so far as is reasonably possible act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities'. The competition objective came into force on 1 March 2014.

The PRA's most significant supervisory decisions are taken by its Board, which the Governor chairs. A majority of the Board must be independent of the Bank. The PRA's strategy is set by the Board, consulting Court, and it publishes a separate *Annual Report*.

The PRA Board consists of the Governor, the Deputy Governor for Financial Stability, the Deputy Governor for Prudential Regulation and the Chief Executive of the Financial Conduct Authority. Further members are appointed by Court with HM Treasury's approval. A majority of the Board (including the Chief Executive of the Financial Conduct Authority) must be independent of the Bank. The Board meets twice a month.

A primary objective of the PRA is to promote the safety and soundness of the firms it regulates

The Bank's Strategic Plan

Following a six-month exercise led by the Governors and the Executive Directors, Court approved the Bank's new Strategic Plan in March 2014.

The Plan, to be implemented over the next three years, provides an ambitious agenda to transform the organisation to fulfil its broader mission. It will create a single, unified institution – 'One Bank' – working together across all the functions and across the complex structure of objectives and committees described in the preceding pages.

At the core of the Plan lies a shared vision for the Bank; while it has many and varied responsibilities there is a single, timeless mission of 'promoting the Good of the People of the United Kingdom by maintaining Monetary and Financial Stability'. The language draws on the original 1694 Charter and emphasises the Bank's longstanding commitment to public service.

Monetary and financial stability both ultimately underpin the public's trust and confidence in their money, and their ability to access it. Placing responsibility for microprudential supervision, macroprudential policy and monetary policy within the same organisation recognises this connection. It means that the Bank is better placed to deliver key economic benefits: stable inflation, economic growth, sound financial institutions and the continuous provision of key financial services.

To reap maximum benefit for the UK from these changes, the Bank needs to fully integrate the skills and resources it possesses across this expanded institution and operate as 'One Bank'. That requires a strong common culture, built from the best of all parts of the Bank, and bringing together the whole of the organisation to better support each policymaker and every policy decision.

The strategy rests on four pillars:

Diverse and talented

A Bank that attracts and inspires the best people to public service, and reflects the diversity of the UK. This means valuing diverse ideas and open debate, while developing and empowering people at all levels to take the initiative and make things happen.

Analytical excellence

A Bank that builds on a long history of intellectual leadership to be at the forefront of research and analysis. This means making creative use of the best analytical tools and data sources to tackle the most challenging and relevant issues.

Outstanding execution

A Bank that works both domestically and internationally to shape an open, resilient global system. To achieve that, co-ordinated, effective and inclusive policy decisions are needed, delivered with reliable, expert execution.

Open and accountable

A Bank that builds on the successes of the past quarter century in combining clear objectives, good governance and constructive transparency. The new legal framework governing the Bank confers greater statutory powers and duties on the institution than at any time in its history. Ultimately, these powers can only be effective if the Bank earns and retains the democratic legitimacy to perform the functions given to it. For the delivery of statutory objectives, the Bank is accountable to the public, through Parliament's Treasury Committee. Parliament has also created the Oversight Committee, described on page 60, to review the Bank's overall financial management and performance.

'One Bank' – maximising our impact by working together

Strategic initiatives

The Plan identifies 15 strategic initiatives to transform the institution, in a programme stretching over the next three years.

The 15 core initiatives

One Mission, One Bank

1. Open, transparent and agile culture
To make a success of 'One Bank', we will break down cultural barriers with new ways of working and commitment to a common set of behaviours and values.

2. Forefront of joint policy decision-making
We will promote connectivity across the MPC, the FPC and PRA Board, through sharing of information and analyses, and more frequent joint meetings in areas of complementarity, such as housing, while respecting external committees' statutory responsibilities.

Diverse and talented

3. A unified pay system
To create a reward scheme that will attract and retain talent while eliminating barriers to internal mobility. We will work to harmonise terms and conditions across the Bank, subject to due process of consultation.

4. Rewarding excellence and teamwork
We will adopt a new performance management approach that will better enable the differentiation of performance and develop talent.

5. Compelling talent strategy
The Bank's talent strategy will seek to attract and inspire the best people to public service. We will continue to improve the diversity of backgrounds and experiences of our people.

Analytic excellence

6. 'One Bank' research agenda
We will set an ambitious Bank-wide agenda for research and analysis at the intersection of monetary, macro and micro policy.

We will open up the Bank's research agenda to external contributions by publishing our key research questions and opening up data sets to the public.

7. New approach to data and analysis
We will create a 'virtual' research community across the Bank to support the Bank's policy priorities. We will partner with outside academic and corporate entities to develop our techniques. We will build advanced analytics capabilities, partnering PhD mathematicians and statisticians with analytic staff across all policy areas.

8. 'One Bank' data architecture
We will revamp our data architecture and governance, ensure data acquisition and integration are as efficient as possible and enable Bank-wide information-sharing. We will seek to use external data sources to enhance our internal data sets.

Outstanding execution

9. One credible voice in international policy
In an era of renewed globalisation, securing monetary and financial stability requires more than a purely domestic focus. To realise globalisation's promise and deliver strong, sustainable and balanced growth, policymakers must rebuild an open, integrated and resilient financial system. As the leading global financial centre, the UK will be central to this task. Our actions will help shape the functioning of core markets, including, given the serious issues raised by the Libor and foreign exchange scandals, ensuring that markets are fair, effective and efficient. Equally, the Bank can help to complete the G20's ambitious programme of financial reform, including building resilient financial institutions, ending 'too big to fail', making derivative markets safer and transforming shadow banking to market-based finance.

10. Delivering supervision as 'One Bank'
We will fully embed the new judgement-based, forward-looking supervisory model.

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Strategic initiatives to transform the Bank over the next three years

Other key changes include the creation of a new Director Notes and Chief Cashier, reporting to the Deputy Governor Monetary Policy, and a new Director for Supervision of Financial Market Infrastructures, reporting to the Deputy Governor Financial Stability.

The new organisation is set out on pages 18–19.

Balanced delivery

Early on in the Plan, we will seek to build the capabilities that will ensure subsequent delivery of more complex, high-investment initiatives. There will be several phases for the Strategy:

I. immediate focus on 'One Bank' changes in culture, organisation and governance and an increase in our investment in research and analytical capabilities;
II. changes in talent management, to drive forward the delivery of the Strategy, and in transparency, to enable our stakeholders to monitor our progress; and
III. longer-term investment in the transformation of our data architecture and cyber security.

Committed leadership

The Bank's senior leaders are committed to implementing the Strategy. One or sometimes two Executive Directors are accountable for delivering each of the 15 initiatives in the Strategic Plan. For each initiative, a senior manager with relevant expertise – in most cases, a Director or Head of Division – will be responsible for day-to-day execution. A central Programme Management Office will actively support implementation from both a process and a content perspective.

Responsible governance

The Executive Directors Committee is responsible for implementing the Strategy and its associated initiatives. The Executive Directors Committee is accountable to Governors, the PRA Board (where applicable) and ultimately to Court. The Project Management Office, under leadership of the Chief Operating Officer, will report monthly to the Executive Directors Committee and the Governors on progress.

The Bank will report to Court on a regular basis and to the PRA Board as needed.

Careful economic stewardship

The Bank is committed to delivering substantial changes and benefits within its existing budgetary envelope. To ensure we do so, the Bank will adopt a new approach to investment project governance to ensure more efficient and effective outcomes.

Close performance measurement

Demonstrating successful delivery of the Strategy will require clear and measurable performance criteria. We will use these to assess the extent to which we have delivered real change during the lifetime of the Strategic Plan. Performance measurement will also help the scoping of any further review that may be required after the end of three years.

The set of measures the Bank will use to evaluate the delivery and benefits of the Strategy is likely to include a combination of:

1. specific, quantitative metrics of monetary stability (such as, for example, measures of inflation expectations and trends in the proportion of counterfeit notes in circulation), financial stability (such as, for example, measures of the resilience of systemically important financial institutions and measures of the continuity of provision by the Bank of real-time gross settlement services), and the Bank's progress towards meeting the targeted composition of its workforce (including, for example, in meeting its diversity objectives);
2. surveys of the general public (such as, for instance, survey-based measures of public confidence in monetary stability and financial stability); and
3. reviews of aspects of the Bank's performance by the independent evaluation unit under the guidance of Court and the Oversight Committee.

The Bank is committed to delivering substantial changes and benefits within its existing budgetary envelope

11. Execution in core markets
We will complete key initiatives already under way such as the polymer note introduction, as well as establishing a new Deputy Governorship to address the future shape and use of the balance sheet, and review the operations of the Markets area in light of the external review being conducted into the foreign exchange markets by the Oversight Committee (page 65).

12. A safer Bank
We will evolve risk governance and oversight in line with central bank best practice, with particular emphasis on operational risk and the maintenance of resilient cyber security.

Open and accountable

13. Enhanced central bank transparency
Greater transparency will help to make our policies more effective. We will establish a Stakeholder Relations Group to ensure external economists and analysts have equal and timely access to information behind MPC, FPC and PRA decisions, in order to improve insight into the Bank's current views and decisions. We will review the case for releasing transcripts of our policy meetings after some years, and report publicly to the Oversight and Treasury Committees on the outcome of that review. We will also publish the results of regular bank stress tests, and as with monetary policy, we intend to publish more of the research and analysis underlying our policy choices.

14. Accountable
We have to be accountable for our actions and their consequences. An independent evaluation unit is being established to support the Oversight Committee in reviewing all aspects of the conduct of the Executive of the Bank, including the delivery of policy, and progress against the strategic initiatives.

15. Engaged and approachable
We will deliver a strategy for building public understanding and a constituency for maintaining monetary and financial stability.

Implementation

New organisational structure

To support the delivery of the Strategic Plan, Court approved a number of changes to the organisational structure of the Bank, to take effect on 1 June 2014.

The changes included the creation of a new Deputy Governor for Markets and Banking, reporting directly to the Governor. The new Deputy Governor is to be a member of the MPC and the PRA Board, and subject to change in the legislation, will also hold a seat on the FPC. The Deputy Governor will help lead the Bank's efforts to reshape core markets and the Bank's relationship to them.

The role of the Bank's Chief Economist has been expanded to build the desired research, analysis and data capability, and a new Financial Stability Strategy and Risk Directorate, will lead on co-ordination of the annual stress-testing exercise (see page 26). The appointment of an Executive Director for Supervisory Risk Specialists and Regulatory Operations, and Deputy Head of the PRA, creates an enhanced senior leadership team for the PRA, and will support microprudential supervision, stress testing and extend co-ordination between the FPC and PRA around liquidity requirements and banks' reliance on liquidity insurance.

The creation of a new Prudential Policy Directorate brings together relevant PRA and Financial Stability policy divisions, while a new International Directorate takes responsibility for the Bank's surveillance and analysis of the international environment and for co-ordinating interactions with international bodies.

PRA line supervision has been reinforced by an Executive Director for International Banks Supervision, who leads supervision of branches and subsidiaries of overseas banks, and a new Executive Director for UK Deposit-takers Supervision.

To support the delivery of the Strategic Plan, Court approved a number of changes to the organisational structure

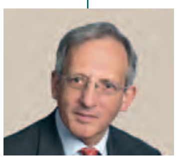
Organisational structure
as at 1 June 2014

The organisation chart shows how responsibility for individual functions is delegated within the Bank as from 1 June 2014. Membership of the MPC, FPC and PRA Board are also indicated.

Mark Carney
Governor
(MPC, FPC, PRA Board)

Ben Broadbent[4]
Deputy Governor, Monetary Policy (MPC, FPC)

Nemat Shafik[5]
Deputy Governor, Markets and Banking (MPC, FPC, PRA Board)



Sir Jon Cunliffe
Deputy Governor, Financial Stability (MPC, FPC, PRA Board)

Andy Haldane
Monetary Analysis and Chief Economist (MPC)

Chris Salmon
Markets

Andrew Gracie
Resolution

Spencer Dale
Financial Stability Strategy and Risk (FPC)

David Rule
Prudential Policy

Paul Fisher
Supervisory Risk Specialists and Regulatory Operations (PRA Board)

—

4 Charlie Bean remains in post until 30 June 2014.

5 Nemat Shafik takes up her position on 1 August 2014. She will join the MPC and PRA Board from that date, and the FPC once the role is placed on a statutory basis.

Anthony Habgood[6]
Chairman of Court

Graham Nicholson
Legal

John Footman
Secretary of the Bank

Nils Blythe
Communications

Jenny Scott
Adviser to the Governor

Audit and Risk Committee

Andrew Bailey
Deputy Governor, Prudential Regulation and CEO of the PRA (FPC, PRA Board)

Charlotte Hogg
Chief Operating Officer

Julian Adams
Insurance Supervision

Megan Butler
International Banks Supervision

Lyndon Nelson
UK Deposit-takers Supervision

Joanna Place
Human Resources

Ralph Coates
Finance

John Finch
Chief Information Officer

Stephen Brown
Internal Audit

6 Sir David Lees remains in post until 30 June 2014.

→ **Find out more online**
www.bankofengland.co.uk

The MPC, FPC and PRA Board have worked together to implement a range of policies to help reinforce the recovery during the year

Review of 2013/14

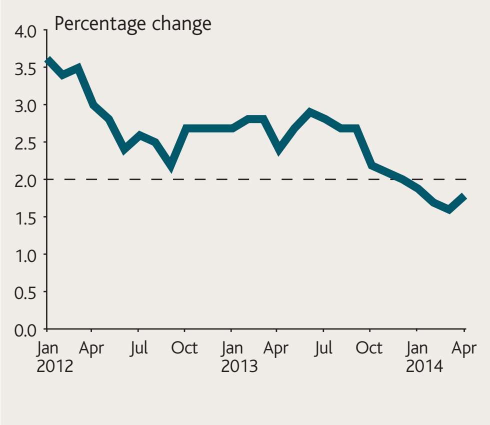
During the year, the 2012 Financial Services Act came into force, creating the Financial Policy Committee and transferring responsibility for the prudential supervision of banks, building societies, insurance companies and some investment institutions from the Financial Services Authority to the Bank.

These changes came at a time of continuing close focus on the international regulatory reform agenda, on banking reform legislation at home, new standards for capital and liquidity, and public expectations about policy settings as the economy started to recover.

Reinforcing the UK economic recovery

The MPC, FPC and PRA Board have worked together to implement a range of policies to help reinforce the recovery during the year. UK economic growth picked up and inflation has fallen back since the Summer of 2013 and is now close to the Government's 2% target (Chart 1). And confidence in the UK financial system rose (Chart 2). But there remain risks stemming from a weak and uneven global recovery, and imbalances in the euro area.

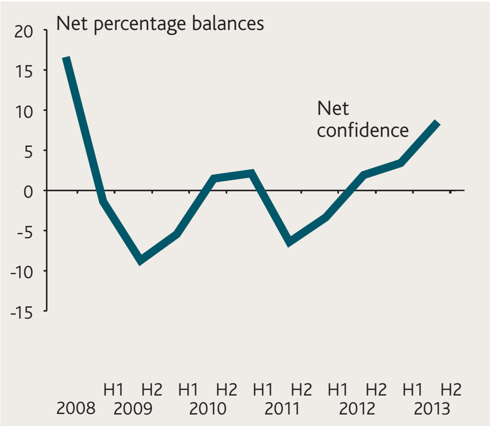
1: Annual rate of inflation



Source: Office for National Statistics

12-month change in the consumer prices index.

2: Confidence in the stability of the UK financial system as a whole over the next three years



Sources: Bank of England Systemic Risk Surveys and Bank calculations

Respondents were asked how much confidence they had in the stability of the UK financial system as a whole over the next three years. The net percentage balance is calculated by weighting responses as follows: complete confidence (1), very confident (0.5), fairly confident (0), not very confident (-0.5) and no confidence (-1).

Inflation has fallen back since the Summer of 2013

Forward guidance

Since its inception in 1997, the MPC has sought to explain how it seeks to achieve its objectives. During the year, the Committee enhanced its communications in order to promote transparency and public understanding of its policy decisions (see box on page 23).

At its meeting on 1 August 2013, the MPC provided additional, explicit guidance about the future path of monetary policy. This met a request by the Chancellor of the Exchequer to provide more information about the trade-offs inherent in setting monetary policy to meet a forward-looking inflation target while avoiding undue output volatility.

The guidance was designed to help people better understand the conditions under which the extraordinary level of monetary stimulus would be maintained. Subject to three 'knockouts', two of which were related to the risks to price stability and one to the risks to financial stability, the MPC indicated that it would not consider tightening policy at least until the unemployment rate had reached 7%. The FPC was given the responsibility to assess the risk to financial stability.

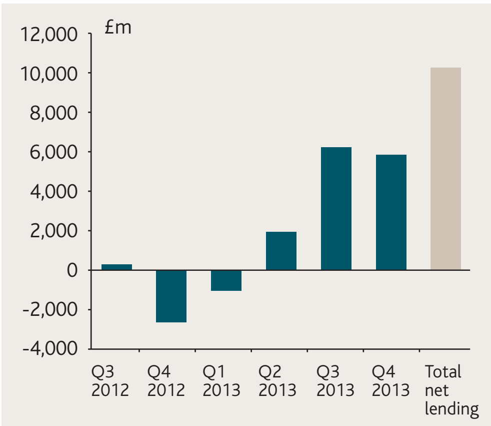
Survey evidence suggests this guidance has been effective in influencing the expectations of households and businesses as to the future path of interest rates. The MPC provided further guidance in February 2014, when new data showed unemployment had fallen quicker than initially expected. This guidance, which was to take effect from the time that unemployment reached the 7% threshold, was that the MPC expects interest rates to rise only gradually, and to remain low for an extended period of time, given the headwinds continuing to face the economy. In February, the MPC judged that there remained scope to absorb further spare capacity before raising Bank Rate.

Funding for Lending

The Funding for Lending Scheme – designed to encourage banks and building societies to boost lending to UK households and businesses – was extended by one year in April 2013 to allow participants to borrow until January 2015. The Scheme's incentives were also skewed towards lending to small and medium-sized businesses. The extension to the Scheme was further focused on business lending in November 2013, when direct incentives to expand household lending were removed. This reflected greater momentum in the UK housing market, which suggested that there was no longer a need for the Funding for Lending Scheme to provide broad support to household lending. Potential risks arising from growth in the UK housing market have been a key area of cross-committee analysis (see box on page 24).

The Funding for Lending Scheme seems to have been successful in meeting its initial objective. It contributed to a substantial fall in bank funding costs and this has fed through to significant improvements in household and corporate credit conditions, boosting net lending (Chart 3).

3: Funding for Lending Scheme net lending data



Source: Bank of England

The FLS measure of lending covers drawn sterling loans to households and private non-financial corporations (PNFCs) by the FLS Group, which includes all UK resident monetary financial institutions and related specialist mortgage lenders within a group.

Providing greater transparency about the MPC's forecasts

Transparent and clear communication is essential for the effectiveness of monetary policy and for the accountability of the MPC. The *Inflation Report* has played a central role in the Bank of England's communications on monetary policy for more than 20 years. Following the Stockton Review in 2012, the Bank has introduced a number of substantial innovations in the *Inflation Report* to provide greater transparency about the MPC's forecasts.

The aim of the innovations has been to provide more information about the MPC's key judgements. In February 2013, the *Inflation Report* contained a description of the main judgements underlying the MPC's forecasts and in the May 2013 *Report*, an indicator table was introduced to help people monitor whether the economy was evolving in line with the MPC's judgements.

In November 2013, the MPC published an evaluation of its forecasts from August 2010 explaining, in more detail than previously, why growth had been weaker and inflation stronger than had been expected. In February 2014, the MPC published projections for ten additional variables. The Committee also set out some scenario analysis to illustrate the sensitivity of its projections for growth and inflation to different assumptions about productivity.

By end-February 2014, 47 institutions had signed up for the Funding for Lending Scheme and there were £41.4bn of outstanding drawdowns. In support of transparency, detailed drawdown and lending data were provided on a bank-by-bank basis. This was supplemented, in early 2014, with the release of disaggregated sectoral lending data for extension participants.

Open for business

In October 2013, the Bank announced a number of significant changes to its approach to providing liquidity insurance to the banking system as part of the Sterling Monetary Framework. The changes announced reflected the recommendations of the Winters Review, together with the Bank's own assessment of the changing regulatory and financial market landscape. In summary, the changes increased the availability and flexibility of liquidity insurance, by providing liquidity at longer maturities, against a wider range of collateral, at a lower cost and with greater predictability of access. The Governor described the Bank's revised Framework as: 'We are open for business'. The total amount of collateral positioned or pre-positioned with the Bank stood at £449bn at end-February 2014. That compared with £378bn a year earlier.

Significant changes to the Bank's Sterling Monetary Framework ensure 'We are open for business'

Cross committee co-ordination

The three policy committees – the MPC, FPC and PRA Board – work closely to achieve their objectives. Overlapping membership and joint chairmanship by the Governor help to support that, aided by staff from all areas of the Bank working together.

All members of the MPC, FPC and PRA Board have access to shared information and can attend each other's staff briefings. Members also receive direct briefing on the impact of the other's policies on their objectives. For example, analysis has been presented to the MPC on the impact of FPC actions relating to bank capital and liquidity policy on credit conditions, growth and inflation. And the FPC has received briefing on how the low interest rate environment may be affecting financial stability risks.

As an example of collaborative work, the MPC and FPC met jointly in November 2013 to discuss developments in mortgage and housing market conditions. The committees considered the implications for economic activity and risks to the financial system that may arise as a result and agreed that macroprudential and microprudential tools would be the first line of defence against any build-up of those risks. Subsequently, the committees' individual assessments were set out in the MPC's *Inflation Report* and in the FPC's *Financial Stability Report*.[7]

Research and analysis

The Bank is determined to enhance its research capabilities by expanding its pool of researchers and creating a 'One Bank' research strategy. As part of the Strategic Plan, the brief of the Chief Economist has been extended to direct the research programme across the entire Bank. Work has already begun on the impact of the Funding for Lending Scheme and quantitative easing. Work has also been done to assess the possible implications for financial stability of changing interest rates and bank forbearance. And progress has been made towards understanding the UK productivity puzzle (see box on page 25).

The Bank is determined to enhance its research capabilities by expanding its pool of researchers and creating a 'One Bank' research strategy

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7 www.bankofengland.co.uk/boe-ar2014/links

Productivity puzzle

Labour productivity – the amount of output that can be produced per unit of labour input – is a key determinant of the economy's supply capacity. And it is the balance between supply and demand in the economy that determines inflationary pressure.

At the start of the recession, labour productivity in the UK fell sharply and has remained weak since. Indeed, in 2013 Q3, it was some 16% below the level that would have prevailed had it continued to grow in line with its pre-crisis trend. Because the explanations for this phenomenon are difficult to identify, it has become known as the UK productivity puzzle. The puzzle has been at the forefront of the discussions of the MPC because reaching a better understanding of the reasons for the UK's productivity performance should help shed light on how inflation will evolve in the future.

Over the past year, Bank economists from across the Monetary and Financial Stability areas and the PRA have collaborated to research a range of possible explanations, analysed varied data sources, including new firm-level data sets with the co-operation of the Office for National Statistics, and engaged with industry practitioners, the academic community and business contacts of the Bank's Agents.

The key insights gained from the work have helped identify and quantify a range of influences on UK productivity: the role of credit provision; innovation, research and development; the desire to retain skilled workers across different firms and sectors; and workers' willingness to accept lower real wages in order to stay in jobs. Those insights have informed the work of the MPC, FPC and the PRA.

Supporting international regulatory reform

The UK is home to one of the world's largest financial centres, and the Bank has played a role in shaping the evolving landscape of international financial regulation since the financial crisis. The Bank has actively contributed in a range of important policy areas over the past year, including: formulating international rules on liquidity; defining leverage ratios; establishing standards for measuring and controlling large exposures; revising bank trading book capital requirements; and generally simplifying and making more consistent the overall regulatory framework.

A key medium-term priority for the FPC has been to set standards around the capital framework for banks, consistent with the implementation of Basel III and CRD IV. The Committee agreed that it should ensure that prospective changes to regulatory capital requirements for UK banks are appropriately calibrated and phased in, such that they deliver a stable, prudent and coherent package, which takes account of the broader impact on the financial system. This has included reviewing appropriate definitions for capital, alongside ensuring bank assets are valued in a sufficiently prudent fashion. Work has also progressed with industry to ensure that insurance companies are prepared for significant regulatory change resulting from the introduction of Solvency II in January 2016.

At the individual-firm level, the Bank has helped to lead Financial Stability Board work on ending 'too big to fail'. This has included steps to develop credible resolution strategies for the world's most systemically important banks, ensuring they have sufficient resources, of an adequate standard, to absorb losses in resolution. The Banking Reform Act 2013 introduced a bail-in power to the UK's Special Resolution Regime that will allow debt to be converted to shareholder equity in a resolution.

The Bank has helped to lead Financial Stability Board work on ending 'too big to fail'

And the European Bank Recovery and Resolution Directive, agreed in December 2013, will, once transposed into UK law, ensure the UK's recovery and resolution regime for banks is compliant with the Financial Stability Board's Key Attributes. The Financial Stability Board has published a list of global systemically important insurers and work is progressing to develop a policy framework to help mitigate the risks they pose to financial stability.

The importance and extent of shadow banking has been the subject of further international and domestic evaluation in 2013. Analysis has been undertaken by the Bank to identify non-bank sectors and markets that may pose risks to the global financial system. And the Bank has sought to collect detailed market intelligence to better determine where the regulatory perimeter should lie.

The Bank has led work in a range of other areas, including international efforts to reform benchmark reference rates, such as Libor and foreign exchange.

The Bank has also supported efforts to make collateralised borrowing markets more transparent and robust and has been a key advocate of the consistent application of rules around derivatives clearing. Further work has been conducted into the resilience of the international financial system, an example being the joint paper with the Bank of Canada on innovative debt instruments.[8]

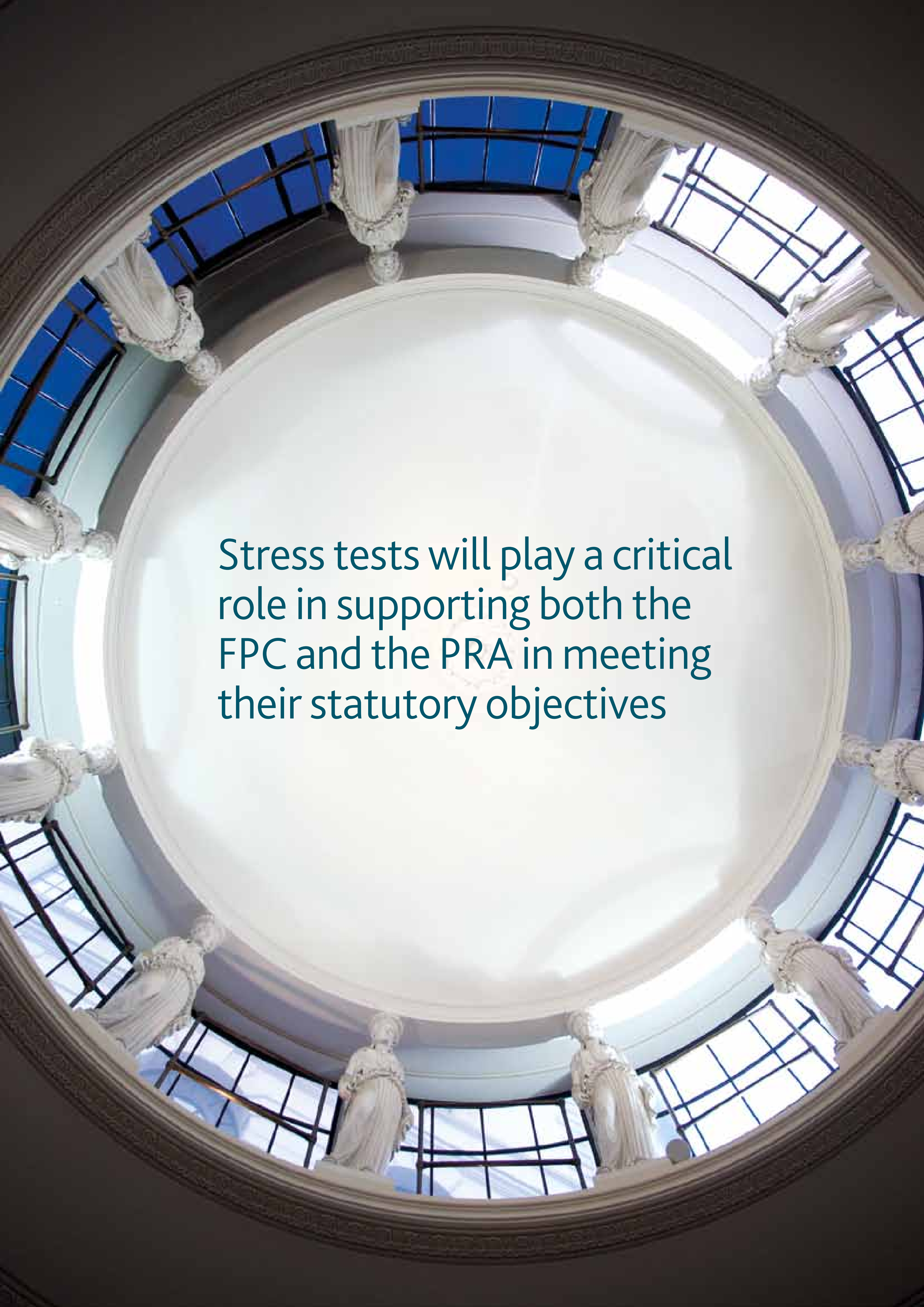
Safety and soundness of firms

The PRA and FPC have worked together to increase the quality and quantity of capital held by the largest UK banks over the past year. As recommended by the interim FPC in March 2013, the PRA assessed the common equity capital position of the major UK banks and building societies, measured after making adjustments for expected future losses, conduct costs and more prudent risk-weighting exposures, with a view to raising their capital ratios to 7% (on the CET1 definition) by end 2013. Most achieved that goal, and a subsequent PRA target to raise their leverage ratios to 3%. Those that did not have agreed plans with the PRA for doing so. These changes came ahead of the PRA's implementation of European rules to strengthen capital, in the form of CRD IV, on 1 January 2014. Preparation is ongoing for the introduction of ring-fencing to separate retail and small business deposits from trading activities, consistent with the recommendations of the Independent Commission on Banking as reflected in the Financial Services (Banking Reform) Act 2013.

In October 2013, the FPC and PRA Board agreed a system of concurrent stress tests of the UK banking system as a variant to those being conducted by the European Banking Authority. The tests will begin in 2014, and will aim to provide a quantitative, forward-looking assessment of the capital adequacy of the UK banking system and individual firms in it. The tests will play a critical role in supporting both the FPC and the PRA in meeting their statutory objectives. The Bank will additionally conduct a review in 2014 into leverage, with a particular focus on assessing the merits of varying the leverage ratio in proportion with risk-weighted assets (in a counter-cyclical manner and across certain firms).

The PRA and FPC have worked together to increase the quality and quantity of capital held by the largest UK banks

8 www.bankofengland.co.uk/boe-ar2014/links



Stress tests will play a critical role in supporting both the FPC and the PRA in meeting their statutory objectives

Banking standards

The Parliamentary Commission on Banking Standards published its final report in June 2013, making recommendations to the Government, to the regulators and above all to the industry itself, aimed at remedying the shortcomings in standards that it had identified. A number of recommendations were addressed to the Bank.

One theme of the Commission's report was 'to make individual responsibility in banking a reality'. A key element in this will be the introduction of a new regime that will provide greater clarity about who is responsible for a firm's key activities and the key risks to which it is potentially exposed, and greater powers to take disciplinary action where those responsibilities are not discharged appropriately. The PRA will consult on the design of the new regime in the summer of 2014, ahead of implementation in 2015.[9]

Another theme of the Commission's report focused on strengthening the remuneration regime for banks through revision of the Remuneration Code on which the PRA will consult during 2014. In March 2014, the PRA issued a consultation paper on extending the Remuneration Code to require all PRA-authorised firms to amend employment contracts to enable the clawback of unvested variable remuneration.[10] The proposed new rules will come into effect on 1 January 2015.

Financial market infrastructures

The Bank sits at the heart of the UK economy and works closely with firms and intermediaries to ensure the resilience and efficiency of payment, clearing and settlement infrastructure.

The Bank acts as settlement agent to the UK's main interbank payment systems. Over the past year, the Bank has worked with CHAPS[11] member banks to make a number of efficiency enhancements to the Bank's Real-Time Gross Settlement System (RTGS) (see box on page 29). Changes have also been made to further increase resilience of RTGS by implementing the Market Infrastructure Resiliency Service – an infrastructure, developed and hosted by SWIFT,[12] that would be used by the Bank should RTGS ever fail simultaneously at both its principal and standby sites. RTGS was available for 100% of its operating hours in 2013, as in 2011 and 2012.

Further steps have been taken to reduce tiering of payment systems participants. In the UK, many banks access payment systems via relationships with other banks. This introduces risks to financial stability, which can be reduced by increasing direct participation. The Bank has worked with the payments industry to achieve that, as part of its broader work to reduce systemic risks. As a consequence, by 2015 all the global systemically important banks that process significant values in CHAPS will become direct participants. This was aided by the adoption of new rules by CHAPS in April 2012, which create a presumption that banks with a significant value of sterling payments should participate in CHAPS directly. These structural changes will significantly reduce interbank exposures, and enhance UK financial stability.

100%

RTGS availability during 2011, 2012 and 2013

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9,10 www.bankofengland.co.uk/boe-ar2014/links

11 Clearing House Automated Payment System.

12 Society for Worldwide Interbank Financial Telecommunication.

Liquidity savings in RTGS

In April 2013, the Bank implemented an innovative, technical change to the way the Real-Time Gross Settlement (RTGS) infrastructure settles CHAPS payments, by introducing a 'liquidity saving mechanism' (LSM).

This change was motivated by the PRA's revised liquidity framework that requires banks to hold sufficient liquid assets to support their intraday payments needs, in addition to prudential balance sheet resilience. As this policy has the potential to increase banks' cost of liquidity to make CHAPS payments, it might incentivise them to economise its use by delaying the timing of their payments, with a possible increase in operational and liquidity risk.

LSM provides a technical means of reducing banks' liquidity requirements in CHAPS by matching groups of payments made by banks in short settlement cycles. All 'matched' payments are settled individually and simultaneously at the conclusion of settlement cycles that are run through the settlement day. The two-year project encompassed concept modelling, system design, development, testing, technical implementation and optimisation of usage.

The LSM has reduced the total liquidity required by CHAPS banks for the settlement of payments across RTGS by approximately £4bn – some 20%. This has contributed to a reduction in CHAPS system liquidity and operational risk.

Under Part 5 of the Banking Act 2009, the Bank is responsible for the oversight of systemically important payment systems. The Bank's approach to this function, and its priorities for the year ahead, are described in its Annual Report on the supervision of financial market infrastructures (FMI) (March 2014).[13] As outlined in that Report, the Bank assumed new responsibilities in 2013 for the supervision of central counterparties (CCPs) and securities settlement systems. Market functioning, and in turn financial stability, relies on ensuring the continuity of the services provided by these systems. The Bank published a paper in April 2013 describing its supervisory objectives.

An FMI Board has been established as an executive committee to exercise the Bank's powers as a statutory regulator of FMIs. It is chaired by the Deputy Governor for Financial Stability and has reserved to itself all decisions (including the exercise of the Bank's statutory powers) which could be expected to have a significant impact on the Bank's ability to carry out its statutory objectives and those which could set a significant precedent for the way in which the Bank supervises FMIs.

The activities of CCPs in the UK are subject to regulation by the Bank under European Markets Infrastructure Regulation (EMIR), which sets new requirements for EU CCPs. Existing EU CCPs, and any future applicants, must demonstrate that they meet EMIR standards in order to be authorised as a CCP under EMIR. The Bank has been assessing the CCPs' applications during 2013/14.

One of the biggest challenges facing the financial infrastructure is the threat of cyber attack. Following an FPC recommendation in June 2013, work has been undertaken involving the Bank, relevant government agencies, the Financial Conduct Authority and the industry to evaluate and improve firm resilience to cyber attack (see box on page 30).

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13 www.bankofengland.co.uk/boe-ar2014/links

Threat of cyber attack

The dependence of major banks and financial market infrastructure on highly complex information technology systems makes them potentially vulnerable to cyber attack. Such attacks are increasing in frequency and sophistication and the dynamic nature of this risk, along with rapidly evolving new threats, makes mitigation particularly challenging.

Following an FPC recommendation in June 2013, a programme of work was established in Autumn 2013, shared by the UK financial authorities, to assess, test and improve cyber resilience across core parts of the UK financial sector. The initial priority has been to develop diagnostic tools for core firms. In early November 2013, an industry-led exercise, supported by the regulators, and including participation by a number of government agencies, as well as the Bank itself, was conducted to test the financial sector's response to a sustained and intensive cyber attack.

Following that exercise, work has progressed to ensure that action plans are in place to deliver a high level of protection for core UK financial system institutions. On 1 November 2013, the Bank appointed a Chief Information Security Officer, supported by a new Information Security Division, to reflect the increasing importance of these issues to the Bank itself.

The Bank offers a range of banking services to infrastructure providers in order to help mitigate the risks they face. Over the past year, the Bank has expanded the number of infrastructure providers to whom these services are provided. This supports commitments made by the G20 to address systemic risk in derivatives markets by requiring a range of derivatives to be cleared through central counterparties. All UK-resident central counterparties now access, or are in the process of accessing, Bank of England banking services. Services are also available to certain non UK-resident central counterparties.

Separately, in 2012, the Bank and HM Treasury proposed changes to the terms of its existing International Swaps and Derivatives Association legal agreements under which they transact with market counterparties in foreign currency over-the-counter derivatives. These transactions are undertaken by the Bank both in relation to its own balance sheet and in its role as HM Treasury's agent in the management of the UK's foreign exchange reserves. These changes, which involved the two-way provisioning of collateral, were adopted in 2013.

Protecting our banknotes

Maintaining public confidence in the currency is a key role of the Bank and one which is essential to the proper functioning of the economy.

Polymer

The Bank announced in late 2013 that the next £5 and £10 banknotes will be printed on polymer, rather than on the cotton paper used currently. The decision followed a three-year research programme by the Bank and extensive consultation with industry and the public. Over the course of two months, the Bank hosted events across the UK to give the public the opportunity to learn more about polymer banknotes, handle prototypes and provide feedback. Nearly 13,000 individuals commented, of whom 87% were in favour of polymer; only 6% were opposed. In parallel with the public consultation, the Bank engaged with a wide range of stakeholders in the cash industry in order to understand the changes required to cash-handling practices if a positive decision were reached. In March 2014, the Bank signed a contract with Innovia Security for the supply of polymer. As part of the contract the firm has committed to create a manufacturing capability for polymer banknotes at a site in Cumbria.

Alongside the decision to change to polymer, it was decided to make new banknotes slightly smaller than their existing paper equivalents in order to improve cash handling and reduce printing and storage costs. The Bank consulted with the Royal National Institute of Blind People on the proposed size change.

Banknote characters

The new £5 note, planned for release in 2016, will feature Sir Winston Churchill on the reverse, while Jane Austen will feature on the new £10 note, to be released around a year later. The Bank reviewed its approach for selecting characters to appear on its banknotes during the year in the light of public concern about the diversity of selected figures. The Bank announced in December 2013 that the selection process would in future seek the advice of outside experts and give the public a meaningfully larger voice.

Cash circulation

Changes in technology, such as self-check-out tills, and business practices have increased the potential for banknotes to spend longer in circulation before passing through the wholesale cash industry. It is important that notes sorted locally are subjected to similar standards as the wholesale cash industry – in particular so that counterfeit notes do not stay in circulation, and the quality of banknotes is preserved. As a result, the Bank worked closely with the Payments Council to consult on, and in July 2013 introduce, a new Code of Conduct for the Authentication of Machine-Dispensed Banknotes.[14]

The number of counterfeits identified and removed from circulation fell during calendar-year 2013, and remains a very small share of the total number of notes. The Bank continues to work closely with law enforcement agencies to detect and stop counterfeiting. A new App was launched in March 2014 to help the public identify genuine banknotes.[15]

87%

of the public in favour of polymer banknotes

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14,15 www.bankofengland.co.uk/boe-ar2014/links

Creating a 'One Bank' pool of talent

A key pillar of the Strategic Plan is the attraction, development and retention of the best people into public service, building a talent base that reflects the diversity of the UK.

Progress has been made towards this objective in 2013/14. At the end of February 2014, the Bank employed 3,625 people. A year previously, the number had been 2,307: the increase was accounted for mainly by the transfer of staff from the Financial Services Authority to the PRA on 1 April 2013. In February 2014, 401 staff were part time, and 175 were on temporary contracts. Of the 3,625, 43% were female and 15% were Black, Asian and Minority Ethnic (BAME). At management levels and above 31% were female and 8% were BAME.

Of the new entrants to the Bank in 2013/14, 76 were recruited as part of the graduate (the highest in its history), masters or PhD level recruitment campaigns, and 21 as apprentices and school leavers. The remainder were mid-career recruits. The Bank has launched a series of new programmes to broaden its recruitment activities and improve diversity (see box on page 33). The Bank continues to develop and promote internally, as well as recruit externally, with 39% of management jobs filled externally over the course of the year.

While turnover levels remain relatively low across the Bank as a whole (8.1%), the PRA has slightly higher levels of turnover (11.6%), in line with prior Financial Services Authority experience. This, together with further work necessary in 2014, for example around stress testing, has required a step up in recruitment capacity, as well as development support.

In order to build expertise, a new talent management programme is being developed in 2014, which will encompass how the Bank recruits and develops its staff. Development of career paths for staff will be complemented by robust career planning and a reassessment of training to ensure a focus on development needs identified through performance management.

The Bank is also looking to learn from industry by encouraging staff secondments across the banking and insurance sectors. That is being replicated internally, with short-term staff secondments between areas of the Bank.

Some divisions have sought to address specific skills gaps by introducing bespoke training programmes. In the Monetary Analysis area, for example, a Technical Economics Programme has been introduced aimed at raising skills to doctorate level. Other areas have introduced training tailored to meet the Bank's new responsibilities – such as in the PRA, where a programme that embeds the requirements and competencies of the PRA approach to supervision is mandatory for all new staff.

A major project has been started to review pay and pension arrangements across the Bank: this is a key initiative in the 'One Bank' strategy, in order to facilitate making staff truly mobile across the Bank. Possible options have been under discussion in the Executive Directors Committee, in Court's Remuneration Committee (with PRA Board representation) and at Court, with a view to consulting staff, the union and the Trustees of the Bank of England Pension Fund later in 2014.

The Bank maintains arrangements for consulting staff on matters affecting their interests, including with representatives of the recognised trade union, Unite.

The Bank has continued to improve the technical and pastoral support it offers staff. Alongside key IT infrastructure projects to ensure reliable access to core hardware and software, new technologies that support mobile and flexible working have been introduced. The Bank's approach to flexible working is that it should be available to all staff, and all roles are reviewed before recruitment to ensure that the scope for flexible working has been considered. 90 different part-time working patterns are in operation across the organisation.

3,625

Staff as at February 2014

Recruitment

Graduate entry is a critical part of the Bank's talent pipeline. In 2012, a review of target universities was conducted to ensure the Bank reached a broader range of students across the UK. In Autumn 2013, the Bank visited 47 university campuses, attending careers fairs, hosting academic lectures or delivering skills sessions. The 2013 graduate intake came from 30 different academic institutions, up from 11 in 2010 and 17 in 2011.

The Bank holds a number of diversity-focused recruitment events, such as an annual event for female Masters' students and 'ACS in the City' – an event for students of African Caribbean heritage – held jointly with other public sector organisations. The Bank additionally held an Insight Day in 2013, with events organised for students from under-represented groups and for first-year degree students. In 2013, our graduate intake was 26% female and 16% BAME.

During our 2014 rounds, we have expanded our total recruitment and looked to further broaden the range of skills and backgrounds of our graduate entry. As of writing we have graduates joining the Bank in the Autumn from 33 different universities.

Of those expected to join in 2014, the representation of new graduate hires in all disciplines (First Degree) is 47% female; 33% BAME; and for First Degree Economics is 50% female; 25% BAME.

Apprenticeships are also an important way for us to build our talent pipelines. The Bank has expanded the range of apprenticeships available, and currently employs 11 apprentices. These are placed in a range of business areas, from Security to IT to Facilities.

Equality and Diversity Committee

Now established as a Committee of Court, the Equality and Diversity Committee has overseen and supported diversity initiatives across the Bank. Focused on outcomes, the Committee encourages the development and retention of the broadest range of talent at all levels and areas of the Bank.

Employee networks

The Bank has a number of active employee networks including Women in the Bank and BEEM (The Bank of England's Ethnic Minority Network). As an organisation, the Bank engages with these networks to understand the key diversity issues around the Bank, and to aid inclusion. The networks also provide support to activities such as graduate recruitment, where their support with marketing materials and campus activities are pivotal to the attraction of diverse graduate talent to the Bank.

Employment of people with disabilities

The Bank is a 'Two Ticks' employer. This is an accreditation that is given to organisations that are committed to employing people with disabilities. The Bank works with partners who specialise in supporting people with disabilities both for existing staff at the Bank and for candidates (for example, Blind in Business, The Disability Café and the National Autistic Society). The Bank also actively advertises roles through sites such as Diversity Jobs (who target diversity strands including disability). The Bank has a Disability Forum employee network.

Equality and Diversity Committee (a Committee of Court)

The Committee was created in 2012 to approve the Bank's diversity strategy and to monitor performance against it.

Its members are:

Spencer Dale
Chairman

Michael Cohrs

Charlotte Hogg

Sir David Lees

Joanna Place

Dave Prentis

Lady Rice

Anna Sweeney*

* Joined the Committee in March 2014.

Transparency and accountability

Many of the initiatives taken this year have been designed to provide greater visibility of the Bank's actions and greater clarity about the Bank's thinking on policy. The MPC's forward guidance, the launch of the revised Sterling Monetary Framework, and the mid-year announcements about capital and liquidity requirements for the major banks are examples of this. Publication of the Minutes of Court meetings, required by statute from April 2013 onwards, has provided another window into the Bank.

Also in April 2013, the Oversight Committee of Court was created with new powers to review and report on the Bank's performance, and also to commission reviews of specific aspects of policy. Such reviews would normally be published. The Committee has also been monitoring the implementation of the three Reviews commissioned by Court in 2012, into forecast capabilities, liquidity assurance and emergency liquidity assistance. The Oversight Committee's report is on page 60.

In addition to press conferences following release of MPC *Inflation Reports* and FPC *Financial Stability Reports*, and on banknote-related issues, Mark Carney held question and answer sessions with the media following each of his major domestic speeches and at selected international events. He gave a number of television interviews to explain forward guidance. He and other Bank officials gave evidence to Parliamentary committees on 20 occasions during the year. Mark Carney gave 43 international and domestic interviews of which six were to UK regional press. Supported by the Bank's network of Agents, he made nine visits across the UK during the year meeting more than 500 local business executives, and will achieve his goal of visiting all the home nations and English regions within his first year as Governor.

A number of innovative communication channels have been used over the past year, alongside more traditional means, to improve understanding, transparency and accountability. A new educational film – 'Keeping on an even keel: the role of the Bank of England' – was launched in June 2013 to explain the Bank's extended remit and responsibilities. In the same month, the Bank released its first App, featuring a virtual tour of its Threadneedle Street building, including panoramic images of the room where the MPC meets to set interest rates, the Dealing Room, and the Bank's gold vaults.[16] In early 2014, a series of 'postcards' describing a variety of aspects of the Bank's work in simple terms were made available. These initiatives have been incorporated into the Bank Museum, which was reopened after maintenance and major refurbishment on 31 March 2014. In calendar-year 2013, the Museum welcomed 130,000 visitors.

MPC, FPC and PRA Board members gave a total of 54 speeches and 194 media interviews with traditional media between 1 March 2013 and 28 February 2014. These were complemented by contributions from other senior members of staff on the Bank's wider responsibilities, including the Bank's first interview on Twitter, given by Spencer Dale.

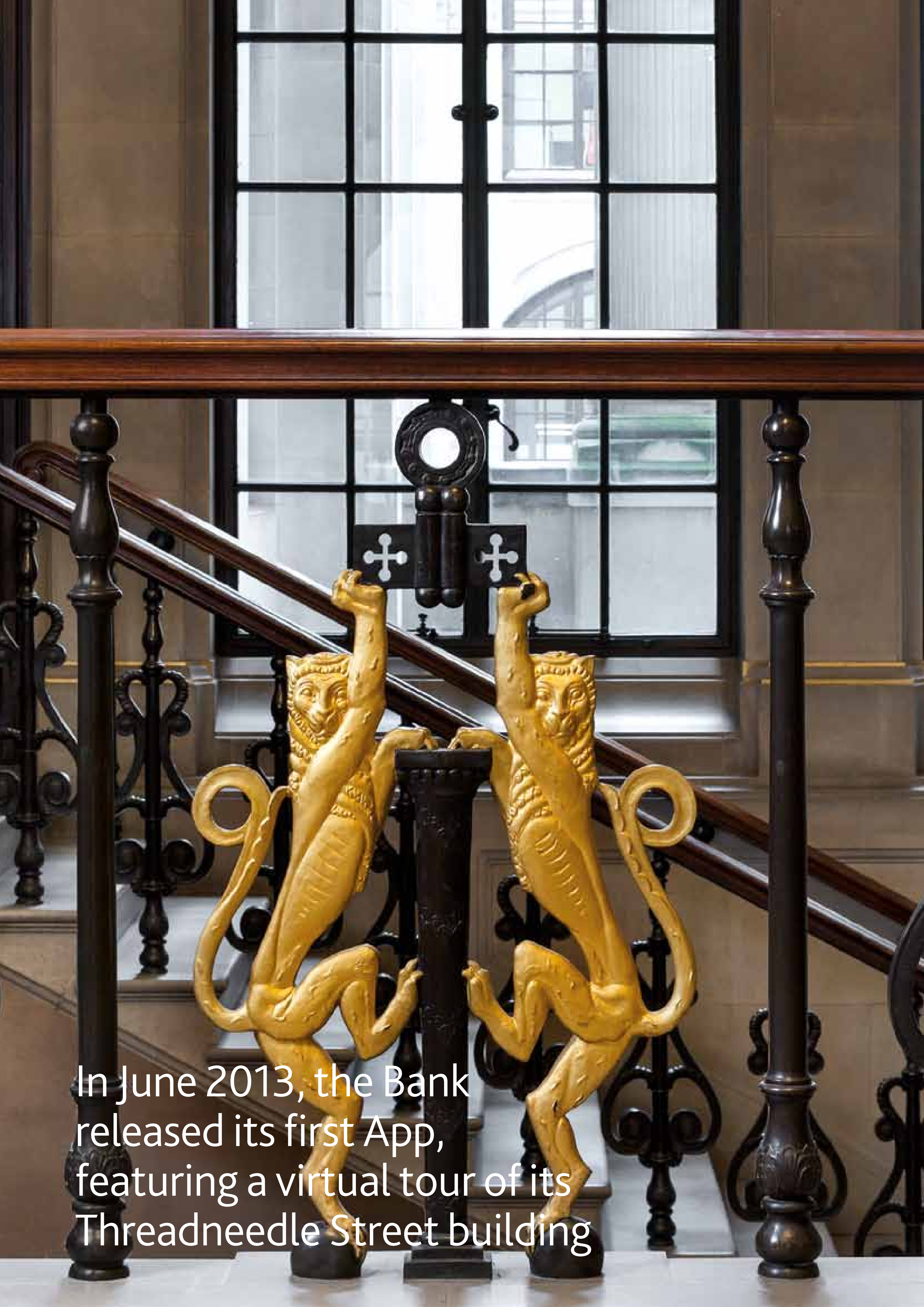
Value for Money

During the Autumn, the Bank launched a Value for Money review of its central services functions, as envisaged in the 2013 Cash Ratio Deposit settlement. The review, which was facilitated by Deloitte, looked at staff deployment and direct expenditure, and identified annual savings of around £18m by 2015/16 (around 10% of the spend reviewed). A number of teams were reorganised, creating a likely need for approximately 80–100 redundancies. The Bank has been working with its recognised trade union (Unite) to ensure that affected staff receive support to find alternative employment. The savings will ensure that the investments required by the Strategic Plan (page 14) will be financed within the Bank's existing budget envelope.

130k

Museum visitors welcomed in calendar-year 2013

16 The Bank provides custodial services for a range of customers. As at 28 February 2014, total assets held by the Bank as custodian were £594bn, of which £140bn were holdings of gold.



In June 2013, the Bank released its first App, featuring a virtual tour of its Threadneedle Street building

The Bank's strategies for monetary and financial stability for 2014/15

The Bank of England's mission is to promote the Good of the People of the United Kingdom by maintaining Monetary and Financial Stability.

This mission is overseen, in the first instance, by the Bank's Governors and the set of policy-making committees described in pages 10–12. Although, for each committee, a single area of the Bank takes the lead in co-ordinating briefing and analysis, each committee draws on the expertise and knowledge of staff in all areas of the Bank. That reflects the benefits of bringing monetary policy, macroprudential policy, microprudential supervision and oversight and the exercise of resolution powers under one roof.

Parliament has given the Bank substantial powers to pursue this mission. Those powers make it imperative that the Bank can be held accountable to Parliament and public. To aid that accountability, the Bank is required by statute to prepare and publish a Financial Stability Strategy, consulting the FPC and HM Treasury; and the PRA is also required to prepare a strategy, consulting Court. Those strategies – and the aims of the Bank in using each of its powers – have been agreed and are set out below. For completeness, a summary of the Monetary Stability Strategy is also given below.

These aims will continue to develop and the Bank's performance should be judged against them.

The Bank's position gives it considerable influence on policymaking in European and international fora. The Bank's interventions here will also be guided by its single mission encompassing objectives for both monetary and financial stability. Over the course of the next year, the Bank's new International Directorate will support the Governors in the drawing up of a more detailed European and international strategy.

Monetary Stability

As the central bank of the UK, the Bank of England is committed to safeguarding public confidence in the nation's currency.

Public confidence in the currency requires stability in its value. That is the task of monetary policy. The Bank of England Act 1998 delegates responsibility for formulating monetary policy to the MPC. The Act sets out that the monetary policy objectives of the Bank shall be to maintain price stability and, subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment.

The exact definition of price stability is laid out annually by the Chancellor of the Exchequer in an annual remit letter; presently it is to achieve a CPI inflation rate of 2%. The framework recognises, however, that inflation will depart from the target because of temporary shocks and disturbances, some of which may be large or persistent, and in such circumstances the Committee faces a judgement about the speed with which to return inflation to target in order to avoid undesirable volatility in output.

In August 2013, the MPC provided guidance regarding the path of monetary policy, stating that it did not intend to raise Bank Rate or reduce its stock of purchased assets at least until unemployment had fallen to a threshold of 7%, subject to maintaining price and financial stability. The Committee judged it appropriate in February 2014 to provide further guidance.

This guidance, which was to take effect from the time that unemployment reached the 7% threshold, was that the MPC expects interest rates to rise only gradually, and to remain low for an extended period of time, given the headwinds continuing to face the economy. In February, the MPC judged that there remained scope to absorb further spare capacity before raising Bank Rate.

The Bank and HM Treasury have determined that the Funding for Lending Scheme will continue to support UK business lending. It was announced in April 2013 that the Scheme would be extended to January 2015, with incentives to boost lending skewed towards small and medium-sized enterprises. The incentives to expand household lending were removed in November 2013.

Bank staff will support the MPC by:

- providing briefing and analysis and producing the *Inflation Report* to the highest standards of quality;
- implementing the decisions of the MPC through its Sterling Monetary Framework and, when the MPC judges it appropriate to do so, to manage the unwinding of the Asset Purchase Facility;
- expanding its research capability and drawing on the range of data across the Bank's functions; and
- enhancing the transparency of the interactions between monetary, macroprudential and microprudential policies.

In addition, the Bank aims to maintain confidence in the currency through:

- the provision of banknotes that, at all times, meet the public's demand for them, including the appropriate mix of denominations; and
- ensuring the physical integrity of banknotes and minimal rates of counterfeiting.

Over the next year, the Bank will approve the final award of the new contract for banknote printing and it will continue to progress its plans for the issuance of the polymer Churchill £5 note in 2016 and, subsequently, the Austen £10 note. The Bank will also intensify its effort to educate cash handlers to identify authentic banknotes and to work with law enforcement to apprehend counterfeiters.

The Bank is committed to safeguarding public confidence in the nation's currency

Financial Stability

The Bank of England Act 1998 sets out that the Bank's Financial Stability Objective is to protect and enhance the stability of the financial system of the UK. It requires Court to determine the Bank's strategy in relation to its Financial Stability Objective, consulting with the FPC and HM Treasury. This subsection fulfils that requirement.

The purpose of preserving stability is to maintain the three vital functions which the financial system performs in our economy:

- providing the main mechanism for paying for goods, services and financial assets;
- intermediating between savers and borrowers, and channelling savings into investment, via debt and equity instruments; and
- insuring against and dispersing risk.

The Bank pursues its Financial Stability Objective through five functions:

- macroprudential policy decisions by the FPC;
- the Bank's prudential regulation of banks, building societies, designated investment firms and insurance companies through the PRA;
- the Bank's oversight and regulation of key payment, clearing and settlement infrastructure;
- the Bank's role as UK resolution authority; and
- the Bank's financial operations, including as lender of last resort.

Macroprudential policy

The statutory objectives of the FPC are to contribute to the achievement of the Bank's Financial Stability Objective and, subject to that, to support the economic policy of the Government, including its objectives for growth and employment. The FPC has powers to give Directions, through the setting of specified macroprudential instruments, to the PRA and the Financial Conduct Authority. It can make Recommendations to any body, including: the PRA and Financial Conduct Authority on a 'comply or explain' basis where appropriate; and to HM Treasury, including on the boundaries within and around the perimeter of the regulatory regime.

The FPC's objectives are clarified through an annual exchange of letters between the Chancellor and the FPC, to specify the Government's economic policy objective and for the Chancellor to give, and the FPC to respond to, a series of recommendations to the FPC on matters it should have regard to and on its responsibilities in relation to its objectives.

The MPC's forward guidance recognises that the tools available to the FPC and other regulators will form the first line of defence against financial stability risks consistent with the statutory objectives of the two committees. The FPC aims to take graduated and proportionate action, as warranted, to manage those risks. The FPC has focused, for example, on risks stemming from the housing market and the set of tools that it could deploy to manage these risks if they emerge.

The FPC is focusing over the next 12–18 months on three key medium-term priorities: the capital framework for banks; ending 'too big to fail'; and identifying and addressing any risks to the stability of the system in shadow banking while working to support diverse and resilient sources of market-based finance. Work in these areas will involve extensive interaction with authorities internationally, as well as domestically with the PRA, FCA and HM Treasury.

The Bank's Financial Stability Objective is to protect and enhance the stability of the financial system of the UK

Bank staff support the FPC by:

- providing briefing and producing the *Financial Stability Report* to the highest standards of quality;
- developing its assessment of financial stability risks, including those emanating from outside the regulatory perimeter, and its strategy for the use of macroprudential instruments;
- monitoring, and where appropriate executing, the implementation of FPC Recommendations and Directions;
- expanding its research capability and drawing on the range of data across the Bank's functions; and
- enhancing the transparency of FPC policy and of the interactions between macroprudential policy and both monetary and microprudential policy.

A number of the Bank's business aims are highly relevant to both macroprudential policy and microprudential objectives. These include:

- a programme of work, conducted by HM Treasury and the relevant regulators and overseen by the FPC, to assess, test and improve the financial system's resilience to cyber attack;
- developing a concurrent stress-testing framework for the eight largest banks in the UK. The Bank, including the PRA, will participate fully in this year's EU-wide stress test and will run an additional macroeconomic sensitivity to that exercise to examine the resilience of banks to a UK housing market shock and to a snap back in interest rates. These stress tests will inform FPC and PRA decision-making on the banking system overall and the capital resilience of individual banks;
- progress with the medium-term capital framework for banks, including, in particular, supporting the FPC's review of the role of the leverage ratio in that framework; and
- influencing the development of enhanced global insurance supervision to assess and regulate the risks posed by globally systemic insurers.

Microprudential supervision and oversight

The Bank, through the PRA, is responsible for the prudential regulation and supervision of banks, building societies, designated investment firms and insurance companies. Effective supervision of these institutions will support financial stability. The strategy for conducting effective supervision adopted by the PRA Board, which is summarised here, is published in full in the PRA's separate *Annual Report*.

The strategy for conducting effective supervision adopted by the PRA Board is published in full in the PRA's separate *Annual Report*

The Financial Services Act 2012 sets out the PRA's general objectives as to promote the safety and soundness of these regulated firms and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders. The PRA also has a secondary objective, subordinated to its general objectives, to facilitate effective competition in the markets for services provided by PRA-authorised firms.

The PRA Board oversees the fulfilment of these objectives and takes the most significant supervisory decisions. The PRA's strategy is to:

- continue to apply a forward-looking, judgement-based supervision approach to firms that pose the greatest risk to the PRA's objectives, while also ensuring an appropriate supervisory regime for smaller firms;[17]
- develop its approach to overseas supervision, following publication of a statement on the PRA's approach to supervision of overseas banks;
- finalise implementation of the Basel III framework;
- promote orderly resolution of firms through structural reform such as ring-fencing of core retail banking services from wholesale and investment banking services;
- implement Senior Persons Regimes for banks, building societies and insurers; and
- advance its new competition objective, by increasing specialist capability in competition, provide guidance and training to staff and beginning periodic reviews of existing rules to identify areas where changes would facilitate greater competition without compromising the safety and soundness and policyholder protection objectives.

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17 For further detail see the PRA's supervisory approach documents, available at www.bankofengland.co.uk/boe-ar2014/links

The Bank is also responsible for the supervision and oversight of financial market infrastructures (FMIs). The Bank's supervisory effort in this area, overseen by the FMI Board, will be based on an assessment of where risks to financial stability are greatest. The Bank's strategy with respect to FMI supervision is set out in its publication on its approach to supervision of financial market infrastructures,[18] with updates provided in its Annual Report on FMI supervision. In short, the strategy includes:

- conducting a thematic review of stress-testing practices across central counterparties (CCPs);
- working with other authorities in the colleges formed for UK CCPs to ensure compliance of these CCPs with European Markets Infrastructure Regulation requirements;
- ensuring that FMIs supervised and overseen by the Bank have complete recovery plans in the event of financial difficulties;
- taking steps to reduce the remaining settlement risks within the UK's recognised retail payment systems;
- working closely with the new payments regulator in respect of those systems where both have a regulatory role; and
- helping to develop European technical standards for central securities depositories.

Resolution

The Bank is the UK's resolution authority. This responsibility, established in the Banking Act 2009, is discharged through the Bank's Resolution Directorate.

The introduction of credible and effective resolution regimes, together with steps to ensure that global systemically important banks (G-SIBs) are resolvable under these regimes, is essential for dealing with the problem of 'too big to fail'. But the Bank's resolution responsibilities extend beyond these firms. The Bank produces and executes plans to resolve failing financial firms which fall within the scope of the UK's Special Resolution Regime and is responsible for ensuring firms are structured in a way which is consistent with executing plans in such a way that the objectives of the Banking Act 2009 are met. The Bank's business aims in this area include:

- securing agreement on, and influencing the design of, a global standard for gone-concern loss-absorbing capacity applied to G-SIBs;
- working with other relevant authorities to ensure financial contracts, including derivatives and debt, are structured in a way that is consistent with effective and orderly resolution;
- working with home and host authorities to produce realistic resolution plans for banks active in the UK, across a range of resolution tools;
- maintaining an appropriate degree of heightened readiness to execute resolution plans for firms which are in distress; and
- influencing the development of the European Commission's upcoming proposal on non-bank recovery and resolution.

The Bank is now responsible for the supervision and oversight of financial market infrastructures

18 www.bankofengland.co.uk/boe-ar2014/links

Financial operations and market intelligence

The Bank also contributes towards financial stability through its role as the ultimate provider of liquidity in sterling. Its regular standing facilities, as set out in the Sterling Monetary Framework, and operations outside of the terms of that Framework are managed by the Markets and Banking Directorates. These two Directorates will continue to take forward the outstanding recommendations from the Winters and Plenderleith reviews.

The Bank's role as a participant in markets – through its sterling money market operations and the management of the country's foreign exchange reserves – leaves it uniquely placed to gather market intelligence relevant to its mission. A number of reviews will be undertaken by the new Deputy Governor for Markets and Banking, and Executive Director for Markets, including a root and branch review of the Market Intelligence function, work to develop a positive agenda to promote fair and effective markets in the UK (alongside the Financial Conduct Authority and HM Treasury), and on the Bank's foreign currency holdings.

Accountability

The Bank of England has unprecedented new powers and responsibilities and it is vital that mechanisms exist to hold it to account. The Bank is ultimately accountable to Parliament, and the Governors, Executive Directors and external MPC and FPC members appear regularly at hearings before its Treasury Committee.

The FPC has also identified as a priority further increasing public awareness and understanding in its role, and is committed to explaining its decisions clearly and transparently including by ensuring that its policy recommendations are, wherever practicable, supported by a published assessment of its costs and benefits, as required by the Act.

In addition, Court, through its Oversight Committee, keeps under review the performance of the Bank in relation to its objectives and strategy, supported by a Director for Independent Evaluation. It will commission performance reviews (including into policy decisions), to elicit recommendations for improvement in the Bank's performance and to monitor the implementation of, and response to, such recommendations by the Bank's Executive.

Financial review 2013/14

Financial statements highlights

The table below presents highlights of the combined 2014 financial statements. Further explanation and commentary is provided below.

Financial statement highlights

	2014 £m	2013 £m
Banking Department total balance sheet size	399,341	397,725
Banking Department profit before tax	180	125
Cash Ratio Deposits	4,078	2,479
Funding for Lending Scheme	41,405	15,166
Funding for Lending Scheme income	89	10
Notes in circulation	60,198	58,022
Net seigniorage income	443	517
Combined cost base	469	323
PRA cost base (included within combined cost base)	202	65
Payment to HM Treasury in lieu of dividend	80	55

Financial framework

The Bank operates as 'One Bank', a single unified institution, and the financial review is presented in a way that is consistent with this operating principle.

The PRA, which became operational on 1 April 2013 is, however, a separate legal entity, operating under the Financial Services Act 2012. The disclosures presented in this review for the PRA are recognised separately in the PRA's Annual Report and Accounts. Additionally, under the 1844 Bank Charter Act, the Bank was divided for accounting purposes into the Issue Department, covering banknote issuance activity, and the Banking Department which encompasses all other activities.

Under the Bank of England Act 1998 the financial statements are prepared on a non-consolidated basis. The 'combined' income statement and balance sheet data represents the aggregation of the Banking Department, Issue Department and PRA, and is presented for information purposes only.

The key elements of the financial framework of each component of the Bank are detailed below.

For the Banking Department, the Bank compiles its medium-term spending plans within a financial framework which has three main tenets:

- First, that policy functions of the Bank (monetary policy and financial stability) are financed by the Cash Ratio Deposit (CRD) scheme. Under the CRD regime, banks and building societies are required to place an interest-free deposit at the Bank which is a set percentage of their deposit base. The Bank then invests those deposits in interest-yielding assets, generating income to fund its policy functions. The CRD requirements are set by HM Treasury through a Statutory Instrument every five years. Following consultation, the latest requirements were renegotiated in May 2013;[19]
- Second, that the remunerated activities of the Bank – banking and lending operations for the Bank's own account – 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 gains or losses from these activities will not flow back to CRD payers, but instead be recognised in the Bank's capital. The Funding for Lending Scheme (FLS) is considered a remunerated activity; and
- Third, that if spending on policy functions is in line with CRD income and other functions break even, the profit of the Bank should be broadly equivalent to the return on the assets in which its capital and reserves are invested – largely gilts. Under the Bank of England Act 1998, the Bank's post-tax profit is shared 50:50 with HM Treasury unless otherwise agreed.

The Issue Department is funded by buying interest yielding assets to back the notes in circulation. The interest earned on these assets is used to fund the costs of note production and supply. The net profits/losses of the Issue Department are referred to as seignorage, and paid/claimed directly to/from HM Treasury via the National Loans Fund.

The PRA, operating under the Financial Services and Markets Act (2000), may levy regulated firms to recover all costs incurred in the performance of the PRA's functions under the Act. The PRA's budget is subject to the approval of Court.

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

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19 For the 2013 Cash Ratio Deposit legislation, see www.bankofengland.co.uk/boe-ar2014/links

Combined financial statements

As noted earlier, the separation of the Bank for accounting purposes is required by statute. A summary combined income statement and balance sheet as at 28 February 2014, aggregating the Banking Department, Issue Department and the PRA, is set out below. It is provided for information purposes only.

Combined income statement

The combined income statement reflects a profit before tax of £180m (2013: £125m). This is effectively equal to the Banking Department profit before tax as the PRA operates a cost recovery model, and Issue Department profits are payable in full to HM Treasury. The year-on-year increase is primarily attributable to growth in Funding for Lending Scheme income.

Summary combined income statement

	2014 £m	2013 £m
Income	**649**	**448**
Banking Department	506	383
Issue Department	513	592
PRA	202	65
less internal income recoveries and seigniorage income		
Banking Department corporate service management fee to the PRA	(59)	–
Issue Department income transferred under seigniorage arrangements[20]	(513)	(592)
Expenses	**(469)**	**(323)**
Banking Department	(326)	(258)
Issue Department	(70)	(75)
PRA	(202)	(65)
less internal cost recoveries and seigniorage expenses		
Issue Department costs transferred under seigniorage arrangements[20]	70	75
PRA corporate services management charge from the Banking Department	59	–
Combined profit before tax	**180**	**125**

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20 Net seigniorage income of £443m is paid to HM Treasury via the National Loans Fund.

Expenditure by function

Total expenditure for 2014 of £469m was broadly flat year on year prior to the inclusion of PRA operations from 1 April 2013, and was £5m below the 2014 budget of £474m.[21] The variance to budget was due primarily to recruitment delays and higher attrition rates in the PRA.

The 2015 budget of £521m reflects a year-on-year increase which is predominantly attributable to the PRA, as prior year vacancies are closed, remit expansion is accommodated and operations extend to a full 12-month period. Higher pension costs account for the remaining budget increase.

Combined expenditure by function[22]

	2014 Actual £m	2013 Actual £m
Policy functions		
Monetary policy	64	68
Financial stability	67	62
Expenditure on policy functions	**131**	**130**
Remunerated functions		
Notes issue costs recharged to the Issue Department	72	77
Government agency services	8	9
Payment and settlement	13	11
Banking services	27	29
Other functions	16	16
Expenditure on remunerated functions	**136**	**142**
Corporate service costs recharged to the PRA	59	–
Statutory and other adjustments[23]	–	(14)
Expenditure on other functions	**59**	**(14)**
Total Banking Department	**326**	**258**
Issue Department	**70**	**75**
Operational expenditure	182	–
Special project and Solvency II costs	11	–
Transition costs	9	65
Prudential Regulation Authority	**202**	**65**
Issue Department costs settled under seigniorage arrangements	(70)	(75)
PRA corporate services management charge from the Banking Department	(59)	–
Internal charges and settlements under seigniorage arrangements	**(129)**	**(75)**
Total combined expenditure	**469**	**323**

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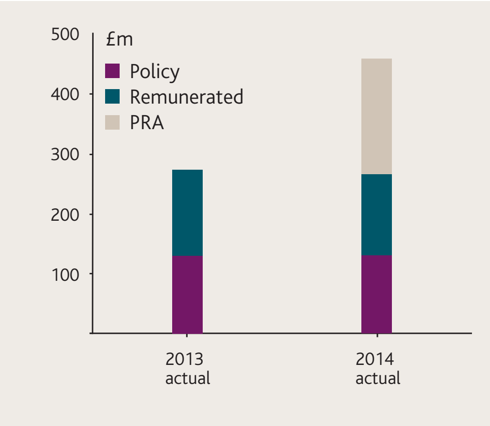
21 The budget of £491m presented in the 2013 Annual Report has been adjusted downwards by £17m to include primarily pension-related items which were excluded from prior year disclosures.

22 Combined expenditure by function represents the aggregation of the Banking Department, Issue Department and the PRA, adjusted for internal charges and eliminations under seigniorage arrangements.

23 Statutory and other adjustments predominantly relate to IAS19 pension adjustments and non-operational expenditure, including pension related compensation payments and one-off onerous lease provisions for Canada Square.

Operating expenditure by function



Source: Bank of England

PRA expenditure reflects operating costs from legal cutover of 1 April 2013, an 11-month period. Other non-operating expenditure, PRA related transition costs and statutory adjustments are not included in the chart above.

Policy functions

Expenditure on policy functions was £131m, marginally above the 2013 level as a result of the continued expansion of the Bank's policy responsibilities.

The increase in policy responsibilities, coupled with declining gilt yields in the previous five years, resulted in CRD income being insufficient to cover costs fully. In June 2013, the CRD scheme was revised to fund expected policy function costs over the five-year period 2013–18.

Remunerated functions

Expenditure of £136m on remunerated functions was lower than the prior year, primarily due to a reduction in note production activity. The first polymer note will be issued in 2016.

The Bank's remunerated functions (operating on a full and fair cost recovery basis) continue to make a surplus as a consequence of the Funding for Lending Scheme income of £89m.

Prudential Regulation Authority

2014 expenditure for the PRA reflects the 11-month operating period from 1 April 2013. The PRA experienced recruitment delays and higher attrition rates in 2014 which resulted in subdued expenditure levels.

The 2015 budgeted cost increase reflects the inclusion of a full year of operations, closure of prior year resourcing gaps, and remit expansion, including:

i. **Concurrent stress testing of the UK banking system,** to assess capital adequacy in line with FPC recommendations;

ii. **Structural reform** of financial service firms, with ring-fencing and loss-absorbing capacity proposals, and implementing a new secondary competition objective; and

iii. **Parliamentary Commission on Banking Standards,** highlighting four main areas where it is believed reform is needed: individual responsibility, governance, competition and the responsibilities of regulators.

A further £9m of cost associated with the transition and set up of the PRA was incurred in 2014 (2013: £65m). All transition costs are recovered via the PRA levy of regulated firms.

Combined balance sheet

The combined balance sheet grew by £1.4bn in 2014. The largest movement in assets was an increase in 'securities held at fair value' of £2.5bn due to increased money market instrument holdings, partially offset by a decrease in loans and advances of £1.5bn.

'Notes in circulation' liabilities increased by £2.2bn, offset by small decreases across other liability categories.

The Funding for Lending Scheme (FLS), which is classified as off balance sheet under a collateral swap arrangement, was introduced in July 2012 and allows participants to borrow UK Treasury bills in exchange for eligible collateral. The balance increase in 2014 is attributable to the completion of the first drawdown window in January 2014 and the start of the FLS extension drawdown period in February 2014.

The FLS is a fully collateralised scheme designed to incentivise banks and building societies to boost their lending to UK households and businesses. The collateral backing lending has been discounted by an average of 36% to protect the Bank against any counterparty risk. The fee paid by participants on their drawings from the first part of the scheme (which ended at the end of January 2014) is determined by their net lending performance, with the majority of participants paying a fee of 0.25% given positive net lending. The fee for all drawings in the second part of the scheme (from the beginning of February 2014) will be 0.25%.

Summary combined balance sheet

	2014 £m	2013 £m
Assets		
Loans and advances	386,175	387,717
Securities held at fair value	6,090	3,573
Available for sale securities	10,566	10,072
Other assets	1,604	1,641
Total assets	**404,435**	**403,003**
Liabilities		
Deposits	336,565	336,814
Notes in circulation	60,198	58,022
Foreign currency bonds in issue	3,599	4,007
Other liabilities	1,026	808
Capital and reserves	3,047	3,352
Total equity and liabilities	**404,435**	**403,003**
Off balance sheet – Funding for Lending Scheme		
Funding for Lending drawdowns	**41,405**	**15,166**

Financial review of Banking and Issue Departments

Banking Department

The Banking Department's financial statements for the year ended 28 February 2014 are shown on pages 70–122 and reflect a profit before tax of £180m (2013: £125m). After a tax charge of £20m (2013: £15m), the profit transferred to reserves amounts to £80m (2013: £55m). The amount payable to HM Treasury in lieu of dividend accounts for the remaining £80m (2013: £55m).

The statement of comprehensive income reflects a net reduction for the year of £225m (2013: £20m income). The 'other comprehensive loss' totalling £385m (2013: £90m) arises predominantly as a result of changes in the fair value of available for sale gilts, and retirement benefit remeasurements. These losses are offset in part by post-tax operating profits of £160m (2013: £110m).

The total balance sheet of the Banking Department increased slightly during the year, from £397.7bn at 28 February 2013 to £399.3bn as at 28 February 2014.

The main change in the components of Banking Department assets was an increase in *'Available for Sale Securities'*, from £5.2bn at 28 February 2013 to £6.3bn at 28 February 2014, principally due to an increase in the level of gilts held following the investment of additional CRDs resulting from the 2013 consultation.

Although overall deposit balances have remained static, there have been significant movements between categories of deposit. *'Deposits from banks and other financial institutions'*, mainly reserves balances, increased by £21.6bn to £318.7bn at 28 February 2014 (2013: £297.1bn). '*Other deposits repayable on demand*' decreased by an offsetting £23bn due to a reduction in the BEAPFF deposit,[24] as surplus cash was transferred to HM Treasury as part of the cash transfer mechanism introduced in January 2013.

The level of CRDs increased to £4.1bn at 28 February 2014 (2013: £2.5bn) following the 2013 review, which increased the CRD ratio to 0.18% from 0.11% but also raised the minimum deposit threshold to £600m, effective 3 June 2013.

'Capital and reserves' decreased to £3.0bn (2013: £3.4bn) largely due to changes in market valuations of gilts and retirement benefit remeasurements. The Bank's retained earnings, together with CRDs, are predominantly invested in gilts and supranational sterling bonds. The Banking Department's holdings of gilt securities and other supranational bonds were £5.9bn at 28 February 2014 (2013: £4.7bn).

At 28 February 2014, the Banking Department balance sheet contained £3.6bn of liabilities associated with the management of the Bank's foreign exchange reserves (2013: £4.0bn).

Issue Department

The statements of account for the Issue Department (which is provided on pages 123–127) reflects net profits of note issue of £443m (2013: £517m), which is payable in full to HM Treasury. The Issue Department holds gilts to back the notes. In 2013, gilt revaluations contributed £82m to income. There were no such revaluation gains in 2014.

'Notes in circulation' continued to increase year on year, and totalled £60.2bn at 28 February 2014 (2013: £58.0bn). Gilt purchases to back banknote issuance, introduced in January 2008, remained on hold during the year whilst BEAPFF undertook gilt purchase operations. The market valuation of gilts on Issue Department was £4.2bn at 28 February 2014 (2013: £4.9bn). The *'Ways and Means advance'* to HM Treasury remained at £370m as at 28 February 2014.

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24 The Bank of England Asset Purchase Facility Fund Ltd, a subsidiary of the Bank of England established on 30 January 2009. This is the vehicle through which quantitative easing is conducted. The Fund and the Bank are indemnified by HM Treasury from any losses arising out of, or in connection with, the Facility.

Report on remuneration

The Remuneration Committee advises and the Oversight Committee determines the remuneration of the Governors, Members of the MPC, FPC and the Independent Directors of the PRA.

The Remuneration Committee advises and Court determines the remuneration of the Chief Operating Officer and the Executive Directors. The Remuneration Committee also advises on major changes to the remuneration structure within the Bank, including pension schemes.

Remuneration policy

The Committee's policy has been and remains to set pay, benefits and other conditions of service that are appropriate to the Bank's needs. The Committee takes account of 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 advisers to benchmark individual roles and pay across the Bank as a whole. The last such review was undertaken in 2006, by Towers Watson. In last year's *Annual Report* it was stated the next five-yearly review of senior Bank remuneration would be undertaken during 2013. This has been deferred pending completion of the current strategic planning exercise.

The 2006 review proposed a rate of £375,000p.a. to £400,000p.a. for the Governor and £315,000p.a. for the Deputy Governors, in all cases with smaller pension benefits. Although the salary for the Governor has been increased, salaries for Deputy Governors do not reflect the full proposed adjustment. Pension benefits for Governors and Deputy Governors have been reduced. The Court pension scheme, along with the Bank's final salary scheme for staff, is now closed to new members, and with Mr Bean's retirement in June there will be no remaining active members. Any new Governor or Deputy Governor is now enrolled into the career average section of the Bank Pension Fund but may opt out and receive a salary supplement of 30% in lieu of pension. Governors receive no bonuses or performance-related pay. It is the Bank's policy to relocate those appointed to senior positions as necessary, and to incur the costs of doing so. In line with this policy, the Bank relocated Mr Carney and his family from Ottawa to London. Procurement decisions in that process were taken by the Bank. The final cost of the relocation was £102,816, of which £10,678 was related to 2012/13. Under HMRC rules, these costs, with the exception of the first £16,106, are also subject to tax, and gave rise to a tax liability borne by the Bank of £95,846.

The Governor is appointed by the Crown for a non-renewable term of eight years,[25] and Deputy Governors are each appointed by the Crown for five-year terms, which may be renewed once. The Governors have no termination provisions, other than a 'purdah' period of three months' continued employment by the Bank when they cease to be members of the Bank's policy committees but remain subject to Bank rules of conduct, including restrictions on public statements and other employment. This provision applied to Sir Paul Tucker when he left the Bank in October 2013.

Members of Remuneration Committee

Sir Roger Carr
Chairman

Michael Cohrs

Sir David Lees

Dave Prentis

John Stewart

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25 Mr Carney indicated at the time of his appointment that he intended to serve only five years.

Under the Bank of England Act 1998, Governors are required to provide remunerated services only to the Bank. With Court's approval other directorships relevant to the Bank's work may be accepted, but any fees must be surrendered to the Bank. The only such directorships held during the past year have been the appointment to the Financial Services Authority (FSA) Board (subsequently the Financial Conduct Authority Board) held by Sir Paul Tucker and Mr Bailey, and the memberships of the Board of the Bank for International Settlements held by Lord King, Mr Carney and Sir Paul Tucker.

Remuneration levels

The remuneration arrangements for the present Governor were agreed and announced in January 2013, and were set out in last year's Report. The Governor's salary was set at £480,000p.a., with membership of the Bank's career average pension scheme or 30% of salary in lieu.[26] This was equivalent to the remuneration of the previous Governor on appointment, although the mix of pension and salary was different.

The salaries of the Governor and the Deputy Governors are reviewed each year. In the 2014 review, the Governor's salary was unchanged. The salaries of the Deputy Governors, which had been £258,809p.a. since 2010, were increased by 2% with effect from 1 March 2014. Mr Bean remains a member of the Court pension scheme (see below): Sir Jon Cunliffe and Mr Bailey both receive 30% of salary in lieu of pension, the latter having stopped accrual in the Court pension scheme in 2012.

The Court section of the Pension Fund allowed members to achieve a maximum pension of two thirds of salary at a normal pension age of 60 after 20 years of service. A part of this is provided in Mr Bean's case by an unfunded scheme, set up for executives who were subject to the pension earnings cap introduced in the Finance Act 1989. Provision for these unfunded benefits is made in the Bank's financial statements. The Court pension scheme is now closed and Court decided in 2005 not to make any further unfunded commitments to members.

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26 In the event, the Bank became subject to pension auto-enrolment in August 2013 and Mr Carney was enrolled into the career average pension scheme. As the table on pages 52–53 shows, the value of accrual in that scheme is approximately 30% of salary.

£	Mr M J Carney 2013/14	Mr M J Carney 2012/13	Lord King 2013/14	Lord King 2012/13	Mr A J Bailey[27 28] 2013/14	Mr A J Bailey[27 28] 2012/13	Mr C R Bean 2013/14	Mr C R Bean 2012/13
Base salary	320,000	–	178,131	305,368	253,127	–	258,809	258,809
Fees	–	–	–	–	–	–	–	–
Salary and fees	**320,000**	**–**	**178,131**	**305,368**	**253,127**	**–**	**258,809**	**258,809**
Taxable benefits[29]	**167,680**	**–**	**36,890**	**3,929**	**11,356**	**–**	**1,670**	**1,705**
Pension benefits	98,330	–	–	–	–	–	116,630	73,440
Payment in lieu of pension	–	–	–	–	75,938	–	–	–
Pension benefits	**98,330**	**–**	**–**	**–**	**75,938**	**–**	**116,630**	**73,440**
Total remuneration	**586,010**	**–**	**215,021**	**309,297**	**340,421**	**–**	**377,109**	**333,954**

	Accrued pension as at 28 Feb 14 £p.a.	Accrued pension as at 28 Feb 13 £p.a.	Increase in accrued pension £p.a.	Pensionable age
Mr M J Carney	4,900	–	4,900	65
Mr C R Bean	119,200	110,900	8,300	60
Sir Paul Tucker	161,100	157,700	3,400	60

No additional benefits are receivable by the Directors on early retirement.

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27 Mr Bailey was appointed to the position of Deputy Governor from 1 April 2014. The table includes his remuneration for the full year.

28 Mr Bailey is deemed to have worked exclusively for the PRA and the Bank therefore recharges his total remuneration to the PRA. Mr Carney, Lord King, Sir Paul Tucker and Sir Jon Cunliffe have also provided director services to the PRA in the year. No apportionment for these services is made in the table above.

29 Taxable benefits comprise rental allowances, leaving gifts, medical and dental cover.

£	Sir Jon Cunliffe 2013/14	Sir Jon Cunliffe 2012/13	Sir Paul Tucker 2013/14	Sir Paul Tucker 2012/13	Non-executive Directors 2013/14	Non-executive Directors 2012/13
Base salary	86,270	–	228,615	258,809	–	–
Fees	–	–	–	–	150,000	150,000
Salary and fees	**86,270**	**–**	**228,615**	**258,809**	**150,000**	**150,000**
Taxable benefits	**584**	**–**	**5,616**	**4,411**	**15,458**	**17,356**
Pension benefits	–	–	–	166,310	–	–
Payment in lieu of pension	25,681	–	–	–	–	–
Pension benefits	**25,681**	**–**	**–**	**166,310**	**–**	**–**
Total remuneration	**112,535**	**–**	**234,231**	**429,530**	**165,458**	**167,356**

Taxable benefits

The Remuneration Committee also keeps under review other benefits available to the Governors. Mr Carney receives, as was announced on his appointment, an annual accommodation allowance of £250,000p.a., to reflect the additional cost of living in London rather than in Ottawa. Medical insurances and health checks were the principal other non-salary benefits received during the year to 28 February 2014. In addition, Lord King received leaving gifts from the Bank with a total pre-tax value of £17,042.

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.[30]

With effect from 1 June 2009, these rates were set at £15,000p.a. for Directors, £20,000p.a. for Committee Chairmen, £25,000p.a. for the Senior Independent Director and £30,000p.a. for the Chairman of Court. In 2013, the rate for the Chairman of Court was increased to £48,000p.a., to take effect from the new chairman's succession in July 2014. 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 meets appropriate travel and subsistence expenses.

30 This function is delegated by Court to the Governor's Committee on Non-executive Directors' remuneration.

Remuneration of MPC, FPC and PRA Board members

The terms and conditions of service of the external members of the MPC and the FPC appointed by the Chancellor of the Exchequer and of the PRA Board members appointed by Court are determined by the Oversight Committee. These members are appointed for terms of three years on a part-time basis, and must not during their term of office retain or accept other appointments or interests that would create a conflict with their responsibilities at the Bank.

The external members of the MPC were each paid £133,091 in 2013/14. The external members of the FPC and the Independent Directors of the PRA were paid at the rate of £77,520p.a. In February 2014, the Committee reviewed, in the light of experience, the time commitment involved for the members of each of these committees, and decided to increase the fees of an FPC external member to £90,698p.a., and of an Independent member of the PRA Board to £102,326p.a., both with effect from 1 March. MPC external members' fees were increased by 2%, to £135,751p.a.

On leaving the Bank, members of the three policy committees are paid their salary for a period of three months, during which time the Bank has the right to veto any employment that would conflict with their former FPC, MPC or PRA responsibilities, and to require continued adherence to the relevant Committee's code of conduct.

COO and Executive Directors' salaries and benefits

The table below shows the basic salaries and taxable benefits of the Chief Operating Officer (COO) and the Executive Directors as at 28 February 2014.

Julian Adams*	239,343
Nils Blythe	168,303
Ralph Coates	209,133
Spencer Dale	189,606
John Finch	220,903
Paul Fisher	189,606
John Footman	196,960
Andrew Gracie	180,243
Andy Haldane	189,606
Charlotte Hogg (COO)	259,756
Graham Nicholson	194,334
Joanna Place	170,613
Chris Salmon	189,606

*FSA terms.

The above figures ignore both pension benefits and performance related pay. In the Bank, Executive Directors may be accruing pension in the final salary pension scheme or (for those joining after 2006) the Bank career average scheme[31] – and where tax limits have been reached they may instead receive a 30% salary supplement. Those who joined from the FSA – indicated * in the table – are still on FSA terms and as such receive a much smaller pension contribution or cash equivalent. Bonus pools are also different for the two groups. In 2013/14, bonus payments were made to Executive Directors, other senior executives and staff on Bank terms from a pool of 6% of relevant base salaries; in the case of those still on FSA terms the pool was 11.25%. All bonuses were allocated on an individual performance-related basis.

31 Accrual rates in those schemes are shown in Note 18 to the Accounts.

Other senior executives' salaries and benefits

The table on the right shows the remuneration ranges for all staff with remuneration in excess of £80,000, apart from those disclosed above. The figures relate to 2013/14, show the full-time equivalent salary and include base pay and any taxable benefit allowances, but exclude individual performance-related payments and employer pension contributions. As noted previously (page 54), there are currently wide divergences between the bonus and pension arrangements for Bank and ex-FSA staff. These issues are being addressed in a Bank-wide project to review pay structures (page 32), which the Committee is monitoring closely.

Remuneration range £	Number in range
230,000–239,999	1
220,000–229,999	1
210,000–219,999	2
200,000–209,999	0
190,000–199,999	9
180,000–189,999	11
170,000–179,999	9
160,000–169,999	18
150,000–159,999	25
140,000–149,999	31
130,000–139,999	40
120,000–129,999	44
110,000–119,999	58
100,000–109,999	81
90,000–99,999	143
80,000–89,999	159
Total	**632**

Sir Roger Carr
Chairman of the Remuneration Committee

Risk management and business practices

Court is responsible for the risk management and internal control systems in the Bank and its subsidiaries. The responsibility for day-to-day operations is delegated to the Executive Directors.

The risk management and internal control systems are based upon what Court considers to be appropriate to the Bank's activities, to the materiality of the financial and other risks inherent in those activities and to the relative costs and benefits of implementing specific controls. They are designed to manage rather than eliminate the risk of failure to achieve the Bank's strategic priorities and, as such, provide reasonable, but not absolute, assurance against material misstatement or loss.

In accordance with the Financial Reporting Council's Revised Guidance for Directors on the UK Corporate Governance Code, Court has reviewed the effectiveness of the risk management and internal control systems. Court confirms that an ongoing process of identifying, evaluating and managing the Bank's risks has operated throughout the year covered in this *Annual Report* and up to the date of its approval. To facilitate Court's review and confirmation, the Executive Directors and Directors have certified compliance with the Bank's risk management and internal control requirements by the areas for which they are responsible. This attestation included a review of the risk and control issues identified and reported during the year. The year ahead will see further evolution of the framework to ensure it continues to meet requirements and support the aims of the Strategic Plan.

The Bank's risk framework

In order to deliver its objectives effectively and efficiently, the Bank is required to identify, assess and manage a wide range of risks. The Bank's risks are managed through an overarching framework in order to apply consistency and transparency of risk management 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. It considers strategic risks, which impact the Bank's ability to deliver its strategic priorities; financial risks to the Bank's balance sheet, arising from credit, market and liquidity risks; and operational risks resulting from weaknesses in business processes, systems or through staff or third-party activities, which may have an impact on the delivery of the key business functions or on the Bank's reputation.

Risk governance

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 management and internal control systems.

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

The Governors: The Governors receive a quarterly high-level report on financial risk from the Executive Director for Markets.

Executive Directors: Executive Directors are responsible for managing the risks within their Directorates. Each Bank Directorate has staff who 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.

The PRA Board: The PRA participates in the Bank-wide risk management framework, and the Board has established reporting systems and controls to ensure that it is able to monitor and manage risks that are specific to the PRA's objectives.

The risk assessments produced through this process are approved by the Board before being shared with ARCo, which Board members attend. Through ARCo, Board members share in monitoring operational risks arising in the Bank's common services.

The Board's appetite for risk is ultimately determined by the statutory objectives of the PRA and is set out in the PRA's strategy and approach documents. The Board is supported by a Supervisory Oversight Function, the aim of which is to provide assurance to senior management on the quality and effectiveness of supervision. The Supervisory Oversight Function reports directly to the Board.

Operations Committee (OpsCo): OpsCo has responsibility for strategic issues relating to the Bank's operations in financial markets. Its scope includes advising the Governor on the fitness of the Bank's financial risk standards and Balance Sheet Remit.

Assets and Liabilities Advisory Committee (ALCo): ALCo supports and advises the Executive Director for Markets on the management of the Bank's balance sheet under the terms of the annual 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.

Internal Audit Division: Internal Audit assists Court and EDCo in protecting the Bank, and its reputation, by independently and objectively evaluating the effectiveness of internal controls, risk management and governance processes.

Exchange Equalisation Account

The Bank acts as agent for HM Treasury in managing the UK'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 to 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. The Executive Director for Markets reports quarterly to HM Treasury on major risks, incidents and control issues on the EEA.

Health and safety

The Bank manages health, safety and risk as a priority. Through its safety management system the Bank delivers a safe working environment and promotes and maintains a positive health and safety culture. Health and safety issues and incidents are monitored by the Bank's Safety, Health and Environment (SHE) Committee which reports annually to Court.

The environment

In addition to health and safety, the SHE Committee monitors the impact of the Bank's operations on the environment. By managing waste production/disposal and reducing energy usage through better power efficiency, the Bank is able to minimise its impact on the environment. Recent replacement of engineering plant at the Bank's premises saw an improvement in efficiency and a reduction in consumption. This reduction is reflected in the displayed energy certificate.

More than 98%, or 1,439 tonnes, of waste generated by the Bank is recycled or reused. One third of this waste is utilised in the production of power through the burning of the waste material at an award winning 'Energy from Waste' facility. The Bank's main publications, including this *Annual Report*, are printed on paper which contains at least 50% recovered waste and 50% virgin fibre and is certified as a Forest Stewardship Council mixed sources product.

98%

Waste recycled

More than 98%, or 1,439 tonnes, of waste generated by the Bank is recycled or reused

Political and charitable donations

The Bank continued to play an active role in community initiatives. During 2013/14, the Bank contributed an estimated total of £824,000 in support of its community programme (2012/13: £615,000).

Cash donations totalled £485,000 (2012/13: £348,000), including:

- £120,000 to community organisations via the Staff Volunteering Award Scheme;
- £60,000 to charities supported by the Bank's Agencies;
- £35,000 to match staff fundraising for the staff charities of the year;
- £40,000 matched funding under the Payroll Giving Scheme;
- £15,000 via the Bank of England Court Awards, through which donations are made to community organisations in recognition of outstanding volunteering contributions by members of staff;
- £93,000 made to partner charitable organisations and membership subscriptions;
- £10,000 for the David Sharp School Governor Awards; and
- £112,000 in donations to support academic research (2012/13: £87,000).

The Bank may grant staff paid leave to perform voluntary duties in the community, or to undertake public and civic duties. The Bank estimates the total value of non-cash community contribution, including time spent by staff on community involvement, travel costs for volunteers and the costs of hosting charitable events at the Bank, to be £339,000 in 2013/14 (2012/13: £152,000), of which £179,000 was for staff time involved in volunteering and taking civic duties and volunteering leave. No donation was made for any political purpose in 2013/14 (2012/13: £nil). No paid leave was granted to staff for political purposes in 2013/14 (2012/13: £nil).

Policy on payment of suppliers

The Bank is an approved signatory to The Prompt Payment Code. Standard payment terms are 30 days but the Bank aims to pay invoices as quickly as possible. Measured in terms of the number of working days between receipt of an invoice and payment by the Bank, average trade creditor payment days were estimated to be 12.94 in 2013/14 (2012/13: 13.3). The average number of invoices processed per month in 2013/14 was 1,815 (2012/13: 1,650).

£824k

Donated

The Bank contributed an estimated total of £824,000 in support of its community programme in 2013/14

Report of the Oversight Committee

The Oversight Committee was created by the Financial Services Act 2012, with effect from April 2013.

Its responsibilities include monitoring the Bank's performance against all its objectives – the statutory objectives for monetary policy and financial stability (including the responsibilities of the FPC), and objectives set by Court itself – and also keeping under review the achievement of the Bank's financial management objectives, the Bank's internal controls, and the procedures of the MPC and the FPC.

Members of the Oversight Committee may attend meetings of the MPC, the PRA Board and the FPC and have access to their briefing papers. The Committee may commission external reviews to inform its work, though these must be retrospective and not related to current policy; subject to confidentiality restrictions, they must be published. This is the Committee's first *Annual Report*.

The Bank's Strategic Plan

The Committee has followed closely the evolution of the Bank's Strategic Plan. It strongly endorses the key theme: One Mission, One Bank, embodying the single core purpose of the Bank and the emphasis on working together. Making a reality of this has to start with the three policy committees – the MPC, the FPC and the PRA Board. We need to respect the committees' independence and separate objectives, but they have to be aware of and contribute to each other's thinking and priorities, and where possible to act together. This is critical to the effectiveness of the organisation as a whole.

There are already some examples of how this can be done: for example the FPC and the PRA Board have been working together on the 2014 stress-testing programme, jointly agreeing the scenarios and hurdle rates. And the combined initiatives on housing in November 2013 developed the synergies between the MPC, the FPC and the PRA.

Equally important is the need to guard against the risk that the policy committees create or reinforce administrative silos beneath them in the Bank. The organisational changes announced in March (pages 16 and 18–19) are designed to ensure that does not happen, and that the committees draw their support from all parts of the Bank.

The Committee will monitor closely the individual projects and initiatives that flow from the Strategy, seeking assurance both as to the control of costs and the ultimate delivery of the expected benefits.

Independent Evaluation Director

The new Strategic Plan proposed the appointment of an Independent Evaluation Director, reporting to the Chairman of Court and the Oversight Committee. The Director will play a role in identifying areas for review and in supporting the reviewers, who would typically be from outside the Bank.

Members of the Oversight Committee

Sir David Lees
Chairman

Sir Roger Carr

Michael Cohrs

Bradley Fried

Tim Frost

Dave Prentis

Lady Rice

John Stewart

The policy objectives

The Oversight Committee, either in Court or separately, receives briefings after each MPC, FPC and PRA Board meeting and there is a full discussion either at a Court or at an Oversight Committee meeting. Members of the Oversight Committee also receive key papers prepared for the three committees, and have exercised their rights to attend meetings as observers.

MPC

The Committee welcomed the MPC's forward guidance policy, announced in August, and believes that it has been highly beneficial in speaking directly and clearly to businesses and consumers in ways that had not been attempted previously, that had been understood, and that had influenced behaviours. The initial guidance – that the MPC would maintain the present policy stance at least until the unemployment rate had reached 7% – was modified following the unexpectedly sharp fall in unemployment in the fourth quarter, but the intention was unchanged and continues to influence expectations.

The Committee asked the Bank to explain the background to the forecast of unemployment published at the time of the August 2013 *Inflation Report*. The Bank's analysis of developments in the labour market have been published in the *Inflation Report*.

FPC

Although an interim FPC had been in operation since 2010, the Committee's official existence started in April 2013 when the relevant sections of the Financial Services Act 2012 came into force.

The FPC has reiterated medium-term policy priorities including the steady-state capital framework for banks, steps to end 'too big to fail', encouraging market-based finance, and identifying risks from shadow banking. The Oversight Committee has noted the importance of close working relationships between the FPC and the PRA. The joint work on stress testing has already been mentioned: another example, involving all three policy committees, was the announcement of co-ordinated initiatives on housing in November: this set out a co-ordinated, graduated, and prudent response to guard against risks to financial stability, the range of additional steps that the FPC could take in the future, an announcement that the PRA would end its temporary capital relief on new household lending, and that the Funding for Lending Scheme would be focused only on the support of business lending.

In addition to its statutory responsibilities, the FPC received during the year a number of commissions from other bodies, including HM Treasury (to conduct an annual assessment on the potential financial stability implications of the Help to Buy scheme) and the MPC (as part of forward guidance, to alert them if the stance of UK monetary policy posed a significant threat to financial stability). In addition, the Chancellor asked the FPC, in November 2013, to conduct a review into the role of the leverage ratio within the capital framework.

Members of the Oversight Committee have exercised their rights to attend meetings of the MPC, FPC and PRA Board as observers

The PRA Board

The PRA Board also came into being in April 2013. It is independently responsible for delivering its statutory objectives, and does that by making policies and rules, by supervising authorised firms to ensure that they continue to meet the Threshold Conditions, and by acting firmly and decisively when they do not. Major decisions concerning the biggest banks and insurance companies are taken by the Board itself.

The Oversight Committee cannot second-guess those decisions, but will maintain an open and frank dialogue with the PRA Board members, both Executive and Independent, to understand any risks or impediments to delivery of its objectives and strategy, including in particular where those relate to resources, remuneration issues or the interaction with the rest of the Bank. Independent PRA Board members have been invited to attend Court's Audit and Risk Committee and Remuneration Committee.

The immediate operational issue has been the high (relative to the rest of the Bank) staff turnover rate at the PRA, and the effectiveness of Bank HR in recruiting replacements. The Committee has been monitoring this closely.

The Committee has noted that the Chancellor announced in November an independent investigation into events at the Co-operative Bank and the circumstances surrounding them. That review will not start until the PRA and the Financial Conduct Authority have completed enforcement investigations. The PRA confirmed in January that it is undertaking an enforcement investigation in relation to the Co-operative Bank and as part of that investigation will consider the role of former senior managers.

Secondary objectives

During the year, the Financial Services (Banking Reform) Act 2013 was passed, giving the PRA a new secondary objective to facilitate competition. The PRA Board has been reflecting on how to incorporate this into its decision-taking. The Oversight Committee intends over the coming year to review the impact of the secondary objectives of each of the MPC, the FPC[32] and the PRA and has asked them to provide an account of how their secondary objectives are embedded into policymaking, how they relate to the primary objective, how success would be judged and what impediments there may be to their achievement.

MPC and FPC procedures

The Oversight Committee is responsible for keeping under review the procedures of the MPC and the FPC. This is achieved through a structured questionnaire circulated to all MPC and FPC members, the results of which are discussed in Court; and the Chairman of the Oversight Committee supplements this with individual meetings with all MPC and FPC members. Additionally, since April 2013, members of the Committee have been able to observe MPC and FPC meetings at first hand.

The MPC process is well established and in the view of all members well supported by the Bank staff. In the latest annual survey many scores were at their highest level on record. Around 80% of scores were 'excellent' or 'very good', compared to around 70% in 2012. Staff inputs continue to be valued more highly than before the crisis.

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32 Both the MPC and the FPC have a secondary objective to support the economic policies of Her Majesty's Government, including its objectives for growth and employment.

Introduction of forward guidance provided a major challenge. A group of economists was assembled to work full time on this, with others contributing significant amounts of time and effort at various stages of the process. In addition to the specific processes supporting the introduction of forward guidance, further changes were undertaken: to improve the forecasting of variables integral to the form of guidance the MPC implemented, such as unemployment and inflation at the 18 to 24-month 'knockout' horizon; to monitor better the impact of guidance on financial markets; and to commission and assess bespoke surveys to ascertain the extent to which forward guidance was understood by companies and households. During the February 2014 forecast round, the staff provided further briefing on ways in which the MPC might wish to update its forward guidance in light of the fact that unemployment looked likely to pass through the MPC's 7% threshold shortly thereafter.

As noted below, process improvements were made following the Stockton Review of forecast capabilities. These led to a substantial improvement in the transparency of monetary policy. An 'MPC key judgements' table of projections is now included in the *Inflation Report*: the table in the February 2014 *Report* contained projections for ten variables. And the *Inflation Report* now includes scenario analysis illustrating the possible implications for the economy if it evolves differently than the judgements underpinning the central projection would suggest.

A biannual MPC challenges meeting now gives the staff an explicit mandate to bring alternative perspectives on aspects of the Committee's forecast.

There have been significant improvements in interaction with the FPC. In Autumn 2013, a joint Special Project Team was convened, comprising staff from across the Monetary Analysis and Financial Stability areas and the PRA, to present to the MPC and FPC on the housing market. More generally, management and staff across Monetary Analysis, Financial Stability and the PRA increasingly worked together to ensure that all of the Bank's policy committees received high-quality and co-ordinated briefing on macroeconomic, financial stability and prudential issues.

The FPC process started inevitably from a lower base, but members commented on an overall improvement during the first year of operation as a statutory committee, with agendas and discussions increasingly focused, and stronger support from the secretariat. In response to the Chancellor's request in his 2013 Remit and Recommendations letter, the FPC agreed and publicised three medium-term priorities: the medium-term capital framework for banks; ending 'too big to fail'; and ensuring diverse and resilient sources of market-based finance. This was seen as helpful, and for each of the priorities, FPC member 'sponsors' have been appointed.

The FPC and PRA Board have also worked closely together on the stress-testing framework for UK banks for 2014 and beyond, with a Discussion Paper published in October 2013. The Chairman however noted some concern among FPC members about the resources available for stress testing.

Reviews

In May 2012, Court commissioned external reviews focused on three areas of the Bank's performance and capabilities that had been tested in the financial crisis: the arrangements for providing emergency liquidity support to an institution; the framework for providing liquidity to the banking system as a whole; and the MPC's forecasting capability. Each review was conducted by an internationally respected expert, with support from Bank staff, and made a number of recommendations. The Bank's responses to the recommendations were published in March 2013. Implementation of the reviews has been monitored by the Oversight Committee. Many of the initiatives reported elsewhere in this *Annual Report* flow directly from the reviews.

Liquidity insurance

The changes to the Bank's Sterling Monetary Framework (SMF) announced in October 2013 reflect the recommendations in the Winters Review, together with the Bank's own assessment of the changing regulatory and financial market landscape. In summary, the changes were designed to increase the availability and flexibility of liquidity insurance, by providing liquidity at longer maturities, against a wider range of collateral, at a lower cost and with greater predictability of access. The Bank published the first of a series of Annual Reports on the SMF in the June 2014 *Quarterly Bulletin*.

Emergency Liquidity Assistance (ELA)

The Plenderleith Review highlighted many of the operational lessons of the crisis and made recommendations to embed those lessons in the Bank's procedures. ELA operations are rarely needed: but when they are, the procedures need to be instantly available for use, and co-ordination both inside and outside the Bank needs to be effective and rapid. The arrangements need to be tested regularly. In the light of the work done over the past 18 months, the Committee is satisfied that the Bank is well-prepared and that the major risks to such operations have been identified. The Bank continues to review the issues surrounding the possible provision of ELA to non-bank financial institutions.

Forecast capabilities

The Stockton Review recommended providing greater transparency about the MPC's forecasts; enhancing the role of monetary policy analysis in the forecast process; and exposing the MPC's forecasts to increased challenge. The Bank's response highlighted three distinct ways in which the Bank would provide greater transparency about the MPC's forecasts: providing more detailed information about the key judgements and risks underlying the Committee's forecasts; producing an enhanced forecast evaluation exercise; and changing the way in which information about the MPC's forecast distributions is communicated. The MPC decided that they would publish more information about the central forecast and the risks around this forecast in the February 2014 *Inflation Report*. They also confirmed their intention to publish an enhanced forecast evaluation exercise in the November 2013 *Inflation Report*, with the staff publishing more of the detailed analysis underlying this evaluation in the Winter 2013 *Quarterly Bulletin*.

Implementation of the reviews has been monitored by the Oversight Committee

Record keeping

In July 2012, concerns were expressed in Parliament about the Bank's procedures for making and keeping records of discussions with market participants. In response, the Chairman of Court commissioned a review by Internal Audit, which was completed and published in 2013.[33] The review concluded that the Bank's arrangements for record management were relatively well developed, comparing favourably with those in other public sector and commercial organisations, but that some policies, particularly around the creation of records, could be improved and arrangements for oversight and monitoring enhanced. The recommendations are being implemented during the course of 2014.

Foreign exchange markets

As part of the Financial Conduct Authority's wider review of foreign exchange market manipulation, the Bank became aware of suggestions that Bank staff had been aware of, and condoned, manipulation of foreign exchange markets around the 4pm fix. The Bank conducted an initial enquiry, using external lawyers to sift records, including emails, phone calls and chatroom conversations. Some records were released under Freedom of Information requests. In March, a member of staff was suspended. At that point the Oversight Committee, which had been kept informed throughout, took over the investigation, and appointed Lord Grabiner QC to lead it. The investigation is to determine whether any Bank official was involved in, or aware of the potential for manipulation of the foreign exchange market, the sharing of confidential client information, or any other unlawful or improper behaviour or practice. Depending on the findings, the Committee may wish to make recommendations to improve processes and controls within the Bank. A report of the investigation will be published, though this is likely to be deferred until the Financial Conduct Authority's investigation is concluded.

Finance and Value for Money

During the year a review of the Bank's central services functions identified savings that would reach £18m p.a. by 2015/16 (around 10% of the spend reviewed). Funds released through this review will be reinvested across the business in order to support delivery of the Bank's objectives, and will enable the Bank to finance its new strategy within existing budget commitments.

The Bank's overall budget at £521m remains tightly controlled; within that, the PRA's 2015 budget is £238m, including central overheads, against the 2014 budget of £230m (on a full-year equivalent basis and including £12m of special project and transition costs). The latter figure was originally based on an agreed division of the Financial Services Authority budget, and represented what the PRA would have cost had it remained within the Financial Services Authority. The Committee has reviewed and is content with the proposed distribution of spending across the Bank's functions.

Risk and controls

The Oversight Committee monitors the Bank's risks and controls, mainly through the Audit and Risk Committee (ARCo). ARCo met seven times during the year, and in addition to its minuted meetings, the Committee held private meetings with the Governor and Deputy Governors, the Chief Operating Officer, and internal and external auditors.

Members of Audit and Risk Committee

Lady Rice
Chairman

Bradley Fried

Tim Frost

John Stewart

(Additionally the Chairman of Court normally attends the Committee's meetings)

33 www.bankofengland.co.uk/boe-ar2014/links

During the year, ARCo oversaw the management of risks relating to high-level projects, notably the PRA's transition following legal cutover, as part of which it received periodic reports on the PRA's Business Transformation Programme. Performance, Finance and Risk reporting for the PRA has been integrated into the Bank's framework, and members of the PRA Board now attend ARCo as the group Audit Committee. The National Audit Office, as statutory auditor of the PRA, also attends some meetings of ARCo.

It received assurance that financial risks to the Bank's enlarged balance sheet were being adequately managed via regular reporting from the Executive Director for Markets, including reports on the sterling bond portfolio and on the collateral management system. Regular reporting and updates on accounting risks and issues were taken to ARCo, with the May 2014 ARCo focusing on the draft *Annual Report and Accounts* for the Bank and the PRA.

ARCo also discussed reports relating to business practice risk, including: an analysis of the financial and business risks associated with contracting for new banknote substrates; annual reports; managing Freedom of Information requests; the Bank's whistle-blowing policy; and on data collected in the Bank's risk management and incident management systems. It received regular reports from the internal and external auditors.

During the year, ARCo oversaw the management of the PRA's transition following legal cutover

Remuneration

The report of the Remuneration Committee is on pages 50–55 and, so far as relevant to the Oversight Committee's responsibilities, is to be regarded as part of this Report.

Attendance

The table below sets out attendance by the Bank's Non-executive Directors at meetings of Court, the Oversight Committee, the Audit and Risk Committee and the Remuneration Committee (RemCo). Attendance by other Court members is also listed.

	Court (8)	Oversight (7)	Audit & Risk (7)	RemCo (8)
Sir David Lees	8	7	6	8
Sir Roger Carr	7	4	–	8
Lady Rice	8	6	7	–
Lord Turner (resigned 31 March 2013)	1 of 1	–	–	–
Mr Stewart	7	7	5	3 of 3
Mr Cohrs	8	7	–	4
Mr Fried	8	7	7	–
Mr Frost	8	7	7	–
Mr Prentis	7	6	–	6
Lord King (retired 30 June 2013)	3 of 3	–	–	–
Mr Carney (appointed 1 July 2013)	5 of 5	–	–	–
Mr Bean	7	–	5	–
Sir Paul Tucker (resigned 18 October 2013)	4 of 5	–	2 of 5	–
Mr Bailey (appointed 1 April 2013)	7 of 7	–	6 of 6	–
Sir Jon Cunliffe (appointed 1 November 2013)	3 of 3	–	2 of 2	–

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 2014 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 Acts 1928 and 1954, the National Loans Act 1968 and the Currency Act 1983. The Court of Directors is responsible for ensuring that the statements of account are prepared in accordance with these requirements as at 28 February 2014 and for the year to that date.

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 of the Accounts. 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 75–83.

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 Bank's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Report of the Independent Auditor

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

We have audited the financial statements of the Banking Department ('financial statements') for the year ended 28 February 2014, set out on pages 70 to 122, and the statements of account of the Issue Department ('statements of account') for the year ended 28 February 2014, set out on pages 123 to 127. The financial reporting framework that has been applied in their preparation is applicable law and 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 Members of Court and auditor

As explained more fully in the Statement of the Responsibilities of the Court of Directors set out on page 67, the Members of Court are responsible for the preparation of the financial statements and statements of account in accordance with applicable law and the bases of preparation set out in note 1 on page 75 and note 2 on pages 75 to 83 respectively.

Our responsibility is to audit, and express an opinion on, the financial statements and statements of account in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements and statements of account

An audit involves obtaining evidence about the amounts and disclosures in the financial statements and statements of account sufficient to give reasonable assurance that the financial statements and statements of account are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Members of Court; and the overall presentation of the financial statements and statements of account. In addition, we read all the financial and non-financial information in the *Annual Report* to identify material inconsistencies with the audited financial statements and statements of account. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements and statements of account

In our opinion:

- the financial statements of the Banking Department on pages 70 to 122 for the year ended 28 February 2014 have been properly prepared, in all material respects, in accordance with the bases of preparation set out in note 2 on pages 75 to 83.
- the statements of account of the Issue Department on pages 123 to 127 for the year ended 28 February 2014 have been properly prepared, in all material respects, in accordance with the bases of preparation set out in note 1 on page 125.

Opinion on other matter

In our opinion the information given in the Remuneration report, the Financial Review, the Risk Management and Business Practices, and the Report of the Oversight Committee for the financial year for which the financial statements and statements of account are prepared is consistent with the financial statements and statements of account.

David Todd
for and on behalf of KPMG Audit Plc
Statutory Auditor
Chartered Accountants
15 Canada Square
Canary Wharf
London E14 5GL

4 June 2014

Banking Department income statement
for the year to 28 February 2014

	Note	2014 £m	2013 £m
Profit before tax		**180**	**125**
Corporation tax net of tax relief on payment to HM Treasury	7	(20)	(15)
Profit for the year attributable to shareholder		**160**	**110**

The notes on pages 75 to 122 are an integral part of these financial statements.

Statement of comprehensive income
for the year to 28 February 2014

	2014 £m	2013 £m
Profit for the year attributable to shareholder	**160**	**110**
Other comprehensive (loss)/income that may be recycled to profit or loss:		
Available for sale reserve		
Net (losses) from changes in fair value	(326)	(44)
Current and deferred tax	81	21
Property Revaluation Reserve		
Net gains from changes in fair value	17	–
Deferred tax	(3)	–
Total comprehensive (loss) that may be recycled to profit or loss	**(231)**	**(23)**
Other comprehensive (loss)/income not recycled to profit or loss:		
Retirement benefit remeasurements	(202)	(95)
Deferred tax	48	28
Other comprehensive (loss) for the period	**(385)**	**(90)**
Total comprehensive (loss)/income for the year	**(225)**	**20**

The notes on pages 75 to 122 are an integral part of these financial statements.

Balance sheet
as at 28 February 2014

	Note	2014 £m	2013 £m
Assets			
Cash and balances with other central banks	9	584	787
Loans and advances to banks and other financial institutions	10	9,899	11,719
Other loans and advances	11	375,197	375,196
Securities held at fair value through profit or loss	12	6,090	3,573
Derivative financial instruments	13	179	334
Current tax assets		–	12
Available for sale securities	14	6,342	5,179
Investments in subsidiaries	15	–	–
Property, plant and equipment	16	262	243
Intangible assets	17	11	11
Retirement benefit assets	18	312	460
Other assets	19	465	211
Total assets		**399,341**	**397,725**
Liabilities			
Deposits from central banks	20	14,854	14,371
Deposits from banks and other financial institutions	21	318,735	297,124
Other deposits	22	58,103	78,063
Foreign currency bonds in issue	23	3,599	4,007
Derivative financial instruments	13	465	229
Deferred tax liabilities	24	60	166
Retirement benefit liabilities	18	197	202
Other liabilities	25	281	211
Total liabilities		**396,294**	**394,373**
Equity			
Capital	26	15	15
Retained earnings		2,391	2,465
Other reserves		641	872
Total equity attributable to shareholder		**3,047**	**3,352**
		399,341	**397,725**

On behalf of the Governor and Company of the Bank of England:

Mr M Carney Governor
Mr C R Bean Deputy Governor
Sir David Lees Chairman of Court
Mr R Coates Finance Director

Statement of changes in equity
for the year to 28 February 2014

	Note	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings £m	Total £m
		Attributable to equity shareholder				
Balance at 1 March 2012		**15**	**750**	**145**	**2,477**	**3,387**
Post-tax comprehensive income/(loss) for the period		–	(23)	–	43	20
Payable to HM Treasury in lieu of dividend	8	–	–	–	(55)	(55)
Balance at 28 February 2013		**15**	**727**	**145**	**2,465**	**3,352**
Post-tax comprehensive income/(loss) for the period		–	(245)	14	6	(225)
Payable to HM Treasury in lieu of dividend	8	–	–	–	(80)	(80)
Balance at 28 February 2014		**15**	**482**	**159**	**2,391**	**3,047**

The notes on pages 75 to 122 are an integral part of these financial statements.

Statement of cash flows
for the year to 28 February 2014

	Note	2014 £m	2013 £m
Cash flows from operating activities			
Profit before taxation		**180**	**125**
Adjustments for:			
Amortisation of intangibles	17	2	4
Depreciation of property, plant and equipment	16	14	11
Dividends received	4	(17)	(14)
Net movement in accrued interest and provisions, including pensions		59	125
Changes in operating assets and liabilities:			
Increase in loan advanced to the Bank of England Asset Purchase Facility Fund Ltd	11	–	(88,614)
Net decrease in other advances		2,463	1,120
Net increase in securities held at fair value through profit or loss		(3,011)	(214)
Net increase in deposits		2,134	87,035
Net (decrease)/increase in foreign currency bonds in issue		(3)	7
Net decrease/(increase) in financial derivatives	13	391	124
Net increase in other accounts		2	(54)
Corporation tax overpayment/(paid)		12	(56)
Net cash inflow/(outflow) from operating activities		**2,226**	**(401)**
Cash flows from investing activities			
Purchase of available for sale securities		(1,768)	(235)
Proceeds from redemption of available for sale securities	14	242	297
Dividends received	4	17	14
Purchase of intangible assets	17	(2)	(5)
Purchase of property, plant and equipment	16	(24)	(37)
Net cash inflow/(outflow) from investing activities		**(1,535)**	**34**
Cash flows from financing activities			
Tax on financing activities		–	633
Payment to HM Treasury under Section 1 (4) of the Bank of England Act 1946		(55)	(2,298)
Net cash (outflow)/inflow from financing activities		**(55)**	**(1,665)**
Net increase/(decrease) in cash and cash equivalents		**636**	**(2,032)**
Cash and cash equivalents at 1 March	27	4,140	6,172
Cash and cash equivalents at 28 February	**27**	**4,776**	**4,140**

Notes to the Banking Department financial statements

1 General information

The Bank of England is the central bank of the UK and is incorporated under a Royal Charter of 1694. Legislation covering its operations includes the Bank Charter Acts of 1694 and 1844, the Bank of England Acts 1946 and 1998, the Banking Act 2009 and the Financial Services Act 2012.

The Bank Charter Act 1844 requires that the Bank's note issue function be separated from its other activities. Accordingly, for accounting purposes, the Bank is divided into Issue Department and Banking Department, which are accounting designations and reporting entities. Neither is an organisational unit of the Bank. The Issue Department is solely concerned with the note issue and the assets backing the issue. The statements of account of the Issue Department are given on pages 123 to 127, and show the note issue, the assets backing the issue, the income generated by those assets and the costs incurred in production, issue, custody and payment of notes. The net income of the Issue Department is paid over to National Loans Fund. Securities held on Issue Department are revalued quarterly at their clean market price. If a revaluation of securities shows a net gain this is included in income. A deficit is not taken against income but is settled by a transfer from the National Loans Fund. The Banking Department comprises all other activities of the Bank. The post-tax profits of the Banking Department are effectively shared equally with HM Treasury unless the Bank and HM Treasury agree otherwise (see note 8).

2 Bases of preparation

The principal accounting policies applied in the preparation of the financial statements of the Banking Department are set out below. These policies have been applied consistently to all of the years presented, unless otherwise stated.

a Form of presentation of the financial statements

The financial statements of the Banking Department comprise the income statement, the statement of comprehensive income, the balance sheet, the statement of changes in equity, the statement of cash flows and related notes.

Under the Bank of England Act 1998, the Bank, in preparing the financial statements of the Banking Department, is subject to requirements corresponding to the Companies Act requirements relating to a banking company. The Bank may, however, disregard a requirement to the extent that it considers it appropriate to do so having regard to its functions.

The financial statements of the Banking Department have been prepared in accordance with the measurement and recognition requirements of the International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRICs) as adopted by the EU (together, 'adopted IFRS').

The financial statements have been prepared on the historical cost basis of accounting, modified to include the revaluation of land and buildings, financial assets that are available for sale and all financial assets and financial liabilities (including derivatives) that are held at fair value through profit or loss.

Adopted IFRS and the Companies Act have been used as a model for the presentation and disclosure framework to provide additional information and analysis of key items in the financial statements except insofar as the Bank considers disclosures inappropriate to its functions.

In exceptional circumstances, as part of its central banking functions, the Bank may act as 'lender of last resort' to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. In some cases, confidence can best be sustained if the Bank's support is disclosed only when conditions giving rise to potentially systemic disturbance have improved. Accordingly, although the financial effects of such operations will be included in the Banking Department's financial statements in the year in which they occur, these financial statements may not explicitly identify the existence of such support. However, the existence of such support will be reported in the *Annual Report* when the need for secrecy or confidentiality has ceased.

Notes to the Banking Department financial statements continued

2 Bases of preparation continued

As a result, the financial statements of the Banking Department disclose less detail of certain elements than would be required under either adopted IFRS or the Companies Act. Disclosure limitations include:

– Constituent elements of the income statement.

– Note disclosures for income and expenses, particularly relating to net interest income and provisions and related disclosures in the balance sheet and statement of cash flows.

– Operating segments.

– Contingent liabilities and guarantees.

– Information on credit risk.

– Fair value of collateral pledged and held.

– Related party disclosure.

– Off balance sheet arrangements.

b New and amended accounting standards

The Bank has considered the potential effect of forthcoming EU endorsed standards which have not been adopted in the financial statements; none of these is expected to materially impact the Bank.

c Consolidation

The financial statements of Bank's subsidiaries, including the Bank of England Asset Purchase Facility Fund Ltd and the Prudential Regulation Authority, have not been consolidated. Under the Bank of England Act 1998 the financial statements are prepared on a non-consolidated basis. Investments in subsidiaries are stated in the balance sheet at cost, less any provision for impairment in value. Dividends from subsidiaries are recognised in the income statement when declared.

d Foreign currency translation

i Functional and presentation currency

The financial statements of the Banking Department are presented in sterling, which is also the Bank's functional currency.

ii Transactions and balances

Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Where a gain or loss on a non-monetary item is recognised directly in other comprehensive income, such as equity investments classified as financial assets that are available for sale, the related exchange gain or loss is also recognised in other comprehensive income.

e Financial instruments: assets

i Classification of financial assets

The Bank classifies its financial assets in the following categories: loans and advances; financial assets at fair value through profit or loss; and financial assets that are available for sale. The Bank determines the classification at initial recognition.

Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money or services directly to a counterparty with no intention of trading the receivable. Assets in this category exclude those reverse repurchase agreements which are designated at fair value through profit or loss.

Financial assets at fair value through profit or loss

A financial asset is classified in this category if it is acquired principally for the purpose of selling in the short term or if so designated by management.

Derivatives must be held at fair value through profit or loss. The Bank does not currently hold any financial assets for trading but designates the following at fair value through profit or loss at inception:

– Securities and reverse repurchase agreements matching the Bank's issued foreign currency securities; and

– Securities and reverse repurchase agreements matching the fixed-term deposits placed at the Bank by other central banks.

This designation is to eliminate, or significantly reduce, inconsistencies that would otherwise arise from measuring assets and liabilities on different bases. The relevant assets and liabilities (including derivatives) are managed together and internal reporting is evaluated on a fair value basis.

Available for sale

Available for sale investments are those intended to be held for an indefinite period of time, which may be sold as part of the Bank's official operations or otherwise. They include sterling debt securities and unlisted equity investments.

ii Initial recognition of financial assets

Loans and advances and reverse repurchase agreements designated at fair value through profit or loss are recognised on a settlement date basis. Purchases of all other categories of financial assets are recognised on a trade date basis. All financial assets are initially recognised at fair value.

iii Subsequent valuation of financial assets

Gains and losses arising from changes in the fair value of assets classified as fair value through profit or loss are included in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of financial assets that are available for sale are recognised as other comprehensive income until the financial asset is derecognised or impaired (see (iv) below), at which time the cumulative gain or loss previously recognised as other comprehensive income is recognised in the income statement. Any premium or discount paid on the purchase of available for sale debt instruments is amortised through the income statement using the effective interest rate method.

The fair values of quoted investments in active markets are based on current bid prices. In other cases, the Bank establishes fair value by using appropriate valuation techniques. The policy for establishing fair values of securities in non-active markets is described in note 3 'Significant accounting estimates and judgements in applying accounting policies' on page 83.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has either transferred substantially all of the risks and rewards of ownership or the Bank deems that it no longer retains control of the risks and rewards of ownership.

Banking Department
Notes to the financial statements continued

2 Bases of preparation continued

iv Impairment of financial assets

Loans and advances

At each balance sheet date the Bank assesses whether there is objective evidence that a financial asset or group of assets is impaired. If there is objective evidence that an impairment loss on loans and advances has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows relating to that loan discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement. A loan is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount and, for a collateralised loan, after taking into account any value of the security which has been realised.

Available for sale financial assets

At each balance sheet date the Bank assesses whether there is objective evidence that a financial asset or group of assets is impaired. If such evidence exists for financial assets that are available for sale, the cumulative loss measured as the difference between acquisition cost and the current fair value, less any impairment loss previously recognised, is removed from equity and recognised in the income statement.

If, in a subsequent period, the fair value of a debt instrument designated as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement.

If, in a subsequent period, the fair value of an equity investment designated as available for sale increases the impairment loss is not reversed through the income statement except on realisation.

v Interest income

Interest income is recognised in the income statement using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability on initial recognition. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument, and any revisions to these estimates are recognised in the income statement. The calculation includes amounts paid or received that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

vi Dividends

Dividends on equity investments that are available for sale are recognised in the income statement when declared.

f Derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, or valuation techniques such as discounted cash-flow models. Generally the best evidence of the fair value of a derivative at initial recognition is the transaction price (ie the fair value of the consideration given or received). All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Derivatives are used for matching exposures on assets and liabilities, both individually and of portfolios. The Bank does not apply the hedge accounting rules of IAS 39.

g Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a current and legally enforceable right to offset the amounts recognised and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

h Property, plant and equipment

i Initial recognition

Expenditure on property, plant and equipment is capitalised if the asset is expected to have a useful economic life of three years or more. The amount capitalised at initial recognition is the purchase price of the asset along with any further costs incurred in bringing the asset to its present condition and location.

ii Subsequent valuation

Subsequent costs are added to an asset's carrying amount or are recognised as a separate asset as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be reliably measured. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Professional valuations of the Bank's properties are carried out each year with subsequent additions included at cost, and provisions made for depreciation as explained below.

Any surplus arising on revaluation is recognised directly in a revaluation reserve within equity, except to the extent that the surplus reverses a previous revaluation deficit on the same asset recognised in the income statement, in which case the credit is to the income statement.

iii Depreciation

Land is not depreciated. Depreciation on other property, plant and equipment is charged on a straight-line basis:

Freehold buildings	over the estimated future lives which range from ten to twenty-five years
Leasehold improvements	over the estimated remaining life of the lease
Plant within buildings	over periods ranging from five to twenty years
IT equipment	over periods ranging from three to seven years
Other equipment	over periods ranging from three to twenty years

The depreciable amount of a revalued asset is based on its revalued amount. The revaluation surplus is not transferred to retained earnings until the asset's ultimate disposal.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Assets that are subject to depreciation are reviewed at each reporting date to assess whether there is any indication that an asset may be impaired. An asset's carrying amount is written down immediately to its recoverable amount if the carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value (less costs to sell) and value in use.

iv Gain or losses on the disposal of property, plant and equipment

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

Banking Department
Notes to the financial statements continued

2 Bases of preparation continued

i Leases

i As lessee

The leases entered into by the Bank are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Where property, plant and equipment have been financed by lease agreements under which substantially all the risks and rewards of ownership are transferred to the Bank, they are treated as if they have been purchased outright and classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the present value of the minimum lease payments or the fair value of the leased asset. Finance charges payable are recognised over the period of the lease based on the interest rate implicit in the lease to give a consistent periodic rate of return.

ii As lessor

Long leases granted on property owned by the Bank are treated as finance leases. Finance lease receivables are stated in the balance sheet at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated across accounting periods giving a constant periodic rate of return before tax on the net investment. Unguaranteed residual values are subject to regular review to identify potential impairment. If there has been a reduction in the estimated unguaranteed residual value, the income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

j Intangible assets

Intangible assets primarily consist of computer software and the costs associated with the development of software for internal use. Costs associated with externally purchased software and costs directly associated with the internal production of unique and separately identifiable software products, which are controlled by the Bank and which will generate economic benefits exceeding those costs are recognised as intangible assets. These costs are amortised over the expected useful lives of the software, which range from three to five years. Costs associated with maintaining software programs are recognised as an expense when incurred. Intangible assets are tested for impairment annually. Intangible assets are also subject to an impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

k Financial instruments: liabilities

i Classification of financial liabilities

The Bank classifies its financial liabilities in the following categories: liabilities measured at amortised cost and financial liabilities at fair value through profit and loss.

Liabilities measured at amortised cost

Short-term customer deposits held are carried at cost with interest expense accruing on an effective interest rate basis. Cash Ratio Deposits are taken to fund certain activities of the Bank in accordance with the Bank of England Act 1998. These deposits are held at cost and are interest free. Money market instruments are carried at cost and are issued at a discount which is amortised through the income statement on an effective interest rate basis.

Financial liabilities at fair value through profit or loss

The Bank designates the following financial liabilities at fair value through profit or loss:

– Three three-year bonds denominated in US dollars, which were issued as part of the Bank's annual medium-term issuance programme; and

– Fixed-term deposits placed by other central banks.

ii Initial recognition of financial liabilities
Fixed-term deposits taken from central banks are recognised on a settlement date basis. Money market instruments issued, short-term deposits and bonds issued by the Bank are recognised on a trade date basis.

iii Subsequent valuation of financial liabilities
Gains and losses arising from changes in the fair value of liabilities classified at fair value through profit or loss are included in the income statement in the period in which they arise.

The fair values of these liabilities are based on current offer prices.

Financial liabilities are derecognised when the obligation to pay cash flows relating to the financial liabilities has expired. If the Bank buys any of its own securities as part of its operations, these are removed from the balance sheet.

l Current and deferred tax
Corporation tax payable on profits, based on the UK tax laws, is recognised as an expense in the period in which profits arise. The Bank is entitled to tax relief on the amount due to HM Treasury as a payment in lieu of a dividend in accordance with section 1(4) Bank of England Act 1946. Tax relief on amount due to HM Treasury is credited directly to the income statement in accordance with paragraph 52B of IAS 12.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates and laws that have been enacted or substantially enacted and which are expected to apply when the related deferred tax asset or liability is realised.

The principal temporary differences arise from depreciation of property, plant and equipment, revaluation of certain financial assets, property revaluations, and provisions for pensions and other post-retirement benefits.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences and losses can be utilised.

Deferred tax related to fair value remeasurement of available for sale securities and actuarial gains and losses on retirement benefit obligations is credited or charged directly to other comprehensive income and is subsequently recognised in the income statement together with the current or deferred gain or loss if and when realised.

m Retirement benefits
The Bank operates a non-contributory defined-benefit pension scheme providing defined benefits based on final and career average pensionable pay. The final salary element of the scheme is closed to new members. The assets of the scheme are held by the Bank in an independent trustee-administered fund. The asset recognised in the balance sheet in respect of the defined-benefit pension scheme is the fair value of the scheme's assets less the present value of the defined-benefit obligation at the balance sheet date. The defined-benefit obligation is calculated annually by an independent actuary using the projected unit method. The present value of the defined-benefit obligation is determined by discounting the estimated cash outflows using interest rates of high-quality sterling corporate bonds that have terms to maturity approximating to the terms of the related pension liability. Remeasurements on retirement benefits comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what actually occurred), as well as the effects of changes in actuarial assumptions. Remeasurements on retirement benefits are recognised immediately in equity and reflected in other comprehensive income. Current and past service costs are recognised immediately in the income statement. Any net defined-benefit surplus is limited to the benefit that is available to the Bank.

The Bank also provides other post-retirement benefits, principally related to redundancy provisions and healthcare for certain pensioners, which are accounted for on a similar basis to the accounting for pension obligations.

Banking Department
Notes to the financial statements continued

2 Bases of preparation continued

Staff transferred to the Bank from the Financial Services Authority (FSA) in April 2013 retained the employment terms and conditions of the FSA. These staff members continue to be active members within the FSA Pension Plan, which operates on a defined contribution basis. The Bank makes fixed contributions for employees into this scheme which are accounted for as contributions in the period they relate to.

n Equity capital

The entire equity capital comprising £14,553,000 of Bank Stock is held by the Treasury Solicitor on behalf of HM Treasury.

Under Section 1 (4) of the Bank of England Act 1946, as amended by the Bank of England Act 1998, subsequent to the end of each year HM Treasury receives payments of half the post-tax profits unless the Bank and HM Treasury agree otherwise. The payments are deductible for corporation tax and charged to equity in the year to which they relate on the basis agreed at the end of the relevant year.

o Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, consisting of cash and balances with other central banks, loans and advances to banks and other financial institutions, amounts due from banks and short-term government securities.

p Fees and commission income

Fees and commissions other than those associated with financial instruments are recognised as the service is provided. Where the level of fee is contingent on a particular outcome, the Bank only recognises the fee that is known to be recoverable.

q Provisions

Provisions are recognised in respect of restructuring, onerous leases and legal claims arising from past events where it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

r Indemnified operations

The Bank may enter into arrangements where it is fully indemnified, without charge, from loss by HM Treasury. Surpluses from such indemnified operations, after the deduction of fees, operating costs and tax, are treated as a capital contribution and taken directly to equity as distributable reserves.

s Collateral pledged under sale and repurchase agreements

Securities sold subject to repurchase agreements are assets provided as collateral where the transferee has the right by contract or custom to sell the collateral. These securities remain on the balance sheet and the liability is included in deposits from banks and other financial institutions. Securities purchased under agreements to resell ('reverse repurchase agreements') are not recognised on the balance sheet; the asset is included in loans and advances to banks and other financial institutions. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements.

Securities loaned to counterparties also remain on the Balance Sheet. Securities borrowed are not recognised on the balance sheet, unless they are sold to third parties, in which case the obligation to return the securities is recorded at fair value as a liability.

The Bank may accept its own securities as collateral for reverse repurchase agreements. Such reverse repurchase transactions are treated as collateralised and are treated in the same way as other reverse repurchase transactions.

t Commitments on behalf of HM Treasury

Commitments on behalf of HM Treasury in foreign currencies and gold arising in the course of operating the Exchange Equalisation Account are not included in these financial statements as the Bank is concerned in such transactions only as agent.

3 Significant accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a Post-retirement benefits

Post-retirement benefits are long-term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (see note 18, which includes relevant sensitivity analysis). Members of Court consider the assumptions used by the actuary in their calculations to be appropriate for this purpose.

b Fair value of equity investments that are available for sale

The Bank's accounting policy for the valuation of financial instruments is described in note 2 (e) and (k). The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. Details of valuation techniques for the different classifications are given in note 28. Fair values of equity investments classified for accounting purposes as available for sale rely to a greater extent on unobservable inputs and therefore require a greater level of management judgement to calculate a fair value than those based on wholly observable inputs. These equity investments, disclosed in note 14, are held by the Bank for the long term as part of its central banking activities and may not be readily saleable. The values have generally been established by discounting expected future dividends reflecting the benefit that the Bank derives from the investments (see note 14b, which includes relevant sensitivity analysis).

c Intangible assets

Management has made certain judgements when capitalising intangible assets. Various costs incurred in the production of an internal project are capitalised if a number of criteria are met. Management has made judgements and assumptions when assessing whether a project meets these criteria and when measuring the costs and economic life attributable to such projects.

d Onerous lease provision

The Bank has recognised an onerous lease provision in respect to certain leased property occupied by the FSA which was vacated on the commencement of the new regulatory regime.

In determining the provision Management has made certain judgements in respect of; the likelihood of sub-letting space, the anticipated income receivable and an appropriate discount rate. The provision is included within note 25.

e Restructuring provision

The result of the Bank's Value for Money review, announced in January 2014, estimates that between 80–100 job redundancies will occur. The affected staff population has been assessed and a provision has been recognised based on the best estimate of the cost of these redundancies. The provision is included within note 25.

Banking Department
Notes to the financial statements continued

4 Profit before tax

	Note	2014 £m	2013 £m
Income includes			
Charges for services to HM Government (including charges to the Issue Department in respect of the Note Issue)		79	88
Funding for Lending Scheme income		89	10
Banking charges and tariff income		23	21
Onerous lease provision release		7	–
Dividend income		17	14
Expenses include			
Staff costs including restructuring provision	5	272	132
Legal fees		5	2
Amortisation of intangible assets	17	2	4
Depreciation of property, plant and equipment	16	14	11
Software expenditure		7	9
Operating lease rentals – property		5	1
– other		–	–
Onerous lease provision		–	19
Other administrative expenses		127	99

The expenses above include £9m of costs incurred in the year to 28 February 2014 (2013: £49m) in relation to the Prudential Regulation Authority transition. A receivable has been recognised on the balance sheet. The PRA Board agreed to recover these costs from fee-payers over a period of five years.

The Bank initially meets all the expenses of the PRA. In the year the Bank has recharged £132m of direct expenditure (of which £98m is included in staff costs but the remainder is excluded from the figures above) and has received £59m of income in respect of corporate services provided by the Bank to the PRA.

5 Staff costs

	Note	2014 £m	2013 £m
Wages and salaries		208	105
Social security costs		22	11
Pension and other post-retirement costs	18	33	16
Costs of restructuring		9	–
		272	**132**

Wages and salaries contain the cost of all Bank staff including those who work exclusively in the PRA. The amount directly recovered from the PRA in respect of staff costs was £98m (2013: £nil). It also includes £2m of costs capitalised as intangible assets (2013: £2m).

Average number of employees

The average number of persons employed by the Bank during the year was made up as follows:

	2014	2013
Governors and other members of Executive Directors Committee	14	13
Managers and analysts	1,921	855
Other staff	1,554	1,305
	3,489	**2,173**

Of which deemed to work exclusively for the PRA:

	2014	2013
Governors and other members of Executive Directors Committee	1	–
Managers and analysts	833	–
Other staff	119	–
	953	**–**

The number of people employed by the Bank at the end of February 2014 was 3,625 of which 3,224 were full time and 401 part time (2013: 2,307; with 2,029 full time and 278 part time). These include 1,045 persons deemed to have worked exclusively for the PRA of which 951 were full time and 94 part time. The average staff numbers for the PRA included in the table reflect the full year. The average staff number for the 11 months that the PRA was operational following legal cutover is 1,038.

Mr Bailey is deemed to have worked exclusively for the PRA in the table above. Mr Bailey is remunerated by the Bank but the total cost of his remuneration is recharged to the PRA.

Banking Department
Notes to the financial statements continued

6 Auditor's remuneration

	2014 £000	2013 £000
Audit fees for the Bank's audit		
– Fees relating to current year	260	260
– Fees relating to prior year	–	–
Fees payable to the Auditor for services provided to the Bank		
– Audit related services	43	43
– Taxation advisory services	16	38
– All other non-audit services	149	70
	468	**411**

In addition, fees of £30,000 for audit services and £7,900 for other services in relation to Bank of England Asset Purchase Facility Fund Ltd paid by the Bank were recovered via a management fee (2013: £30,000 and £9,000 respectively). Audit related services includes £25,000 for providing assurance to HM Treasury on the allocation of costs (2013: £25,000), and £18,000 for the submission for Whole Government Accounts (2013: £18,000). Other non-audit fees principally relate to advisory services to the Bank.

7 Taxation

The tax charged within the income statement is made up as follows:

	2014 £m	2013 £m
Current year corporation tax	6	6
Prior year corporation tax	–	–
Deferred tax – current year	14	9
Tax charge on profit	**20**	**15**

The tax charged within the income statement differs from the amount calculated at the basic rate of tax on the profit for the year as follows:

	2014 £m	2013 £m
Profit before tax	**180**	**125**
Tax calculated at rate of 23.08% (2013: 24.17%)	41	30
Tax relief on payment to HM Treasury	(18)	(13)
Non-deductible expenses	1	1
Dividend not subject to corporation tax	(3)	(3)
Movement in unrecognised deferred tax on properties	–	–
Change in tax rate to 20% (2013: 23%)	(1)	–
Total tax charge for the period	**20**	**15**

Tax (credited)/charged to equity comprises:

	2014 £m	2013 £m
Tax (credited) to equity through the statement of comprehensive income		
Current year corporation tax	(6)	(5)
Deferred tax	(120)	(44)
Tax (credited) to equity	**(126)**	**(49)**

Tax (credited)/charged to equity is attributable as follows:

	2014 £m	2013 £m
Tax (credited)/charged to equity through the statement of comprehensive income		
Revaluation of available for sale securities	(75)	(11)
Revaluation of the property	4	–
Remeasurements on retirement benefits	(47)	(23)
Change in tax rate to 20% (2013: 23%)	(8)	(15)
Tax (credited) to equity	**(126)**	**(49)**

The main UK corporation tax rate is 23% with effect from 1 April 2013. The rate reduction on the deferred tax balances as at 28 February 2014 has been disclosed in note 24.

Banking Department
Notes to the financial statements continued

8 Payable to HM Treasury under Section 1 (4) of the Bank of England Act 1946

	2014 £m	2013 £m
Payable 4 April (2013: 5 April)	34	25
Payable 3 October (2013: 4 October)	46	30
	80	**55**

The Bank of England Act 1946, as amended by the Bank of England Act 1998, requires the Bank to pay HM Treasury, in lieu of dividend on the Bank's capital, on 5 April and 5 October, a sum equal to 25% of the Banking Department's post-tax profit for the previous financial year or such other sum as the Bank and HM Treasury may agree. When the due date falls on a non-business day, the payment is made on the last business day before the due date. These payments have been accrued and charged to equity at 28 February 2014. The payments are deductible for corporation tax in the year to which the payments relate. The overall effect is that the Bank and HM Treasury will normally share Banking Department's post-tax profits equally.

9 Cash and balances with other central banks

	2014 £m	2013 £m
Cash	–	–
Balances with other central banks	584	787
	584	**787**

Balances with other central banks are correspondent accounts with other central banks used for Bank and customer business.

10 Loans and advances to banks and other financial institutions

	2014 £m	2013 £m
Reverse repurchase agreements held at amortised cost	670	570
Reverse repurchase agreements held at fair value through profit or loss	8,979	11,145
Other loans and advances	250	4
	9,899	**11,719**

These balances include advances and reverse repurchase agreements arising as part of the Bank's open market operations, as well as advances matching the deposits taken (notes 20 to 22). Amounts are stated after provisions for impairment, where appropriate. The level and composition of the Bank's open market operations, including the split between Banking and Issue Departments, depends on movements in the Bank's balance sheet as described in the published Bank of England's *Sterling Monetary Framework* (updated January 2014).

At 28 February 2014 loans and advances to banks and other financial institutions included cash and cash equivalents of £3,998m (2013: £3,353m) which are disclosed in note 27 i.

11 Other loans and advances

	2014 £m	2013 £m
Loan to the Bank of England Asset Purchase Facility Fund Ltd	375,193	375,193
Term loans	4	3
	375,197	**375,196**

Loan to Bank of England Asset Purchase Facility Fund Ltd (BEAPFF)

In January 2009, the Chancellor of the Exchequer authorised the Bank to set up an Asset Purchase Facility (APF) to buy high-quality assets financed by the issue of Treasury bills and the Debt Management Office's (DMO) cash management operations. The aim of the Facility was to improve liquidity in credit markets. The Chancellor also announced that the APF provided an additional tool that the Monetary Policy Committee (MPC) could use for monetary policy purposes. When the APF is used for monetary policy purposes, purchases of assets are financed by the creation of central bank reserves.

The Asset Purchase Facility transactions are undertaken by a subsidiary company of the Bank of England – the Bank of England Asset Purchase Facility Fund Limited (BEAPFF). The transactions are funded by a loan from the Bank.

In line with the MPC's most recent decision in relation to the asset purchase programme; the APF has purchased £375,000m of assets by the creation of central bank reserves. Additionally, the APF continues to operate its corporate facilities, with purchases financed by the issue of Treasury bills and the DMO's cash management operations. The loan in relation to the corporate facilities is £193m. The total loan from the Bank to BEAPFF is £375,193m (2013: £375,193m).

12 Securities held at fair value through profit or loss

	2014 £m	2013 £m
Money market instruments	2,235	–
Listed foreign government securities	3,855	3,573
	6,090	**3,573**

The holdings of foreign government securities are funded by the Bank's issuance of medium-term securities (note 23) and fixed term deposits placed by other central banks.

At 28 February 2014 securities held at fair value through profit or loss included cash and cash equivalents of £194m (2013: £nil) which are disclosed in note 27i.

Banking Department
Notes to the financial statements continued

13 Derivative financial instruments

The Bank uses the derivative instruments described below. The main purpose of these is to manage the currency and interest rate exposures on the Bank's portfolio of financial assets and financial liabilities. They may also be used as an instrument in monetary policy transactions.

Cross-currency interest rate swaps, interest rate swaps and forward exchange contracts are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or coupons (eg fixed rate for floating rate) or a combination of these. An exchange of principal occurs for cross-currency interest rate swaps and forward exchange contracts, but no such exchange of principal usually occurs for interest rate swaps. The Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligations. The risk is monitored on an ongoing basis with reference to the current fair value. To control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities and will take collateral, either securities or cash, if the net replacement cost of all transactions with the counterparty exceeds relevant thresholds.

The notional amounts of derivative financial instruments provide a basis for comparison with other instruments recognised in the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and therefore do not indicate the Bank's exposure to credit or price risks. The derivative instruments move into profit (in which case they are treated as assets) or loss (in which case they are treated as liabilities) as a result of fluctuations in market prices relative to their terms. The aggregate contractual or notional amount of derivative financial instruments outstanding, the extent to which instruments have moved into profit or not, and thus the aggregate fair values of derivative financial instruments and liabilities, can fluctuate significantly over time. The fair values of derivative instruments are set out below.

a As at 28 February 2014

	Contract notional amount £m	Fair Values	
		Assets £m	Liabilities £m
Cross-currency interest rate swaps	2,694	118	(48)
Interest rate swaps	6,141	14	(29)
Forward exchange contracts	13,164	47	(388)
Total recognised derivative assets/(liabilities)		**179**	**(465)**

b As at 28 February 2013

	Contract notional amount £m	Fair Values	
		Assets £m	Liabilities £m
Cross-currency interest rate swaps	2,712	163	–
Interest rate swaps	7,928	36	(59)
Forward exchange contracts	13,350	135	(170)
Total recognised derivative assets/(liabilities)		**334**	**(229)**

14 Available for sale securities

	2014 £m	2013 £m
Debt securities at fair value		
British Government securities listed on a recognised UK exchange	5,543	4,265
Other sterling securities listed on a recognised exchange	397	435
	5,940	4,700
Unlisted equity investments at fair value	402	479
	6,342	**5,179**

The movement in available for sale securities comprises:

	2014 £m	2013 £m
Available for sale debt securities		
At 1 March	4,700	4,852
Purchases	1,792	235
Redemptions	(242)	(297)
Mark-to-market movements through equity	(249)	(35)
Amortisation of premium/discount	(62)	(52)
Movement in accrued interest	1	(3)
At 28 February	**5,940**	**4,700**
Available for sale unlisted equity investments		
At 1 March	479	488
Revaluation of securities	(77)	(9)
Disposal of securities	–	–
At 28 February	**402**	**479**
	6,342	**5,179**

There were no gains or losses on the sale of available for sale securities transferred to the income statement during the year (2013: £nil).

a Debt securities

British Government securities and other sterling securities are held as investments and are one of the principal sources of income for the Bank. The Bank holds these securities for the long term, generally to maturity. However, as the Bank can envisage circumstances in which they might be sold before maturity they have been classified as assets that are available for sale.

All debt securities have fixed coupons.

Banking Department
Notes to the financial statements continued

14 Available for sale securities continued

b Unlisted equity investments

The unlisted equity investments held by the Bank are held as part of its functions as a central bank and are thus of a long-standing nature. The Bank's holdings in any particular institution may change from time to time as part of realignments of holdings among the shareholders and participants. Fair values of unlisted equity investments reflect the price that a knowledgeable willing party would pay in an arm's length transaction.

The Bank's investment in the Bank for International Settlements (incorporated in Switzerland) consists of shares of 5,000 Special Drawing Rights, which are 25% paid. At 28 February 2014 the holding represents 8.5% (2013: 8.5%) of the issued share capital. The investment has been valued on a dividend yield basis providing a value of £397m (2013: £474m) at the year end. A discount rate of 6.78% (2013: 6.5%) was used. Increasing the discount rate by one percentage point would deflate the valuation by £81m, while decreasing the discount rate by one percentage point would inflate the valuation by £139m.

The Bank's holding in the European Central Bank (ECB) represents 0.7% (2013: 0.8%) of the ECB's paid-up share capital. In accordance with the Treaty on the Functioning of the European Union, and in line with other non euro area national central banks, the Bank is only required to pay up 'a minimal percentage' by way of contribution to the operational costs of the ECB; in the Bank's case this is currently 3.75% amounting to €56m (2013: 3.75% amounting to €59m) of its total allocation of the ECB's subscribed capital of €1.5bn (2013: €1.6bn). If the United Kingdom were to participate in Economic and Monetary Union a further contribution would be required and the Bank's paid-up share capital would then amount to 13.7% (2013: 14.5%). On 1 January 2014, the ECB capital key was changed as a result of the quinquennial review and Latvia adopting the euro. As part of this change the Bank received back €3m from the ECB.

Contributions to the ECB are non-refundable and as a non euro area member the Bank is not entitled to any dividends. The fair value of the holding has therefore been assessed as £nil (2013: £nil).

15 Investments in subsidiaries

The Bank has a number of subsidiaries, which are wholly owned, that are stated in the Bank's balance sheet at an aggregate cost under £1m. These are:

The Securities Management Trust Ltd	1,000 ordinary shares of £1
Bank of England Asset Purchase Facility Fund Ltd	100 ordinary shares of £1
Houblon Nominees Ltd	2 ordinary shares of £1
Bank of England Nominees Ltd	2 ordinary shares of £1
BE Pension Fund Trustees Ltd	2 ordinary shares of £1
Prudential Regulation Authority Ltd	1 ordinary share of £1
Olive 863 Ltd	1 ordinary share of £1

16 Property, plant and equipment

For the period to 28 February 2014	Freehold land and buildings £m	Leasehold improvements £m	Equipment* £m	Total £m
Cost or valuation				
At 1 March 2013	210	10	57	277
Additions	10	1	13	24
Disposals/write-offs	–	–	(6)	(6)
PRA disposals	–	–	(9)	(9)
Revaluation of properties	10	–	–	10
At 28 February 2014	**230**	**11**	**55**	**296**
Accumulated depreciation				
At 1 March 2013	–	–	34	34
Charge for the period	7	1	6	14
Disposals/write-offs	–	–	(6)	(6)
PRA disposals	–	–	(1)	(1)
Revaluation of properties	(7)	–	–	(7)
At 28 February 2014	–	**1**	**33**	**34**
Net book value at 1 March 2013	210	10	23	243
Net book value at 28 February 2014	**230**	**10**	**22**	**262**

*Net book value of equipment at 28 February 2014 included £3m held under finance leases.

PRA disposals relate to assets purchased by the Bank in respect of the set-up of the PRA. These assets were transferred to the PRA on the 1 April 2013 when the new regulatory regime commenced.

Banking Department
Notes to the financial statements continued

16 Property, plant and equipment continued

For the period to 28 February 2013	Freehold land and buildings £m	Leasehold improvements £m	Equipment* £m	Total £m
Cost or valuation				
At 1 March 2012	204	–	50	254
Additions	13	10	14	37
Disposals/write-offs	(1)	–	(7)	(8)
Revaluation of properties	(6)	–	–	(6)
At 28 February 2013	**210**	**10**	**57**	**277**
Accumulated depreciation				
At 1 March 2012	–	–	36	36
Charge for the year	6	–	5	11
Disposals/write-offs	–	–	(7)	(7)
Revaluation of properties	(6)	–	–	(6)
At 28 February 2013	**–**	**–**	**34**	**34**
Net book value at 1 March 2012	204	–	14	218
Net book value at 28 February 2013	**210**	**10**	**23**	**243**

*Net book value of equipment at 28 February 2013 included £4m held under finance leases.

The figures for freehold land and buildings reflect independent professional valuations on a market value basis as at 28 February 2014 by Deloitte LLP, members of the Royal Institution of Chartered Surveyors (RICS). These valuations have been incorporated into the financial statements and were performed in accordance with the RICS Valuation Standards.

17 Intangible assets

	2014 £m	2013 £m
Cost		
At 1 March	37	35
Additions	2	5
Disposals/write offs	(3)	(3)
At 28 February	**36**	**37**
Accumulated amortisation		
At 1 March	26	25
Charge for the year	2	4
Disposals/write offs	(3)	(3)
At 28 February	**25**	**26**
Net book value at 1 March	11	10
Net book value at 28 February	**11**	**11**

Intangible assets primarily comprise computer software and related costs.

Banking Department
Notes to the financial statements continued

18 Retirement benefits

a Defined contribution

Staff transferred to the Bank from the Financial Services Authority (FSA) in April 2013 retained the employment terms and conditions of the FSA. These staff members continue to be active members within the FSA Pension Plan, which operates on a defined contribution basis. The Bank makes fixed contributions for employees into this scheme which are accounted for as contributions in the period they relate to. During the year total contributions made by the Bank were £8m (2013: £nil). No contributions were outstanding at the year end.

b Defined benefit and career average

The Bank operates a non-contributory defined-benefit pension scheme providing benefits based on final and career average pensionable pay. The final salary element of the scheme is closed to new members. The assets of the scheme are held by the Bank in an independent trustee-administered fund. The Bank also provides other post-retirement benefits, principally healthcare, for certain pensioners.

The pension scheme is an HMRC registered pension scheme and is subject to standard UK pensions and tax law. This means that the payment of contributions and benefits are subject to the appropriate tax treatments and restrictions and the scheme is subject to the scheme funding requirements outlined in section 224 of the Pensions Act 2004.

In accordance with UK trust and pensions law, the pension scheme has appointed trustees who are independent of the Bank. Although the Bank bears the financial cost of the scheme, the responsibility for the management and governance of the scheme lies with the trustees, who have a duty to act in the best interest of members at all times.

The pension scheme's assets are mostly invested in fixed interest and index-linked gilts which are intended to match the nature of the future benefit payments due from the scheme. This helps to reduce volatility in the funding level on the scheme funding basis and, to a lesser extent, in the statement of financial position in the Bank's accounts. The effect of the liability-matching investment policy is not fully reflected in the accounting figures as the assumptions dictated for the purposes of the valuation under IAS 19 are different from those used for the funding valuation.

Valuation for funding purposes

The main pension scheme, the Bank of England Pension Fund, is valued for funding purposes at intervals of not more than three years by an independent qualified actuary, with interim reviews in the intervening years. The 2014 triennial valuation is being prepared as at 28 February 2014 and the results are not yet available. The latest valuation for funding purposes was as at 28 February 2011; it used the current unit method, and thus the funding target was based on each active member's current earnings, with the effect of future earnings increases on the accrued liabilities being included in normal future service contribution.

The valuation as at 28 February 2011	£m
Value of Fund assets	2,522
Actuarial value of scheme liabilities in respect of:	
– In-service members	(442)
– Deferred pensioners	(499)
– Current pensioners and dependants	(1,682)
– Members' additional voluntary contributions	(4)
Total	(2,627)
Scheme (deficit)	**(105)**
Funding level	96%
Future service contribution rate	29.7%

For the 2011 valuation, the liabilities were valued by the actuary on an index-linked gilts yield discount rate, and no credit was taken in advance for the possibility that returns on investments held by the Fund would exceed the long-term interest rate. Allowance was made for past and prospective mortality improvements. The rate of RPI inflation used in the valuation and the pension increase assumption was 3.1%.

The Bank and the Pension Fund Trustees had previously agreed a deficit reduction plan following the 2008 valuation. This was reviewed after the valuation in 2011 and it was agreed to maintain the plan. At the balance sheet date there was one payment of £27m which remains to be paid.

Excluded from the contribution rate is the cost of administration and other services which is met by the Bank.

The 2014 valuation is currently underway and expected to be completed by the time the Bank publishes its 2015 *Annual Report*.

Summary of amounts recognised in the financial statements under IAS 19

In the statutory financial statements the Bank accounts for pension costs, other post-retirement benefits and related redundancy provisions in accordance with IAS19 (Employee Benefits). Under the standard, the difference between the market values of scheme assets and the present value of scheme liabilities is reported as a surplus or deficit in the balance sheet. The accounting value is different from the result obtained using the funding basis.

The accounts show the main scheme in surplus, while the Bank is making good the deficit revealed by the funding valuation. The main reason for this is the different assumptions used to value the liabilities in the accounting and funding valuations for the main scheme. The aim of the liability matching policy is that by investing in a range of assets (mostly government bonds) that broadly match the expected future benefit payments from the scheme, no surplus or deficit will arise.

The funding valuation, therefore, discounts expected future benefit payments at the appropriate yield available on government bonds to produce the value of the funding liabilities. The accounting standard requires that expected future benefit payments are discounted at the appropriate yield available on high quality corporate bonds, which is higher than the corresponding yield available on government bonds. The value placed on the liabilities for accounting purposes is, therefore, lower than the funding valuation.

In the preparation of their valuations under IAS 19 referred to in this note, the actuary has used the assumptions indicated below, which members of Court have accepted for the purposes of accounting and disclosure under the standard.

Banking Department
Notes to the financial statements continued

18 Retirement benefits continued

Amounts recognised as assets/(liabilities) in the balance sheet

	Note	2014 £m	2013 £m
Funded pension schemes	(i)	312	460
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	(79)	(81)
Other pension schemes	(iii)	(8)	(8)
Medical scheme	(iv)	(110)	(113)
		115	**258**

Pension expense recognised in the income statement

	Note	2014 £m	2013 £m
Funded pension schemes	(i)	17	4
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	3	4
Other pension schemes	(iii)	–	–
Medical scheme	(iv)	5	8
		25	**16**

Remeasurements recognised in the statement of comprehensive income

	Note	2014 £m	2013 £m
Funded pension schemes	(i)	(205)	(148)
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	(1)	(4)
Other pension schemes	(iii)	–	(1)
Medical scheme	(iv)	4	58
		(202)	**(95)**

(i) Funded pension scheme
As described above, the Bank has a final salary section within the pension scheme that provides pensions based on members' pensionable service and final salary at retirement. The pension is payable for life and increases in payment in line with inflation. Existing members of this section of the scheme continue to accrue future benefit but it is closed to new members.

For new employees, the Bank offers a career average revalued earnings (CARE) section of the pension scheme that provides pensions based on members' earnings each year revalued in line with inflation up to retirement.

The pension is payable for life and increases in payment in line with inflation.

(ii) Redundancy provisions
As part of redundancy arrangements with staff in place until 5 April 2010, the Bank could give enhanced pension entitlement in the form of added years service or early pension rights. The costs of such benefits cannot be charged to the Pension Fund. The costs are therefore borne in the Bank's accounts, and represent the future cost of decisions that have already been taken. Provision was made for the costs of these benefits at the time the redundancy offer was announced based on actuarial advice. No further similar entitlements will be given by the Bank.

The valuation of these provisions has been performed using the relevant assumptions applied for the IAS 19 valuation of pension schemes and updated annually.

(iii) Other pension schemes
As explained in the Remuneration section of the *Annual Report* on page 51, for Governors subject to the pensions earnings cap introduced in the Finance Act 1989, the Bank offers additional unfunded pensions so that their total pensions broadly match what would have been provided by the former Court Pension Scheme in the absence of a cap. Provision is made for these in the Bank's accounts. In addition certain former Governors and Directors and the widows of some former Governors and Directors were granted ex-gratia pensions. Provision for these was made in the Bank's accounts when the grants were made.

The valuation of this scheme has been performed by using the relevant assumptions applied for the IAS 19 valuation of pension schemes and updated annually.

(iv) Medical scheme
Some current and former staff are entitled to receive healthcare benefits in retirement. Separate provision is made for these in the Bank's accounts as these cannot be paid out of the pension scheme. The defined benefit liability is the expected cost to the Bank of the claims anticipated from the eligible members once in retirement.

Banking Department
Notes to the financial statements continued

18 Retirement benefits continued

Risks

The main risks to which the Bank is exposed in relation to the funded pension scheme are:

- Mortality risk – the assumptions adopted by the Bank make allowance for future improvements in life expectancy. However, if life expectancy improves at a faster rate than assumed, this would result in greater payments from the Fund and consequently increases in the scheme's liabilities. The Bank and the scheme's trustees review the mortality assumption on a regular basis to minimise the risk of using an inappropriate assumption;
- Investment risk – the Fund invests the vast majority of its assets in a portfolio of UK government bonds as the changes in the value of the bonds most closely match the movements in the Fund's liabilities. There remains the residual risk that the selected portfolio does not match the liabilities closely enough or that as it matures there is a risk of not being able to reinvest the assets at the assumed rates. The scheme's trustees review the structure of the portfolio on a regular basis to minimise these risks;
- Yield risk – a fall in government bond yields will increase both the scheme's assets and liabilities. As the scheme's liabilities, on the funding basis used to calculate the Bank's contributions to the scheme, are greater than its assets until the deficit is made good, during that time the liabilities may grow by more in monetary terms, increasing the deficit in the scheme; and
- Inflation risk – the majority of the scheme's liabilities increase in line with inflation and so if inflation is greater than expected, the liabilities will increase. The scheme's investment strategy is to hold government bonds that are also linked to inflation so this risk is mostly mitigated.

The redundancy provision and other pension schemes are primarily exposed to the mortality and inflation risks above. As they are not backed by any assets, these risks cannot be so easily managed. However, these arrangements (and therefore the risks associated with them) are small in comparison to the funded pension scheme.

The two main risks to which the Bank is exposed in relation to the medical scheme are mortality risk, as described above, and increases in the costs incurred being greater than assumed, either due to inflation of future medical costs or the frequency of members' claims.

Components of pension expense in the income statement

			2014			2013
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Current service cost	38	–	1	32	–	1
Net interest on the net defined (liability)/asset	(21)	3	4	(28)	4	7
Total pension expense	**17**	**3**	**5**	**4**	**4**	**8**

Remeasurements recognised in other comprehensive income

	2014			2013		
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Remeasurements recognised at the beginning of the period	75	(26)	5	223	(21)	(53)
Actuarial gains arising from changes in demographic assumptions	–	–	5	62	–	68
Actuarial (losses) arising from changes in financial assumptions	(48)	(1)	(2)	(210)	(5)	(12)
Actuarial gains/(losses) arising from experience on the scheme's liabilities	8	–	1	(18)	–	2
Return on schemes' assets excluding interest income	(165)	–	–	18	–	–
Remeasurements recognised at the end of the period	**(130)**	**(27)**	**9**	**75**	**(26)**	**5**

Reconciliation of present value of defined-benefit obligation

	2014			2013		
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Present value of defined-benefit obligation at the beginning of the period	2,676	89	113	2,470	85	167
Current service cost	38	–	1	32	–	1
Interest expense	108	3	4	109	4	7
Actuarial (gains) arising from changes in demographic assumptions	–	–	(5)	(62)	–	(68)
Actuarial losses arising from changes in financial assumptions	48	1	2	210	5	12
Actuarial (gains)/losses arising from experience on the scheme's liabilities	(8)	–	(1)	18	–	(2)
Benefits paid out	(104)	(6)	(4)	(101)	(5)	(4)
Present value of defined obligation at the end of the period	**2,758**	**87**	**110**	**2,676**	**89**	**113**

During the reporting period there have been no plan amendments, curtailments or settlements.

Banking Department
Notes to the financial statements continued

18 Retirement benefits continued
Reconciliation of the fair value of assets

	2014 Main pension scheme £m	2014 Other pensions £m	2014 Medical scheme £m	2013 Main pension scheme £m	2013 Other pensions £m	2013 Medical scheme £m
Fair value of schemes' assets at the beginning of the period	3,136	–	–	3,034	–	–
Interest income	129	–	–	137	–	–
Return on schemes' assets excluding interest income	(165)	–	–	18	–	–
Bank contributions	74	6	4	48	5	4
Benefits paid out	(104)	(6)	(4)	(101)	(5)	(4)
Fair value of schemes assets at the end of the period	**3,070**	**–**	**–**	**3,136**	**–**	**–**

Summary of assumptions
Under IAS 19 measurement of scheme liabilities must be calculated under the projected unit method, which requires certain demographic and financial assumptions, including an assumption about future salary growth. The assumptions used are applied for the purposes of IAS 19 only.

The significant financial and other assumptions used by the independent actuary to calculate scheme liabilities over the life of the scheme on an IAS 19 basis were:

	2014 %	2013 %
Discount rate	4.0	4.1
Rate of increase in salaries	4.55	4.55
Rate of increase of pensions in payment*	3.1	3.1
Rate of increase for deferred pensioners*	**3.1**	3.1

* This represents a weighted average of RPI and CPI, which are the indices used in the scheme.

The discount rate assumption reflects the investment return on a high quality corporate bond at the balance sheet date, as required by the standard.

The assumption on salary growth is for the long term over the life of the scheme. For the purposes of the valuation this assumption has been modified to reflect the Bank continuing to abide by public sector pay guidelines.

An age-related promotion scale has been added to the increase in salaries assumption.

The assumption for life expectancy for the scheme assumes that a male member reaching 60 in 2014 will live for 29.8 years (28 February 2013: 29.6 years) and a female member 30.5 years (28 February 2013: 30.3 years), and a male member reaching 60 in 2034 will live for 32.8 years (28 February 2013: 32.7 years) and a female member 33.4 years (28 February 2013: 33.3 years).

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with both current industry experience and the actual experience of the relevant scheme.

The assets in the scheme were:

	Value £m	2014 Percentage of total value %	Value £m	2013 Percentage of total value %
UK Government fixed interest bonds	250	8.1	242	7.7
UK Government index-linked bonds	2,302	75.0	2,468	78.7
Corporate index-linked bonds	498	16.2	405	12.9
Cash and other assets	20	0.7	21	0.7
Total market value of investments	**3,070**	**100.0**	**3,136**	**100.0**

For the purposes of IAS 19, the asset values stated are at the balance sheet date. Market values of the scheme's assets, which are not intended to be realised in the short-term, may be subject to significant change before they are realised. Of the corporate index-linked bonds £182m were quoted and £316m were unquoted (2013: £93m quoted and £312m unquoted). Of the unquoted bonds £294m (2013: £290m) were guaranteed by the UK Government.

Main scheme

	2014 £m	2013 £m
Present value of defined-benefit obligations	(2,758)	(2,676)
Assets at fair value	3,070	3,136
Defined-benefit asset	**312**	**460**

The duration of the pension scheme liabilities is in the region of 19 years. A +/- 0.1% change to the discount rate would change the surplus on the pension scheme by +/- £50m (28 February 2013: +/- £48m).

A +/- 0.1% change to the to the assumed difference between CPI and RPI inflation would change the present value of defined-benefit obligations for the pension scheme by +/- £40m with a similar offsetting change expected in the value of the pension scheme's assets given the matching nature of the investment strategy.

A +/- 0.5% change to the assumed rate of increases in salaries would change the surplus on the pension scheme by +/- £33m.

If mortality rates were adjusted such that individuals were assumed to live for an additional year, the scheme's liabilities at the year end would increase by approximately £74m (28 February 2013: £71m).

The Bank expects to pay contributions of £83m in the forthcoming year (2013: £74m).

Banking Department
Notes to the financial statements continued

18 Retirement benefits continued

Redundancy provisions

	2014 £m	2013 £m
Unfunded defined-benefit liability	**(79)**	**(81)**

The Bank expects to make payments of £5m in the forthcoming year (2013: £5m).

Other pension schemes

	2014 £m	2013 £m
Unfunded defined-benefit liability	**(8)**	**(8)**

The Bank expects to make payments of less than £1m in the forthcoming year (2013: less than £1m).

During the year to 28 February 2014 the Bank incurred services costs of less than £1m (2013: less than £1m).

Medical scheme

Some staff are entitled to receive healthcare benefits in retirement. Separate provision is made for these in the Bank's accounts as these cannot be paid out of the Pension Fund.

Summary of assumptions

The discount rates used for the purposes of measuring post-retirement benefit liabilities is the same as used in the IAS 19 valuation of pension scheme liabilities. Following a review of the recent experience of the medical scheme, the level at which claims are assumed to arise on average has been updated. This has resulted in a reduction of £5m in the unfunded defined-benefit recognised. Additionally, for accounting purposes the following assumptions have been made in respect of medical expense inflation:

	2014 %	2013 %
Initial medical trend	5.0%	5.5%
Ultimate medical trend	5.0%	5.0%
Years to ultimate	–	1

Post-retirement benefits – medical

	2014 £m	2013 £m
Unfunded defined-benefit liability	**(110)**	**(113)**

Sensitivity analysis provided by the actuary indicates that 0.1% decrease in the discount rate would change the deficit on the other post-retirement benefits by £2m (28 February 2013: £2m) and a 1% increase in the rate of medical claims by £20m (28 February 2013: £22m). If the mortality rates were adjusted such that individuals were assumed to live for an additional year, the other post-retirement liabilities at the year-end would increase by approximately £4m (28 February 2013: £4m). The Bank expects to pay premiums of £4m in the forthcoming year (2013: £4m).

19 Other assets

	2014 £m	2013 £m
Finance lease receivables	6	6
Short term debtors and other assets	381	140
Amounts due from the PRA	78	65
	465	**211**

The amount owed by the PRA includes £44m due in more than one year (2013: £50m). Finance lease receivables also include £6m due in more than one year (2013: £6m).

20 Deposits from central banks

	2014 £m	2013 £m
Deposits repayable on demand	1,926	1,994
Term deposits held at fair value through profit or loss	12,928	12,377
	14,854	**14,371**

21 Deposits from banks and other financial institutions

	2014 £m	2013 £m
Deposits repayable on demand		
Sterling	314,588	294,488
Non-sterling	69	157
Cash Ratio Deposits	4,078	2,479
	318,735	**297,124**

The majority of deposits repayable on demand comprise of reserves accounts held at the Bank. Reserves accounts are sterling current accounts for banks and building societies. They are the most liquid asset a bank or building society can hold and are the ultimate means of settlement between banks and building societies.

The rate paid by the Bank on reserves account balances is also the means by which the Bank keeps market interest rates in line with Bank Rate. All reserves balances are remunerated at Bank Rate.

Under the Cash Ratio Deposit (CRD) scheme, institutions place non-interest bearing deposits at the Bank of England. The Bank invests these deposits (mainly in gilts) and the income earned is used to fund the costs of its monetary policy and financial stability operations, which benefit sterling deposit takers.

Banking Department
Notes to the financial statements continued

21 Deposits from banks and other financial institutions continued

Under the Bank of England Act 1998, the percentage and threshold used in calculating the CRDs is set by HM Treasury, having regard to the financial needs of the Bank and subject to approval of both Houses of Parliament. This is reviewed, at the latest, every five years and was last reviewed in May 2013.

22 Other deposits

	2014 £m	2013 £m
Deposit by Issue Department	55,109	52,744
Public deposits repayable on demand	1,611	949
Other deposits repayable on demand	1,383	24,370
	58,103	**78,063**

Public deposits are the balances on HM Government accounts, including Exchequer, National Loans Fund, Debt Management Office, National Debt Commissioners and dividend accounts.

23 Foreign currency bonds in issue

	2014		2013	
	£m Fair value	US$m Nominal	£m Fair value	US$m Nominal
Total amounts issued to third parties	**3,599**	**6,000**	**4,007**	**6,000**

All changes in fair values since 1 March 2013 are considered attributable to changes in prevailing interest rates and movements in relative foreign currency exchange rates.

At 28 February 2014, as part of the Bank's annual medium-term security issuance programme the Bank had three US$2bn three-year US dollar bonds in issue (2013: three US$2bn three-year dollar bonds); the first maturing on 7 March 2014, the second on 6 March 2015 and the third on 21 March 2016.

The most recent bond (the eighth in the overall programme) was issued on 10 March 2014 with settlement on 17 March 2014. This bond matures on 17 March 2017.

Of the above liabilities to third parties, £1,201m (2013: £1,339m) fall due within one year.

24 Deferred tax liabilities

Deferred tax is calculated on all temporary differences under the liability method using an effective tax rate of 20% (2013: 23%). A reduction in the UK corporation tax rate from 24% (effective from 1 April 2012) to 23% (effective 1 April 2013) was substantively enacted on 3 July 2012. Further reductions to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Bank's future current tax charge accordingly. The deferred tax liability at 28 February 2014 has been calculated based on the rate of 20% substantively enacted at the balance sheet date.

The movement on the deferred tax account is as follows:

	Note	2014 £m	2013 £m
Deferred tax			
Net liability at 1 March		(166)	(201)
Income statement charge	7	(14)	(9)
Tax credited/(charged) directly to equity		120	44
Net liability at 28 February		**(60)**	**(166)**

	2014 £m	2013 £m
Deferred tax liability relates to:		
Available for sale equity investment through comprehensive income	(78)	(110)
Fair value losses on available for sale debt securities recognised in other comprehensive income	42	–
Pensions and other post-retirement benefits	(23)	(59)
Other provisions	(1)	3
	(60)	**(166)**

25 Other liabilities

i Analysis of other liabilities

	2014 £m	2013 £m
Items in course of collection	26	1
Payable to HM Treasury	82	55
Short term creditors and other liabilities	157	136
Provisions	16	19
	281	**211**

Payable to HM Treasury includes £80m payment in lieu of dividend (note 8) and a further £2m which relates to the over recovery of costs associated with the management of the notes issue and the Exchange Equalisation Account.

Banking Department
Notes to the financial statements continued

25 Other liabilities continued

ii Analysis of provisions

	Restructuring provision £m	Onerous lease provision £m	Total £m
Balance at 1 March 2013	–	19	19
Provisions made during the year	8	–	8
Provisions used during the year	–	(4)	(4)
Provisions reversed during the year	–	(7)	(7)
Balance at 28 February 2014	**8**	**8**	**16**

Onerous lease provision

The Bank has undertaken to bear the costs arising from certain leased property previously occupied by the Financial Services Authority and which was vacated upon the commencement of the new regulatory regime. The amount provided for represents the net present value of the future lease payments and the costs of dilapidations required as part of the lease less any expected lease income from sub-letting the floor space.

The estimated future inflow of income from sub-letting the floor space has been revised and as such has led to a gain of £7m released through the income statement for the year to 28 February 2014.

The estimated net cash outflow arising has therefore decreased from £15m to £8m as at 28 February 2014.

The lease expires in November 2018. Of the above provision £2m (2013: £4m) falls due within one year. The cash flows are discounted at a risk free rate at 28 February 2014. The impact of the discount unwind is negligible.

Restructuring provision

The result of the Bank's Value for Money review, announced in January 2014, estimates that between 80–100 job redundancies will occur. The affected staff population has been assessed and a provision has been recognised based on the best estimate of the cost of these redundancies. Of these costs less than £1m is expected to be paid in more than one year.

26 Capital

	2014 £m	2013 £m
Capital	**15**	**15**

The entire capital comprising £14,553,000 of Bank Stock is held by the Treasury Solicitor on behalf of HM Treasury.

The Bank regards its shareholder's funds as the capital it uses to support its normal operations. For special operations it may also obtain indemnities from HM Treasury.

27 Cash and cash equivalents

i Analysis of cash balances

	Note	At 1 March 2013 £m	Cash flows £m	At 28 February 2014 £m
Cash and balances with other central banks	9	787	(203)	584
Loans and advances to banks and other financial institutions	10	3,353	645	3,998
Securities held at fair value through profit or loss	12	–	194	194
		4,140	**636**	**4,776**

ii Stock of liquidity

For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand and amounts due from banks within three months from the date of acquisition. This definition, which is required by IAS 7 (Cash Flow Statements), covers the Bank's stock of liquidity for operational purposes, but is not well suited to the Bank which as the central bank is the ultimate source of sterling liquidity. These include advances to the money market and banks, and reverse repurchase agreements which are regarded as a pool of assets for these purposes. The allocation of this liquidity between the components depends upon prevailing market conditions.

28 Financial risk management

The Bank is required to manage the financial risks that arise on its balance sheet and as a consequence of its operations to deliver its policy objectives. These include credit risk, market risk and liquidity risk.

The Bank's management seek to ensure that effective risk management processes exist for assessing, managing and monitoring risk, within clear risk policies. There are governance arrangements set out in a Balance Sheet Remit and financial risk standards approved by the Governor, and documented delegated authorities for implementation of financial risk management and oversight of the Bank's operations.

The Bank applies fundamentally the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks. In the case of commitments to lend, customers and counterparties will be subject to the same credit management policies as for loans and advances.

Specialist teams and committees support senior management in ensuring that agreed standards and policies are followed.

The Risk Management Division (RMD) within the Bank's Markets Directorate is responsible for analysing the financial risks faced by the Bank in its operations in financial markets. RMD is responsible for the development of the appropriate framework for the management of financial risks.

The Market Strategy and Risk Operations Division (MSROD) 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.

Banking Department
Notes to the financial statements continued

28 Financial risk management continued

a Credit risk

Credit risk is the risk of loss arising from the failure of a borrower, issuer, counterparty or customer to meet its financial obligations to the Bank. The Bank is exposed to credit risk both through direct exposures and contingent exposures, such as via collateral or insurance contracts. The primary source of credit risk arises as a result of the Bank providing liquidity to financial institutions via the Sterling Monetary Framework; intra-day in the Bank's provision of liquidity to facilitate the operation of the sterling high-value payment system (CHAPS) and the securities settlement system, CREST; and elsewhere in the Bank's management of its balance sheet, for example in the investment of the Bank's own funds and in the course of the banking services it provides to its customers. In addition, the Bank incurs credit risk in connection with any support operations it may undertake.

The Bank's credit risk policies define high-level risk parameters under which credit risk is monitored and controlled. Unsecured credit exposures are controlled by a system of limits based on internal credit ratings. This system applies to all unsecured credit exposures, including intra day exposures, foreign exchange settlement exposures and exposures arising from settling securities trades for customers. Separately, limits exist to control the maximum outright (uncollateralised) exposures to a single entity. Credit assessments are performed on all market counterparties, issuers and customers to which the Bank may be exposed. These are performed both regularly, following a timetable that reflects the risk of the actual or potential exposure, and dynamically, in response to market or specific entity conditions.

The Bank's Credit Ratings Advisory Committee (CRAC), chaired by the Head of RMD, reviews the creditworthiness of issuers, counterparties and customers to whom the Bank may have credit exposures. CRAC makes recommendations to the Executive Director for Markets, who is responsible for decisions on internal credit ratings. CRAC is supported by a credit risk analysis team.

Banking services are provided to the UK government and other public sector entities, overseas central banks, international institutions, infrastructure providers, Bank staff and pensioners, and other customers. The Bank may incur credit exposures to its customers in the course of providing such services. The reinvestment of customer deposits via secured on-placements may also give rise to credit exposures.

Credit risk on the securities held outright by the Bank is managed by holding only securities internally rated as equivalent to investment-grade in routine circumstances, which are issued chiefly by governments, government agencies and supranational organisations; and by a schedule of credit limits that vary based on internal rating.

Collateral management

In providing short-term liquidity via the Bank's Sterling Monetary Framework operations and, intra-day, via the Bank's operation of wholesale payment systems, credit risk is managed by ensuring that exposures are fully collateralised (with appropriate haircuts) by securities, which are issued chiefly by governments, government agencies and supranational organisations, which meet the Bank's minimum standards of liquidity and credit risk. A summary of eligible collateral can be found on the Bank's website.[34]

In the Bank's Indexed Long-Term Repo Operations, Discount Window Facility, Contingent Term Repo Facility and Funding for Lending Scheme, the Bank may take a wide range of private sector collateral. Depending on the facility, the collateral may include mortgage-backed securities, covered bonds backed by mortgages or public sector securities, other asset-backed securities (such as asset-backed securities backed by credit card receivables, student loans or auto loans), or pools of loans. The collateral must meet published eligibility criteria.

The Bank manages the risk in this wider collateral portfolio by applying haircuts to take account of liquidity risk, credit risk and all other material risks to the realisable value of the collateral. Where appropriate the Bank undertakes stress testing of securities in order to ensure that haircuts are sufficient to protect against idiosyncratic risk in the underlying collateral pool and counterparty risk. The Bank may vary haircuts at its discretion, including on individual securities.

34 www.bankofengland.co.uk/boe-ar2014/links

The Bank values securities daily and calls for additional collateral where the haircut-adjusted value is less than the value of its exposure. Where possible, the Bank uses a market price to value securities. Where no such market price exists, the Bank uses a model price designed to deliver a price that is as close as possible to what a market price would have been had such a price existed. The valuations methodology, the use of spreads in models and collateral eligibility are under regular review. A Collateral Risk Committee chaired by the Head of RMD reviews issues relating to the wider collateral portfolio and considers policy issues relating to stress testing, valuation and eligibility of collateral including market or entity specific conditions.

In the Bank's Indexed Long-Term Repo Operations, Discount Window Facility, Contingent Term Repo Facility and Funding for Lending Scheme, the Bank may take portfolios of loans in unsecuritised form as collateral. A Collateral Eligibility Committee chaired by the Head of RMD reviews the eligibility of a counterparty to pledge portfolios of loans as collateral, based on an assessment of the firm's risk management policies and also reviews eligibility of individual portfolios.

In non-routine circumstances, the Bank may seek other methods of mitigating credit risk, which may include indemnities from HM Treasury.

Geographical concentration of assets and liabilities

The Bank undertakes its operations in the UK. It does, however, accept deposits from overseas central banks. An analysis of the Bank's assets and liabilities by geographical area is given below:

	2014 £m	2013 £m
Assets		
UK	388,101	389,508
Rest of Europe	9,741	6,133
Rest of the world	1,499	2,084
	399,341	**397,725**
Liabilities and equity		
UK	371,054	369,064
Rest of Europe	13,956	14,993
Rest of the world	14,331	13,668
	399,341	**397,725**

b Market risk

Market risk is defined as the risk of loss as a result of changes in market prices, including prices of securities, interest rates, foreign exchange rates, commodity prices and credit spreads. The Bank is exposed to market risk as a consequence of its operations to deliver its policy objectives and, in the course of managing the Bank's balance sheet, principally through changes in the relative interest rates received on its assets and paid on its liabilities. Limited exposure may also be incurred to changes in exchange rates and to shifts in general market conditions, such as the liquidity of asset markets.

The Bank's market risk policies set out risk management parameters, governance and control frameworks as well as reporting arrangements for key risk indicators.

The Bank is exposed to interest rate risk through the investment of the Bank's capital and Cash Ratio Deposits in high-quality securities in the sterling bond portfolio. These are bought and, in normal circumstances, held to maturity with the intention of maintaining the value of the Bank's capital and generating income to pay for the Bank's policy functions.

Banking Department
Notes to the financial statements continued

28 Financial risk management continued

Value at Risk measurement

The Bank measures the Value at Risk (VaR) of all its positions. VaR estimates the potential loss that might arise if existing positions were unchanged for 10 working days under normal market conditions, given the historical volatility of the returns on different assets, and the historical correlation between those returns.

VaR on the Bank's balance sheet is calculated against the risk factors to which the Bank is exposed. During the year VaR arose mostly from market risk on the Bank's sterling bond portfolio.

Value at Risk

	2014 £m	2013 £m
At 28 February	98.2	76.7
Average	94.8	86.5

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based do give rise to some limitations, including the following:

- A 99% confidence level does not reflect losses that may occur beyond this level. Even within the model used there is a 1% probability that losses could exceed the VaR.
- A ten-day holding period assumes that it is possible to hedge or dispose of positions within that period. This may not be realistic in a situation where there is severe market illiquidity.
- VaR data is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during the day.
- The model uses historical data from 1 March 2012 to 28 February 2014 on a basis for determining the possible ranges of outcomes and may not always cover all possible scenarios, especially those of an exceptional nature.

The Bank back-tests its VaR by comparing actual profit or loss to the VaR estimation. The results of the back-testing process are one of the methods by which the Bank monitors the ongoing suitability of its VaR model.

The Bank also undertakes stress tests on positions on its balance sheet. The results of the stress testing complement the VaR measure in informing management about financial risk on the balance sheet.

To mitigate the fourth limitation above, the Bank has developed 'stressed' VaR which is calibrated not on recent data, but on data drawn from the two-year period of maximum volatility since January 2000. Stressed VaR avoids the understatement problem as changes generally arise from a change in the underlying portfolio, rather than a short-run change in market volatility. The Bank introduced the stressed VaR in June 2013; at 28 February 2014, stressed VaR was £162.92m.

Currency risk

The Bank may take currency risk in the context of foreign exchange intervention and in the course of balance sheet management. However, the majority of these potential exposures are matched, mainly through the use of forward exchange contracts and currency swaps, and residual foreign exchange exposures are hedged on a regular basis. Therefore the Bank has no significant net foreign currency exposure, other than the Bank's investment in the Bank for International Settlements (note 14b) which is denominated in Special Drawing Rights and held at fair value of £397m (2013: £474m). Excluding this, the Bank's net foreign exchange exposure at 28 February 2014 was £1m (2013: £17m).

c Liquidity risk

Liquidity risk is the risk of encountering difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

In sterling, liquidity risk does not arise as the Bank is able to create sterling liquidity through its market operations.

For foreign currency, in addition to holding appropriate cash balances, the Bank manages liquidity through cash-flow matching and the use of forward exchange contracts and currency swaps; the Bank also holds a portfolio of liquid foreign exchange reserves. Throughout 2013/14, the Bank continued weekly tender operations (which had recommenced in May 2010) to lend US dollar funds for seven days against eligible collateral. Since October 2011, monthly US dollar tender operations with a 3-month term have also been offered. US dollar funding to facilitate these operations would be provided through a reciprocal swap agreement with the US Federal Reserve.

In view of the improvement in US dollar funding conditions and the low demand for US dollar liquidity-providing operations, the Bank of England, in co-ordination with other central banks, has decided to phase out its current US dollar liquidity-providing operations during 2014. The network of bilateral central bank liquidity swap arrangements, moved on to a standing basis in October 2013, provide a framework for the reintroduction of US liquidity operations if warranted by market conditions.

The Bank's Balance Sheet Remit and Liquidity Risk standard and supporting policies set out risk tolerances and detailed parameters and controls to minimise the foreign currency liquidity risk that arises. These include limits over cash flow and maturity mismatches, and for bond holdings, minimum issue size and concentrations limits are set as well as reporting requirements for key risk indicators.

Banking Department
Notes to the financial statements continued

28 Financial risk management continued

The following tables analyse the Bank's foreign currency financial assets and liabilities at the balance sheet dates into relevant maturity groupings based on the remaining period to the contractual maturity date.

Foreign currency liquidity risk

As at 28 February 2014	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Assets						
Cash and balances with other central banks	584	–	–	–	–	584
Loans and advances to banks and other financial institutions	2,972	4,404	1,606	–	–	8,982
Securities held at fair value through profit and loss	413	1,425	2,851	1,599	–	6,288
Derivative financial instruments:						
Cash inflow	1,034	1	128	631	–	1,794
Cash outflow	(1,705)	(764)	(462)	(561)	–	(3,492)
Other assets	–	–	–	–	–	–
Total assets	**3,298**	**5,066**	**4,123**	**1,669**	**–**	**14,156**
Liabilities						
Deposits from central banks	1,903	4,387	3,247	–	–	9,537
Deposits from banks and other financial institutions	69	–	–	–	–	69
Other deposits	488	–	–	–	–	488
Foreign currency bonds in issue	1,208	–	6	2,398	–	3,612
Derivative financial instruments:						
Cash inflow	(2,611)	(4,391)	(3,139)	(1,198)	–	(11,339)
Cash outflow	2,616	4,684	3,232	1,256	–	11,788
Other liabilities	–	–	–	–	–	–
Total liabilities	**3,673**	**4,680**	**3,346**	**2,456**	**–**	**14,155**
Net liquidity gap	**(375)**	**386**	**777**	**(787)**	**–**	**1**
Cumulative gap	**(375)**	**11**	**788**	**1**	**1**	

Foreign currency liquidity risk

As at 28 February 2013	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Assets						
Cash and balances with other central banks	786	–	–	–	–	786
Loans and advances to banks and other financial institutions	1,344	6,040	3,766	–	–	11,150
Securities held at fair value through profit and loss	564	483	470	2,059	–	3,576
Derivative financial instruments:						
Cash inflow	2,427	4,128	2,032	1,869	–	10,456
Cash outflow	(2,121)	(4,037)	(1,982)	(1,731)	–	(9,871)
Other assets	–	–	–	–	–	–
Total assets	**3,000**	**6,614**	**4,286**	**2,197**	**–**	**16,097**
Liabilities						
Deposits from central banks	1,240	4,384	3,698	–	–	9,322
Deposits from banks and other financial institutions	157	–	–	–	–	157
Other deposits	410	–	–	–	–	410
Foreign currency bonds in issue	1,351	–	12	2,654	–	4,017
Derivative financial instruments:						
Cash inflow	(1,574)	(302)	(1,691)	(4)	–	(3,571)
Cash outflow	1,885	2,042	1,789	29	–	5,745
Other liabilities	–	–	–	–	–	–
Total liabilities	**3,469**	**6,124**	**3,808**	**2,679**	**–**	**16,080**
Net liquidity gap	**(469)**	**490**	**478**	**(482)**	**–**	**17**
Cumulative gap	**(469)**	**21**	**499**	**17**	**17**	

Banking Department
Notes to the financial statements continued

28 Financial risk management continued

d Fair value of financial assets and liabilities

The table below shows the financial instruments carried at fair value by valuation method:

As at 28 February 2014	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets					
Loans and advances to banks and other financial institutions	10	–	8,979	–	8,979
Securities held at fair value through profit or loss	12	6,090	–	–	6,090
Derivative financial instruments	13	–	179	–	179
Available for sale securities	14	5,940	–	402	6,342
		12,030	**9,158**	**402**	**21,590**
Liabilities					
Deposits from central banks	20	–	12,928	–	12,928
Foreign currency bonds in issue	23	3,599	–	–	3,599
Derivative financial instruments	13	–	465	–	465
		3,599	**13,393**	**–**	**16,992**

As at 28 February 2013	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets					
Loans and advances to banks and other financial institutions	10	–	11,145	–	11,145
Securities held at fair value through profit or loss	12	3,573	–	–	3,573
Derivative financial instruments	13	–	334	–	334
Available for sale securities	14	4,700	–	479	5,179
		8,273	**11,479**	**479**	**20,231**
Liabilities					
Deposits from central banks	20	–	12,377	–	12,377
Foreign currency bonds in issue	23	4,007	–	–	4,007
Derivative financial instruments	13	–	229	–	229
		4,007	**12,606**	**–**	**16,613**

There have been no transfers between levels in the year.

Level 1 Valued using unadjusted quoted prices in active markets for identical financial instruments.

Level 2 Valued using techniques that rely upon relevant observable market data curves. This category of instruments comprised derivatives, repurchase transactions, commercial paper and deposits.

Level 3 Valued using techniques where at least one input that could have a significant impact on the valuation is not based on observable market data. During the year this category consisted primarily of the Bank's investment in the Bank for International Settlements (note 14b).

The fair values of financial assets and liabilities classified as loans and receivables and deposits at amortised cost approximate to their carrying values due to their short-term nature.

29 Off balance sheet arrangements – Funding for Lending Scheme

The Funding for Lending Scheme (FLS) has been designed to incentivise banks and other financial institutions to boost their lending to UK households and businesses.

FLS does this by providing funding for an extended period with a direct link between the quantity and price of funding available from the scheme and participants' performance in lending to the real economy.

	Up to 1 year £m	1 to 3 years £m	3 to 5 years £m	2014 Nominal £m	2014 Fair value £m	2013 Nominal £m	2013 Fair value £m
Securities lent to banks and other financial institutions	–	13,486	27,919	41,405	41,334	15,166	15,139
Securities borrowed from DMO	–	(13,486)	(27,919)	(41,405)	(41,334)	(15,166)	(15,139)
Total obligations	–	–	–	–	–	–	–

As of the end of February 2014 there were 47 banking groups signed up to the scheme out of which 39 have outstanding drawings. Treasury bills with a market value of £41.3bn had been lent to the participants at year-end (2013: £15.1bn). The Bank has borrowed these Treasury bills from the DMO to whom they are owed back.

30 Contingent liabilities and commitments

a Contingent liabilities

Contingent liabilities and commitments, some of which are offset by corresponding obligations of third parties, arise in the normal course of business, including contingent liabilities in respect of guarantees and indemnities in connection with liquidity support operations.

As part of its normal business, the Bank acts as custodian of its customers' assets and fulfils an agency role. No significant irrecoverable liability arises from these transactions.

Since 1930 there has also been a contingent liability in respect of uncalled capital on the Bank's investment in the Bank for International Settlements, now denominated in Special Drawing Rights (SDR). The sterling equivalent of this liability based on the SDR price at the balance sheet date was £166m (2013: £179m).

The Bank has been required to subscribe to the share capital of the European Central Bank (ECB) since its establishment in 1998. Subscriptions depend on shares which are fixed in accordance with Article 29.3 of the European System of Central Banks (ESCB) Statute and which must be adjusted every five years and on the accession of new states to the European Union. The next quinquennial adjustment is due in 2019.

Banking Department
Notes to the financial statements continued

30 Contingent liabilities and commitments continued

In accordance with the Treaty on the Functioning of the European Union, and in line with other non euro area national central banks, the Bank is only required to pay a 'minimal percentage' of its subscribed share capital, currently 3.75% amounting to €56m (2013: 3.75% amounting to €59m) by way of contribution to the operational costs of the ECB. The 'minimal percentage' can be varied by the General Council of the ECB. The Bank has not been notified of any intentions to change the 'minimal percentage'.

b Capital commitments

Capital commitments outstanding at 28 February 2014 amounted to £11m (2013: £11m).

In addition the Bank did not have any contingent capital commitments outstanding at 28 February 2014 (2013: £nil).

c Operating lease commitments – minimum lease payments

	2014 Land and buildings £000	2014 Computer and other equipment £000	2013 Land and buildings £000	2013 Computer and other equipment £000
At the year end, minimum lease payments under non-cancellable operating leases were				
Expiring within one year	7,700	251	7,865	194
Between one and five years	30,944	133	31,353	282
Expiring in five years or more	44,257	–	50,884	–
	82,901	**384**	**90,102**	**476**

The Bank leases the premises occupied by its Agencies and the PRA.

31 Related parties

Transactions with those commercial banks which are related parties but not wholly-owned by HM Treasury have not been disclosed as the Bank does not believe such disclosures to be appropriate having regard to its functions.

a HM Government

The Bank provides a range of activities to its shareholder, HM Treasury, and to other Government departments and bodies:

- Provision of banking services, including holding the principal accounts of Government.
- Management of the Exchange Equalisation Account.
- Management of the note issue.

The Bank also engaged in transactions with the Financial Services Compensation Scheme and other related parties.

The aggregate balances on HM Treasury and other public sector accounts are disclosed in note 22 as public deposits. The total charges made to the Government are disclosed in note 4.

Debt Management Office and Debt Management Account

The Bank has entered into agreements with the UK Debt Management Office (DMO) through the Debt Management Account (DMA) whereby the DMA lends UK government securities to the Bank with the simultaneous agreement that the Bank would deliver equivalent securities to the DMA on termination of those agreements.

At 28 February 2014 the Bank had a loan from the DMA of £193m (2013: £193m) in relation to the provision of funding to the Bank of England Asset Purchase Facility Fund Ltd.

At 28 February 2014 the Bank had borrowed Treasury bills with a nominal value of £41.4bn (2013: £15.2bn) under the Bank's Funding for Lending Scheme. The Bank has paid the DMA a loan fee for the Treasury bills borrowed.

In addition, the DMA placed interest bearing deposits with the Bank during the year, which is included within note 22 as public deposits.

HM Treasury
HM Treasury continued to indemnify the activities of the Bank of England Asset Purchase Facility Fund Ltd during the year.

The Bank has requested HM Treasury to require the Financial Services Compensation Scheme (FSCS) to make a payment reimbursing the sum of £2.9m in respect of expenses incurred by the Bank in connection with the resolution of Dunfermline Building Society in accordance with the Financial Services and Markets Act 2000 (Contribution to Costs of Special Resolution Regime Regulations 2009).

Financial Services Compensation Scheme
The Financial Services Compensation Scheme (FSCS) is the UK's statutory fund of last resort for customers of authorised financial services firms set up under the Financial Services and Markets Act 2000 (FSMA). The FSCS is independent from the PRA and FCA (formerly the FSA), although accountable to them and ultimately to HM Treasury.

The FSCS placed interest bearing deposits with the Bank during the year, which are included within note 22 as public deposits.

Bradford & Bingley plc and Northern Rock (Asset Management) plc
Bradford & Bingley plc and Northern Rock (Asset Management) plc are wholly-owned by HM Treasury through the holding company UK Asset Resolution Ltd and placed interest bearing deposits with the Bank during the year, which are included within note 21.

b Subsidiaries
Full details of the subsidiaries of the Bank are disclosed in note 15.

Bank of England Asset Purchase Facility Fund Ltd (BEAPFF)
BEAPFF is a wholly-owned subsidiary of the Bank. It was established on 30 January 2009 in order to fulfil the remit of the Chancellor of the Exchequer given to the Bank on 19 January 2009. This remit was subsequently expanded to enable the Fund to be used as a monetary policy tool at the request of the Monetary Policy Committee.

BEAPFF's operations are fully indemnified for loss by HM Treasury and any surplus for these operations is due to HM Treasury.

Purchases of assets by BEAPFF are financed via a loan from the Bank. From 6 March 2009 to 4 February 2010 and from 7 October 2011 advances on this loan were financed by the issuance of central bank reserves. Prior to 6 March 2009 and from 4 February 2010 to 6 October 2011 advances on this loan were financed by a loan from the DMO.

At 28 February 2014 the loan from the Bank to BEAPFF was £375.2bn (2013: £375.2bn). Interest on this loan is receivable at Bank Rate and amounted to £1.9bn for the year ending 28 February 2014 (2013: £1.7bn).

At the year end BEAPFF held a deposit at the Bank of £1.0bn (2013: £24.1bn), which is included in other deposits (note 22). Interest on this deposit is payable at Bank Rate and totalled £47m for the year ending 28 February 2014 (2013: £132m).

A management fee of £2m was payable by BEAPFF to the Bank in respect of the year ended 28 February 2014 (2013: £2m).

Banking Department
Notes to the financial statements continued

31 Related parties continued

Prudential Regulation Authority (PRA)

PRA is a wholly-owned subsidiary of the Bank. The company was established on 21 November 2011 and began to operate when the new regulatory framework for the UK's financial sector came into effect on 1 April 2013. To fulfil the requirements of the Financial Services Act 2012 the PRA is responsible for the prudential regulation of banks, building societies and credit unions, insurers and major investment firms. As prudential regulator, the PRA will promote the safety and soundness of these firms, seeking to minimise the adverse effects that they can have on the stability of the UK financial system; and contribute to ensuring that insurance policyholders are appropriately protected.

The Bank initially pays all of the expenses of the PRA. The Bank will then recharge relevant expenditure, such as the costs of 20 Moorgate the building from which the PRA operates, directly to the PRA. During the year the Bank recharged expenditure of £132.0m. Additionally the Bank provides central services and support functions, such as IT, finance, property and procurement, and human resources, to the PRA for which it charges a management fee on a monthly basis. In the year the management fee charged was £59.4m. As at 28 February 2014 the Bank was owed £19.1m by the PRA in respect of recharged expenditure and management fee, this amount is included in Note 19.

Additionally the Bank incurred further costs in relation to the set up of the PRA of £9.2m in the year (2013: £48.5m) and has charged the current year's costs to the PRA. The PRA Board had previously agreed that the costs of the transition will be recovered from the fee-payers over a period of five years. As a result the PRA has a liability to the Bank and the Bank has a receivable from the PRA as at the year end of £59.0m (2013: £64.7m) which is disclosed as a receivable within note 19. The Bank held on balance sheet as at 28 February 2014 £14.3m (2013: £22.8m) at cost of property, plant and equipment related to the set up of the PRA which is disclosed within note 16. During the year property, plant and equipment of £7.9m was transferred from the Bank to the PRA at net book value, of which £0.3m was transferred post legal cutover.

c Key management personnel

Members of Court are covered by an indemnity from the Bank, granted in 2000 (see page 7).

The following information is presented only in respect of those employees of the Bank who would be considered as key management personnel, as defined under IAS 24 (Related Party Disclosures). This comprised the Governors, members of the Executive Team and Non-executive Directors. At 28 February 2014, the number of key management personnel was 26 (2013: 22).

The following particulars relate to loans and deposits between the Bank and key management personnel and persons connected with them:

	2014 £000	2013 £000
Loans		
Balance brought forward	28	32
Loans made during year	35	22
Loans repaid during year	(20)	(26)
	43	**28**
Interest income earned	2	2
Number of key management personnel with loans at 28 February	**5**	3

No provisions have been recognised in respect of loans given to related parties (2013: £nil).

	2014 £000	2013 £000
Deposits		
Governors and Executive Directors		
Balance brought forward	872	745
Deposits taken during year	512	592
Deposits repaid during year	(1,104)	(465)
	280	**872**
Non-executive Directors		
Balance brought forward	6,159	5,548
Deposits taken during year	12	611
Deposits repaid during year	–	–
	6,171	**6,159**
Interest expense on above deposits	17	16
Number of key management personnel with deposits at 28 February	5	7

There were no other transactions that would be required to be shown under the provisions of the Companies Act 2006. None of the key management personnel had a material interest, directly or indirectly, at any time during the year in any other significant transaction or arrangement with the Bank or any of its subsidiaries.

All employees, excluding external MPC members, are entitled to season ticket loans (repayable monthly over five to 12 months) and may choose to take personal loans (for periods of up to five years and at a variable interest rate equal to HMRC's Official Rate of Interest currently 4%) as part of their remuneration package.

Staff, including Governors and Executive Directors, holding current and interest-bearing deposit accounts at the Bank of England receive interest at commercial rates.

Banking Department
Notes to the financial statements continued

31 Related parties continued
Key management remuneration

	2014 £000	2013 £000
Salaries and short-term benefits	4,836	3,329
Post-employment benefits	873	374
	5,709	**3,703**

Post-employment benefits have been estimated using an expected cost of pension on a funding valuation basis.

Full information on the remuneration (including pension arrangements) of the Members of Court is given in the Remuneration report on pages 50 to 55.

d The Bank's pension scheme
The Bank provides the secretariat, accounting services and some banking and custodial services to the Bank's funded pension scheme. In the year to 28 February 2014 no charge was made for these services (2013: £nil). These activities are undertaken on behalf of, and under the supervision of, the Trustee of the Pension Fund. The contribution paid to the scheme during the year was £48m (2013: £48m). There were no other material transactions between the Bank and the pension scheme during the year to 28 February 2014. At 28 February 2014 the balances on accounts held with the Bank were £11m (2013: £11m).

e Other entities with links to the Bank
In the normal course of its activities as a central bank, the Bank has relationships, involving some representation at management level and participation in funding, with international and domestic institutions. The Bank does not consider these institutions to be related parties.

32 Date of approval
The Members of Court approved the financial statements on pages 70 to 122 on 4 June 2014.

Issue Department Account
for the period ended 28 February 2014

	2014 £m	2013 £m
Income and profits		
Securities of, or guaranteed by, the British Government	238	330
Other securities and assets	275	262
	513	**592**
Expenses		
Cost of production of banknotes	36	40
Cost of issue, custody and payment of banknotes	25	27
Other expenses	9	8
	70	**75**
Paid to National Loans Fund	**443**	**517**

Issue Department
Statement of balances
for the period ended 28 February 2014

	Note	2014 £m	2013 £m
Assets			
Securities of, or guaranteed by, the British Government	3	4,594	5,263
Other securities and assets including those acquired under reverse repurchase agreements	4	55,604	52,759
Total assets		**60,198**	**58,022**
Liabilities			
Notes issued:			
In circulation	5	60,198	58,022
Total liabilities		**60,198**	**58,022**

On behalf of the Governor and Company of the Bank of England:

Mr M Carney Governor
Mr C R Bean Deputy Governor
Sir David Lees Chairman of Court
Mr R Coates Finance Director

The notes on pages 125 to 127 are an integral part of these statements of accounts.

Notes to the Issue Department Statements of account

1 Bases of preparation

The statements of account are prepared in accordance with the requirements of the Currency and Bank Notes Acts 1928 and 1954, the National Loans Act 1968 and the Currency Act 1983. All profits of the Issue Department are payable to the National Loans Fund.

– The statements of account are prepared on the basis of amounts received and paid as modified by the effects of a revaluation of securities.

– All securities are revalued quarterly at their clean mid-market price and are stated, with purchased accrued interest, in the balance sheet at this valuation. The last valuation was made as at 27 February 2014.

– If a revaluation of securities shows a net gain this is included in income. A deficit is not taken against income but is settled by a transfer from the National Loans Fund. Total gains taken to income in the year to 28 February 2014 amounted to £nil (2013: £82m) and total deficits paid by the National Loans Fund amounted to £282m (2013: £195m).

– Notes in circulation exclude those old series notes which have been written off. The value of the note is still given by the Bank on presentation. The Bank is reimbursed by HM Treasury in these instances.

2 Expenses

The expenses shown represent charges from the Banking Department for costs incurred in relation to the note issue.

On an accruals basis, the cost of note issue for the year to 28 February 2014 was £72m (2013: £78m).

3 Securities of, or guaranteed by, the British Government

	2014 £m	2013 £m
British Government Stocks	4,224	4,893
Ways and Means advance to the National Loans Fund	370	370
	4,594	**5,263**

The Ways and Means advance earns interest at Bank Rate.

4 Other securities and assets including those acquired under reverse repurchase agreements

	2014 £m	2013 £m
Deposit with Banking Department	55,109	52,744
Reverse repurchase agreements	495	15
	55,604	**52,759**

The deposit with Banking Department earns interest at Bank Rate.

Notes to the Issue Department Statements of account continued

5 Notes in circulation

	2014 £m	2013 £m
£5	1,540	1,526
£10	7,182	7,234
£20	36,484	35,163
£50	11,025	10,323
Other notes*	3,967	3,776
	60,198	**58,022**

* Includes higher value notes used as cover for the note issues of banks in Scotland and Northern Ireland.

6 Assets and liabilities

a Interest rate exposure

As the liabilities of the Issue Department are interest free, the income of the Issue Department is directly exposed to movements in interest rates. As at the year end 28 February 2014, the assets of the Issue Department had the following repricing period profile.

	2014 £m	2013 £m
Repricing up to one month	55,974	53,129
Repricing in greater than one month but less than three months	–	–
Repricing in greater than three months but less than six months	–	–
Repricing in greater than six months but less than 12 months	222	404
Repricing in greater than 12 months	4,002	4,489
	60,198	**58,022**

b Currency exposure

All the assets and liabilities of the Issue Department are denominated in sterling. The collateral provided under reverse repurchase agreements may be in currencies other than sterling but this does not give rise to any direct currency exposure.

c Credit risk

Credit risk is the risk of loss arising from the failure of a borrower, issuer, counterparty or customer to meet its financial obligations to the Bank. The Bank is exposed to credit risk both through direct exposures and through contingent exposures, such as custody arrangements and holdings of collateral. Credit risk arises in the course of the operations of the Note Circulation Scheme, Agency Notes Store and Notes Printing Contract; and as a result of the Bank providing liquidity to financial institutions via open market operations.

In providing liquidity via routine open market operations credit risk is managed by ensuring that exposures are fully collateralised (with appropriate margin) by internally rated as equivalent to investment-grade securities.

Credit risk on the securities held by the Bank is managed by holding only internally rated as equivalent to investment-grade securities in routine circumstances, issued chiefly by governments and central banks.

7 Accrued interest

At 28 February 2014 the unrecognised accrued interest on the assets held on the Issue Department statement of balances was £68m (2013: £80m).

8 Date of approval

The Members of Court approved the statements of account on pages 123 to 127 on 4 June 2014.

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BANK OF ENGLAND

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