BANK OF ENGLAND

Annual Report **2016**

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)).

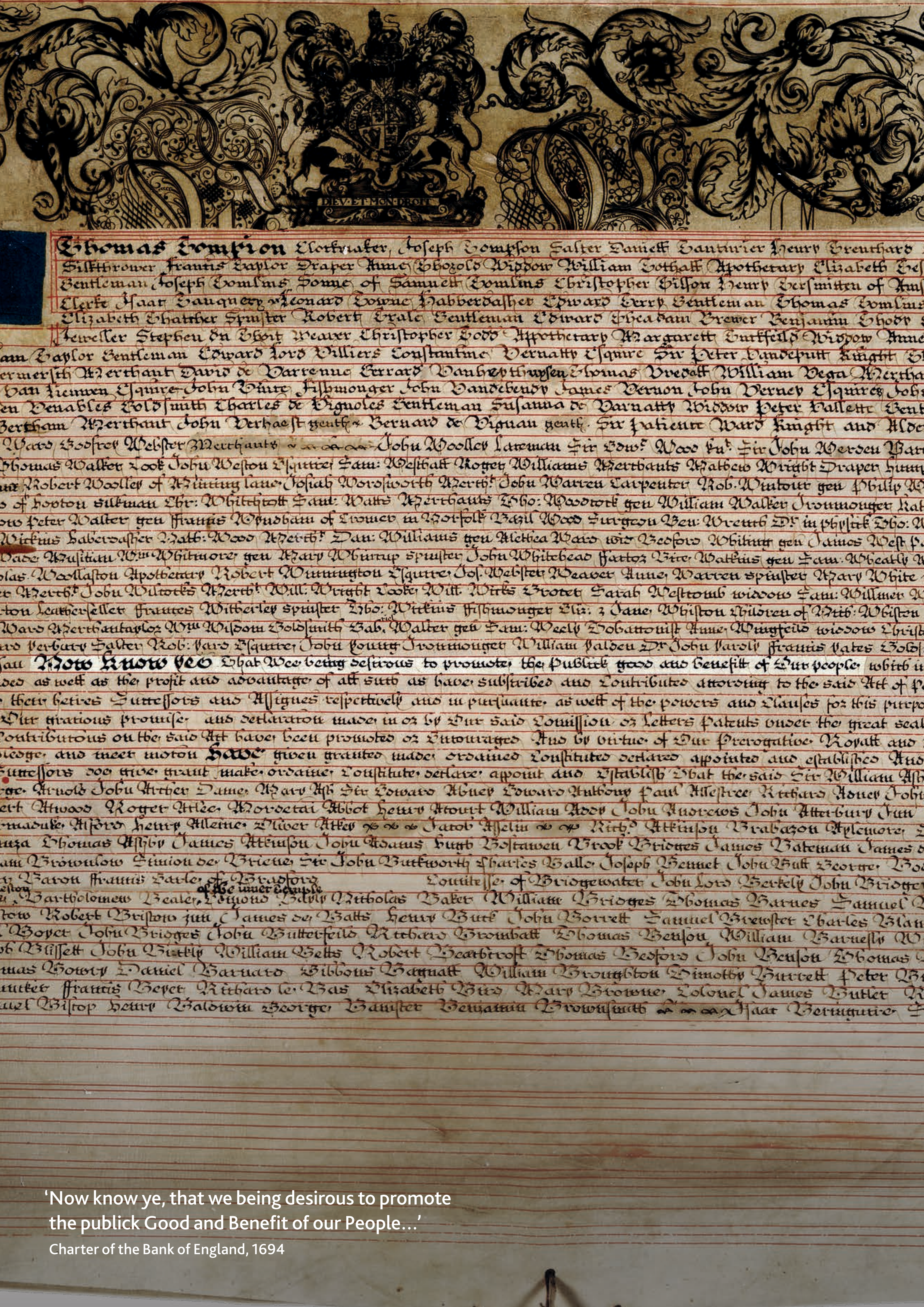
The Prudential Regulation Authority has published a separate report as required by Paragraph 19 of Schedule 1ZB of the Financial Services and Markets Act 2000, and in accordance with the requirements of the Companies Act 2006.

The Bank has also published a separate report, as required by section 203B of the Banking Act 2009 and paragraph 33 of Schedule 17A of the Financial Services and Markets Act 2000, on its supervision of financial market infrastructures.

Bank of England
Annual Report 2016

1 March 2015 to 29 February 2016

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



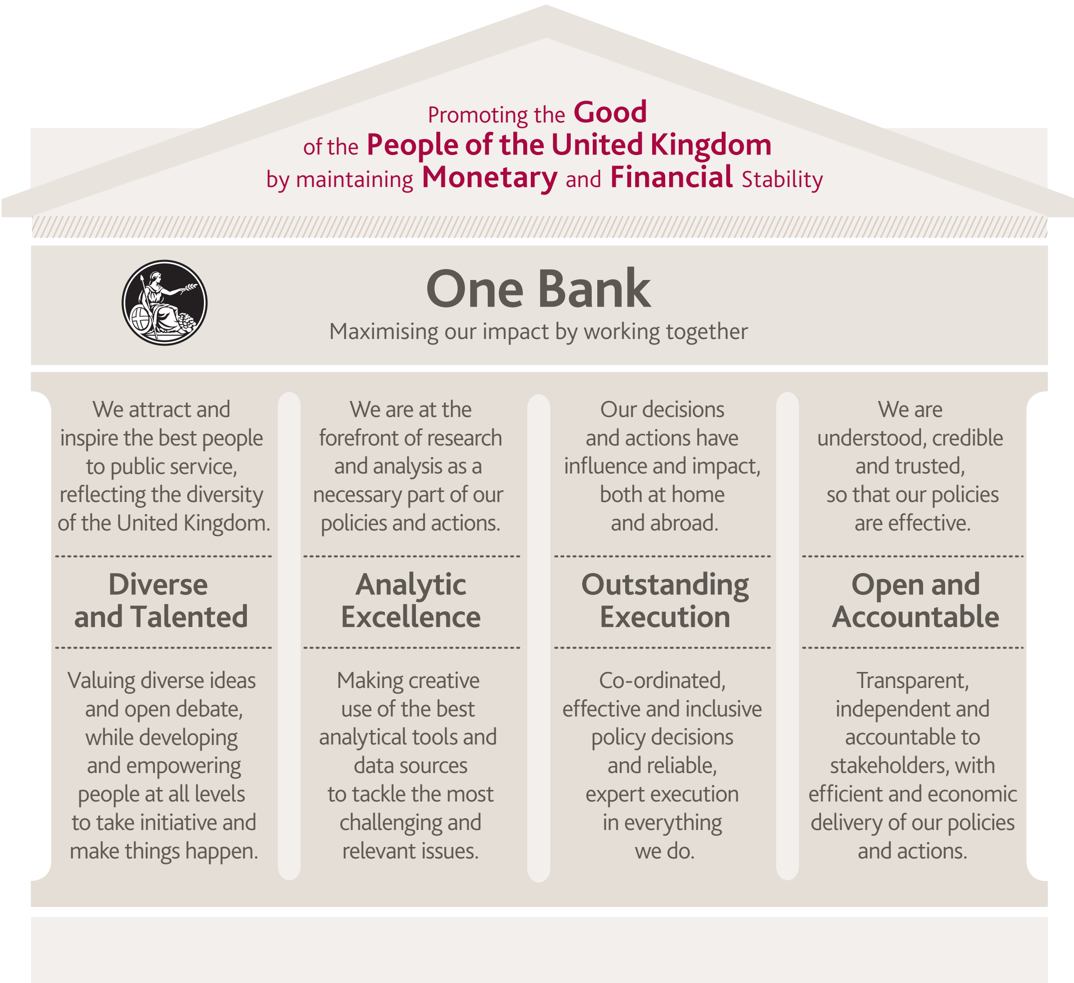
'Now know ye, that we being desirous to promote the publick Good and Benefit of our People…'

Charter of the Bank of England, 1694

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.



Statement by the Chairman of Court

Anthony Habgood
Chairman of Court

The Bank has set out an ambitious vision for the future, and is starting to reap the rewards of investments made in its Strategic Plan.

The past twelve months have seen considerable achievements as the Bank strives to be the best in the world at what it does. Particular progress has been made on professional standards, on 'One Bank' working and on Court's role as a robust and independent Board.

Conduct and ethics

As the Bank's Board, Court is ultimately responsible for the institution's culture and values. Over the past year, Court has overseen the development of 'Our Code', which sets out the principles that define public service at the Bank. All employees have attested to their understanding of these principles, as well as to their compliance with the Code's policies (see the Corporate Social Responsibility Report, page 60). Court has also reviewed and rationalised the specific codes of conduct that apply to the Bank's statutory policy committees (see the Oversight Committee Report, page 75).

The Bank rightly demands exemplary ethical standards from its employees, and Court plays an important role in ensuring that these are rigorously adhered to. In support of this, the Bank has introduced a strengthened compliance function, reporting to Court's Audit and Risk Committee. And Court will continue to ensure that ongoing legal investigations — especially those relating to records of the Bank's crisis-era liquidity auctions[1] — are followed up in a rigorous, timely and appropriately transparent manner.

Professionalising the Bank

Well-run organisations ensure clear delegation and accountability, one of the core aims of the Senior Managers Regime (SMR) for the UK financial sector. The Bank rightly believes that it should adhere to the same high standards that it demands of its regulated firms. It has accordingly applied the core principles of the SMR to its own business, laying out clearly the responsibilities of its Senior Managers, and the ways in which they will be held to account for their actions.

The past year has also seen numerous improvements in the Bank's wider financial and general management practices. These include the Bank's crisis management framework, which has been reworked and reinforced following the October 2014 outage of the RTGS payments system, and the subsequent independent report by Deloitte. The Bank is continuing to refine its approach, and progress will be monitored by Court.

The Bank has introduced a more robust and consistent approach to risk management, including the establishment of a new Bank-wide risk management framework to support Court's Audit and Risk Committee (see the Audit and Risk Committee Report, page 77). Among the key risks currently being monitored by Court is that of cyber resilience. Court receives regular updates on the evolving nature of the cyber threats facing the Bank, and on the protection that the institution is putting in place, both for itself and for the wider financial system.

The most important asset of any business is its people, and the Bank has implemented a series of improvements in its approach to people management over the past year. Court regularly discusses talent management and succession planning, and monitors the numerous initiatives

1 As set out in last year's *Report*, records relating to the Bank's liquidity auctions in 2007/08 were referred to the Serious Fraud Office, on recommendation of counsel.

that the Bank has put in place to attract, train and retain a diverse and talented workforce. Court will continue its work on talent management and succession planning over the coming year, as well as supporting the Bank's increasing focus on improving organisational agility.

'One Bank' working

The driving force behind the Bank's Strategic Plan has been 'One Bank' working — that is, making the most of the wide range of expertise that is housed within the institution. This approach makes the Bank not only a fascinating place to work, but also is increasingly reaping rewards in terms of performance and staff engagement. I have seen first-hand the positive impact that 'One Bank' working is having, both when observing meetings of the Bank's policy committees, and in my discussions with individual MPC, FPC and PRA Board members. Recent improvements in research performance are a further sign of the Bank's progress in this regard.

Embedding the 'One Bank' approach throughout the organisation is an ongoing process, and is recognised as such by the leadership team. The links between the Bank's policy and operational experts are among the areas where there is scope to improve effectiveness, and work on, for example, cyber resilience and fintech, provides clear opportunities to further 'One Bank' collaboration.

The Independent Evaluation Office (IEO)

Successful institutions continually strive to do better. One of Court's core duties is to keep the performance of the Bank under review, and it is supported in doing so by its Independent Evaluation Office (IEO). The IEO has over the past year published two in-depth assessments of performance — the Bank's forecasting performance and the PRA's approach to its secondary competition objective. These made a series of recommendations for change, and Court will be monitoring their implementation closely.

For the coming year, Court has commissioned two further in-depth reports from the IEO: the Bank's supervision of financial market infrastructures and the PRA's approach to its insurance objective.

Court and accountability

Court itself also needs to ensure that it is striving for best practice, and the regular review of Court effectiveness pointed to continued improvements over the past year (see the Oversight Committee Report, page 76). The changes enacted in the Bank of England and Financial Services Act 2016 ('the Act') provide further opportunities to improve Court effectiveness and efficiency, formalising as they do Court's role as a unitary Board with responsibility for monitoring the Bank's performance and its financial management.

The Act also provides a new basis for the engagement of the National Audit Office (NAO) with the Bank, including the provision of 'value for money' reviews by the NAO of aspects of the Bank's work. This represents a welcome opportunity to underscore the Bank's accountability. It is, however, essential that the work of the NAO does not inadvertently compromise either the independence of the Bank in setting policy or the effectiveness of Court as the Bank's unitary Board. The Act provides a number of assurances in this regard, and I look forward to the Bank building a productive and constructive relationship with the NAO in the coming year.

Court has an important responsibility to be accountable for its actions, including through testimony to the Treasury Committee, and the published minutes of its meetings. Over the past year, and in line with the Bank's wider commitment to openness and accountability, Court has chosen to release previously redacted excerpts of the minutes of its 2013 meetings. Court will continue to review any redacted material on a regular basis, and to ensure that this is brought into the public domain in a timely manner.

Effective Boards maintain good relationships with their shareholders, and I am grateful for the continuing support of HM Treasury and the UK Parliament for the work of the Bank and its mission.

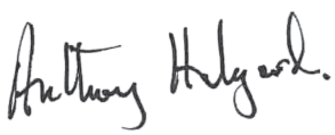
Court composition

Court has seen a number of recent changes, and I would like to thank former Non-executive Directors Michael Cohrs and John Stewart for their service to the Bank over many years. I would also like to congratulate Bradley Fried on his appointment as Senior Independent Director, and Dido Harding on becoming Chairman of the Remuneration Committee. And following the implementation of the Act, Dame Minouche Shafik, Deputy Governor of Markets and Banking, will become a full member of Court, in line with the role being brought into statute.

As of July 2016, Sam Woods will join Court as Deputy Governor for Prudential Regulation and Chief Executive of the PRA. Sam replaces Andrew Bailey, who is leaving the Bank to lead the Financial Conduct Authority. I would like to thank Andrew for his many years of dedicated service to the Bank and for his outstanding leadership of the PRA. The role of PRA Chief Executive is of critical importance, and the Bank's ability to field a number of strong internal candidates is evidence not only of the high calibre of its people, but also of recent investments in talent management and succession planning.

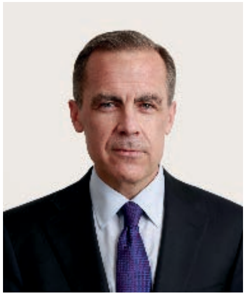
Outlook

Successful institutions do not stand still, and further investment in professional standards, in 'One Bank' working and in organisational agility are all essential if the Bank is to continue to thrive in a fast-changing world. I have every confidence that the Bank will rise to the challenge, aided by its tradition of objective analysis, the strong leadership of the Governor and his senior team, and the institution's deep commitment to promoting the good of the people of the United Kingdom.



27 June 2016

Report by the Governor



Mark Carney
Governor

In a challenging global environment, it is more important than ever that the Bank co-ordinates its microprudential, macroprudential and monetary policies to promote the good of the people of the United Kingdom by maintaining monetary and financial stability.

To realise the potential of the new Bank of England, our ambitious three-year 'One Bank' Strategic Plan was launched in early 2014. It seeks to create a diverse and talented institution that uses analytical excellence and outstanding execution to deliver our policy goals while being transparent and accountable to the people and their representatives in Parliament.

In the second year of the plan, we continued to make excellent headway with three quarters of our stretching targets now met. This progress is testament to the tremendous efforts of colleagues across the Bank. It is particularly encouraging to see our objectives reinforced by an increasing number of unprompted local initiatives formulated by staff themselves. I thank all my colleagues for their hard work, commitment and innovation.

The Bank is committed to attracting and inspiring the best people, and ensuring our workforce reflects the public we serve. To these ends, we have set ourselves challenging diversity targets to broaden our staff base and have seen encouraging progress with female representation at senior management level rising from 25% in 2015 to 28% in 2016 and BAME representation below senior management from 15% to 17% over the same period. Our performance management framework has been significantly enhanced with all people managers now undertaking 360° feedback centred around our values. New leadership training now sits alongside our new talent management and succession planning programmes. We have taken concrete steps to empower our staff, by ensuring greater contact with our most senior policymakers. To recruit and inspire the next generation of central bankers, we have launched a formal postgraduate Central Banking Qualification in partnership with Warwick Business School.

Effective policymaking requires cutting-edge research into how best to advance our monetary and financial stability goals. In 2015, supported by our One Bank Research Agenda, the quantity, quality and impact of our research across all aspects of central banking has improved. In addition to working with external collaborators, we have also sought to provide earlier insight into our thinking, and to stimulate debate, via our popular 'Bank Underground' blog. Since its creation last year the blog has had over 375,000 hits. We are also investing in improving the data that is available to our staff and ensuring they have access to the most advanced analytical tools.

We have continued to lead the development of new reforms both domestically and internationally. For example, in the past year, we issued, alongside the Financial Conduct Authority and HM Treasury, the Final Report of the Fair and Effective Markets Review, and played a significant role in securing agreement at the G20 level on total loss-absorbing requirements for banks, a key plank of ensuring failing banks will be truly resolvable in the future, and so helping bring an end to the 'Too Big to Fail' problem. This was complemented by the Bank's work to help extend the enforceability of contractual stays in resolution, which significantly limit the risk of mass close-out of derivatives and other financial contracts in the event of a firm failure. The Bank played a leading role in the launch of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures, which is in the process of developing voluntary and consistent climate-related financial disclosures, thereby promoting understanding and management of climate risks and opportunities among investors, lenders, insurers and other stakeholders. Looking ahead, we launched our RTGS Strategy Review to agree a blueprint for the next generation of the Bank of England's Real-Time Gross Settlement system, which supports the vast majority of payments in the real economy.

Meanwhile we have successfully implemented a number of key financial reforms that affect the way we regulate the financial system as a whole as well as individual financial institutions within it. The Financial Policy Committee (FPC) set out the overall capital framework for the UK banking system, giving greater clarity and certainty to banks about the capital regime which they must meet. And our insurance supervisors successfully oversaw industry's transition to the new Solvency II Directive, a once in a generation reform to insurance regulation.

Consistent with our statutory remits, and goal of analytical excellence, the Bank assessed the implications of the referendum on EU membership for our ability to achieve our core objectives of maintaining monetary and financial stability. To meet the fundamental standard of being an open and transparent central bank, the Bank reported our evidence-based judgements to Parliament and the public. In October 2015 we delivered a detailed, comprehensive report on how EU membership affects the Bank's ability to achieve its objectives. The Monetary Policy Committee (MPC) and FPC also explained in their official publications and through parliamentary testimony, the risks posed to our monetary and financial stability objectives and how these may influence policy actions. In response to the risks, the Bank and its policy committees prepared extensive contingency plans. On 23 June the United Kingdom voted to leave the European Union. The implications of this decision are wide-ranging and are explained further in the announcement we made following the result.[1]

The second annual concurrent stress tests conducted jointly by the FPC and PRA Board offered comfort as to the resilience of the banking sector in the face of a severe but plausible shock stemming from a deterioration in global economic conditions. Consistent with the weaker conjuncture, and its intention to move gradually, the FPC decided to increase the UK countercyclical capital buffer rate from 0% to 0.5% of risk-weighted assets.

We have also done much to make the Bank stronger, safer and more secure. We have invested in our cyber security, including through a major programme to raise staff awareness, given that our staff will always be the first line of defence against potential cyber attack. In 2015 we also created a new, formal, second line of defence for our balance sheet as one of the key findings from our Financial Risk Management Review. Work to launch our cleaner, safer, stronger polymer note is well on track — the new £5 note, featuring Sir Winston Churchill, will go into issue in September.

The Bank has taken great strides to enhance our transparency and accountability. August 2015 saw the first simultaneous publication of our monetary policy decision, Minutes and *Inflation Report* — dubbed by the media as 'Super Thursday'. The Bank's Independent Evaluation Office published its first reports, evaluating the Bank's forecasting performance[2] and the PRA's approach to its secondary competition objective.[3] These identified areas for improvement which will enhance our approach in future. We also announced we would hold ourselves to the same high standards we demand of the firms we regulate by applying the core principles of the Senior Managers Regime to the Bank's

1 www.bankofengland.co.uk/publications/Pages/news/2016/056.aspx.

2 www.bankofengland.co.uk/about/Documents/ieo/evaluation1115.pdf.

3 www.bankofengland.co.uk/about/Documents/ieo/evaluation0316.pdf.

leadership team and our work and as a result published our 'Responsibilities Map'.

We broke new ground in our efforts to engage with a wider set of stakeholders by hosting in November 2015 an Open Forum. This event, unique in central banking, brought together a wide audience from the public, media, financial markets and industry to discuss how we can build real markets for the good of the people. In addition to building public understanding of our mission, these conversations have had real consequences for how we think about delivery of our policies and actions. And the new character for our £20 note, J M W Turner, was announced following a new, much more open process that began with almost 30,000 members of the public nominating some 600 candidates from the visual arts.

Looking ahead to next year, the coming into effect of the Bank of England and Financial Services Act 2016, will reinforce the transformation of the Bank and our strategy. By placing the Bank's three major policy committees on the same statutory footing, by streamlining the MPC's meeting schedule, and by further enhancing the transparency and governance of the Bank's operations, this legislation will ensure the institution can operate more effectively as One Bank to maintain the monetary and financial stability of the United Kingdom.

Finally, on behalf of the whole Bank I want to take this opportunity to thank Andrew Bailey for his dedication and extraordinary contribution over a distinguished 30-year career at the Bank. In particular I want to thank him for his work in managing the creation of the PRA as a highly respected and effective regulator, within the enlarged Bank. I want to wish him every success as he takes up his role as head of the Financial Conduct Authority.

27 June 2016

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.

Court sets the Bank's strategy and budget, takes key decisions on resourcing and appointments, and keeps the Bank's performance and financial management under review. The Court meets at least seven times a year, and its minutes are published.[1]

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 Non-executive Directors 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 (including the PRA's) expenditure budget;
- major capital projects;
- the Bank's financial framework;
- the Bank's risk tolerance framework;
- 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; and
- the Bank's succession plan.

When the Bank of England and Financial Services Act[2] comes into force later this year the statutory Oversight Committee, through which Court has exercised some of its oversight of the Bank, will cease to exist and all of the oversight functions will revert to Court as the Bank's unitary Board.

The major sub-committees of Court are the Audit and Risk Committee, the Remuneration Committee and the Nominations Committee. Terms of reference of these and other Committees are published on the Bank's website.[3]

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.

1 www.bankofengland.co.uk/publications/minutes/Pages/court/default.aspx.

2 www.bankofengland.co.uk/publications/Pages/news/2016/050.aspx.

3 www.bankofengland.co.uk/about/Documents/matters122014.pdf.

The Court of Directors*
as at 27 June 2016

Anthony Habgood
Chairman of Court

Appointed NED
1 July 2014
Term expires on
30 June 2018

- Chairman, RELX Group plc
- Chairman, Preqin Holding Limited
- Non-executive Director, Norwich Research Partners LLP
- Visiting Fellow, Oxford University

Mark Carney
Governor

- Chairman, Financial Stability Board
- First Vice-Chair, European Systemic Risk Board
- Member, Group of Thirty
- Member, Board of Directors, Bank for International Settlements
- Member, Group of Governors and Heads of Supervision, Basel Committee on Banking Supervision
- Member, Board of Trustees, World Economic Forum

Andrew Bailey
Deputy Governor, Prudential Regulation

- Board Member, Financial Conduct Authority
- Management Board Member, European Banking Authority

Ben Broadbent
Deputy Governor, Monetary Policy

- Alternate, ECB General Council
- Member, OECD Working Party No. 3

Sir Jon Cunliffe
Deputy Governor, Financial Stability

- Member, G20 Financial Stability Board Steering Committee
- Member, European Systemic Risk Board
- Member, Board of Directors, Bank for International Settlements

Bradley Fried

Appointed NED
1 June 2012
Term expires on
31 May 2019

- Partner, Grovepoint Capital LLP
- Non-executive Director, Financial Conduct Authority
- Fellow of Magdalene College, Cambridge
- Governor, London Business School

* The Deputy Governor for Markets and Banking will become a member of Court on the commencement of the relevant provisions in the Bank of England and Financial Services Act 2016.

Tim Frost

Appointed NED
1 June 2012
Term expires on
31 May 2018

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

Baroness (Dido) Harding of Winscombe

Appointed NED
1 August 2014
Term expires on
31 July 2018

- Chief Executive, TalkTalk Telecom Group plc
- Life Peer taking the Conservative Whip
- Member of the Jockey Club
- Trustee of DotEveryone
- Member of the UK Holocaust Memorial Foundation

Dave Prentis

Appointed NED
1 June 2012
Term expires on
31 May 2019

- 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
- President of Unity Trust Bank

Don Robert

Appointed NED
1 August 2014
Term expires on
31 July 2018

- Chairman, Experian plc
- Senior Independent Director, Compass Group plc
- Chairman, Achilles Group Limited
- Chairman, Validis Holdings Limited
- Visiting Fellow, Oxford University

Dorothy Thompson

Appointed NED
1 August 2014
Term expires on
31 July 2018

- Director, Drax Group plc
- Director, Haven Power Limited
- Director, Drax Biomass Inc
- Director, Drax Power Limited
- Non-executive Director, Johnson Matthey plc
- Chairman, The Sustainable Biomass Partnership Limited

Find out more online
www.bankofengland.co.uk

Policy committees

Monetary Policy Committee (MPC)

Members as at 27 June 2016
Top row, left to right

Mark Carney
Governor

Ben Broadbent
Deputy Governor, Monetary Policy

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Kristin Forbes
External member
Term: 1 July 2014 – 30 June 2017

Andy Haldane
Executive Director and Chief Economist

Bottom row, left to right

Ian McCafferty
External member
Term: 1 September 2012 – 31 August 2018

Dame Minouche Shafik
Deputy Governor, Markets and Banking

Dr Gertjan Vlieghe
External member
Term: 1 September 2015 – 31 August 2018

Martin Weale
External member
Term: 1 August 2010 – 8 August 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 2016, the Chancellor of the Exchequer re-confirmed the inflation target[1] as '2 per cent as measured by the twelve-month increase in the Consumer Prices Index'. The economic policy objective of the Government is 'to achieve strong, sustainable and balanced growth shared more evenly across the country and between industries'.

The MPC has nine members. Five are Bank Governors and officials and four are external members appointed by the Chancellor. An HM Treasury representative also sits with the Committee at its meetings. The Committee meets at least once a month to set policy. The MPC's Minutes are published alongside the Committee's decisions after each meeting. The Bank's quarterly *Inflation Report* includes the MPC's projections for inflation and output.

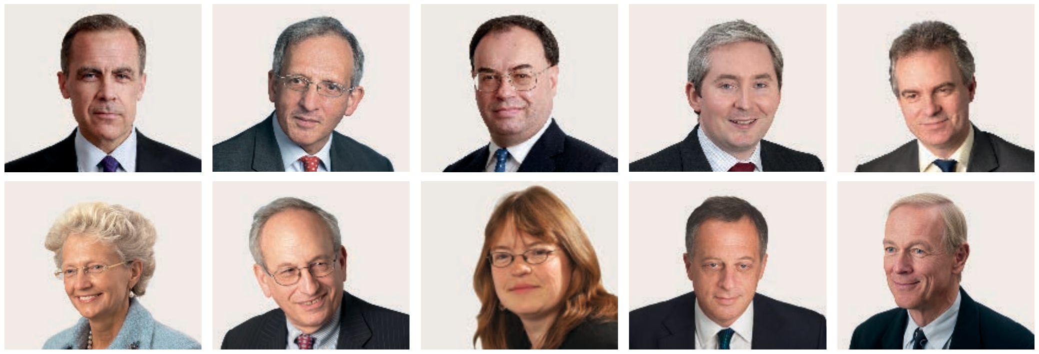
The Warsh Review,[2] led by former Federal Reserve Governor Kevin Warsh, recommended in December 2014 that the MPC should in future meet on eight occasions through the year rather than twelve as at present. This change will be implemented under the Bank of England and Financial Services Act 2016.

Since February 2016 members of the MPC have been indemnified by the Bank against personal civil liability on the same terms as members of Court (see page 7).

1 www.bankofengland.co.uk/monetarypolicy/Documents/pdf/chancellorletter160316.pdf.

2 www.bankofengland.co.uk/publications/Documents/news/2014/warsh.pdf.

Financial Policy Committee (FPC)



Members as at 27 June 2016
Top row, left to right

Mark Carney
Governor

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Andrew Bailey*
Deputy Governor, Prudential Regulation and Chief Executive of the PRA

Alex Brazier
Executive Director, Financial Stability Strategy and Risk

Ben Broadbent
Deputy Governor, Monetary Policy

Bottom row, left to right

Dame Clara Furse
External member
Term: 1 April 2013 – 31 March 2019

Donald Kohn
External member
Term: 1 April 2013 – 31 March 2018

Tracey McDermott
Acting Chief Executive, Financial Conduct Authority

Richard Sharp
External member
Term: 1 April 2013 – 31 March 2019

Martin Taylor
External member
Term: 1 April 2013 – 31 March 2018

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.[1]

The FPC consists of eleven members. Five are Bank Governors and officials, and six are external members — the Chief Executive of the Financial Conduct Authority, four members appointed by the Chancellor and a non-voting member from HM Treasury. 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*.

The FPC is currently a Committee of Court. Under a provision of the Bank of England and Financial Services Act 2016 the FPC will become a committee of the Bank, and will have two extra members: the Deputy Governor for Markets and Banking and a further external member.

Since February 2016 members of the FPC have been indemnified by the Bank against personal civil liability on the same terms as members of Court (see page 7).

1 The 2016 remit and recommendations is at www.bankofengland.co.uk/financialstability/Documents/fpc/letters/chancellorletter160316.pdf. And the FPC's response is at www.bankofengland.co.uk/financialstability/Documents/fpc/letters/governorletter260516.pdf.

* From 1 July 2016 Andrew Bailey will sit on the FPC as FCA Chief Executive and Sam Woods will sit on the FPC as Deputy Governor, Prudential Regulation and CEO of the PRA.

Find out more online
www.bankofengland.co.uk

Board of the Prudential Regulation Authority (PRA)

Members as at 27 June 2016
Top row, left to right

Mark Carney
Governor

Andrew Bailey*
Deputy Governor, Prudential Regulation and Chief Executive of the PRA

David Belsham
Appointed NED
Term: 1 May 2015 – 30 April 2018

Sandy Boss
Appointed NED
Term: 1 September 2014 – 31 August 2017

Middle row, left to right

Norval Bryson
Appointed NED
Term: 1 September 2015 – 31 August 2018

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Tracey McDermott
Acting Chief Executive, Financial Conduct Authority

Charles Randell
Appointed NED
Term: 20 February 2014 – 19 February 2017
First appointed: 20 February 2013

Bottom row, left to right

Dame Minouche Shafik
Deputy Governor, Markets and Banking

David Thorburn
Appointed NED
Term: 1 September 2015 – 31 August 2018

Mark Yallop
Appointed NED
Term: 1 December 2014 – 30 November 2017

The Prudential Regulation Authority is a subsidiary of the Bank of England. In April 2013, it became the United Kingdom's prudential regulator for banks, building societies and credit unions, insurers and major investment firms.

The PRA's objectives are set out in statute, in the Financial Services and Markets Act 2000 (FSMA). The PRA has three statutory objectives: a general objective to promote the safety and soundness of PRA-authorised firms; specifically for insurers, to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders; a secondary objective to, so far as is reasonably possible, act in a way which facilitates effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.

The PRA's most significant supervisory decisions are taken by its governing body, the PRA Board. It is chaired by the Governor of the Bank and three of its other members are Bank staff — the Deputy Governor for Prudential Regulation, the Deputy Governor for Financial Stability and the Deputy Governor for Markets and Banking. The CEO of the Financial Conduct Authority is also a member. Appointed members are chosen by the Bank's Court of Directors with HM Treasury's approval. A majority of the Board must be non-executive members.

The PRA's strategy is set by its Board, in consultation with Court. Under FSMA, the PRA is required to determine and publish its strategy in relation to how it will deliver its statutory objectives and this can be found in the PRA's *Annual Report*.[1]

With the Bank of England and Financial Services Act 2016 the PRA will become part of the Bank, acting through a Prudential Regulation Committee of similar composition to the PRA Board.

Members of the PRA Board have been indemnified by the Bank against personal civil liability as outlined in the PRA *Annual Report* 2016.

1 See www.bankofengland.co.uk/publications/Documents/annualreport/2016/prareport.pdf.

* From 1 July 2016 Andrew Bailey will sit on the Board as FCA Chief Executive and Sam Woods will sit on the Board as Deputy Governor, Prudential Regulation and CEO of the PRA.


BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Our organisation

The executive and their membership, where relevant, of the MPC, FPC and PRA Board are indicated below.

Governor

Mark Carney
(MPC, FPC, PRA Board)

Deputy Governors

Andrew Bailey
Prudential Regulation and Chief Executive of the PRA (FPC, PRA Board)

Ben Broadbent
Monetary Policy (MPC, FPC)

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

Charlotte Hogg
Chief Operating Officer

Dame Minouche Shafik
Markets and Banking (MPC, PRA Board)

Executive Directors

Sonya Branch
General Counsel

Alex Brazier
Financial Stability Strategy and Risk (FPC)

Sarah Breeden
International Banks Supervision

Ralph Coates
Finance

John Footman
Secretary of the Bank

Andrew Gracie
Resolution

Andy Haldane
Monetary Analysis and Chief Economist (MPC)

Andrew Hauser
Banking, Payments and Financial Resilience

Lyndon Nelson
Supervisory Risk Specialists and Regulatory Operations; Deputy Chief Executive, PRA

Joanna Place
Human Resources

James Proudman
UK Deposit-takers Supervision

David Rule
Prudential Policy

David Rule will move to be Executive Director for Insurance Supervision on 1 July.

Chris Salmon
Markets

Jenny Scott
Communications

Sam Woods
Insurance Supervision

Sam Woods will move to be Deputy Governor for Prudential Regulation and CEO of the PRA on 1 July.

Review of 2015/16

The Strategic Plan, adopted by Court in March 2014,[1] has continued to be the driving force behind the work of the Bank this year.

One Bank

Initiatives

1. Open, transparent and agile culture
2. Forefront of joint policy decision-making

Diverse and Talented

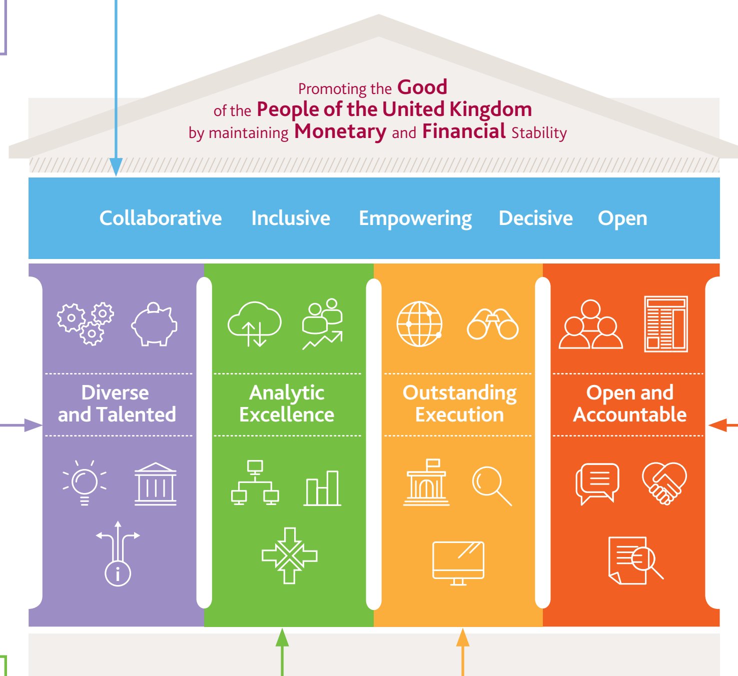
Initiatives

3. 'One Bank', Your Reward
4. Rewarding excellence and teamwork
5. Compelling talent strategy

Open and Accountable

Initiatives

13. Enhanced central bank transparency
14. Accountable
15. Engaged and approachable



Analytic Excellence

Initiatives

6. 'One Bank' Research Agenda
7. New approach to data and analysis
8. One Bank data architecture

Outstanding Execution

Initiatives

9. One credible voice in international policy
10. Delivering supervision as 'One Bank'
11. Execution in core markets
12. A safer Bank

1 The Strategic Plan was summarised in the 2014 *Annual Report*, pages 14–17; www.bankofengland.co.uk/publications/Documents/annualreport/2014/boereport.pdf.

In 2014, the Bank of England launched its Strategic Plan to create a single, unified, institution, working as 'One Bank' across all its functions, with a single mission: 'promoting the good of the people of the United Kingdom by maintaining monetary and financial stability'. To ensure that the entire organisation works together in support of our mission, we have committed to seek out new ways of working and to promote further connectivity across the institution.

In the two years since launching our strategy, we have achieved a great deal and are on track to meet our goals. We have now completed 75% of our strategic milestones. These have been reinforced by an array of local initiatives.

The Bank of England and Financial Services Act 2016 will also reinforce the transformation of the Bank that is under way. By placing the Bank's three major policy committees on the same statutory footing, by streamlining the MPC's meeting schedule, and by further enhancing the transparency and governance of the Bank's operations, this legislation will ensure the institution can operate more effectively as One Bank to promote the monetary and financial stability of the United Kingdom (see the box on page 17).

This Review begins by detailing the specific steps that the Bank has taken over the past twelve months to work as One Bank and to strengthen the four pillars that underpin the Strategic Plan: Diverse and Talented; Analytic Excellence; Outstanding Execution; Open and Accountable. It then goes on to describe the Bank's work to advance its policy objectives in the areas of monetary policy, financial policy, and regulatory policy; together with recent developments in the Markets and Banking and International areas, which support the delivery and execution of initiatives across the Bank's policy work.

Highlights include: the introduction of 'Our Code' which sets out our commitment to how we work at the Bank of England; the strengthening of our leadership programme; the launch of our 'Bank Underground' staff blog that promotes independent thinking and analysis; the development of our first polymer banknote; and our 'Open Forum' on financial markets.

Bank of England and Financial Services Act

The Bank of England and Financial Services Bill began its passage through Parliament in October 2015. It was introduced in the House of Lords, went to the House of Commons in January 2016, and received Royal Assent in May 2016.[1] Many of its provisions will be brought into force by way of Commencement Orders made by HM Treasury.

The Act follows the proposals in *Transparency and Accountability at the Bank of England, the Bank's response to the Warsh Review*, published in December 2014,[2] and HM Treasury's Technical Consultation published in July 2015.[3]

The Act includes reforms to further strengthen the Bank's governance, transparency and accountability, enhance the ability of the Bank to discharge its macroprudential, microprudential, and monetary policy responsibilities in a co-ordinated way, and ensure that the United Kingdom's crisis management arrangements keep pace with developments in resolution policy. In particular, the Act brings forward the following reforms:

- Improving the governance of the Bank by making the Court of Directors a more focused unitary board, and including the new Deputy Governor position for Markets and Banking.

- Aligning the governance of monetary policy, macroprudential policy and microprudential supervision under the aegis of one institution by:

  - bringing the Prudential Regulation Authority (PRA) within the Bank, and creating a new committee of the Bank to be known as the Prudential Regulation Committee (PRC);

  - making the Financial Policy Committee (FPC) a committee of the Bank, rather than a sub-committee of Court; and

  - moving the Monetary Policy Committee (MPC) to a schedule of eight meetings a year, which will enable more joint meetings of the MPC and the FPC.

- Giving the National Audit Office a role in respect of the Bank's external audit process and HM Treasury-indemnified activities; and giving the National Audit Office power to examine the economy, efficiency and effectiveness with which the Bank uses its resources.

- Updating provisions about resolution planning and crisis management arrangements between the Treasury and the Bank to reflect recent improvements to resolution planning for systemic financial institutions, and crisis management for institutions in distress.

The Act also includes various financial services provisions, including provisions to extend the Senior Managers and Certified Person Regime to all authorised firms.

1 www.bankofengland.co.uk/publications/Pages/news/2016/050.aspx.

2 www.bankofengland.co.uk/publications/Documents/news/2014/warshresponse.pdf.

3 www.gov.uk/government/consultations/bank-of-england-bill-technical-consultation.

Strategic initiatives

Open transparent and agile culture

New values launched	2014
Our Code	2015
Viewpoint Staff Survey	**page 54**

Forefront of joint policy decision-making

New organisational structure in place	2014
Increased connectivity across the MPC, FPC and PRA Board	2015

One Bank Your Reward

Integrated Reward Framework	2015
New Bank-wide contract	2015

Rewarding excellence and teamwork

New performance management framework	2014
360° feedback introduced for all people managers	2015

Compelling talent strategy

Launch of new talent strategy	2014
Aspirational targets for diversity	2014
Enhanced School Leaver, Graduate and PhD Programmes	2015
'Leading through People'	**page 20**
Central Banking Qualification	**page 54**
Wellbeing strategy: 'think well, live well, be well'	**page 59**
African Caribbean Scholarship	**page 61**

One Bank Research Agenda

One Bank Research Agenda launch	2015
Research conferences	2015

New approach to data and analysis

Data lab opened	2015
Research Hub	**page 20**
'Bank Underground' blog	**page 22**

One Bank data architecture

Chief Data Officer appointed	2015
Enhanced data governance	2015
Data Inventory	**page 22**

One credible voice in international policy

Formation of International Directorate	2014
Report on 'EU membership and the Bank of England'	**page 30**

Delivering Supervision as 'One Bank'

PRA and Resolution implementation of BRRD	2014
Joint work on Recovery and Resolution Plans	2014

Execution in core markets

Access to Sterling Monetary Framework	2014
Improvements in ELA readiness	2014
Collateral Operations Review	2014
Fair and Effective Markets Review	**page 22**
Polymer banknotes	**page 35**
Market Intelligence Review and Charter	**page 60**

A safer Bank

Revamp of risk management framework for the Bank	2015
Launch of central compliance function	2015
Chief Information Security Officer appointed	2015
Cyber strategy agreed	2015
Security Operations Centre	**page 23**
Cyber security programme	**page 23**
Executive Risk Committee	**page 48**

Enhanced central bank transparency

PRA/FPC stress tests	2014
Transparency of Court documents	2015
Implementation of Warsh recommendations	**page 24**
New Stakeholder Relations Group	**page 25**

Accountable

Improvements in Court governance	2014
Creation of Independent Evaluation Office	2014
Grabiner Review	2014
RTGS Review	2014
IEO report on forecasting	**page 24**
IEO report on the PRA's competition objective	**page 24**

Engaged and approachable

Open Forum	**page 25**
Public Understanding strategy	**page 25**
Enhanced social media presence	**page 25**

One Bank

At the core of the Bank's Strategic Plan is a commitment to build One Bank. One Bank is about maximising our impact by working together to make full use of the knowledge, resources and skills from across the organisation. It is also about building a strong common culture that will mobilise everyone in the Bank to support our policy and operational decisions.

Working together

The Bank has continued to promote connectivity across the MPC, FPC and PRA Board by sharing information and analysis and holding more joint committee meetings. This has helped us harness the synergies from having monetary, macroprudential policy and microprudential supervision within one institution.

During 2015/16, our work has been supported by a number of dedicated teams of experts taken from across the Bank. This includes work on the annual concurrent stress test of the UK banking system (page 27), on the risks from UK property markets and on the impact of digital currencies.

We have also committed to measuring ourselves through hard performance metrics which are reported biannually to Court. This allows us continuously to improve our performance and accountability, and to demonstrate the impact we have made throughout the life of the Strategic Plan.

Strengthening our tools

Making a success of One Bank also means enhancing the effectiveness of the tools we use to support our policy and operational functions. Over the past twelve months, we have implemented all the recommendations from the Market Intelligence Review.[1] We have also looked to develop the way we use our balance sheet to support our policy objectives. We have initiated a review of the Bank's role in the provision of payments services (page 34), and as part of broadening our provision of liquidity to smaller banks have consulted on means of including Islamic banks through a Shari'ah compliant facility (page 33).

One Bank

'One Bank' is about maximising our impact by working together to make full use of the knowledge, resources and skills from across the organisation

1 www.bankofengland.co.uk/markets/Documents/marketintelligence/review.pdf.

Diverse and talented

The Bank of England is committed to attracting and inspiring the best people to public service. To do that we need to continue valuing diverse ideas and open debate, while developing and empowering people at all levels to take initiative and make things happen.

Enhanced performance framework

Over the past year we have continued to improve our performance management framework which is designed to deliver clear and honest messages, motivate the right behaviours, differentiate our talent and support each individual's career development. Core to the framework is a requirement for all our people managers to undertake 360° feedback which is centred around our values and how we demonstrate them to others. Evidence of behaviours demonstrated as well as achievement of objectives feed directly into each individual's annual pay award.

Leadership

Strengthening our talent and its impact is also about providing opportunities to enable everyone to reach their full potential. We have introduced a new 'Leading through People' programme that introduces leadership concepts through a combination of courses, individual coaching and group working. This programme sits alongside an existing series of development reviews that supports talent management and succession planning within the organisation.

Diversity and inclusion

The Bank of England values diverse ideas and talent. We believe that diversity is essential to our aim to make better decisions and more effectively fulfil our mission. An important part of this is to ensure that the Bank reflects the diversity of the public it serves. In 2015 we recruited graduates from close to 40 different academic institutions, and looking forward our campaign 'You define tomorrow' saw a 125% increase in graduate applications for entry in Autumn 2016. This has been supported by an enhanced assessment process that tests candidates' business and analytical skills.

Our corporate social responsibility report sets out the steady progress we have made against our targets for diversity (page 55), as well as other initiatives in this area over the past year, including a new Central Banking Qualification accredited by Warwick Business School (page 54).

Analytic excellence

For the Bank, analytic excellence is about being at the forefront of research and analysis as a necessary part of ensuring we have effective policymaking, operations and tools. And it means making creative use of the best analytical tools and data sources to tackle the most challenging and relevant issues.

Conducting world-leading research

The Bank aims to conduct cutting-edge research and analysis at the intersection of monetary policy, macroprudential policy and microprudential regulation. Outstanding research and analysis underpins everything we do — from policymaking, to the design of central bank operations and tools, to providing high-quality, secure banknotes.

Through our One Bank Research initiative,[1] overseen by the Research Hub and supported by the Advanced Analytics area, the Bank is taking an integrated approach to increase the quantity, quality and impact of the Bank's research across all aspects of central banking. Following the launch of our One Bank Research Agenda in February 2015, we have conducted a wide range of innovative research across diverse topics spanning all of the Bank's responsibilities, often in conjunction with external collaborators. While we have more work to do, our commitment to research has resulted in an improvement in our ranking among central banks from 19th at the start of the Strategic Plan to 13th at end-February 2016.

13

Central bank research ranking February 2016

(March 2014: ranking 19)

1 www.bankofengland.co.uk/research/Pages/onebank/agenda.aspx.

Looking forward, our key research priorities for 2016 are: supervisory tools, communication and behaviours, and the interaction with firms and their culture and behaviour; macroprudential framework (including stress testing), instruments within and beyond the banking sector and transmission mechanisms including the interaction with monetary policy, microprudential regulation and internationally; exploiting big data to understand the economy and financial system; and technological and structural change in money, banking and financial markets.

We also successfully launched our 'Bank Underground' blog.[1] Promoting independent thinking and analysis, it provides an opportunity for our staff to share views that challenge, or support, prevailing policy orthodoxies. As at February 2016, 75 posts by over 100 staff have been published and the site has received over 375,000 views.

Building our capabilities to analyse and assess emerging risks

To produce the best research and analysis possible, the Bank relies on high-quality data and advanced analytical tools. Our Data Programme is an important step change in achieving our vision for One Bank Data. The Programme will lead to better decision-making by improving the collection, management, exploitation, collaboration and standardisation of data. In support of our aims we have launched a Data Inventory which contains over 1,300 data sets from across the Bank. And we are implementing a cross-Bank data governance structure to better organise and co-ordinate data across the Bank.

Leading the development of the next phase of reforms

Analytic excellence also means maximising our impact on the development of international reforms that affect us all. The Bank has played a significant role in the design and delivery of a number of international reforms over the past twelve months. These include: loss-absorbing capital requirements for banks (page 27); measures to improve the resolution of both banks (page 30) and central counterparties (page 29); and finalisation of the rules for the Senior Managers Regime (page 23).

In June 2015, the Bank, along with the FCA and HM Treasury, published the Final Report of the Fair and Effective Markets Review (FEMR).[2] The Report set out 21 recommendations to help to restore confidence in the fairness and effectiveness of wholesale financial markets in the wake of a number of high-profile abuses. The Report also initiated the creation of a new Fixed Income, Currency and Commodities Market Standards Board to establish an enduring culture of openness and dialogue. FEMR Chairs will provide a full implementation report to the Chancellor of the Exchequer and the Governor of the Bank of England by July 2016.

The Fair and Effective Markets Review (FEMR)

21 recommendations to help restore confidence in financial markets

Initiated creation of a Fixed Income, Currency and Commodities Market Standards Board

1 http://bankunderground.co.uk/.

2 www.bankofengland.co.uk/markets/Documents/femrjun15.pdf.

Outstanding execution

The Bank recognises that it is only as effective as its actions. No matter how good our analysis, our decisions and actions need to have influence and impact, both at home and abroad. To achieve our mission, we need co-ordinated and inclusive policy decisions, and reliable, expert execution in everything we do.

Implementing agreed financial reforms

Over the past twelve months the Bank has successfully implemented a number of key financial reforms that affect the way we regulate individual institutions and the financial system as a whole, including:

- In December 2015, the FPC set out its view on the overall amount of capital for the UK banking system and the appropriate structure of those capital requirements. It also described how the framework of capital requirements is expected to evolve between now and the end position in 2019 (page 27).
- In January 2016, the Bank successfully implemented the new Solvency II Directive that codifies and harmonises insurance regulation within the European Union, particularly around the amount of capital that insurance companies need to hold to reduce the risk of insolvency.
- In March 2016, the Bank with the Financial Conduct Authority launched the Senior Managers Regime (SMR)[1] which represents a significant overhaul in the way we supervise individual accountability and governance, both in the banking sector and the insurance sector. Though we are not subject to the SMR, the Bank also published details of how we will adhere to the core principles of the new regime in support of our Open and Accountable principles.

Execution in core markets

The Bank is also engaged in a number of major changes related to the use of its balance sheet that are integral to delivering outstanding execution. This includes work to broaden access to the Sterling Monetary Framework (SMF) through a consultation on the introduction of Shari'ah compliant central bank facilities (see page 33), extending access to the SMF for broker-dealers, and leading preparations for the extension of operating hours of our high-value payments system (RTGS). The Bank is also continuing to look for ways to enhance transparency around its operations and, building on the introduction of an SMF Annual Report in 2015,[2] we now publish a full range of RTGS availability statistics on our website.[3]

Making the Bank stronger, safer and more secure

Security is vital to our mission at the Bank of England. We have continued to invest in information security. A key initiative this year was the creation of a new Security Operations Centre (SOC) as part of the 'A Safer Bank' initiative. Through the SOC we have recruited a team of technically skilled and experienced cyber analysts supported by new technology to detect and respond to increasingly sophisticated cyber attacks.

To make the Bank stronger, safer and more secure we are proactively growing our information security, capability and understanding through our cyber programme. This programme comprises a combination of training, communications, events and campaigns to advise staff on best practice to protect the Bank and themselves against information security related risks, so they can stay safe at work and at home. The programme has already led to a significant improvement in cyber security awareness among staff.

We have also embedded Our Code which represents a commitment to how we conduct ourselves both within and outside the Bank, and which is supported by a new Central Compliance Division (page 60).

Stronger, safer, more secure

We continue to make the Bank stronger, safer and more secure through our cyber programme

1 www.bankofengland.co.uk/about/Documents/smr.pdf.

2 For the 2016 *SMF Annual Report* see www.bankofengland.co.uk/markets/Documents/smf/annualreport16.pdf.

3 www.bankofengland.co.uk/markets/Pages/paymentsystem/statistics.aspx.

Open and accountable

The Bank recognises that we need to earn the legitimacy to perform the functions given to us by Parliament by becoming more open, more accountable and more transparent. Without doing so, we cannot earn the trust or credibility required for our policies to be effective.

Transparency and accountability

Consistent with our Open and Accountable aims, the Bank's Independent Evaluation Office (IEO) is now fully established. The IEO has published an in-depth evaluation of our forecasting performance in November 2015, followed by a review of the PRA's secondary competition objective evaluation in March 2016.[1]

The Bank also believes that it is essential we hold ourselves to the same high standards that we demand of the firms we regulate. Although the Bank is not legally required to adhere to the Senior Managers Regime (SMR),[2] we have set out how we intend to apply the core principles of the SMR to the Bank's leadership team and our work.

At the core of the SMR is the belief that companies should be led by skilled, principled individuals, that there is absolute clarity about the responsibilities of the senior leadership team and that leaders of a business are held to account for its failures as well as its successes. In line with our commitment we have published our SMR 'Responsibilities Map' (see graphic), alongside 'Statements of Responsibilities' for our designated 'Senior Managers'.[3]

In December 2014, the Warsh Review[4] made a number of recommendations to improve

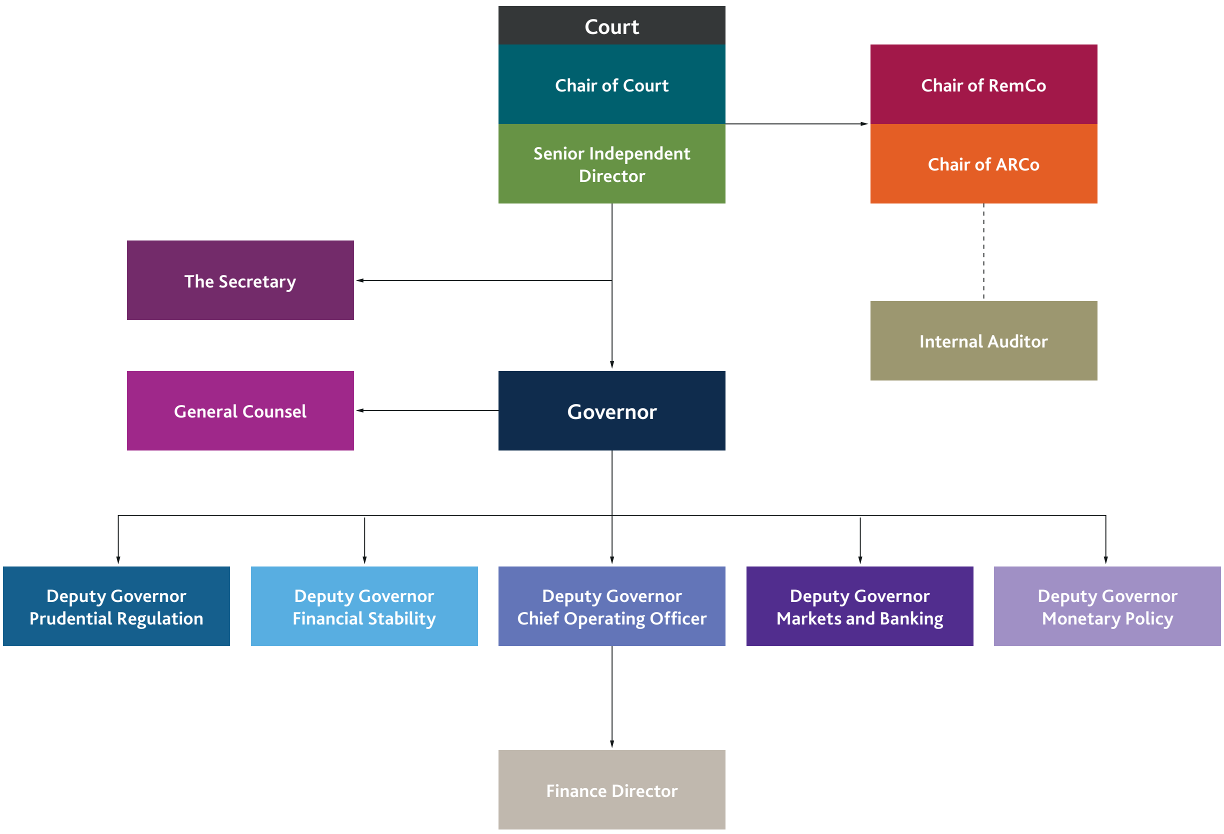
1 www.bankofengland.co.uk/about/Documents/ieo/evaluation1115.pdf and www.bankofengland.co.uk/about/Documents/ieo/evaluation0316.pdf.

2 www.bankofengland.co.uk/about/Documents/smr.pdf.

3 The Bank may determine alternative arrangements for those circumstances where the location of responsibilities may conflict with legal or regulatory requirements in any jurisdiction.

4 www.bankofengland.co.uk/publications/Documents/news/2014/warsh.pdf.

'Responsibilities Map' under the SMR



effective transparency and accountability of our monetary policy practices. In response, from August 2015 we now simultaneously publish the monetary policy decision, Minutes and *Inflation Report*. Under the Bank of England and Financial Services Act 2016, the number of MPC meetings will reduce from twelve to eight a year.

To support our transparency aims, the Bank has also established a Stakeholder Relations Group to ensure that external economists and analysts have equal and timely access to information behind our policy and operational decisions. The team facilitates engagement through a number of channels including policy briefings, stakeholder roundtables, and flagship seminars. This supports our existing engagement with stakeholders across the United Kingdom through the Bank's Agency network, and through direct regional engagement by members of the MPC, FPC and PRA Board.

Engaged and approachable
In November 2015, the Bank held its first Open Forum[1] bringing together policymakers, financial market participants, academics, media representatives and wider society to map a positive future for financial markets. The Open Forum marked a new approach to engaging with the wider public by listening and talking about the issues that matter to all of us. Through the use of digital and social media we were able to reach new sections of society. Our hashtag #BoEOpenForum received over 3,000 tweets and was in the United Kingdom's Top 10 trending hashtags.

The Open Forum reinforced our responsibility to talk and listen to a broader set of stakeholders across society when we design and implement policy; and our responsibility to explain clearly and simply what we are doing so we better serve the needs of society. In support of that aim the Bank has formulated a Public Understanding strategy. This strategy will help us reach wider audiences to build and maintain support for the importance of our mission, as well as our role in achieving it. Consistent with our aim to reach wider audiences, we are growing our social media presence and interaction.

Agency key facts

Held some 4,900 in-depth meetings with senior company executives, drawn from all sectors of the economy, and all parts of the United Kingdom

Supplemented those company meetings with panel discussions with some 3,700 businesses

Hosted 66 visits across the country from members of the MPC, FPC and PRA Board

Gave 540 speeches and presentations to external audiences explaining the work of the Bank and its policy committees

1 www.bankofengland.co.uk/Pages/openforum/index.aspx.

Monetary policy

The Bank of England's Monetary Policy Committee (MPC) contributes to the Bank's mission to achieve monetary stability by setting monetary policy to meet the 2% inflation target and, subject to that, helps to support growth and employment.

Recent developments and the year ahead

CPI inflation has remained below the MPC's 2% inflation target this year due predominantly to unusually large drags from energy and food prices. And while those effects are expected to fade, core inflation remains relatively subdued. Inflation is likely to remain below 1% for much of the rest of the year.

Consistent with the MPC's remit, the Governor sent an open letter to the Chancellor of the Exchequer in August and November 2015 and in February and May 2016[1] to explain why inflation has moved away from the 2% target and the policy action that the MPC is taking in response.

The MPC judges that it is more likely than not that Bank Rate will need to be higher by the end of the forecast period than at present to ensure inflation returns to the target in a sustainable manner. When Bank Rate does begin to rise it is expected to do so gradually and to a lower level than in recent cycles. This guidance is an expectation, not a promise. The actual path Bank Rate will follow over the next few years will depend on economic circumstances.

Key analytical work

The Bank's commitment to analytical excellence, and to harnessing the synergies from having monetary policy, macroprudential policy and microprudential supervision within a single institution, have underpinned the work of the MPC and the Monetary Analysis area over the past year. All members of the MPC, Financial Policy Committee (FPC) and Prudential Regulation Authority (PRA) Board have access to shared information and can, and do, attend each other's staff briefings. They also have joint meetings on topics of mutual interest.

Staff from across the Bank's policy areas worked together on a number of analytical issues over the year, including: supply, the pass-through of import prices; wages; international developments, with a focus on emerging markets; and the transmission mechanism of monetary policy.

Forecasting is an essential input to the work of the MPC, and, increasingly since the advent of the 'One Bank' strategy, into the work of the FPC and the PRA Board. Following a review by the Bank's Independent Evaluation Office (IEO), the MPC has put in place a number of new initiatives to assist the Bank's desire to deliver improvements in its forecasting performance.

The analysis supporting the MPC, and the rationale for the MPC's decisions, are set out more fully in the Minutes of the Committee's policy meetings and its *Inflation Reports*.

Independent Evaluation Office

The Bank's Independent Evaluation Office published its first in-depth report evaluating our forecasting performance in November 2015

1 www.bankofengland.co.uk/monetarypolicy/Pages/letters.aspx.

Overview
Court, and the Bank's policy committees
Our organisation
Review of 2015/16
Financial review 2015/16
Risk management and business practices
Corporate social responsibility
Report of the Remuneration Committee
Report of the Oversight Committee
Report of the Audit and Risk Committee
Statement of the responsibilities of the Court of Directors in relation to the financial statements
Financial statements
Contacting the Bank of England

Financial policy

The Bank of England's Financial Policy Committee (FPC) contributes to the Bank's mission to achieve financial stability by identifying, monitoring and taking action to remove or reduce systemic risks with a view to protecting and enhancing the stability of the United Kingdom's financial system. Subject to that, it supports the economic policy of the Government, including its objectives for growth and employment.

In March 2016, the FPC met to agree its view on the outlook for financial stability and, on the basis of that, its intended policy action. The FPC judged that the outlook for financial stability in the United Kingdom had deteriorated since it met in November 2015. Consistent with the Committee's assessment of the current risk environment, and its intention to move gradually, the FPC decided to increase the UK countercyclical capital buffer rate from 0% to 0.5% of risk-weighted assets. This new rate will become binding with effect from 29 March 2017. The FPC also announced that later this year it intends to publish a review of whether there are any possible refinements to internationally agreed post-crisis regulations that could further promote market effectiveness without compromising the resilience of the core of the financial system.

During the past twelve months, the FPC has also completed its review of the overall capital framework for the UK banking system in order to clarify where overall requirements would settle, and to confirm its response to the results of the 2015 banking system stress-test exercise.

The capital framework for UK banks

In December 2015, the FPC set out its view on the overall amount of capital for the UK banking system and the appropriate structure of those capital requirements. It also described how the framework of capital requirements is expected to evolve between now and the end position in 2019. In reaching its assessment, the FPC considered the overall amount of equity banks should have to absorb losses so they can continue to operate. That judgement was informed by new, and forthcoming, requirements for banks to have additional capacity to absorb losses in resolution.

Stress tests

In December 2015, the Bank published the results of its second annual, concurrent stress test,[1] conducted under the joint guidance of the FPC and PRA Board. The stress-test exercise covered seven major UK banks and building societies, and explored vulnerabilities facing the UK banking system, given the outlook for financial stability. It brought together expertise from across the Bank, including macroeconomists, financial stability experts and supervisors. The PRA Board and FPC used the results of the stress test as part of their respective evaluation of the capital adequacy of individual institutions and the resilience of the system as a whole.

Stress testing

In December 2015, the Bank published the results of its second annual, concurrent stress test, conducted jointly by the FPC and PRA Board

1 www.bankofengland.co.uk/financialstability/Documents/fpc/results011215.pdf.

The 2015 stress test was designed specifically to assess the resilience of the UK banking system to a severe global stress scenario which adversely affects the United Kingdom. Following the stress-test exercise, the PRA Board judged that two of the seven participants needed to strengthen their capital position further. But given continuing improvements to their resilience over the course of 2015 and plans to increase capital, these banks were not required to submit a revised capital plan. The FPC also judged that no macroprudential actions on bank capital were required in response to the 2015 stress test.

In October 2015 the Bank published its approach to stress testing the UK banking system.[1] The framework is designed to support the FPC and PRA in meeting their statutory objectives.

Other financial policy developments

In June 2015, the FPC had recommended that the Bank, the PRA and the Financial Conduct Authority (FCA) work with firms at the core of the UK financial system to ensure that they complete CBEST tests and adopt individual cyber resilience action plans, and that the Bank, the PRA and the FCA should also establish arrangements for CBEST tests to become one component of regular cyber resilience assessment within the UK financial system. Since then, progress on CBEST testing has continued, with 20 core firms having completed CBEST tests, up from five at the time of the FPC's Recommendation. The FPC intends to review this Recommendation alongside a report from the UK authorities on their wider cyber resilience work programme, expected by Summer 2016.

The work of the FPC over the past year is set out more fully in the twice-yearly *Financial Stability Report* and in the records of the FPC's quarterly policy meetings.

Prudential regulation

The Prudential Regulation Authority and microprudential regulation

The Prudential Regulation Authority (PRA) is responsible for the prudential regulation and supervision of over 1,600 banks, building societies, credit unions, insurers and major investment firms. The PRA has three statutory objectives: (i) a general objective to promote the safety and soundness of regulated firms; (ii) a specific objective for insurance firms, to contribute to the securing of an appropriate degree of protection for those who are or may become insurance policyholders; and (iii) a secondary objective to facilitate effective competition.

Over the past year, the PRA has continued to focus on the delivery of its statutory objectives. For banks, the PRA has implemented the Bank Recovery and Resolution Directive and the Financial Policy Committee Leverage Ratio, and has consulted on ring-fencing core banking activities and 'bail-in' arrangements to increase resolvability and resilience. In the area of governance, the PRA has developed and finalised the rules for the Senior Managers Regime.

For insurance firms, the PRA has completed the implementation of Solvency II and embedded the regime into the PRA's supervisory approach. The PRA has also conducted stress tests on UK insurers' resilience and contributed to the Europe-wide insurance stress tests. And with regard to its secondary objective to facilitate effective competition the PRA has established a New Bank Start-up Unit and published its first *Annual Competition Report*.[2]

More detail on these and other activities are provided in the PRA's *Annual Report*, published in June 2016.[3]

BANK OF ENGLAND PRUDENTIAL REGULATION AUTHORITY

The PRA is responsible for the prudential regulation and supervision of over 1,600 banks, building societies, credit unions, insurers and major investment firms

1 www.bankofengland.co.uk/financialstability/Documents/stresstesting/2015/approach.pdf.

2 www.bankofengland.co.uk/publications/Documents/annualreport/2016/compreport.pdf.

3 www.bankofengland.co.uk/publications/Documents/annualreport/2016/prareport.pdf.

Supervision of financial market infrastructures

The Bank of England has responsibility for supervising financial market infrastructures (FMIs) that underpin most of the economic and financial transactions in the United Kingdom, and many transactions internationally. The Bank currently has statutory responsibility for ten FMIs: five payments systems, one securities settlement system and four UK central counterparties, in addition to other responsibilities under FMI legislation. The delivery of this responsibility is discharged through the FMI Board, chaired by the Deputy Governor for Financial Stability.

The Bank has made real progress over this year in addressing risks in FMIs. Areas of focus have included: enhancing cyber resilience; increasing the robustness of a range of financial risk mitigants across FMIs; and improving the governance of FMIs, in particular the effectiveness of FMI boards, and of central counterparty (CCP) board risk committees.

The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) independently assessed the Bank's supervision of FMIs against the Responsibilities set out in the CPMI-IOSCO 'Principles for financial market infrastructures', and concluded that all Responsibilities were fully observed.

FMIs remain a strong focus of domestic and international regulatory agendas. The Bank is actively involved in driving forward a range of international regulatory work announced in 2015, focusing on the resilience of CCPs, as well as their recovery tools and resolution regimes, in addition to better understanding the key interlinkages between CCPs and their members. This and other changes such as the implementation of the European Central Securities Depositories Regulation during 2016, should contribute to continued improvement in the safety and soundness of FMIs.
More detail on these and related matters are given in *The Bank of England's supervision of financial market infrastructures — Annual Report*, published in March 2016.[1]

Resolution

The Bank of England is the United Kingdom's resolution authority. Resolution is the process by which the authorities intervene to manage the failure of a firm to prevent disruption to the financial system, maintain critical economic functions and services provided to customers, and protect public funds. An enhanced legislative framework came into force in January 2015 under the Bank Recovery and Resolution Directive, creating some new responsibilities for the Bank to remove barriers to resolvability before any failure occurs, so that the tools within the regime can be used to resolve a firm if that proves necessary.

Financial market infrastructures

The Bank has the responsibility for supervising financial market infrastructures that underpin most of the economic and financial transactions in the UK

1 www.bankofengland.co.uk/publications/Documents/fmi/annualreport2016.pdf.

Over the past year, the work of the Resolution Directorate has focused on measures needed to improve resolvability. This has involved work with market participants, for example to adapt market contracts and conventions to permit resolution measures (rather than insolvency) so as to reduce the risk that contracts or operating arrangements are interrupted when a firm enters resolution. It has also involved resolution planning and assessing the resolvability of cross-border firms with other resolution authorities, through existing crisis management groups (CMGs) and new, resolution colleges established in a European context.

In addition, the Bank has set out its new power to direct firms to remove barriers to resolvability, with a consultation and final statement of policy issued during the year. The Bank has also consulted on its proposed approach to setting loss-absorbing requirements for firms, so that public funds are not needed to stabilise failing firms. It has also worked with the PRA to consult on arrangements firms need to make to ensure operational continuity in resolution.

These measures to improve resolvability have been targeted at banks and investment firms, where the legislative arrangements are now in place. For financial market infrastructures, work is at an earlier stage, and international work on resolution arrangements for central counterparties being carried out by the Financial Stability Board should translate into a European proposal for a common framework later in 2016.

International

The United Kingdom is closely integrated with the rest of the world in part through its role as one of the world's largest global financial centres. A strong understanding of how the rest of the world affects the United Kingdom is therefore vital if we are to achieve our mission to maintain monetary and financial stability.

The Strategic Plan led to the establishment of a new International Directorate (ID) to bring together many of the Bank's international experts to examine how our domestic economy and financial sector interact with the rest of the world, and to ensure that we speak with a single, credible voice on international policy.

Over the past twelve months, ID has undertaken work for both the MPC and FPC bringing together monetary analysis and financial stability perspectives to ensure we can make the best possible use of synergies across the organisation. Staff have worked together on a number of analytical issues, including: the spillovers to the United Kingdom from recent developments in emerging economies and oil prices; international elements of the stress-testing framework; and the risks around a persistently large current account deficit. Staff from across the institution were also involved in the delivery of a report on how membership of the European Union affects the Bank's ability to fulfil its mission,[1] and in response to the European Commission's Green Paper on *Building a Capital Markets Union*.[2]

International Directorate

The Strategic Plan led to the establishment of a new International Directorate to bring together many of the Bank's international experts

1 www.bankofengland.co.uk/publications/Documents/speeches/2015/euboe211015.pdf.

2 www.bankofengland.co.uk/financialstability/Documents/cmu/greenpaperresponse.pdf.

The Bank's position at the heart of the world's global financial centre affords it unique credibility as an honest broker on international fora, allowing us to play a leading role in strengthening international and European monetary and financial systems. The Bank of England regularly participates in international groups including the G7, G20, Bank for International Settlements and the Financial Stability Board. During 2015/16 staff have in particular played a significant role in shaping the global policy debate through their work on global financial safety nets and GDP-linked bonds.

To support our Strategic Plan objective to speak with one credible voice in international discussions, the Bank has initiated a new International Steering Board with senior-level representation from across the Bank. The International Steering Board acts to provide counsel on international engagement strategy, resourcing, planning and governance, as well as to facilitate information sharing across the Bank on international developments.

Markets and banking

Markets

The Bank's Markets area manages the Bank's balance sheet, implements the policy decisions of the MPC, provides liquidity insurance to the financial system, and manages the UK Government's foreign currency and gold reserves. At end-February 2016, total assets held by the Bank as custodian were £567 billion (2015: £514 billion), of which £135 billion (2015: £130 billion) were holdings of gold. The Markets area also acts as the Bank's eyes and ears in markets, gathering intelligence on financial market developments to support all of the Bank's policy committees.

One clear theme that came out of our Open Forum (page 25) was a clear recognition of the importance of financial markets to everyone's lives. But there was also a lack of trust in financial markets and institutions because of misconduct and a perceived lack of customer focus. This mistrust reinforces the importance of individual accountability, which is the focus of the Fair and Effective Markets Review that will provide an implementation report by July 2016, and also the Senior Managers Regime which came into force in March 2016. More information on both these initiatives are provided on pages 22 and 23.

Sterling Monetary Framework

The Bank of England is the sole provider of central bank money in the United Kingdom. Central bank money takes two forms: the banknotes that are used in everyday transactions; and the reserves that commercial banks and building societies hold at the Bank. Through its role as the provider of central bank money, the Bank operates in sterling money markets to implement the MPC's monetary policy decisions, and to reduce the cost of disruption to the liquidity and payment services supplied by banks to the UK economy.

Open Forum

#

The event was in the UK's Top 10 trending hashtags that day

The hashtag was used in over 3,000 tweets

There were almost 11,000 playbacks of our YouTube content


TB
TB 26

To reduce the cost of disruption to services supplied by banks, the Bank of England is seeking to broaden liquidity provision to the market. The Bank commenced work in the second half of 2015 to assess the feasibility of establishing a Shari'ah compliant facility in response to the fact that Islamic banks are currently unable to use the Bank's existing liquidity facilities. The Bank's work is progressing, and responses have been received to our consultation paper, published on 12 February 2016.[1] This sets out the Bank's preliminary findings from the feasibility study, and sets out four potential models that could form the basis of future Shari'ah compliant central bank facilities.

Funding for lending

The Funding for Lending Scheme (FLS) was extended for a further two years in November 2015. The FLS is designed to incentivise banks and building societies to boost their lending to the UK real economy. It does this by providing funding to banks and building societies for an extended period, with both the price and quantity of funding provided linked to their lending performance.

The FLS has contributed to a substantial fall in bank funding costs since its launch in 2012. That has fed through to improvements in credit conditions for households and businesses. Reflecting these improvements, the scope of the FLS has been narrowed several times since it was launched. Most recently, the FLS was refocused towards lending to small and medium-sized enterprises (SMEs). The latest extension will ensure that the FLS is gradually phased out, with borrowing allowances reducing over time, thereby minimising risks to the economic recovery from the withdrawal of funding support.

The FLS complements other initiatives undertaken by the Treasury and the Bank of England that tackle longer-term structural constraints on SME lending. These include: the Bank's work on widening access to credit data to improve the quality of credit scores provided to trade creditors; the joint Bank of England-European Central Bank initiative to improve the functioning of securitisation markets, including securitisation of SME loans; and the continued expansion of the activities of the British Business Bank to support access to finance for SMEs.

Banking

The Banking, Payments and Financial Resilience Directorate operates the United Kingdom's high-value payments system — the Real-Time Gross Settlement (RTGS) system — and acts as the 'bank' within the Bank of England. It is responsible for the Bank's lender of last resort function, the provision of Emergency Liquidity Assistance (ELA), and the provision of bespoke banking services for financial stability reasons.

RTGS Strategy Review

The RTGS system plays a vital role in the safe functioning of the economy. By allowing banks to settle their obligations to each other electronically and immediately via the central bank, RTGS eliminates settlement risk on the largest payments flows. As a result, the vast majority of payments in the real economy — some £500 billion every single day — ultimately settle over RTGS.

Following the service disruption to RTGS on 20 October 2014, the Bank commissioned an independent review[2] into the causes of the incident, the effectiveness of the Bank's response, and the lessons to be learned. The Bank has now implemented all of the review's recommendations, and has announced a wider strategic review of the RTGS system (see the box on page 34).

Liquidity provision

The Bank is assessing the feasibility of broadening our provision of liquidity to Islamic banks by establishing a Shari'ah compliant facility

1 www.bankofengland.co.uk/markets/documents/scfgreenpaper.pdf.

2 www.bankofengland.co.uk/publications/Documents/news/2015/rtgsdeloitte.pdf.

RTGS Strategy Review

The RTGS Strategy Review has been established to agree a blueprint for the next generation of the Bank of England's Real-Time Gross Settlement (RTGS) system.

On an average day, RTGS settles around £500 billion between banks. In turn, those payments back the vast majority of payments in the real economy.

The way payments are made has changed dramatically in recent years, reflecting changes in the needs of households and companies, changes in technology, and an evolving regulatory landscape. The range of payment providers is growing rapidly. Given the implications of these changes for the Bank's mission and for users, businesses and regulators, it is important that the Bank considers how RTGS will need to evolve to meet and shape payments trends in the coming decades. That is why the Bank has launched a broadly scoped review of RTGS, which will consider:

- What should the Bank's policy objectives be in the delivery of sterling settlement in central bank money?
- What functions should the UK high-value payment system have?
- Who should be able to access it and how?
- What should the role of the Bank of England be in the delivery of that service?

The Bank will seek input on these questions from a wide range of stakeholders in the first part of 2016, before consulting formally on a small number of alternative ways forward later in the year. The intention is that by the end of 2016 we will have agreed a blueprint for high-value sterling settlement in the years ahead, with technological development of that blueprint beginning in 2017.

Protecting our banknotes

Maintaining public confidence in the currency is core to the Bank's mission to promote the good of the people of the United Kingdom through monetary and financial stability. To achieve this we need to provide good-quality and counterfeit-resilient banknotes in the quantities and denominations demanded by the public.

In April 2015, following a formal procurement process, the Bank began a new ten-year contract with De La Rue plc for the production of banknotes. Demand for banknotes has continued to grow over recent years.[1] Today there are close to £70 billion worth of Bank of England notes in circulation. This increase in banknote demand means we need to supply notes that are fit for the future.

Polymer

In September, the Bank of England will introduce a new £5 note featuring Sir Winston Churchill that will be printed on polymer, followed by a £10 note featuring Jane Austen in 2017, and a £20 note featuring J M W Turner by 2020. The chosen character for the £20 note was informed by almost 30,000 nominations from the public on close to 600 visual artists who they believed helped to shape British thought, innovation, leadership, values and society.

Polymer banknotes with enhanced security features are cleaner, safer and stronger than paper banknotes. They will provide enhanced counterfeit resilience, and increase the quality of banknotes in circulation. Over the past two years, the Bank has worked closely with firms throughout the cash industry to deliver readiness for the new polymer banknotes. The Bank has shared information via regular industry forums and has commissioned five industry-led working groups, representing all parts of the cash distribution chain. The decision to move to printing banknotes on polymer followed a three-year research programme and extensive public consultation. This consultation in 2013 demonstrated overwhelming public support, with 87% of respondents in favour of the change.

Banknote authentication

Alongside the move to polymer notes, the Bank is working with the cash industry to implement the Code of Conduct for the Authentication of Machine-Dispensed Banknotes. The Code requires that Bank of England banknotes issued by customer-operated note-dispensing machines (COCDs), such as ATMs and self-service checkouts, are first authenticated by a testing device. The large majority of COCDs are already compliant with the Code; the compliance deadline for those remaining is 31 March 2017.

Counterfeit banknotes

Through a combination of research and investment, collaboration with law enforcement agencies, and our banknote education programme, we have been able to keep counterfeit levels low. In 2015, 243,000 counterfeit banknotes were removed from circulation down from 430,000 in 2014. Although we always strive for a lower number, this represents only a tiny fraction of 1% of notes in circulation.

Digital currencies

As part of the One Bank Research Agenda, the Bank is currently researching the desirability and feasibility of a central bank-issued digital currency. This is a long-term research project and will consider the rationale for broad access to digital central bank money, the potential impact it could have on the financial system, and what technological solutions would be required.

New £5 polymer note September 2016

£5

The new note will be cleaner, safer and stronger

Printing for issue date started September 2015 and will complete in July 2016

440 million £5 notes need to be printed before issue date

6 directorates are working together to make the change happen

5,000 ATMs and 35,000 cash-accepting machines will need to be modified to dispense and accept polymer £5 notes

1 See www.bankofengland.co.uk/publications/Pages/quarterlybulletin/2015/q3prerelease_1.aspx.

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Financial statements highlights

The table below presents highlights of the combined 2016 financial statements. Further explanation and commentary is provided below.

Financial statement highlights

	2016 £m	2015 £m
Banking Department total balance sheet size	405,758	402,573
Banking Department profit before tax	233	198
Cash Ratio Deposits	4,136	4,098
Funding for Lending Scheme	57,645	56,836
Funding for Lending Scheme income	160	132
Notes in circulation	67,818	63,789
Net seigniorage income	462	506
Combined cost base	549	510
PRA cost base	253	236
Payment to HM Treasury in lieu of dividend	105	93

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 is a separate legal entity, operating under the Financial Services and Markets Act 2000 (as amended). 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;[1]
- 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 seigniorage, and paid/claimed directly to/from HM Treasury via the National Loans Fund.

The PRA, operating under the Financial Services and Markets Act 2000 (as amended), may levy regulated firms to recover all costs incurred in the performance of the PRA's functions under that 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. Since the inception of the Funding for Lending Scheme, the Bank has generated a profit in excess of the return on invested capital.

1 The current requirements were agreed in May 2013; see www.legislation.gov.uk/uksi/2013/1189/pdfs/uksi_20131189_en.pdf for the 2013 Cash Ratio Deposit legislation.

Combined income statement

The combined income statement reflects a profit before tax of £233 million (2015: £198 million). 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.

Year-on-year growth in profit before tax was driven by increases in Funding for Lending Scheme (FLS) fees, mark-to-market gains on foreign currency deposits and reserves and increased fees on secured lending within the Sterling Monetary Framework, partly offset by increased policy function costs.

Summary combined income statement[1]

	2016 £m	2015 £m
Income	**782**	**708**
Banking Department	626	569
Issue Department	542	576
PRA	253	236
less internal income recoveries and seigniorage income		
Banking Department corporate service management fee to the PRA	(97)	(97)
Issue Department income transferred under seigniorage arrangements	(542)	(576)
Expenses	**(549)**	**(510)**
Banking Department	(393)	(371)
Issue Department	(80)	(70)
PRA	(253)	(236)
less internal cost recoveries and seigniorage expenses		
Issue Department costs under seigniorage arrangements	80	70
PRA corporate services management charge from the Banking Department	97	97
Combined profit before tax	**233**	**198**
Taxation	(24)	(19)
Payment in lieu of dividend	(105)	(93)
Profit after tax and dividend for the year ended 29 February	**104**	**86**

1 The separation of the Banking and Issue Department for accounting purposes is required by statute. A summary 'combined' income statement and balance sheet as at 29 February 2016, aggregating the Banking Department, Issue Department and the PRA, is provided in this financial review. It is provided for information purposes only.

Expenditure by function

Total expenditure for 2016 of £549 million was in line with the 2016 budget. The 2017 cost budget has been set at £582 million, the year-on-year increase being driven primarily by banknote production costs due to both higher anticipated printing volumes and incremental costs associated with the introduction of polymer notes. Budgeted cost growth excluding banknote production costs has been limited to 1.5%.

The overall cost budget of £582 million includes £253 million for the PRA, in line with its 2015 expenditure.

Combined expenditure by function[1]

	2016 Actual £m	2015 Actual £m
Policy functions		
Monetary policy	77	69
Financial stability	75	63
Expenditure on policy functions	**152**	**132**
Remunerated functions		
Notes issue costs recharged to the Issue Department	83	72
Government agency services	9	9
Payment and settlement	13	12
Banking services	35	33
Other functions	4	16
Expenditure on remunerated functions	**144**	**142**
Corporate service costs recharged to the PRA[2]	97	97
Total Banking Department	**393**	**371**
Issue Department	**80**	**70**
Operational expenditure	240	229
Special project and Solvency II costs	13	7
Transition costs	–	–
Prudential Regulation Authority	**253**	**236**
Issue Department costs settled under seigniorage arrangements	(80)	(70)
PRA corporate services management charge from the Banking Department	(97)	(97)
Internal charges and settlements under seigniorage arrangements	**(177)**	**(167)**
Total combined expenditure	**549**	**510**

1 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.

2 The Bank provides certain central and support services to the PRA, for which it charges a corporate services fee.

Policy functions

Expenditure on policy functions was £152 million, a year-on-year increase of £20 million due to continued investment in the Financial Stability and Resolution functions, the Bank's research and analytical capability, and information security.

Remunerated functions

Expenditure was largely unchanged at £144 million (2015: £142 million).

The Bank's remunerated functions (operating on a full and fair cost recovery basis) continue to make a surplus as a consequence of FLS income of £160 million (2015: £132 million).

Prudential Regulation Authority

Operating costs for 2016 were £253 million (2015: £236 million). The year-on-year increase was attributable to the delivery of the PRA's expanded regulatory agenda, notably Solvency II, CRD IV, Structural Reform and Stress Testing.

Issue Department

Expenditure of £80 million on the Issue Department increased by £10 million year on year due to preparatory spend in anticipation of the switch to polymer notes in 2016.

Combined balance sheet

The combined balance sheet grew by £14.2 billion in 2016. The largest movement in assets was an increase in 'loans and advances' of £12.6 billion, primarily attributable to an increase in Indexed Long-Term Repo (ILTR) balances (£12.5 billion).

The upward trend in 'notes in circulation' (NIC) continued in 2015, bringing the liability to £67.8 billion (2015: £63.8 billion).

Drawings on FLS as at 29 February of £57.6 billion were largely consistent with the prior year (£56.8 billion). During the year, additional drawdowns were largely offset by repayments. In November 2015, the Bank and HM Treasury announced a further two-year extension to the FLS. The FLS Extension drawdown window will now remain open until January 2018, with incentives of the scheme focused towards lending to small and medium-sized enterprises.

FLS is a fully collateralised scheme, classified as off balance sheet under a collateral swap arrangement, which allows participants to borrow UK Treasury bills in exchange for eligible collateral.

Combined balance sheet

	2016 £m	2015 £m
Assets		
Loans and advances	401,886	389,330
Securities held at fair value through profit or loss	7,190	5,160
Available for sale securities	11,178	11,075
Other assets	2,448	2,927
Total assets	**422,702**	**408,492**
Equity and liabilities		
Deposits	344,594	336,714
Notes in circulation	67,818	63,789
Foreign currency bonds in issue	4,333	3,898
Other liabilities	1,367	692
Capital and reserves	4,590	3,399
Total equity and liabilities	**422,702**	**408,492**
Off balance sheet — Funding for Lending Scheme		
Funding for Lending drawdowns	**57,645**	**56,836**

Financial review of Banking and Issue Departments

Banking Department

The Banking Department's financial statements for the year ended 29 February 2016 are shown on pages 84–135 and reflect a profit before tax of £233 million (2015: £198 million) and tax charge of £24 million (2015: £19 million). The Bank and HM Treasury normally share Banking Department's post-tax profits equally. Profit transferred to reserves amounted to £104 million (2015: £86 million), and the amount payable to HM Treasury in lieu of dividend totalled £105 million (2015: £93 million including £1.75 million compensation in relation to the Special Liquidity Scheme).

The statement of comprehensive income reflects a net increase for the year of £1,296 million (2015: £445 million increase), comprising post-tax operating profits of £209 million (2015: £179 million) and 'other comprehensive income' totalling £1,087 million (2015: £266 million). 'Other comprehensive income' includes a net increase in the fair value of available for sale assets of £758 million (2015: increase of £95 million), positive retirement benefit remeasurement of £300 million (2015: £130 million increase) and property revaluation gains of £29 million (2015: £41 million gain).

The total balance sheet of the Banking Department increased during the year, from £402.6 billion at 28 February 2015 to £405.8 billion as at 29 February 2016.

The main change in Banking Department assets was an increase in 'securities held at fair value' in 'loans and advances to banks and other financial institutions' of £1.1 billion, primarily due to increases in secured lending and reverse repurchase agreements.

'Capital and reserves' increased to £4.6 billion (2015: £3.4 billion), largely due to changes in market valuations of available for sale assets and retirement benefit remeasurements. The Bank's retained earnings, together with Cash Ratio Deposits, are predominantly invested in gilts and supranational sterling bonds. The Banking Department's holdings of gilt securities and other supranational bonds totalled £6.8 billion at 29 February 2016 (2015: £6.7 billion).

At 29 February 2016, the Banking Department balance sheet contained £4.3 billion of liabilities associated with the management of the Bank's foreign exchange reserves (2015: £3.9 billion).

The main movement in Banking Department liabilities was an increase of £6.0 billion in 'deposits repayable on demand', offset by a decrease in the Issue Department deposit resulting from increased secured lending within the Sterling Monetary Framework.

Issue Department

The statements of account for the Issue Department (which are provided on pages 136–40) reflect net profits from note issue of £462 million (2015: £506 million), payable in full to HM Treasury. In 2016, gilt revaluations contributed £47 million to income, a reduction on the 2015 level (£81 million) and, combined with higher note production costs, drove the decrease in net profits in 2016.

'Notes in circulation' continued to increase year on year, and totalled £67.8 billion at 29 February 2016 (2015: £63.8 billion). Gilt purchases to back banknote issuance, introduced in January 2008, remained on hold during the year while Bank of England Asset Purchase Facility Fund Ltd undertook gilt purchase operations. The market valuation of gilts on Issue Department was £3.2 billion at 29 February 2016 (2015: £4.1 billion). The 'Ways and Means advance' to HM Treasury remained at £370 million as at 29 February 2016.

Risk management and business practices

Court is responsible for the risk management and internal control systems in the Bank and its subsidiaries.

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

In accordance with the Financial Reporting Council's guidance on the UK Corporate Governance Code,[1] 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 Governors, 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.

Risk governance

Executive responsibility

As explained in Review of 2015/16, the Bank has voluntarily adopted the core principles of the Senior Managers Regime. Within the Senior Managers Regime framework, the Governor has overall executive responsibility for risk and ensures that the Bank has a risk profile consistent with ensuring the delivery of its objectives. The Governor delegates line management responsibility for financial risk and day-to-day management of the Bank's balance sheet to the Deputy Governor for Markets and Banking and delegates line management responsibility for non-financial risk, including oversight of the Bank's risk profile, to the Chief Operating Officer. Executive Directors manage risk on a day-to-day basis within their directorates, identifying, assessing, and mitigating the risks associated with the Bank's business-critical functions, processes and systems.

The Governor delegates management of the Bank's balance sheet through a Balance Sheet Remit to the Deputy Governors (principally the Deputy Governor for Markets and Banking), and in part on to Executive Directors and Directors (principally Executive Director for Markets, and Executive Director for Banking, Payments and Financial Resilience). The Balance Sheet Remit governs the management of the Bank's balance sheet for both routine balance-sheet activities and in the event of contingencies. It sets out the high-level purposes, responsibilities, constraints and associated delegated authorities with respect to those activities.

1 Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, published September 2014.

The role of Committees

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. Court determines the strategy for managing risk and the Bank's tolerance for risk. It takes the lead in setting a strong risk management culture across the Bank and relies on a sound governance structure to ensure its risk management strategy is implemented through frameworks, policies and risk reporting.

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. 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. ARCo reviews accounting policies and the annual financial accounts for approval by Court. The Chair of ARCo is responsible for the performance of the Committee, and for ensuring and overseeing the integrity of the independence of the Bank's risk functions. The Bank's Internal Auditor and Head of Bank-wide Risk have reporting lines to the Chair of ARCo.

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. Risk assessments produced through this process are approved by the Board and 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 supervisory 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.

The Bank's risk management framework

In 2015, the Bank completed a Financial Risk Management Review. This review had been instigated to reflect the facts that the Bank's balance sheet had changed substantially over the course of the 2008 financial crisis, in terms of both volume and composition; that the Bank's responsibilities and institutional structure have changed; and that risk management operations had developed quickly, expanding in scale and scope. Therefore the primary driver of the review was to ensure that risks to the Bank's balance sheet be managed effectively and to appropriately high standards, in light of this new paradigm. The review made broader recommendations on the structure and framework for risk management in the organisation, beyond financial risk.

Three Lines of Defence

The Bank operates a 'Three Lines of Defence' model to distinguish between those areas which:

1. own risk and implement controls. This is delivered by first line risk functions, embedded within directorates;

2. provide independent forward-looking assessment and challenge of overall risks across operations and business lines, and define risk management frameworks and tools. This is delivered by second line risk functions, including a central Bank-wide risk function, a second line financial risk division and a new compliance division, which was established during the course of the year; and

3. provide assurance that the risk management framework is robust and internal controls are appropriate and effective by independently and objectively evaluating internal controls, risk management and governance processes. This third line is delivered by the Bank's Internal Audit function as part of its role in helping Court and executive management protect the Bank and its reputation.

As an outcome of the Financial Risk Management Review, the new financial risk second line of defence was created in 2015. It started to discharge its new responsibility to provide forward-looking assessment and challenge of financial risks to the Bank's balance sheet across all its financial operations, so that it can achieve monetary and financial stability. This resulted in a programme of work comprising four elements. First, the detection of vulnerabilities of the balance sheet through stress testing and risk reviews. Second, the evaluation of current and contingent financial risk exposures across all operations, including a framework for capital adequacy. Third, the articulation of the financial component in the Bank's risk tolerance statement, and the design of a system of limits and thresholds across the balance sheet to translate this tolerance into practice, including periodic reporting to Court. Fourth, the challenge of policy proposals from the perspective of their risk implications, and of risk assessments or tools developed by the first line of defence.

The recommendations from the Financial Risk Management Review also included creating a Bank-wide risk tolerance framework for both financial and non-financial risks, enhancing tools and capabilities to support this framework, establishing an Executive Risk Committee, strengthening the role of a central risk function to support this committee, maintaining a strong risk management function in the Markets Directorate, and establishing a financial risk second line of defence in the Banking, Payments and Financial Resilience Directorate.

Consequently, later in the year Court approved a new Risk Management Framework to support a consistent and holistic approach to identifying, assessing and monitoring material risks to the Bank's mission, and the actions required to mitigate them. Robust risk management is integral to all aspects of the Bank's activities given the potential serious adverse impact on the Bank's reputation and credibility in the event of an operational or financial risk crystallising. Risk management processes and systems of internal control are embedded within its operations. The principal types of risk to which the Bank is exposed are outlined in the section below.

A core part of the new framework is a Risk Tolerance Statement which provides an approach for managing risks within agreed tolerance levels. The Bank accepts a level of risk appropriate to the achievement of its policy objectives. Generally, the Bank seeks to keep its exposure to risk low and aims to have a control environment and risk culture which supports this. Where risks are assessed as out of tolerance, action plans are developed to bring those risks within the Bank's tolerance threshold. The framework recognises that there may be instances where the Bank chooses to accept a risk in the interests of delivering its mission.

To support consistent assessment of non-financial risk against tolerance, a likelihood and impact matrix is used to determine a risk rating. This includes an assessment of both the reputational and financial impact in the event of a risk crystallising. The Bank translates its financial risk tolerance into a set of limits and monitoring thresholds in order to facilitate day-to-day control of financial exposures and appropriate senior management involvement. In certain circumstances, informed by robust analysis, a decision may be taken by the Governors, with approval from Court, to exceed the Bank's usual limits and expose the balance sheet to significant risk of material financial loss, if it is determined that the expected benefits to monetary and financial stability outweigh the risk.

The Executive Risk Committee (ERC) oversees the operation of the Bank's risk governance framework, including proactive monitoring of the Bank's financial and operational risk profile against tolerance and prioritisation of mitigating actions. The ERC is chaired jointly by the Bank's Chief Operating Officer and Deputy Governor for Markets and Banking. The ERC reviews and challenges risks before escalation to ARCo.

Principal risks

The Bank designs and implements its policies in order to maintain monetary and financial stability.

Risk considerations enter policy processes in two ways:

i) all policy choices are made after a thorough assessment of the risks to which they expose the Bank. The Governor/Deputy Governors brief the relevant committee on material risk issues; and

ii) policy choices are implemented in a way that risks taken are appropriate given the policy's objectives. In making policy and other decisions, the Bank is mindful of the risk of behavioural bias and promotes a climate in which all views and perspectives are properly considered.

Policy decisions are taken by the Monetary Policy Committee, Financial Policy Committee and Board of the Prudential Regulation Authority. Policy formulation risks are the remit of the Committees. Policy decisions expose the Bank to a broad range of operational and financial risks, of which the principal types of risk are described below.

Strategic risk

The Bank faces strategic risks when, for example, deciding the best way of executing a policy, or *not* to pursue a certain opportunity. An actual or perceived inability to deliver on its strategic initiatives could impact both the achievement of the Bank's mission and consequently damage its reputation. The Bank has a low tolerance for threats to the effective delivery of its strategic initiatives.

Financial risk

The Bank is exposed to credit, market and liquidity risk in its operations to implement monetary and financial stability policies. Those operations include notes and payments systems operations as well as its operations in financial markets. Other activities, such as budget management and procurement activities, also expose the Bank to financial risk. Financial risks are managed so that the occurrence of any material loss in the Bank's operations resulting from policy decisions is a very rare event. The Bank seeks to maintain a level of its own financial resources that provides it with sufficient resilience to be able to withstand a severe but plausible scenario without its capital falling negative.

Conduct risk

The Bank has a very low tolerance for any conduct which may negatively impact its credibility and reputation. The Bank holds its staff to the highest standards of integrity. The policies and rules that underpin these standards are brought together in Our Code. All employees are required to attest on an annual basis that they have adhered to the requirements of Our Code. Compliance with Our Code is monitored by the new Compliance Division.

Operational risks

The Bank faces different types of operational risk, including people risks, process and systems risks, as well as those arising from external events that would have an operational impact. There is a very low tolerance for operational risks which impact business-critical functions — these include activities such as the provision of liquidity to sterling markets; operation of the United Kingdom's real-time gross payment system; and the production and distribution of banknotes — unless a higher level of tolerance is agreed in order to meet specific policy objectives. Further detail is provided below.

i) People risk

The Bank is committed to attracting and retaining people of the highest calibre and relevant experience, and aims to be fully and appropriately resourced. It seeks to mitigate the risk of the loss of key skills and experience through talent management, training, and motivating and developing staff to fulfil their potential. The Bank has a low tolerance for resourcing risks which impact the delivery of its mission.

ii) Information management and security risks

The Bank seeks to operate within a highly secure environment which protects its people, data, systems and digital assets from cyber threats through robust technology solutions, security policies and processes. We continue to proactively mitigate against this risk through our cyber security programme. The Bank has established processes for data integrity and compliance with legal requirements. Its tolerance for compromise of IT security, data integrity, or core operational systems is very low.

iii) Physical security risks

The Bank aims to have high standards of physical security and to operate robust incident management processes to protect its people and physical assets from external or internal threats. Its tolerance for compromise of physical security is very low.

iv) Process risks

The Bank has in place business processes to support development and delivery of policy and to ensure compliance with legal requirements. Processes are managed through control frameworks and independent review. It has a low tolerance for process failures which impact negatively on the outcomes of business-critical functions.

v) Business continuity risks

The Bank aims to maintain the capability both to respond effectively to, and recover safely from incidents that could affect its people, operations or credibility. It gives priority to providing stable, high-availability systems to support its business-critical activities, in particular the provision of payment and settlement services, and critical banking services. Its tolerance for disruption to transaction-processing capabilities is low. Its tolerance for outages of critical business systems is very low.

vi) Outsourcing and procurement risks

The Bank uses third parties in some areas to assist delivery of its mission; this exposes it to risk from the poor performance or failure of those parties, and risk to its reputation through association should such a third party act in a way that is inconsistent with its standards. Risk management is a key consideration in the Bank's outsourcing and procurement. The Bank has a very low tolerance for poor performance of third parties and breaches of its ethical standards.

vii) Health and safety risks

The Bank aims to create a safe working environment which is fully compliant with legal requirements. It has a very low tolerance for any actions or behaviours which may cause harm to its staff.

viii) Financial crime

The Bank aims to meet all legal and regulatory requirements and to have business processes which prevent financial crime, including money laundering.

Exchange Equalisation Account

The Bank acts as agent for HM Treasury in managing the United Kingdom's foreign currency assets and gold reserves, and its foreign currency liabilities. These funds are not held on the Bank's balance sheet, but in HM Government's Exchange Equalisation Account (EEA). The risks incurred in conducting this business are similar to those in relation to the Bank's own business, namely credit, market, liquidity and operational risk and the controls are applied and monitored alongside 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.

Corporate social responsibility

For the Bank, Corporate Social Responsibility (CSR) is about how we contribute to society while working together to support our mission. That helps us focus on the activities that truly make a difference. We want to give our staff the opportunity to do interesting and challenging work, while supporting their development, and rewarding them appropriately. We also want to be a responsible employer by supporting our staff's involvement in their community and by minimising our impact on the environment.

This review details the key initiatives that the Bank has undertaken over the past year in support of these two broad aims of developing our staff and developing our institution. Highlights include: a major initiative to create a new postgraduate qualification in central banking (see page 54); the embedding of standards on ethics and conduct across the organisation through 'Our Code' (see page 60); and a new set of full disclosures of diversity and inclusion metrics following the recommendations of the Gadhia Report on female representation (see page 55).

Looking forward, the Bank has a number of CSR initiatives under way, and we are increasing our focus and energy on supporting the development and implementation of a CSR strategy.

Our people

The Bank's greatest asset is the people who work for it. They are crucial to our success. Only by attracting and inspiring the best people to public service, and encouraging a range of thought through diversity and inclusion, can we achieve our mission to promote the good of the people of the United Kingdom by maintaining monetary and financial stability.

The Bank was proud to be included in *The Times* Top 100 Graduate Employers in 2015/16. But our journey is far from over. We know that we need to continually enhance the way we support and develop our staff if we are to meet our responsibilities.

Key initiatives

Central Banking Qualification

A major and unique initiative this year is our work with Warwick Business School to create a suite of tailor-made postgraduate qualifications in central banking, including a Master of Science and a Master of Research degree awarded by Warwick University. The new Central Banking Qualification (CBQ) programme officially began in October 2015 with a Foundation Year, designed by our Centre for Central Banking Studies and taught in-house. The CBQ supports our aspirations on inclusion by giving our staff the opportunity to study for a postgraduate qualification while at work. The CBQ will also ensure we train a pool of future central bankers with specific areas of technical expertise but who will also share a common, well-rounded understanding of the economics of central bank functions as well as practical knowledge of the Bank's mission and policymaking.

Engagement and enablement

In 2015, the Bank ran 'Viewpoint', an employee survey, to receive feedback on how we can make the Bank a more effective and better place to work. Over 80% of staff participated and by listening we formed a clear impression of how people feel about working at the Bank and how we can all work together to fulfil the Bank's mission.

One core message we took away was that the responses from staff did not depend on where they worked, their experiences, or their background. This suggested that the integration to One Bank was working well. The results also indicated several hallmarks of a strong, positive corporate culture including high levels of pride in working for the Bank, a strong alignment with the Bank's mission, and a commitment to diversity and inclusion. But there was also a recognition that there are a

125% ⇧

Rise in graduate applications

number of areas where we need to do more. Key areas for improvement included: ensuring that decisions are being made at the appropriate levels; perceived fairness of the performance management system; and the openness and transparency of our internal communications.

In response the Bank has developed a number of significant ideas to improve communication, decision-making and work/life balance and these have been supported by around 250 local initiatives that target feedback from specific areas. Looking forward the results from Viewpoint will be a key input into the future strategic direction of the Bank.

Diversity and inclusion

The Bank values diverse ideas, open debate and perspectives that challenge the prevailing wisdom. To support that we seek to develop and empower people at all levels to take initiative and make things happen. We view this as our duty to the public. We also believe it is necessary if we are to reach the right policy and operational decisions in support of our mission.

In March 2016 the Bank hosted the launch of a report on 'Empowering productivity: harnessing the talents of women in financial services' led by Jayne-Anne Gadhia.[1] The Bank strongly supports the principles and values of the Gadhia Report which also underpin our aims on diversity and inclusion, and in response we are publishing the full range of reporting requirements that the Report recommends (see following graphics). The Bank also adheres to the other recommendations of the Gadhia Report that cover executive accountability and remuneration.

To meet our diversity and inclusion aspirations the Bank has set itself some challenging, but achievable, targets to broaden the range of thought, skills and experience within the institution. This is supported by a rigorous approach to monitoring progress including through annual review and challenge by Court.

For gender our targets are 35% female representation at senior management and 50% below senior management by 2020; and for ethnicity our targets are 13% Black, Asian and Minority Ethnic (BAME) representation at senior management and 20% below senior management by 2020. We are currently finalising the end date for our BAME target for senior management in consultation with the Bank's Ethnic Minorities (BEEM) network and will announce this by the end of the year.

These targets have been instrumental in the progress we have made over the course of the Strategic Plan and they show that we have made a step change in behaviours at all levels of our organisation. While there is much left to do to ensure we have a sufficient pipeline of female and BAME staff in our senior management team, we continue to make progress. During 2015/16, senior management female representation increased from 25% to 28%, and female representation below senior management rose from 43% to 44%. This reflects an improvement in both hiring and retention rates.

On ethnicity, we are attracting higher proportions of BAME employees and this year we saw a significant improvement in the retention of BAME staff. Consequently, BAME representation below senior management has risen from 15% to 17%. The representation of BAME staff at the Bank now substantially exceeds that for the UK population (at 11%), though it is below that for London (at 37%).

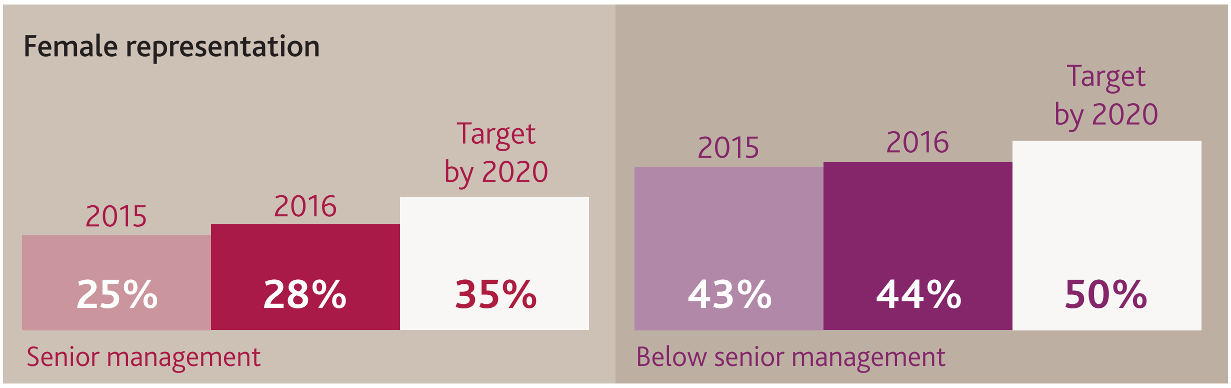
We recognise, however, that we still have some way to go to increase the representation of BAME staff in senior management which rose from 5% to 6% this year.

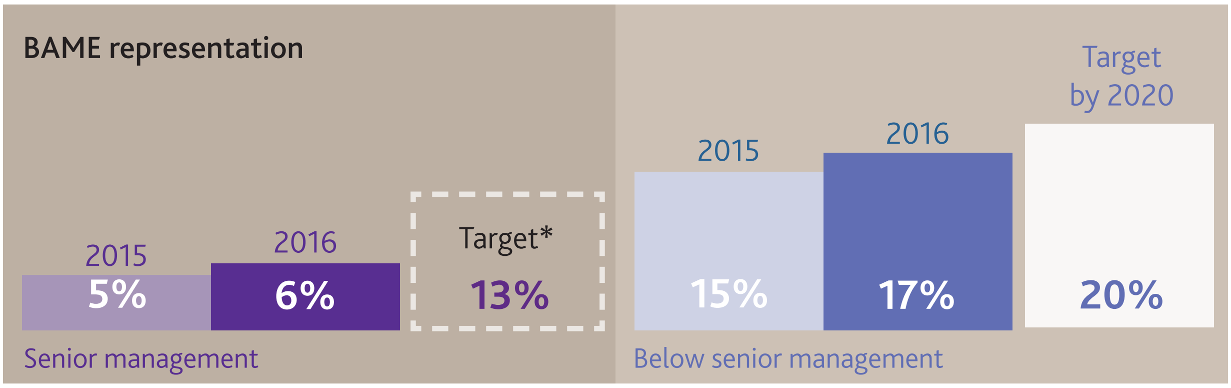
Diversity and inclusion targets

We have set ourselves challenging diversity and inclusion targets — in order to achieve our mission we need to encourage a range of thought by better reflecting the diversity in the UK

1 www.bankofengland.co.uk/publications/Documents/speeches/2016/speech893.pdf.

Diversity and inclusion metrics

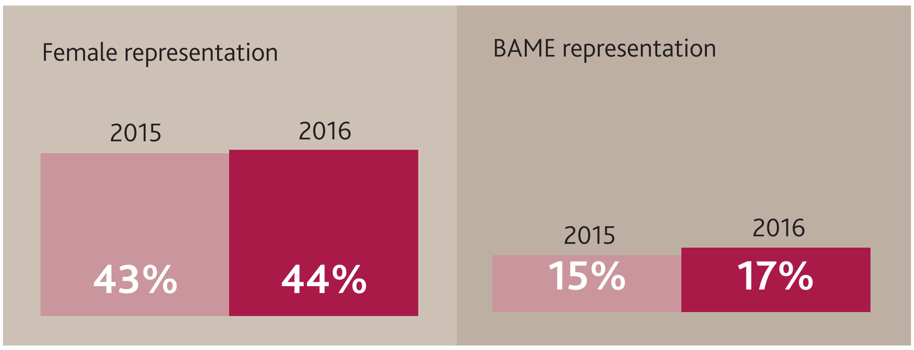




Senior management refers to Governors, Executive Directors, Directors, Heads of Division and Senior Advisors.

* We are currently finalising the end date for our BAME target for senior management in consultation with the Bank's Ethnic Minorities (BEEM) network and will announce this by the end of the year.

Overall split



Female representation

	2015	2016
Those newly hired	41%	42%
Those promoted	44%	43%
Those working flexibly	82%	83%
Those leaving the Bank	34%	37%

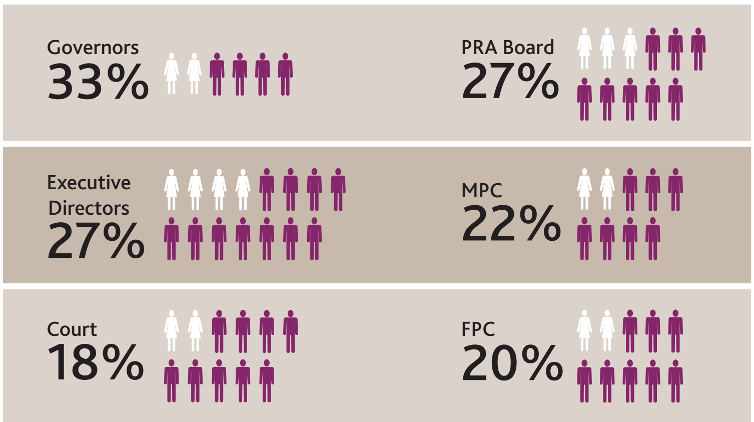
BAME representation

	2015	2016
Those newly hired	21%	23%
Those promoted	16%	17%
Those working flexibly	11%	12%
Those leaving the Bank	20%	18%

Female and BAME representation across the functions of the Bank

	Female representation		BAME representation	
Deputy Governorship	2015	2016	2015	2016
Governor's Office	62%	**66%**	10%	**14%**
Chief Operating Officer's Office	38%	**36%**	15%	**18%**
Financial Stability	36%	**39%**	15%	**13%**
Markets & Banking	47%	**49%**	13%	**14%**
Monetary Policy	46%	**48%**	10%	**11%**
Prudential Regulation Authority	42%	**43%**	20%	**20%**

Female representation among the Executive and Committees



Creating an inclusive environment is fundamental to how we want to work as an organisation. We are encouraged that the number of staff that have disclosed themselves as lesbian, gay, bisexual and transgender (LGBT) has increased to 2.5% compared to 2% in the previous year. These higher disclosure rates reflect our aspiration to be a place where staff can be themselves and the vital role that our broad range of diversity and inclusion networks have played in driving forward our inclusion strategy. Flexible working is also encouraged and the Bank's working practices include many different working patterns at all levels of the organisation. Currently 11% of our staff work part-time which is unchanged from the previous year.

Over the past year the Bank has put in place a number of initiatives to help us achieve our diversity goals. This includes our work with external recruitment consultants and professional networks to enhance the diversity of our workforce and to help us harness the talent within minority groups. To support this programme of engagement we have also introduced unconscious bias training for all senior managers. Substantial works have also been undertaken to the Bank's front entrance on Threadneedle Street which will greatly improve access for wheelchair users. Currently 3% of our staff have declared they have a disability (up from 1.9% last year).

Consistent with our ambitions on diversity, in our Viewpoint staff survey 73% of staff responded positively to the statement '[t]he Bank takes diversity seriously'. And we are pleased that over 80% of our staff are comfortable to share their diversity data with us. This helps us to improve our diversity and inclusion statistics.

Promoting an inclusive working environment which encourages staff to contribute their unique perspective to the work of the Bank is also one of our key values in support of our Diverse and Talented aspirations. The Bank supports inclusion through a number of widely supported diversity and inclusion networks.[1] Membership numbers have continued to increase, as has participation in network speaker and development events. These networks celebrate the diversity of our staff, help to promote awareness and understanding across the institution, and provide support to their members.

Key initiatives this year are the new LGBT Allies Network where staff sign up to make a simple but clear statement in support of our LGBT colleagues; the introduction of a new Carers Network; and our Bank of England Ethnic Minorities Network's (BEEM) sponsorship of a new 'Building Bridges' reciprocal mentoring scheme between senior management and BAME staff. In recognition of this and other work, the BEEM network was shortlisted for the BITC Race for Opportunity Network of the Year in 2015. In support of our work on inclusion, the Viewpoint staff survey reported that 83% of staff responded positively to the statement '*I am treated with respect as an individual*'.

Wellbeing

To support our Diverse and Talented strategic objective we are working at the cutting edge of best practice in psychological, physical and social wellbeing. The Bank was recently invited to submit material for a case study for the World Economic Forum Global Agenda Council on Mental Health, outlining the work we have done in this area, as well as wellbeing more generally. The Bank has also been shortlisted in the 2016 BITC Responsible Business Awards for the Bupa Wellbeing at Work Award.

The Bank provides a wide range of services which support the wellbeing of its employees. These include: a regular series of 'Working Life Seminars' that offer practical advice to staff on work and family issues including techniques such as mindfulness; an Employee Assistance Programme that offers counselling and

Diversity and inclusion networks

BITC Responsible Business Awards

1 Bank of England Ethnic Minorities (BEEM), Carers Network, Christian Union, Disability Network, Jewish Network, Lesbian, Gay, Bisexual and Transgender Network (LGBT), and Allies Network, Mental Health Network (MHN), Muslim Network, Women in the Bank (WIB).

additional support; and the provision of accredited in-house counsellors who work closely with the Bank's medical team.

To promote their use the Bank has launched a wellbeing brand and symbol '*think well, live well, be well*' that is signposted throughout the organisation to publicise the wide range of wellbeing initiatives and events. The Bank has also worked with the Bank Workers Charity, in conjunction with Mind, the Mental Health Charity, and the Chartered Institute of Personnel and Development, to deliver a pilot mental health training programme for line managers.

Learning and development

The Bank's commitment to learning and development remains as strong as ever, and is firmly embedded as part of our Talent Strategy within the Strategic Plan. The Bank offers a range of training frameworks and courses to meet the needs of staff at all stages of their career. These include frameworks to support development of core business skills, IT skills, management skills and technical skills on central banking and financial regulation. The aim is to provide flexibility and choice, to ensure a good balance between formal training and easily accessible online resources and toolkits. This helps to support our staff that work remotely or choose to adopt different working patterns.

Following the completion of the Market Intelligence (MI) Review,[1] the Bank has also developed a training programme for employees who gather MI in meetings or phone calls with external contacts. All relevant staff are required to successfully complete the training before they can actively engage in MI activities.

Our Code

Our ability to achieve our mission relies on public trust. To maintain that trust it is essential that the Bank holds itself and its staff to the very highest ethical standards. During 2015/16, the Bank has embedded our standards on ethics and conduct through Our Code. Our Code represents our commitment to how we work at the Bank of England and how we should conduct ourselves both within and outside the Bank. It applies to all staff including Governors, MPC, FPC and PRA Board members.

Our Code is based on five principles that are drawn from the Nolan principles of public life, the values we established in the Strategic Plan, and the principles we require of others under the Senior Managers Regime. They are: acting with integrity; creating an inclusive environment; demonstrating impartiality; being open and accountable; and feeling empowered.

Our staff are required to attest annually, confirming that they have read, understood, and complied (as appropriate) with the policies in Our Code. As part of Our Code we also expect our staff to escalate any concerns they have through the Bank's 'Speaking Up' policy. The Bank has set up a central compliance division to support Our Code and other policies. This function reports to the General Counsel and independently to the Audit and Risk Committee, and through them to Court.

Health and safety

The Bank attaches the upmost importance to the health and safety of its staff. Through its safety management system the Bank delivers a safe working environment and promotes and maintains a positive health and safety culture. The Bank monitors its performance on health and safety on a regular basis, and reports annually to Court.

Bank of England employees work in a relatively low-risk environment and are not exposed to significant occupational health and safety hazards. During 2015/16 there were a total of 20 recorded accidents involving employees and one reportable injury as defined by the UK Health and Safety Executive's (HSE) reporting of Injuries, Diseases and Dangerous

1 www.bankofengland.co.uk/markets/Documents/marketintelligence/review.pdf.

Occurrences. Overall, the Bank's Annual Injury Rate was 29 which is substantially below the benchmark rate for similar institutions published by the HSE.[1]

Supporting communities

The Bank has a long history of community involvement, and supporting the voluntary sector continues to be an important part of the Bank's culture. The Bank encourages staff to become involved in community initiatives, and promotes initiatives that contribute to the Bank's Diverse and Talented aspirations.

Key initiatives

Volunteering

The Bank offers its employees paid leave to perform voluntary duties in the community, or to undertake public and civic duties in a way that caters for a variety of staff levels and time commitments. Volunteering helps us to build relationships with our communities, support recruitment and retention, and provides real situations in which to develop our skills.

During 2015/16 it is estimated that over 2,000 staff took part in some form of community activity. 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 £405,000 in 2015/16 (2014/15: £343,000), of which £186,000 was for staff time involved in volunteering and undertaking civic duties and volunteering leave.

Charitable giving

The Bank and its employees also support local and national communities through a range of schemes that support charitable giving. Bank staff chose Mind and Alzheimer's Research UK as their charities of the year and raised over £104,500 through various fundraising activities from quiz nights to auctions. The Bank was also one of the few recipients of a Platinum Award from Pennies from Heaven. Around 45% of our staff currently round down their monthly income and donate this money to charity via the Pennies from Heaven scheme.

During 2015/16, the Bank contributed a total of £935,000 in support of its community programme (2014/15: £832,000). Cash donations totalled £530,000 (2014/15: £489,000) including:

- £73,000 to community organisations via the Staff Volunteering Award Scheme;
- £60,000 to charities supported by the Bank's regional Agencies;
- £35,000 to match record 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;
- £121,000 made to partner charitable organisations and membership subscriptions;
- £10,000 for the David Sharp School Governor Awards; and
- £104,000 in donations to support academic research.

The Bank also launched the African Caribbean Scholarship to support undergraduate talent. Over 2,000 applicants applied for support from the Bank to cover their tuition fees, and in its first year the cost to the Bank was £72,000. No donation was made for any political purpose in 2015/16 (2014/15: nil). And no paid leave was granted to staff for political purposes in 2015/16 (2014/15: nil).

£935k

contributed in support of our community programme during 2015/16

1 The Annual Injury Rate is calculated by multiplying the number of reportable accidents by 100,000 divided by annualised employee numbers.

Work experience

The Bank contributes to our local communities through prioritising work experience for our state school partners located in the disadvantaged areas that surround the City of London. In 2015/16 the Bank welcomed close to 150 community students between 14–18 years' old placed through our school partners.

The Bank also offers a number of temporary vacation placements each year for state school students via our partner organisations Brokerage Citylink and Career Ready. With the help of these organisations we are able to build stronger links with our local communities, and attract a workforce that is more reflective of the diversity among the public we serve.

Centre for Central Banking Studies (CCBS)

In 2015, CCBS celebrated its 25th year of contributing to the Bank's mission by sharing international best practice and new ideas with central bankers from around the world. During 2015, CCBS events were attended by delegates from 130 central banks and 30 non-central bank regulatory authorities with over two thirds of delegates originating from emerging and developing economies. To support our global community we have continued to build special partnerships with central banks from emerging and developing economies including the East African Community, Centre for Latin American Monetary Studies and the Arab Monetary Fund.

Responsible supply chains

The Bank recognises that the products and services that we buy have important external environmental and social impacts. When we partner with organisations in our supply chain to meet our requirements, we do not outsource our responsibilities at the same time. We aim to source goods and services sustainably and responsibly while meeting the Public Procurement Regulations under which we are a contracting authority.

Where feasible, and as part of getting best value for the contracts we hold, we ask our suppliers to develop innovative ideas to improve our sustainability performance including reducing waste, improving access to healthy food for our people, and sourcing their own supply chain as sustainably as possible. We also do not discriminate against small and medium-sized enterprises (SMEs) as suppliers. During 2015/16 around one half of our main suppliers were SMEs.

Key initiatives

London Living Wage

The Bank pays its entire staff at least the Living Wage. During 2015/16 we brought all our contracted service staff in London up to the London Living Wage through agreement with our supply chain. Through this action the Bank is now an accredited Living Wage employer.

Close to 150 community students between 14–18 years' old were welcomed for work experience through our school partners in 2015/16

Over 25 years of the CCBS

Over 2,100 seminars

Over 26,000 delegates

From 176 central banks

Protecting the environment

Key to the Strategic Plan is a commitment that we will be accountable for our actions and their consequences. This extends to our responsibility to minimise the impact the Bank has on the environment, through reducing our consumption of natural resources and managing our waste production and disposal. To support this commitment the Bank has signed up to RE:FIT London which is an award-winning programme to help make London's non-domestic public buildings and assets more energy efficient.

Key initiatives

Energy Management Systems

The Bank uses Building Management Systems (BMS) to control and monitor the status of building services including: lighting, heating, cooling, ventilation and environmental control. During 2015/16 the Bank introduced, as part of an ongoing programme, Energy Management Systems (EMS) in our Threadneedle Street and Debden buildings to supplement the BMS and optimise performance through enhanced monitoring and measurement of energy use across the institution.

Light Emitting Diodes (LEDs)

LEDs are an extremely energy efficient form of lighting. They consume up to 90% less power than incandescent bulbs and have a much greater life expectancy resulting in a significant decrease in energy consumption and reduced maintenance. During 2015/16 we have continued our ongoing programme of rolling out LEDs across the Bank as older incandescent bulbs require replacement.

Our commitment to reduce our consumption of natural resources is reflected in the progress we have made against the Carbon Reduction Commitment (CRC). The CRC is a mandatory scheme aimed at improving energy efficiency and cutting emissions in large public and private sector organisations. Since 2013/14, the Bank has reduced its CO_2 emissions per employee from 7.5 tonnes to 5.7 tonnes, equivalent to a fall of around 25% over the period.

Cleaning our building

During 2015/16 the Bank undertook a scheduled clean of the façade of its Threadneedle Street premises. The Bank took this as an opportunity to reduce its environmental impact by appointing a company with outstanding environmental performance. The cleaning process resulted in a significant reduction in water usage, and removed the need for scaffolding with the negative environmental impact that would have had on the local area.

Recycling and reusing

The Bank is proud of the systems we have in place to reduce our wastage. More than 98% of waste — equivalent to over 1,100 tonnes — is diverted from landfill and either recycled or used to produce power at an award-winning 'Energy from Waste' facility.

To reduce our impact on forestry, the Bank's main publications, including this *Annual Report*, are available digitally online. To the extent that they are printed, the paper contains 75% post-consumer recycled fibre and 25% virgin fibre sourced from well-managed, responsible, Forestry Stewardship Council® (FSC) certified forests. Consequently, our publications are certified as a FSC® mixed sources product. The Bank also participates in HM Government's Re-use scheme through which we reuse and donate equipment with UK government departments.

98% of waste recycled or reused

More than 98% of our waste — equivalent to over 1,100 tonnes — is recycled or reused

Disposal of banknotes

Each year the Bank recycles around 700 million paper banknotes into briquettes that are used to make compost for agriculture. Looking ahead to the introduction of the new £5 polymer note in September 2016, the Bank has commissioned an independent study to assess the environmental impact of the Bank's polymer banknotes over their entire life cycle. The study demonstrated that polymer banknotes have a lower environmental impact overall due to their longer life — expected to be over 2.5 times that of currently circulating paper banknotes. The polymer notes' higher environmental performance is mainly due to the reduced environmental burdens associated with raw material production and processing of new banknotes to replace unfit ones. The Bank is currently investigating a number of options to identify the most sustainable way for recycling polymer banknotes when they become unfit for use.

700m

Around 700 million banknotes are recycled each year into briquettes used to make compost for agriculture

Report of the Remuneration Committee

The Remuneration Committee (RemCo) advises Court and its Oversight Committee on the remuneration of the Governors, other senior executives and the external members of the MPC, the FPC and the PRA Board.

The Committee also advises on major changes to remuneration structures within the Bank, including pension schemes.

Remuneration policy

The Committee's policy is 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 for senior roles in the Bank, while bearing in mind the Bank's position within the public sector.

In April 2015, we implemented the new 'One Bank' reward scheme. It introduced a new set of pay scales, a fixed benefits allowance of 7%, and a discretionary performance award pot of 10%, reducing the differences that had historically existed between employees from different heritages. For example, historically, former Financial Services Authority (FSA) colleagues had had a discretionary performance award pot of 15% and former Bank employees, one of 6%.

Prior to April 2015, three different pension schemes existed within the Bank. Those employees who joined the Bank before 2007 were on a final salary scheme; those who joined the Bank after 2007 were on a Career Average (CARE) scheme at 1/65th accrual rate; and former FSA employees were on a defined contribution scheme. The 'One Bank' reform introduced a single CARE scheme with multiple accrual rates; and the Bank's final salary scheme, which had been closed to new entrants since 2007, was closed to new accrual as of April 2015. All new employees to the Bank now receive an accrual rate of 1/95th, while existing employees — Bank and ex-FSA — received a starting accrual rate geared towards broadly maintaining their overall remuneration. Former final salary members, for example, receive a starting accrual rate of 1/50th while former FSA employees receive a starting accrual rate of 1/95th, and former CARE members 1/65th. These differences are taken into account when setting other elements of remuneration. Employees have flexibility to exchange pension accrual for income and *vice versa*, and to stop pension accrual entirely when tax limits are reached.

The objective of the new scheme was to create consistency across the Bank, enabling career moves, while aligning the Bank's pension model more closely to the rest of the public sector and reducing the risks associated with a final salary scheme. The new scheme has been effective in allowing staff to manage their pension accrual on a consistent basis, and by providing fair and market-consistent rates the Bank has been able to moderate the growth of its pension liabilities and thus to reduce its exposure to further longevity improvements.

The Governors

The Governor is appointed by the Crown for a non-renewable term of eight years, and Deputy Governors are each appointed by the Crown for five-year terms, which may be renewed once. As office-holders, the Governors have no termination provisions, although RemCo has discretion to impose a period of restricted duties, of up to six months, before individuals can accept roles outside the Bank. The Executive Directors, who have normal employment contracts, are subject to a notice period of up to six months.

Under the Bank of England Act 1998, Governors and Deputy 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 waived or surrendered to the Bank. The only such directorships held during the past year have been the (statutory) appointment to the Financial Conduct Authority Board held by Mr Bailey, and the appointments to the Board of the Bank for International Settlements held by Mr Carney and Sir Jon Cunliffe.

The Governors do not participate fully in the flexible pension arrangements described above. Since 2007, any new Governor or Deputy Governor has been enrolled into the Career Average section of the Bank Pension Fund, but when relevant tax limits are reached they may choose to reduce their accrual rates or to opt out altogether and receive a salary supplement of 30% in lieu. They may also choose to increase pension accrual subject to a reduction in salary calculated at rates consistent with the Bank's funding valuation.

Governors and Deputy Governors receive no bonuses or other performance-related pay. It is the Bank's policy to provide for relocation support as necessary to those appointed to senior positions. Such support was provided to Mr Carney in 2013,[1] and to Kristin Forbes, who joined the MPC in 2014.

Remuneration levels

The salaries of the Governor and the Deputy Governors are reviewed each year.

The remuneration arrangements for the present Governor were agreed and announced in January 2013, and were set out in the *Annual Report* 2013. The Governor's salary was set at £480,000p.a., with membership of the Career Average section of the Bank Pension Fund or 30% of salary in lieu. The Governor has since then declined to accept the increases in pay proposed by RemCo for the Governors as a group.

The Deputy Governors, including Dame Minouche Shafik[2] and Charlotte Hogg, are paid at a standard rate, which was increased by 2% in March 2014, 1.5% in March 2015 and 1% in March 2016. Sir Jon Cunliffe and Mr Bailey both received 30% of salary in lieu of pension accrual; Mr Carney and Mr Broadbent are both members of the Career Average section of the Bank Pension Fund, as are Dame Minouche Shafik and Charlotte Hogg. During the year Mr Broadbent received additional pension contribution and an appropriate reduction in his salary.

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. Insurances, relocation assistance and health checks were the principal other non-salary benefits received by Governors during the year.

1 2014 *Annual Report*, page 50.

2 During the year Dame Minouche Shafik and Charlotte Hogg were both employed by the Bank on terms identical to the Deputy Governors appointed under statute. Dame Minouche's position, as Deputy Governor for Markets and Banking, is provided for in amendments to the Bank of England and Financial Services Act 2016 that will come into force later this year.

£	Mr M J Carney 2015/16	Mr M J Carney 2014/15	Mr A J Bailey 2015/16	Mr A J Bailey 2014/15	Sir Charles Bean 2015/16	Sir Charles Bean 2014/15	Sir Jon Cunliffe 2015/16	Sir Jon Cunliffe 2014/15
Base salary	480,000	480,000	267,946	263,986	–	153,992	267,946	263,986
Fees	–	–	–	–	–	–	–	–
Salary and fees	**480,000**	**480,000**	**267,946**	**263,986**	**–**	**153,992**	**267,946**	**263,986**
Taxable benefits	**251,734**	**251,633**	**578**	**2,791**	**–**	**1,250**	**1,518**	**1,320**
Pension benefits	145,584	148,140	–	–	–	–	–	–
Payment in lieu of pension	–	–	80,384	79,196	–	–	80,384	79,196
Pension benefits	**145,584**	**148,140**	**80,384**	**79,196**	**–**	**–**	**80,384**	**79,196**
Other remuneration	**2,167**	**2,095**	**1,402**	**1,349**	**–**	**770**	**1,438**	**1,382**
Total remuneration	**879,485**	**881,868**	**350,310**	**347,322**	**–**	**156,012**	**351,286**	**345,884**

£	Dr B Broadbent 2015/16	Dr B Broadbent 2014/15	Dame Minouche Shafik 2015/16	Dame Minouche Shafik 2014/15	Ms C Hogg 2015/16	Ms C Hogg 2014/15	Non-executive Directors 2015/16	Non-executive Directors 2014/15
Base salary	240,928	175,991	267,946	153,992	267,946	263,986	–	–
Fees	–	–	–	–	–	–	171,750	162,833
Salary and fees	**240,928**	**175,991**	**267,946**	**153,992**	**267,946**	**263,986**	**171,750**	**162,833**
Taxable benefits	578	709	10,832	709	–	179	3,292	13,655
Pension benefits	**104,586**	**54,080**	**82,009**	**47,180**	**81,765**	**74,330**	–	–
Payment in lieu of pension	–	–	–	–	–	**6,600**	–	–
Pension benefits	**104,586**	**54,080**	**82,009**	**47,180**	**81,765**	**80,930**	**–**	**–**
Other remuneration	**1,402**	**634**	**1,444**	**835**	**1,444**	**1,391**	**–**	**–**
Total remuneration	**347,494**	**231,414**	**362,231**	**202,716**	**351,155**	**346,486**	**175,042**	**176,488**

The following table shows accrued pension for those Governors still active members of the pension scheme

	Accrued pension as at 29 Feb 16 £p.a.	Accrued pension as at 28 Feb 15 £p.a.	Increase in accrued pension £p.a.	Pensionable age
Mr M J Carney	20,000	12,500	7,500	65
Dr B Broadbent	8,000	2,700	5,300	65
Dame Minouche Shafik	6,500	2,400	4,100	65
Ms C Hogg	7,900	3,700	4,200	65

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. With effect from 1 June 2009, these rates were set at £15,000p.a. for Directors, £20,000p.a. for Committee Chairs, and £25,000p.a. for the Senior Independent Director and Deputy Chairman. The Chairman of Court is paid £48,000p.a. 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.

External members of the FPC, the MPC, and the PRA Board

The external members of the FPC, the MPC and the PRA Board are appointed on a part-time basis, and their remuneration reflects the different time commitments involved for each committee. In 2015/16, the external members of the FPC were each paid at a rate of £92,058p.a. and the independent PRA Board members were paid at a rate of £103,861p.a. The external MPC members' pay was increased by 7.6% during the year, to £148,200, so as to bring their hourly rate closer to that of the other two committees. For 2016/17, all fees were increased by 1%. MPC members, who work on average three days a week in the Bank, are also entitled to join the Bank's private medical insurance scheme.

Members of the policy committees (including the PRA Board) must not during their terms of office retain or accept other appointments or interests that would create a conflict with their responsibilities at the Bank. On leaving the Bank, members are paid their fee for a further 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 requires continued adherence to the relevant Committee's code of conduct.

Executive Directors' salaries and benefits

Executive Directors are on the new 'One Bank' reward scheme described above. Their remuneration is comprised of their salaries, a 7% flexible benefit allowance (which may be exchanged for a range of benefits or taken as non-pensionable cash), a discretionary performance award pool of 10% and a Career Average defined benefit pension. The first table below shows, for Executive Directors serving at the end of 2015/16, the first two elements of their remuneration as well as their individual pension accrual rates. The Remuneration Committee determines their salaries and in doing so takes into account the differences in their pension to achieve a greater consistency in total reward.

RemCo determines performance awards (bonuses) from a pool currently equal to 10% of salary on the basis of recommendations from the Governors as to their performance for the year. Performance is assessed on the basis of both objectives and values and both play a part in determining the appropriate performance award. Formerly Bank terms included a discretionary pool of 6% and FSA terms a discretionary pool of 15%. While former FSA employees have seen a decrease in their performance award pot and benefit allowances, this has been compensated with an improvement in their pension arrangements.

While all Executive Directors are now within the CARE pension scheme, they do have different starting accrual rates depending on their heritage (as described above). These are shown in the table below.

£ Year to 29 February 2016	Salary	Benefits	Pension accrual fraction
Sonya Branch	156,903	10,983	1/95th
Alex Brazier	175,000	12,250	1/50th
Megan Butler	222,295	15,561	1/95th
Ralph Coates	202,878	14,201	1/65th
John Finch	209,848	14,689	1/65th
Paul Fisher	182,088	12,746	1/50th
John Footman	187,295	13,111	1/65th
Andrew Gracie	179,928	12,595	1/65th
Andy Haldane	182,088	12,746	1/50th
Andrew Hauser	158,329	11,083	1/50th
Lyndon Nelson	220,145	15,401	1/95th
Joanna Place	157,639	11,035	1/50th
David Rule	222,295	15,561	1/95th
Chris Salmon	182,088	12,746	1/50th
Jenny Scott	151,650	10,616	1/65th
Sam Woods	208,401	14,588	1/95th

A key feature of the scheme is that it allows staff to vary their rate of pension accrual, either by surrendering pension accrual for a cash supplement or by sacrificing salary to secure more pension. Choices can be made each year. An essential feature of such a scheme is that the rates at which pension was exchanged for cash and *vice versa* are fair both to the individuals and to the Bank. This means that they have to be consistent with the scheme funding valuation, and that they are updated each year to reflect market movements and changes in actuarial assumptions. Currently these rates are elevated by the very low levels of risk-free interest rates, and for 2015/16 ranged from 24.5% of salary (1/95th accrual) to 46.5% of salary (1/50th accrual). What these valuations do not take account of is the mitigation of longevity risks that result from an overall lower accrual rate, and the potential longer-term benefits to the Bank of that.

The Bank's overall pension contribution is driven by both the current CARE scheme, as well as the now closed final salary scheme. Long-serving employees from the Bank will have naturally built up a much greater accrued pension during their years of service and participation in the final salary scheme. While the final salary scheme is now closed, any increases in salary for those individuals will result in a consequent increase in their accrued pension which in turn will drive the Bank's contribution. The table below shows the accrued pension in the Bank's defined benefit schemes of those Executive Directors who were active members during the year. It does not reflect their positions in other pension schemes, including the FSA's. It also identifies those Executive Directors who have stopped further accrual and therefore receive cash in lieu at the rates listed above.

	Accrued pension £p.a. Feb 16	Accrued pension £p.a. Feb 15	Increase in pension £p.a.	Pensionable age
Sonya Branch	1,960	0	1,960	65
Alex Brazier	46,656	29,093	17,563	60
Megan Butler	2,144	0	2,144	65
Ralph Coates	5,433	2,288	3,145	65
John Finch	3,807	2,048	1,759	65
Paul Fisher*	–	–	–	60
John Footman*	–	–	–	
Andrew Gracie	10,478	8,103	2,375	65
Andrew Haldane	83,816	80,657	3,159	60
Andrew Hauser	72,902	56,040	16,862	60
Lyndon Nelson*	–	–	–	
Joanna Place*	87,808	84,178	3,630	60
David Rule	2,546	0	2,546	65
Chris Salmon*	–	–	–	60
Jenny Scott	5,161	2,276	2,885	65
Sam Woods	2,071	0	2,071	65

*Denotes those who have opted out of further pension accrual and receive cash in lieu.
Mr Footman and Mr Nelson have currently no pension in the Bank scheme; Mr Fisher was granted a deferred pension of £76,872p.a. and Mr Salmon was granted a deferred pension of £73,253, both in 2014.

Other Senior Executives' salaries and benefits

The following table shows remuneration ranges for the year to February 2016 for all staff below Executive Director level with remuneration in excess of £80,000p.a. on a full-time equivalent basis, excluding employer pension contributions and performance awards.

All staff participate in the career average defined benefit pension with flexible accrual rates; and in the flexible benefits scheme worth 7% of base pay. Discretionary performance awards are paid from a pool equal to 10% of salaries.

Remuneration range £	Number of staff
200,000–249,999	4
190,000–199,999	5
180,000–189,999	10
170,000–179,999	10
160,000–169,999	16
150,000–159,999	29
140,000–149,999	30
130,000–139,999	45
120,000–129,999	49
110,000–119,999	80
100,000–109,999	102
90,000–99,999	173
80,000–89,999	238
Total	**791**

Dido Harding
Chairman of Remuneration Committee

Report of the Oversight Committee

The Oversight Committee consists of the Bank's Non-executive Directors. The Committee is responsible for monitoring the Bank's performance against its objectives — that is, the statutory objectives for monetary policy and financial stability, and the objectives set by Court itself — and the Bank's financial management, including the efficient use of its resources.

The Committee is required to make a Report on the matters for which it is responsible. The Review of 2015/16 (page 15), the Financial Review (page 38), the Report on Risk Management and Business Practices (page 46), the Corporate Social Responsibility Report (page 54), the Report of the Remuneration Committee (page 65) and the Report of the Audit and Risk Committee (page 79) should, insofar as they relate to the Committee's responsibilities, all be regarded as part of this Report.

Changes to Bank governance

As described on page 7, the Bank of England and Financial Services Act 2016 provides that the functions of the Committee will in future be carried out by Court itself. This change, which was initially proposed by the Bank,[1] reflects the way in which the Committee has in practice operated, conducting most of its business in meetings with the executive members of Court present. The non-executives will continue to meet separately, as a matter of good practice, after each meeting of Court and at other times when necessary. And the non-executives will continue to have the right to attend meetings of the MPC, the FPC and the new Prudential Regulation Committee (PRC), and to have access to their policy papers. Provisions for the commissioning of Reviews of aspects of the Bank's work also continue unchanged. The Committee believes that this formal return to a conventional unitary Board structure will be more efficient and conducive to the good governance of the Bank.

Independent Evaluation Office

The Independent Evaluation Office (IEO), which was formed in 2014 under a Director reporting directly to the Chairman of Court, supports the Committee and Court in discharging the oversight functions. During the year the IEO completed reviews of the Bank's performance in economic forecasting and of the PRA's approach to its secondary competition objective. Both of these reports were published, and made recommendations for change which the Bank is implementing. During the coming year the IEO has proposed and agreed with Court two further reviews: one into the Bank's approach to the supervision of FMI — clearing and settlement — entities; and another into the PRA's supervision of insurance firms.

The IEO has also arranged in-depth briefings for the non-executives on issues that may be discussed in Court or the subject of future reports. In the current year these have included FEMR (page 22), the Bank's banking operations, the structural reform project, the RTGS review (page 34), the Sterling Monetary Framework, the Bank's framework for providing emergency liquidity assistance, the resilience of the Bank and the financial sector to cyber attack, the Bank's arrangements for monitoring financial risk and the Bank's talent management framework.

1 See 2015 *Annual Report*, page 1.

Policy committee processes

The Committee has kept under review the processes of the FPC, the MPC and the PRA Board. In doing so it benefits from the ability to observe the meetings of those committees, and the Chairman undertakes a formal annual review based on a questionnaire and individual meetings with the members.

The FPC

The FPC has made rapid progress over the past year. Key areas of progress have been setting the capital framework for UK banks and the countercyclical capital buffer, the continued development of the stress-testing framework and — with the PRA Board — initiatives to contain the risks in buy-to-let lending. The Committee has also responded to evidence of fragile liquidity in some fixed-income markets and has commissioned work on the activities of investment funds and on the reliance of UK corporate finance on market-based sources of finance. Court members have noted that the Committee's deliberations were well-informed and robust.

A structured survey of all FPC members showed a marked improvement in perceptions of the quality of Bank support for the Committee. There were three issues for improvement, all of which are being addressed. First, the process for drafting and approving the FPC record was seen as inefficient: this is being changed to bring in new authors and better co-ordination. Second, members were concerned about the effectiveness of the Committee's communications: in response the *Financial Stability Report* had been reorganised to differentiate more clearly between risk and resilience, and a pull-out executive summary has been introduced. Third, there was an appetite for more interaction with the FCA given the Committee's concerns about market risks.

The MPC

During the year the MPC adopted most of the recommendations of the Warsh Review, and from October will move to meeting eight times each year (which has required a change in legislation). The combined publication of the decision and the Minutes (with the *Inflation Report*) has worked well operationally. All members are positive about the quality of research and other support they receive from the Bank. They were less positive about the effectiveness of forecast processes, but in the light of the IEO's study of the Bank's forecasting record, Monetary Analysis staff have developed a more systematic approach to analysing the MPC's forecast performance. Committee members have also been concerned to ensure that staff seconded to work for individual members are not disadvantaged in career terms. This issue is being addressed by management in MA.

The PRA Board

The PRA Board meets much more frequently than the MPC and the FPC and has a large and varied flow of business. It is required to make Rules and Policy Statements of the PRA, and also under its agreed delegations approves key decisions in relation to major firms. It is thus responsible for the execution as well as the formulation of policy. There is some concern among Board members that this drives the non-executives too much into the detail of day-to-day supervision, and the Board has attempted to address this by seeking more structured management information to provide assurance that individual supervisory decisions across the PRA are consistent with the Board's supervisory risk tolerance. These issues will need to be addressed as much by the new PRC as by the present PRA Board, as the Bank's functions as PRA are to be exercised through the PRC.

Joint meetings
During the year there have been two joint meetings of the MPC and the FPC, and six joint meetings of the FPC and the PRA Board. It was clear from the survey responses that more work was required to make these meetings fully effective and this has been addressed by the Governors.

The National Audit Office (NAO) and the Bank

The Bank of England and Financial Services Act 2016 provides a new basis for the NAO's engagement with the Bank. Hitherto the NAO has been auditor of the PRA, and has also been involved with the Bank as auditor of the Treasury's Exchange Equalisation Account (which holds the United Kingdom's foreign exchange and gold reserves). Under the new provisions, the financial audit of the Bank (including the PRA) will be conducted by a firm appointed by the Bank, but the NAO will be consulted about the appointment and about the audit plan, will have access to audit papers and will attend meetings of the Bank's audit committee relating to the audit. The NAO itself will audit activities of the Bank indemnified by the Treasury.

The NAO will also be able to conduct examinations of the 'economy, efficiency and effectiveness with which the Bank has used its resources in discharging its functions'. Court had been concerned about this provision on two grounds: first, that it should not impair the policy independence of the Bank's functions; and second, that it should not diminish the role of Court in overseeing the efficient use of the Bank's resources. The new Act meets these concerns in four ways: first by providing that an examination should not be concerned with the merits of the Bank's policy objectives; second, by providing that an examination must not be concerned with the policy decisions of the MPC, the FPC, the PRC or of the Bank Committees responsible for FMI supervision and Resolution policy; third, by providing for the Bank and the NAO to agree in a Memorandum of Understanding (MoU) any further areas that the NAO would not normally examine; and fourth by providing for Court to be consulted about the scope of any examination before it starts. During the year a draft of the MoU was agreed between the Bank and the NAO and published in Parliament to aid consideration of the Bank of England and Financial Services Bill.

Codes of Conduct

During the year the Bank reviewed and updated its codes of conduct for staff, requiring all staff to attest that they understood, met and would continue to meet its requirements. These included requirements for escalation and the avoidance of conflicts of interest. The new Bank of England and Financial Services Act requires conflict codes to be drawn up for the MPC, the FPC and the PRC and those have been approved by Court and will be implemented on the coming into force of the legislation, following consultation with the Treasury. The existing MPC and FPC codes have been recast to cover communications issues only.

Compliance

The Committee welcomed the formation during the year of a new independent Compliance function, reporting to the General Counsel.

Investigations

As reported last year, issues around the conduct of some of the Bank's liquidity auctions during the crisis of 2007–08 were referred to the Serious Fraud Office (SFO). The Bank has been operating closely with the SFO in its investigation and the Oversight Committee has been kept informed of developments. The Bank has also provided documents relevant to several cases that the SFO has prosecuted during the year.

Court effectiveness

As in previous years, the Chairman of Court undertook a review of Court effectiveness during the year and the Senior Independent Director undertook a parallel review of the Chairman. The review was conducted through questionnaires to all members and a series of structured interviews. All members agreed that the Court and its sub-committees were effective and well-chaired, and there was strong support for the work of the IEO. Areas for improvement included finding more time to discuss strategic issues, including changes to the staffing model and succession planning, and finding clearer metrics for reports on performance. The evolution of the NAO relationship was seen as a potential concern for the coming year, as was the transition from the PRA Board to the PRC.

Members of Court attendance for Annual Report 2016

Attendance	Court (7)	Oversight (7)	Audit & Risk (6)	RemCo (5)	NomCo (3)
Mr Habgood	7	7	6	5	3
Mr Stewart (resigned 30.11.15)	4 of 5	4 of 5	2 of 2	4 of 4	1 of 1
Mr Cohrs (resigned 31. 5.15)	2 of 2	2 of 2	–	1 of 1	–
Mr Fried	7	7	6	–	3
Mr Frost	7	7	5 of 6	1 of 1	–
Mr Prentis	6 of 7	5 of 7	–	5	–
Baroness Harding	6 of 7	6 of 7	–	5	–
Mr Robert	7	7	6	–	–
Ms Thompson	6 of 7	5 of 7	5 of 5	–	2 of 2
Mr Carney	7	*	–	–	0 of 1
Mr Bailey	7	*	4 of 6	–	–
Sir Jon Cunliffe	6 of 7	*	–	–	–
Mr Broadbent	7	*	–	–	–

* Governor/Deputy Governors may attend meetings of the Oversight Committee by invitation.

Report of the Audit and Risk Committee

Introduction

This report provides an overview of the work of the Audit and Risk Committee (ARCo) and how it has discharged its duties over the year. The body of the report is split into two sections — '*risk*' and '*audit*' — reflecting the components of the Committee's remit.

Meetings and attendance

The Court of Directors monitors the Bank's risks and controls and the integrity of its financial statements mainly through ARCo. The Committee's remit is set out in 'Matters Reserved to Court'.[1]

ARCo is comprised of four Non-executive Directors of Court, with wide and recent experience of company board practice and risk control. The Chairman of ARCo is appointed by Court.

ARCo met six times during the year. The Chairman of Court, the Deputy Governor and Chief Executive Officer for the PRA, the Deputy Governor for Markets and Banking, the Chief Operating Officer, the Finance Director, the Executive Directors for Markets and for Banking, Payments and Financial Resilience, the Head of Internal Audit, the Head of Risk, and a Non-executive Director of the PRA attend ARCo meetings by invitation. The Bank's external auditors and the National Audit Office which audits the PRA attend relevant parts of ARCo meetings.

In addition to its scheduled meetings, the Committee members hold separate private meetings with the Governor and Deputy Governors, the Chief Operating Officer, and the internal and external auditors so that they can have an open discussion without the Bank Executives present.

The Chairman of ARCo regularly meets the Chief Operating Officer, the Finance Director, the Heads of Risk and Internal Audit as well as with other Bank Executives outside the formal ARCo meetings.

Section 1 — risk-related items

Risk management framework

During the year, ARCo oversaw the introduction and bedding in of the Bank's revised risk management framework. Under that framework, the Bank's Executive Risk Committee (ERC), is responsible for the operation of its risk governance framework including monitoring its overall risk profile. The ERC held regular meetings during the year, reporting to the Deputy Governor for Markets and Banking and the Chief Operating Officer. Management of the Bank's financial risks has been restructured within the Markets and Banking Directorate to provide greater opportunity for constructive challenge. The structure of the committees that support risk management in the Bank's market operations has also been reformed.

A new high-level Risk Tolerance Statement, setting out the Bank's risk tolerances and approach to risk management, was recommended by ARCo and approved by Court during the year.

Risk and control processes

ARCo is responsible for oversight of the effectiveness of the Bank's risk framework, risk management policies and processes, reviews regular reports on the risk profile of the Bank, and evaluates the actions being taken by management to bring these risks within tolerance. As part of these responsibilities, the Committee:

- Reviewed Quarterly Risk Reports from the Finance Director and Bank-wide Risk Division covering the main strategic, operational and financial risks to the Bank (including the PRA), including a forward-looking consideration of risks. During 2015/16 the Committee discussed risks including those

1 See page 7.

relating to the Bank's assumption of responsibility for administration of the SONIA benchmark. ARCo also considered the actions being taken by management to bring risks within tolerance.

- Received and considered regular reports from the Executive Director for Markets and from the Executive Director for Banking, Payments and Financial Resilience on developments relating to the Bank's balance sheet, including reviews of the balance sheet remit and collateral management, and sought assurance that the financial risks to the Bank's balance sheet were being managed effectively.

- Received and discussed the regular 'deep dive' individual Directorate Risk Drilldown Reports, including reports from the PRA Directorates, and provided feedback to the Directors.

- Received and discussed regular updates and reports from the Bank's Chief Operating Officer summarising major operational issues and control-related and risk issues including those relating to strategic and other key Bank initiatives. Areas of focus in 2015/16 included: actions taken forward following the Deloitte review of RTGS; the launch of Our Code[1] and the process for annual attestation; the implementation of the core principles of the Senior Managers Regime for the Bank;[2] the progress of the Bank of England Bill; the consultation on and implementation of the closure of the Bank's personal banking services; and the employee engagement survey.

As part of its oversight of the effectiveness of the Bank's systems of internal control, the Committee:

- Received regular reports on the management of current significant projects and related controls. In 2015/16 these included Solvency II; major collateral projects; and the Information Security programme.

- Received regular updates from the Executive Director for Technology and from Information Security on initiatives and projects relating to information technology and data architecture, cyber risk and systems resilience and security.

- Assessed reports from the internal and external auditors to ensure that necessary standards of risk management were being applied and that appropriate action was being taken in relation to significant incidents and to major projects. In particular, the Committee received assurance regarding the Bank's new arrangements for monitoring and valuing collateral.

- Reviewed annual reports on controls in place against business practice risk, including Notes Division's report on the counterfeit threat to the Bank's issue of banknotes; a report on the Bank's insurance arrangements; a report on business continuity; a report on Freedom of Information (FoI) requests received by the Bank; a Health and Safety annual update; and an update on pension administration and payroll outsourcing arrangements.

- The Committee reviewed and approved the Bank's arrangements for its employees to raise concerns in confidence, 'Speaking Up' (whistle-blowing) and considered the annual report on this subject from the Bank Secretary.

1 See page 60.

2 See page 24.

Section 2 — audit-related items

Integrity of financial reporting

In terms of discharging its responsibilities in relation to monitoring the integrity of the Bank's Annual Financial Report, ARCo:

- Reviewed the accounting policies and practices adopted in the preparation of the Bank's annual financial statements.
- Reviewed the annual financial statements for the Bank and PRA before their submission to Court at its May 2016 meeting, including the adequacy of the disclosures made. Supporting these, the Annual Risk Control attestations were also provided to the Committee.
- Reviewed reports from the Finance Director, including regular accounting updates, and an annual update on taxation.

External auditors

In relation to the external auditors, ARCo:

- Received and discussed regular updates from KPMG, the Bank's external auditors, and from the NAO, the PRA's external auditors. These included the nature and scope of the external audit plans for the Bank and PRA and a review of the findings of the audits.
- Reviewed the external auditors' Management Letters for the Bank and the PRA.
- Assessed the extent to which non-audit services were provided by KPMG to the Bank and the associated fees.

Internal Audit

The Internal Audit Division evaluates the design and effectiveness of the governance, internal controls and risk management processes that exist across the Bank to provide Court and Executive Management with assurance over the control environment in the Bank. The Head of Internal Audit reports to the Chair of ARCo and has direct access to the Audit and Risk Committee and Executive Management.

In relation to the Bank's Internal Audit, the Committee:

- Considered and approved the remit, resources and budget for the Internal Audit function and confirmed that it was satisfied that the Internal Audit function had appropriate resources.
- Reviewed and approved the Internal Audit plan and monitored its execution, including progress in respect of recommendations made.
- Considered major findings arising from Internal Audit's work, and reviewed and monitored management's responsiveness to Internal Audit's findings and recommendations.

Audit and Risk Committee effectiveness

The effectiveness of ARCo was reviewed as part of the 2015/16 evaluation of Court and its sub-committees.

Other responsibilities

The Committee reviewed a summary of the annual expenses of the members of Court.

Audit and Risk Committee: regular attendees 2015–16[1]

ARCo members	ARCo meetings (6)
Bradley Fried (Chairman)	6
Tim Frost	5 of 6
Don Robert	6
Dorothy Thompson	6
Anthony Habgood[2]	6
Executive	
Andrew Bailey	5 of 6
Minouche Shafik	4 of 6
Charlotte Hogg	6
Ralph Coates	6
Paul Fisher	2 of 2
Andrew Hauser	4 of 4
Chris Salmon	4 of 6
Internal Auditor	
Stephen Brown	6
External Auditor (KPMG)	
David Todd (KPMG)	5 of 6
Satish Iyer (KPMG)	6
NAO[3]	
Nick Bateson	3 of 6
Alex Clark	1 of 6
Stephen Corbishley	1 of 6
Marc Nuttall	1 of 6
Stephen Smith	1 of 6
Mark Yallop (PRA)	6
David Thorburn (PRA)[4]	1 of 1

1 Covering ARCo meetings held on 2 July, 13 October and 3 December 2015, and 1 February, 18 April and 9 May 2016.

2 Anthony Habgood is not a member of the Committee but attends the meetings by invitation.

3 NAO attend meetings on PRA-related items and to present their report.

4 Attended the meeting as an observer.

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 29 February 2016 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 29 February 2016 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 89 to 97.

The Directors who held office at the date of approval of this *Annual 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 United Kingdom 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 29 February 2016, set out on pages 84 to 135, and the statements of account of the Issue Department ('statements of account') for the year ended 29 February 2016, set out on pages 136 to 140. 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 81, 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 89 and note 2 on pages 89 to 96 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 and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. 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 84 to 135 for the year ended 29 February 2016 have been properly prepared, in all material respects, in accordance with the bases of preparation set out in note 2 on pages 89 to 96.

- the statements of account of the Issue Department on pages 136 to 140 for the year ended 29 February 2016 have been properly prepared, in all material respects, in accordance with the bases of preparation set out in note 1 on page 138.

Opinion on other matter

In our opinion the information given in the Report of the Remuneration Committee, 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 LLP,
Statutory Auditor

Chartered Accountants
15 Canada Square
Canary Wharf
London E14 5GL

27 June 2016

Banking Department statement of income
for the year to 29 February 2016

	Note	2016 £m	2015 £m
Net interest income		15	12
Fee income	4	182	155
Trading income	4	214	192
Management fees	4	191	181
Other income	4	24	29
Net operating income		**626**	**569**
Staff costs	5	(354)	(330)
Infrastructure costs	4	(84)	(84)
Administration and general costs	4	(111)	(96)
Less: Costs recharged to the PRA	4	156	139
Operating expenses		**(393)**	**(371)**
Profit before tax		**233**	**198**
Taxation	7	(24)	(19)
Profit after tax		**209**	**179**

The notes on pages 89 to 135 are an integral part of these financial statements.

The income statement has been represented to show gross costs incurred by the Bank less costs recharged to the PRA.

Banking Department statement of comprehensive income
for the year to 29 February 2016

	2016 £m	2015 £m
Profit for the year attributable to shareholder	**209**	**179**
Other comprehensive income/(loss) that may be recycled to profit or loss:		
Available for sale reserve		
Net gains/(losses) from changes in fair value	920	119
Current and Deferred tax	(162)	(24)
Property revaluation reserve		
Net gains from changes in fair value	34	51
Deferred tax	(5)	(10)
Total other comprehensive income/(loss) that may be recycled to profit or loss	**787**	**136**
Other comprehensive income/(loss) not recycled to profit or loss:		
Retirement benefit remeasurements	358	162
Deferred tax	(58)	(32)
Total other comprehensive income/(loss) not recycled to profit or loss	**300**	**130**
Total comprehensive income/(loss) for the year	**1,296**	**445**

The notes on pages 89 to 135 are an integral part of these financial statements.

Banking Department statement of financial position
as at 29 February 2016

	Note	2016 £m	2015 £m
Assets			
Cash and balances with other central banks	9	637	1,005
Loans and advances to banks and other financial institutions	10	12,706	11,662
Other loans and advances	11	375,198	375,198
Securities held at fair value through profit or loss	12	7,190	5,160
Derivative financial instruments	13	488	1,251
Available for sale securities	14	7,944	6,994
Investments in subsidiaries	15	–	–
Inventories	16	2	–
Property, plant and equipment	17	392	341
Intangible assets	18	18	12
Retirement benefit assets	19	932	540
Other assets	20	251	410
Total assets		**405,758**	**402,573**
Liabilities			
Deposits from central banks	21	15,355	15,601
Deposits from banks and other financial institutions	22	324,546	318,576
Other deposits	23	55,583	60,432
Foreign currency bonds in issue	24	4,333	3,898
Derivative financial instruments	13	476	46
Current tax liabilities		34	10
Deferred tax liabilities	25	341	128
Retirement benefit liabilities	19	194	208
Other liabilities	26	306	275
Total liabilities		**401,168**	**399,174**
Equity			
Capital	27	15	15
Retained earnings		3,011	2,607
Other reserves		1,564	777
Total equity attributable to shareholder		**4,590**	**3,399**
Total liabilities and equity attributable to shareholder		**405,758**	**402,573**

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

Mr M Carney Governor
Mr B Broadbent Deputy Governor
Mr A Habgood Chairman of Court
Mr R Coates Finance Director

Banking Department statement of changes in equity
for the year to 29 February 2016

		Attributable to equity shareholder				
	Note	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings £m	Total £m
Balance at 28 February 2014		**15**	**482**	**159**	**2,391**	**3,047**
Post-tax comprehensive income/(loss) for the period		–	95	41	309	445
Payable to HM Treasury in lieu of dividend	**8**	**–**	**–**	**–**	**(93)**	**(93)**
Balance at 28 February 2015		**15**	**577**	**200**	**2,607**	**3,399**
Post-tax comprehensive income/(loss) for the period		–	758	29	509	1,296
Payable to HM Treasury in lieu of dividend	8	–	–	–	(105)	(105)
Balance at 29 February 2016		**15**	**1,335**	**229**	**3,011**	**4,590**

The notes on pages 89 to 135 are an integral part of these financial statements.

Banking Department statement of cash flows
for the year to 29 February 2016

	Note	2016 £m	2015 £m
Cash flows from operating activities			
Profit before taxation		**233**	**198**
Adjustments for:			
Amortisation of intangibles	18	3	2
Depreciation of property, plant and equipment	17	19	17
Dividends received	4	(10)	(9)
Net movement in accrued interest and provisions, including pensions		182	924
Changes in operating assets and liabilities:			
Increase in loan advanced to the Bank of England Asset Purchase Facility Fund Ltd		–	–
Net (increase)/decrease in other advances		556	(1,714)
Net increase/(decrease) in securities held at fair value through profit and loss		(2,046)	521
Net increase in deposits		874	2,917
Net increase/(decrease) in foreign currency bonds in issue		465	4
Net (increase)/decrease in financial derivatives		1,193	(1,491)
Net decrease in other accounts		14	28
Net increase in inventories		(2)	–
Corporation tax (paid)/received		(11)	(6)
Net cash inflow from operating activities		**1,470**	**1,391**
Cash flows from investing activities			
Purchase of available for sale securities		(532)	(940)
Proceeds from redemption of available for sale securities		427	315
Dividends received	4	10	9
Purchase of intangible assets		(6)	(3)
Purchase of property, plant and equipment		(30)	(40)
Net cash outflow from investing activities		**(131)**	**(659)**
Cash flows from financing activities			
Payment to HM Treasury under Section 1 (4) of the Bank of England Act 1946		(93)	(80)
Net cash outflow from financing activities		**(93)**	**(80)**
Net increase in cash and cash equivalents		**1,246**	**652**
Cash and cash equivalents at 1 March	28	5,428	4,776
Cash and cash equivalents at 29 February	**28**	**6,674**	**5,428**

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 136 to 140, and show the note issue, the assets backing the issue, the income generated by those assets and the costs incurred in the production, issue, custody and payment of notes. The net income of the Issue Department is paid over to the National Loans Fund. Securities held by the 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 statement of income, the statement of comprehensive income, the statement of financial position, 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 financial stability objective.

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, financial liabilities (including derivatives) that are held at fair value through profit or loss and retirement benefit assets and liabilities.

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 financial stability objective.

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:

- Presentation of the Statement of Income disclosures.
- Operating segments.
- Contingent liabilities and guarantees.
- Information on credit and liquidity 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 non-EU endorsed standards which have not been adopted in the financial statements, comprising IFRS9 Financial Instruments, IFRS15 Revenue from Contracts with Customers and IFRS16 Leases.

Initial impact assessments have been performed, implementation will be in line with effective dates.

c Consolidation

The financial statements of the 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 measured at amortised cost

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:

- Secured lending 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.

The Bank defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

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 97.

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.

Notes to the Banking Department 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.

No impairments to financial assets have been recognised in the year.

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 seventy-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 less any residual value. 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.

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.

Notes to the Banking Department financial statements continued

2 Bases of preparation continued

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, as this is considered to be the price that would be paid to transfer a liability in an orderly transaction between market participants.

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 career average pensionable pay. The final salary element of the scheme is closed to future accrual for service but a link to final salary remains for current active 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.

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 continued to be active members within the FSA pension plan, which operated on a defined contribution basis until 31 March 2015. The Bank continued to make fixed contributions for employees into this scheme which are accounted for as contributions in the period they relate to. From 1 April 2015 all members within the FSA pension plan transferred to the Bank's defined-benefit pension scheme, contributions are no longer made by the Bank to the FSA pension plan.

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, with a corresponding liability reflecting the obligation to make these payments to HM Treasury.

Notes to the Banking Department financial statements continued

2 Bases of preparation continued

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 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 there is a constructive obligation and 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.

u Inventories

Inventories comprise the raw materials utilised in the production of polymer banknotes.

Inventories are valued at the lower of cost and net realisable value.

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 19, 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 29. 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 using an adjusted net asset value basis (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

In 2013 the Bank 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 made certain judgements in respect of; the current contract in place sub-letting the space, the contracted income receivable and an appropriate discount rate. The provision is included within note 26.

Notes to the Banking Department financial statements continued

4a Net operating income

	Note	2016 £m	2015 £m
Fee income			
Funding for Lending Scheme fees	30	160	132
Payment services fee income		12	13
Banking operations		10	10
Net fee income		**182**	**155**
Trading income			
Net income from financial instruments designated at fair value		23	(2)
Income from available for sale securities	14	191	194
Net trading income		**214**	**192**
Management fees			
Fee for services to BEAPFF	32	2	2
Charges to HM Government bodies	32	92	82
PRA corporate services fee	32	97	97
Total management fees		**191**	**181**
Other income			
Dividend income		10	9
Onerous lease provision release		–	–
Premises income		10	11
Compensation payment on Special Liquidity Scheme		–	8
Sundry income		4	1
Total other income		**24**	**29**
Net operating income (excluding net interest income)		**611**	**557**

4b Operating expenses

	Note	2016 £m	2015 £m
Infrastructure costs			
Property and equipment		54	57
Depreciation of property, plant and equipment	17	19	17
Operating lease rentals		7	8
Amortisation of intangible assets	18	3	2
Impairment of property, equipment and intangible assets		1	–
Less: PRA infrastructure recharge		(3)	(2)
Total infrastructure costs		**81**	**82**
Administration and general costs			
Consultancy, legal and professional fees		38	37
Subscriptions, publications, stationery and communications		5	5
Travel and accommodation		6	6
Other administration and general expenses		62	48
Less: PRA administration and general cost recharge		(18)	(15)
Total administration and general costs		**93**	**81**
Staff costs	**5**	**354**	**330**
Less: PRA staff cost recharge	5	(135)	(122)
Total staff costs	**5**	**219**	**208**
Operating expenses		**393**	**371**

Notes to the Banking Department financial statements continued

5 Staff costs

	2016 £m	2015 £m
Wages and salaries	271	253
Social security costs	28	25
Pension and other post-retirement costs	54	50
Costs of restructuring	1	2
	354	**330**

Of which PRA:

	2016 £m	2015 £m
Wages and salaries	102	99
Social security costs	11	11
Pension and other post-retirement costs	22	12
	135	**122**

Average number of employees

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

	2016	2015
Governors and other members of Executive Team	22	20
Managers and analysts	2,555	2,230
Other staff	1,406	1,430
	3,983	**3,680**

Of which deemed to work exclusively for the PRA:

	2016	2015
Governors and other members of Executive Team	5	4
Managers and analysts	1,028	894
Other staff	209	241
	1,242	**1,139**

The number of persons employed by the Bank at the end of February 2016 was 4,108 of which 3,650 were full-time and 458 part-time (2015: 3,868; with 3,463 full-time and 405 part-time). These include 1,285 persons deemed to work exclusively for the PRA of which 1,137 were full-time and 148 part-time (2015: 1,205; with 1,088 full-time and 117 part-time).

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

6 Auditor's remuneration

	2016 £000	2015 £000
For the period to 29 February 2016		
Fees relating to current year	260	260
Fees relating to prior year	27	17
Fees payable to the Auditor for services provided to the Bank		
Audit-related services	43	43
Taxation advisory services	7	25
All other services	–	16
	337	**361**

Fees of £30,000 for audit services in relation to Bank of England Asset Purchase Facility Fund Ltd were paid by the Bank and recovered via a management fee (2015: £30,000 for audit).

Audit-related services comprise £25,000 for providing assurance to HM Treasury on the allocation of costs (2015: £25,000), and £18,000 for the submission for Whole Government Accounts (2015: £18,000). Other non-audit fees principally relate to advisory services to the Bank.

Notes to the Banking Department financial statements continued

7 Taxation

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

	2016 £m	2015 £m
Current year corporation tax	14	8
Prior year corporation tax	(1)	1
Deferred tax – current year	10	12
Deferred tax – prior year	1	(2)
Tax charge on profit	**24**	**19**

The tax charged within the income statement differs from the amount calculated at the basic rate of tax on the profit for the year and is explained below:

	2016 £m	2015 £m
Profit before tax	**233**	**198**
Tax calculated at rate of 20.08% (2015: 21.17%)	47	42
Tax relief on payment to HM Treasury	(21)	(20)
Non-deductible expenses	–	1
Dividend not subject to corporation tax	(2)	(2)
Prior year items	–	(1)
Change in tax rate to 18% (2015: 20%)	–	(1)
Total tax charge for the period	**24**	**19**

Tax charged/(credited) to equity comprises:

	2016 £m	2015 £m
Tax (credited)/charged to equity through the statement of comprehensive income		
Current year corporation tax	23	8
Deferred tax	202	58
Tax (credited)/charged to equity	**225**	**66**

Tax charged/(credited) to equity comprises:

	2016 £m	2015 £m
Tax (credited)/charged to equity through the statement of comprehensive income		
Revaluation of available for sale securities	185	(19)
Use of tax losses brought forward	–	43
Revaluation of property	7	10
Remeasurements of retirement benefits	72	34
Change in tax rate to 18% (2015: 20%)	(39)	(2)
Tax (credited)/charged to equity	**225**	**66**

The main UK corporation tax rate was 20% for the year beginning 1 April 2015 (1 April 2014: 21%). The effective rate for the year ended 29 February 2016 is therefore 20.08% (2015: 21.17%).

The rate reduction on the deferred tax balances as at 29 February 2016 is disclosed in note 25.

Notes to the Banking Department financial statements continued

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

	2016 £m	2015 £m
Payable 5 April 2016 (2015: 3 April)	51	49
Payable 5 October 2016 (2015: 5 October)	54	44
	105	**93**

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%, on each of those dates, 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 29 February 2016. 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.

In the prior year the Bank and HM Treasury agreed to an additional payment in lieu of dividend of £7.75m paid 2 April 2015. This relates to the compensation received by the Bank for the reduction in Special Liquidity Scheme (closed 30 January 2012) fees received as a result of manipulation by Lloyds Bank plc and Bank of Scotland plc of submissions to the British Bankers' Association GBP repo rates.

9 Cash and balances with other central banks

	2016 £m	2015 £m
Balances with other central banks	637	1,005
	637	**1,005**

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

	2016 £m	2015 £m
Secured lending agreements held at amortised cost	2,177	1,529
Reverse repurchase agreements held at fair value through profit and loss	10,525	10,131
Other loans and advances	4	2
	12,706	**11,662**

These balances include advances, secured lending and reverse repurchase agreements arising as part of the Bank's open market operations, as well as advances matching the deposits taken (notes 21 to 23). 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 November 2014).

At 29 February 2016 loans and advances to banks and other financial institutions included cash and cash equivalents of £5,648m (2015: £4,048m) which are disclosed in note 28i.

11 Other loans and advances

	2016 £m	2015 £m
Loan to the Bank of England Asset Purchase Facility Fund Ltd	375,193	375,193
Term loans	5	5
	375,198	**375,198**

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 APF 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 APF 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 maintained the level of assets by the creation of central bank reserves at £375,000m. 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 (2015: £375,193m). Accrued interest of £133m on the loan is recognised in note 20.

12 Securities held at fair value through profit or loss

	2016 £m	2015 £m
Money market instruments	2,381	2,160
Listed foreign government securities	4,809	3,000
	7,190	**5,160**

The holdings of foreign government securities are funded by the Bank's issuance of medium-term securities (note 24) and fixed term deposits placed by other central banks.

At 29 February 2016 money market instruments included cash and cash equivalents of £389m (2015: £375m) which are disclosed in note 28i.

Notes to the Banking Department 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. 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, can fluctuate significantly over time. The fair values of derivative instruments are set out below.

a As at 29 February 2016

	Contract notional amount £m	Fair Values	
		Assets £m	Liabilities £m
Cross-currency interest rate swaps	3,196	367	(48)
Interest rate swaps	6,282	17	(19)
Forward exchange contracts	14,184	104	(409)
Total recognised derivative assets/(liabilities)		**488**	**(476)**

b As at 28 February 2015

	Contract notional amount £m	Fair Values	
		Assets £m	Liabilities £m
Cross-currency interest rate swaps	3,011	510	(26)
Interest rate swaps	5,872	8	(18)
Forward exchange contracts	13,924	733	(2)
Total recognised derivative assets/(liabilities)		**1,251**	**(46)**

14 Available for sale securities

	2016 £m	2015 £m
Debt securities at fair value		
British Government securities listed on a recognised UK exchange	6,707	6,423
Other sterling securities listed on a recognised exchange	126	280
	6,833	6,703
Unlisted equity investments at fair value	1,111	291
	7,944	**6,994**

The movement in available for sale securities comprises:

	2016 £m	2015 £m
Available for sale debt securities		
At 1 March	6,703	5,940
Purchases	532	915
Redemptions	(427)	(315)
Mark-to-market movements through equity	100	230
Amortisation of premium/discount	(72)	(65)
Movement in accrued interest	(3)	(2)
At 29 February	**6,833**	**6,703**
Available for sale unlisted equity investments		
At 1 March	291	402
Revaluation of securities	793	(105)
Foreign exchange gains/(losses)	27	(6)
At 29 February	**1,111**	**291**
	7,944	6,994

There were no items in the course of settlement at the year ended 29 February 2016 (2015: £nil).

There were no gains or losses on the sale of available for sale securities transferred to the income statement during the year (2015: £nil).

Net income recognised in the year ended 29 February 2016 for the Bank's available for sale investments was £191m (2015: £194m).

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.

Notes to the Banking Department 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 (BIS) (incorporated in Switzerland) consists of shares of 5,000 Special Drawing Rights, which are 25% paid. At 29 February 2016 the holding represents 8.5% (2015: 8.5%) of the issued share capital. In the financial year 2016 the model used to value the investment has been revised to an adjusted net asset value basis providing a value of £1,106m at the end of February, under the dividend growth model, previously used to value the investment in the BIS, the valuation at 29 February 2016 would have been £207m, a difference of £899m.

The fair value of the BIS shares is estimated to be 70% of the Bank's interest in the net asset value of the BIS at the reporting date. The 30% discount to net asset value is based on the discount rate used by the BIS for all share repurchases since the 1970s and was further endorsed by a decision by the International Court at the Hague relating to a share repurchase by the BIS in 2001 (the last share repurchase conducted by the BIS). The Bank's financial statements incorporate the most recently available data from the BIS. The Bank expects the value of the BIS shares to fluctuate over time in conjunction with the strength of the BIS balance sheet and exchange rates. If the value of the net assets of the BIS changed by 1%, the value of the investments would change by £11m.

Since 1930 there has been 75% uncalled capital in respect of the Bank's investment in the BIS, now denominated in SDR. The sterling equivalent of this uncalled capital based on the SDR price at the balance sheet date was £178m (2015: £163m). The balance of £178m is callable at three months' notice by a decision of the BIS Board of Directors.

The Bank's holding in the European Central Bank (ECB) represents 0.7% (2015: 0.7%) 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 (2015: 3.75% amounting to €56m) of its total allocation of the ECB's subscribed capital of €1.5bn (2015: €1.5bn). 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% (2015: 13.7%).

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 (2015: £nil).

15 Investments in subsidiaries

The Bank has a number of subsidiaries, which are wholly owned and incorporated in the United Kingdom, 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, principal activity is that of a nominee company.
Bank of England Asset Purchase Facility Fund Ltd 100 ordinary shares of £1, principal activity is to fulfil the remit given to the Bank by the Chancellor of the Exchequer and for monetary policy.
Bank of England Nominees Ltd 2 ordinary shares of £1, principal activity is that of a nominee company.
BE Pension Fund Trustees Ltd 2 ordinary shares of £1, principal activity is the provision of trustee services to the Bank of England Pension Fund.
Prudential Regulation Authority 1 ordinary share of £1, principal activity is that of the United Kingdom's prudential regulator.
Houblon Nominees, a wholly-owned subsidiary, was in members' voluntary liquidation at the balance sheet date.

16 Inventories

	2016 £m	2015 £m
Raw materials (at cost)	2	–
	2	–

During 2016, £14m (2015: £nil) was recognised as an expense for inventories carried at the lower of cost or net realisable value. This is recognised in other general and administration expenses.

17 Property, plant and equipment

For the period to 29 February 2016	Freehold land and buildings £m	Leasehold improvements £m	Equipment[1] £m	Total £m
Cost or valuation				
At 1 March 2015	278	11	86	375
Additions	9	1	27	37
Disposals/write-offs	–	–	(7)	(7)
Revaluation of properties	30	–	–	30
At 29 February 2016	**317**	**12**	**106**	**435**
Accumulated depreciation				
At 1 March 2015	–	2	32	34
Charge for the period	4	1	14	19
Disposals/write-offs	–	–	(6)	(6)
Revaluation of properties	(4)	–	–	(4)
At 29 February 2016	**–**	**3**	**40**	**43**
Net book value at 1 March 2015	278	9	54	341
Net book value at 29 February 2016	**317**	**9**	**66**	**392**

1 Net book value of equipment at 29 February 2016 included £2m held under finance leases.

The figures for freehold land and buildings reflect independent professional valuations performed in accordance with the Royal Institution of Chartered Surveyors (RICS) on a market value basis as at 29 February 2016 by Deloitte LLP, members of RICS.

Notes to the Banking Department financial statements continued

17 Property, plant and equipment continued

For the period to 28 February 2015	Freehold land and buildings £m	Leasehold improvements £m	Equipment[1] £m	Total £m
Cost or valuation				
At 1 March 2014	230	11	55	296
Additions	5	–	35	40
Disposals/write-offs	(1)	–	(10)	(11)
Purchase of assets from PRA	–	–	6	6
Revaluation of properties	44	–	–	44
At 28 February 2015	**278**	**11**	**86**	**375**
Accumulated depreciation				
At 1 March 2014	–	1	33	34
Charge for the period	7	1	9	17
Disposals/write-offs	–	–	(10)	(10)
Revaluation of properties	(7)	–	–	(7)
At 28 February 2015	–	**2**	**32**	**34**
Net book value at 1 March 2014	230	10	22	262
Net book value at 28 February 2015	**278**	**9**	**54**	**341**

1 Net book value of equipment at 28 February 2015 included £2m held under finance leases.

Purchase of assets from the PRA relate to assets purchased by the Bank from the PRA. These assets were transferred to the Bank on 28 February 2015.

18 Intangible assets

	2016 £m	2015 £m
Cost		
At 1 March	38	36
Additions	10	3
Disposals/write-offs	(22)	(1)
At 29 February	**26**	**38**
Accumulated amortisation		
At 1 March	26	25
Charge for the year	3	2
Disposals/write-offs	(21)	(1)
At 29 February	**8**	**26**
Net book value at 1 March	12	11
Net book value at 29 February	**18**	**12**

Intangible assets primarily comprise computer software and related costs.

19 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 continued to be active members within the FSA Pension Plan, which operates on a defined contribution basis, until 31 March 2015. The Bank made 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 £0.7m (2015: £8m) of which £0.5m was recharged to the PRA (2015: £7m). No contributions were outstanding at the year end.

From 1 April 2015 staff on the FSA legacy contracts became members of the Bank's career average pension scheme.

b Defined benefit and career average

The Bank operates a non-contributory defined-benefit pension scheme providing benefits based on career average pensionable pay. The final salary element of the scheme is closed to future accrual for service but a link to final salary remains for active 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.

Notes to the Banking Department financial statements continued

19 Retirement benefits continued

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 latest valuation for funding purposes was as at 28 February 2014; it used the Defined Accrued Benefit Method. Under this method, active members are assumed to leave the Fund on the date of the valuation and hence the past service liability does not include an allowance for any salary increases or in-service CARE revaluation after that date. Instead members' benefits are assumed to increase in line with the deferred pension revaluation assumptions.

The valuation as at 28 February 2014	£m
Value of Fund assets	3,075
Actuarial value of scheme liabilities in respect of:	
– In-service members	(613)
– Deferred pensioners	(663)
– Current pensioners and dependants	(1,825)
– Members' additional voluntary contributions	(5)
Total	(3,106)
Scheme (deficit)/surplus	**(31)**
Funding level	99%
Service contribution rate for March	39%

For the 2014 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 3.3%.

The Bank and the Pension Fund Trustees had agreed a deficit reduction plan and a new schedule of contributions following the valuation. The Bank paid an additional lump sum contribution of £4.4m to the Fund in July 2014 which when taken together with the contribution of £26.7m paid in March 2014 under the previous recovery plan, is sufficient to eliminate the deficit as at 28 February 2014.

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

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 IAS 19 (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 has been clearing the deficit revealed by the previous funding valuations. 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.

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

	Note	2016 £m	2015 £m
Funded pension schemes	(i)	932	540
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	(73)	(83)
Other pension schemes	(iii)	(8)	(9)
Medical scheme	(iv)	(113)	(116)
		738	332

Pension expense recognised in the income statement[1]

	Note	2016 £m	2015 £m
Funded pension schemes	(i)	44	32
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	3	3
Other pension schemes	(iii)	–	–
Medical scheme	(iv)	5	5
		52	40

1 Of the total defined-benefit pension expense of £52m, £20m relates to staff working for the PRA and has been included in the PRA accounts.

Notes to the Banking Department financial statements continued

19 Retirement benefits continued

Remeasurements recognised in the statement of comprehensive income

	Note	2016 £m	2015 £m
Funded pension schemes	(i)	346	173
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	7	(6)
Other pension schemes	(iii)	1	(1)
Medical scheme	(iv)	4	(4)
		358	**162**

(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. This section of the scheme ceased to accrue benefits on a final salary basis from 1 April 2015. Former members of this section can continue to accrue benefits in the CARE section.

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

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 expected to be incurred by the eligible members once in retirement.

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 are risks with the selected portfolio such that it 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, the liabilities would be expected to grow by more in monetary terms, increasing the deficit in the scheme.

- 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

	2016			2015		
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Current service cost	63	–	1	45	–	1
Past service cost	–	–	–	–	–	–
Net interest on the net defined (liability)/asset	(19)	3	4	(13)	3	4
Total pension expense	**44**	**3**	**5**	**32**	**3**	**5**

Notes to the Banking Department financial statements continued

19 Retirement benefits continued

Remeasurements recognised in other comprehensive income

	2016			2015		
	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	43	(34)	5	(130)	(27)	9
Actuarial gains/(losses) arising from changes in demographic assumptions	96	3	–	42	1	7
Actuarial losses arising from changes in financial assumptions	139	3	5	(314)	(8)	(11)
Actuarial losses/(gains) arising from experience on the scheme's liabilities	50	2	(1)	26	–	–
Return on scheme's assets excluding interest income	61	–	–	419	–	–
Remeasurements recognised at the end of the period	**389**	**(26)**	**9**	**43**	**(34)**	**5**

Reconciliation of present value of defined-benefit obligation

	2016			2015		
	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	3,052	92	116	2,758	87	110
Current service cost	63	–	1	45	–	1
Interest expense	104	3	4	110	3	4
Actuarial (gains)/losses arising from changes in demographic assumptions	(96)	(3)	–	(42)	(1)	(7)
Actuarial losses arising from changes in financial assumptions	(139)	(3)	(5)	314	8	11
Actuarial losses/(gains) arising from experience on the scheme's liabilities	(50)	(2)	1	(26)	–	–
Benefits paid out	(109)	(6)	(4)	(107)	(5)	(3)
Present value of defined obligation at the end of the period	**2,825**	**81**	**113**	**3,052**	**92**	**116**

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

Reconciliation of the fair value of assets

	2016			2015		
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Fair value of scheme's assets at the beginning of the period	3,592	–	–	3,070	–	–
Interest income	123	–	–	123	–	–
Return on scheme's assets excluding interest income	61	–	–	419	–	–
Bank contributions	90	6	4	87	5	3
Benefits paid out	(109)	(6)	(4)	(107)	(5)	(3)
Fair value of scheme's assets at the end of the period	**3,757**	–	–	**3,592**	–	–

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:

	2016 %	2015 %
Discount rate	3.7	3.4
Rate of increase in salaries	3.5	3.5
Rate of increase of pensions in payment[1]	3.3	3.3
Rate of increase for deferred pensioners[1]	3.3	3.3

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.

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 2016 will live for 28.2 years (28 February 2015: 29 years) and a female member 30 years (28 February 2015: 30.7 years), and a male member reaching 60 in 2036 will live for 30.6 years (28 February 2015: 32.1 years) and a female member 32.5 years (28 February 2015: 33.8 years).

The Bank has adopted the latest available mortality projections model, which reduces the Fund's liabilities as a result of recent improvements in mortality being slightly lower than previously assumed. The Bank has also adopted a slightly lower long-term rate of assumed future mortality improvements, again reducing the Fund's liabilities, partly to reflect the recent experience described above and partly to be more in line with wider market practice.

Notes to the Banking Department financial statements continued

19 Retirement benefits continued

The assets in the scheme were:

	2016 Value £m	2016 Percentage of total value %	2015 Value £m	2015 Percentage of total value %
UK Government fixed-interest bonds	356	9	261	7
UK Government index-linked bonds	2,280	61	2,492	69
Corporate index-linked bonds	1,081	29	816	23
Cash and other assets	40	1	23	1
Total market value of investments	**3,757**	**100**	**3,592**	**100**

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 £686m were quoted and £395m were unquoted (2015: £319m quoted and £497m unquoted). Of the corporate index-linked bonds £1,039m (2015: £772m) were guaranteed by the UK Government.

Main scheme

	2016 £m	2015 £m
Present value of defined-benefit obligations	(2,825)	(3,052)
Assets at fair value	3,757	3,592
Defined-benefit asset (liability)	**932**	**540**

The Bank has recognised the net surplus in full on the balance sheet as it can realise any surplus on the winding up of the scheme after all other benefits have been paid in full in accordance with the Fund's rules.

The duration of the pension scheme liabilities is in the region of 18 years. A +/- 0.1% change to the discount rate would change the surplus on the pension scheme by +/- £51m (28 February 2015: +/- £58m).

A +/- 0.1% change to the assumed difference between CPI and RPI inflation would change the present value of defined-benefit obligations for the pension scheme by +/- £42m 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 +/- £22m.

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 £87m (28 February 2015: £93m).

The Bank expects to pay contributions of £68m in the forthcoming year (2015: £90m).

Redundancy provisions

	2016 £m	2015 £m
Unfunded defined-benefit liability	**(73)**	**(83)**

The Bank expects to make payments of £6m in the forthcoming year (2015: £6m).

Other pension schemes

	2016 £m	2015 £m
Unfunded defined-benefit liability	**(8)**	**(9)**

The Bank expects to make payments of less than £1m in the forthcoming year (2015: less than £1m).

During the year to 29 February 2016 the Bank incurred services costs of less than £1m (2015: 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 medical benefit liabilities is the same as used in the IAS 19 valuation of pension scheme liabilities (see Summary of assumptions on page 117). 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 an increase of £5m in the unfunded defined-benefit liabilities recognised. Additionally, for accounting purposes the following assumptions have been made in respect of medical expense inflation:

	2016 %	2015 %
Initial medical trend	5.0	5.0
Ultimate medical trend	5.0	5.0
Years to ultimate	–	–

Post-retirement benefits — medical

	2016 £m	2015 £m
Unfunded defined-benefit liability	**(113)**	**(116)**

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 2015: £2m) and a 1% increase in the rate of medical claims by £19m (28 February 2015: £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 2015: £5m).

The Bank expected to pay premiums of £4m in the forthcoming year (2015: £4m).

Notes to the Banking Department financial statements continued

20 Other assets

	2016 £m	2015 £m
Finance lease receivables	6	6
Short term debtors and other assets	190	345
Amounts due from the PRA	55	59
	251	**410**

The amount owed by the PRA includes £15m due in more than one year (2015: £30m). Finance lease receivables also include £6m due in more than one year (2015: £6m).

21 Deposits from central banks

	2016 £m	2015 £m
Deposits repayable on demand	1,497	1,271
Term deposits held at fair value through profit and loss	13,858	14,330
	15,355	**15,601**

22 Deposits from banks and other financial institutions

	2016 £m	2015 £m
Deposits repayable on demand	320,410	314,478
Cash Ratio Deposits	4,136	4,098
	324,546	**318,576**

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.

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.

23 Other deposits

	2016 £m	2015 £m
Deposit by Issue Department	50,870	57,873
Public deposits repayable on demand	2,781	1,028
Other deposits repayable on demand	1,932	1,531
	55,583	**60,432**

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

24 Foreign currency bonds in issue

	2016		2015	
	£m Fair value	US$m Nominal	£m Fair value	US$m Nominal
Total amounts issued to third parties	4,333	6,000	3,898	6,000

All changes in fair values since 1 March 2015 are considered attributable to changes in prevailing interest rates and movements in relative foreign currency exchange rates.

At 29 February 2016, as part of the Bank's annual medium-term security issuance programme the Bank had three US$2,000m three-year dollar bonds in issue (2015: three US$2,000m three-year dollar bonds); the first maturing on 21 March 2016, the second on 17 March 2017 and the third on 16 March 2018.

The most recent bond (the tenth in the overall programme) was issued on 7 March 2016 with settlement on 14 March 2016. This bond matures on 14 March 2019.

Of the above liabilities to third parties, £1,435m (2015: £1,298m) fall due within one year.

Notes to the Banking Department financial statements continued

25 Deferred tax liabilities

The deferred tax liability at 29 February has been calculated on all temporary differences under the liability method using an effective rate of 18% (2015: 20%) substantively enacted as at balance sheet date.

A reduction in the UK corporation tax rate from 20% (effective from 1 April 2015) to 18% (effective from 1 April 2020) was announced in July 2015 and had been substantially enacted as at 29 February 2016.

The movement on the deferred tax account is as follows:

	Note	2016 £m	2015 £m
Deferred tax			
Net liability at 1 March		128	60
Income statement charge	7	11	10
Tax credited/(charged) directly to equity		202	58
Net liability at 29 February		**341**	**128**

	2016 £m	2015 £m
Deferred tax liability relates to:		
Available for sale equity investments through comprehensive income	193	53
Pensions and other post-retirement benefits	133	66
Other provisions	15	9
	341	**128**

26 Other liabilities

i Analysis of other liabilities

	2016 £m	2015 £m
Items in course of collection	1	1
Payable to HM Treasury	102	94
Short term creditors and other liabilities	196	172
Provisions	7	8
	306	**275**

Payable to HM Treasury includes payment in lieu of dividend (note 8) and the under/over recovery of costs associated with the management of the notes issue and the Exchange Equalisation Account.

ii Analysis of provisions

	Restructuring provision £m	Onerous lease provision £m	Other provisions £m	Total £m
Balance at 1 March 2015	2	6	–	8
Provisions made during the year	–	–	2	2
Provisions used during the year	(2)	(1)	–	(3)
Provisions reversed during the year	–	–	–	–
Balance at 29 February 2016	–	5	2	7

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 lease expires in November 2018. Of the above provision £2m (2015: £2m) falls due within one year. The cash flows are discounted at a risk-free rate at 29 February 2016. The impact of the discount unwind is negligible.

27 Capital

	2016 £m	2015 £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.

28 Cash and cash equivalents

i Analysis of cash balances

	Note	At 1 March 2015 £m	Cash flows £m	At 29 February 2016 £m
Cash and balances with other central banks	9	1,005	(368)	637
Loans and advances to banks and other financial institutions	10	4,048	1,600	5,648
Securities held at fair value through profit and loss	12	375	14	389
		5,428	1,246	6,674

Notes to the Banking Department financial statements continued

28 Cash and cash equivalents continued

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.

29 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 Financial Risk Management Division (FRMD) within the Bank's Markets Directorate is responsible for analysing the financial risks faced by the Bank in its operations in financial markets.

The Financial Risk and Resilience Division (FRRD) is responsible for providing forward-looking assessment and challenge of financial risks to the Bank's balance sheet across all its financial operations.

Middle Office is responsible for the pricing, valuation and financial control of exposures and collateral positions arising from the Bank's market operations, including counterparty and instrument management.

This section reflects practice in the 2015/16 financial year. A new financial risk management framework is being developed, consistent with the financial risk component of the Risk Tolerance Statement described in the Risk management and business practices section (pages 46–52).

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; intraday 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 intraday 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 FRMD, reviews the creditworthiness of issuers, counterparties and customers to whom the Bank may have credit exposures. CRAC is supported by a credit risk analysis team.

The Bank provides wholesale banking services to the UK Government, other central banks, and, where there are financial stability reasons to do so, certain other financial sector firms. 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.

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. The collateral can include mortgage-backed securities, covered bonds backed by mortgages or public sector securities, other asset-backed securities (such as those backed by credit card receivables, student loans or auto loans), or portfolios of loans in unsecuritised form. The collateral must meet published eligibility criteria.

The Bank manages the risk in this wider collateral portfolio by applying haircuts to take account of market risk, 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.

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 a market price is not available the Bank uses a model to approximate a market value. The pricing methodologies and the use of spreads in models are under regular review, including via a Valuation Review Committee chaired by the Head of Middle Office.

A Collateral Risk Committee chaired by the Head of FRMD reviews issues relating to the full range of collateral and considers policy issues relating to stress testing, valuation and eligibility of collateral including in response to market or entity-specific conditions. It also reviews 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.

Models used for calculating haircuts are designed by FRMD, then independently reviewed and validated by FRRD.

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

Notes to the Banking Department financial statements continued

29 Financial risk management continued

Geographical concentration of assets and liabilities

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

	2016 £m	2015 £m
Assets		
United Kingdom	392,591	391,249
Rest of Europe	10,463	9,309
Rest of the world	2,704	2,015
	405,758	**402,573**
Liabilities and equity		
United Kingdom	382,663	385,809
Rest of Europe	7,952	2,814
Rest of the world	15,143	13,950
	405,758	**402,573**

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 (see below) 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. A 1% change in market prices would change the value of the sterling bond portfolio at 29 February 2016 by approximately £67m (2015: £66m).

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 ten 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

	2016 £m	2015 £m
At 29 February	126.7	112.4
Average	115.2	101.3

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 are calculated on an end-of-day basis and do not reflect exposures that may arise on positions during the day.
- The model uses two years of historical data as a basis for determining the possible ranges of outcomes and may not always cover all possible scenarios, especially those of an exceptional nature.
- An assumption of log-normality, which may underestimate the size of extreme movement in market data.

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.

To mitigate the fourth limitation above, the Bank has developed two additional variations of VaR: an exponentially weighted measure that gives greater weight to the most recent data and also a 'Stressed' VaR measure. The latter is calibrated not specifically on recent data, but on data drawn from the two-year period of maximum volatility since January 2000. Stressed VaR helps to mitigate 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 29 February 2016, Stressed VaR was £183.39m (2015: £190.97m).

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

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 £1.1bn (2015: £287m). Excluding this, the Bank's net foreign exchange exposure at 29 February 2016 was £7m (2015: £2m).

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 2015/16, the Bank continued weekly tender operations (which had recommenced in May 2010) to lend US dollar funds for seven days against eligible collateral.

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.

Notes to the Banking Department financial statements continued

29 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 29 February 2016	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	637	–	–	–	–	637
Loans and advances to banks and other financial institutions	4,913	2,688	2,921	–	–	10,522
Securities held at fair value through profit and loss	1,298	1,037	2,422	2,429	–	7,186
Derivative financial instruments:						
Cash inflow	4,475	2,242	1,110	1,340	–	9,167
Cash outflow	(4,158)	(2,209)	(1,086)	(1,175)	–	(8,628)
Other assets	–	–	–	–	–	–
Total assets	**7,165**	**3,758**	**5,367**	**2,594**	–	**18,884**
Liabilities						
Deposits from central banks	4,113	2,384	1,231	–	–	7,728
Deposits from banks and other financial institutions	69	–	–	–	–	69
Other deposits	529	–	–	–	–	529
Foreign currency bonds in issue	1,454	–	15	2,904	–	4,373
Derivative financial instruments:						
Cash inflow	(1,310)	(144)	(5)	(551)	–	(2,010)
Cash outflow	2,580	1,230	3,843	535	–	8,188
Other liabilities	–	–	–	–	–	-
Total liabilities	**7,435**	**3,470**	**5,084**	**2,888**	–	**18,877**
Net liquidity gap	**(270)**	**288**	**283**	**(294)**	–	**7**
Cumulative gap	**(270)**	**18**	**301**	**7**	**7**	–

As at 28 February 2015	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	1,005	–	–	–	–	1,005
Loans and advances to banks and other financial institutions	2,714	3,575	3,843	–	–	10,132
Securities held at fair value through profit and loss	699	870	1,747	2,021	–	5,337
Derivative financial instruments:						
Cash inflow	3,817	2,804	2,645	1,989	–	11,255
Cash outflow	(3,969)	(4,169)	(5,312)	(1,652)	–	(15,102)
Other assets	–	–	–	–	–	–
Total assets	**4,266**	**3,080**	**2,923**	**2,358**	**–**	**12,627**
Liabilities						
Deposits from central banks	2,975	2,898	2,628	–	–	8,501
Deposits from banks and other financial institutions	2	–	–	–	–	2
Other deposits	164	–	–	–	–	164
Foreign currency bonds in issue	1,307	–	9	2,609	–	3,925
Derivative financial instruments:						
Cash inflow	(96)	(70)	(1)	(124)	–	(291)
Cash outflow	93	71	1	159	–	324
Other liabilities	–	–	–	–	–	–
Total liabilities	**4,445**	**2,899**	**2,637**	**2,644**	**–**	**12,625**
Net liquidity gap	**(179)**	**181**	**286**	**(286)**	**–**	**2**
Cumulative gap	**(179)**	**2**	**288**	**2**	**2**	**–**

Notes to the Banking Department financial statements continued

29 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 29 February 2016	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets					
Loans and advances to banks and other financial institutions	10	–	10,525	–	10,525
Securities held at fair value through profit or loss	12	7,190	–	–	7,190
Derivative financial instruments	13	–	488	–	488
Available for sale securities	14	6,833	–	1,111	7,944
		14,023	**11,013**	**1,111**	**26,147**
Liabilities					
Deposits from central banks	21	–	13,858	–	13,858
Foreign currency bonds in issue	24	4,333	–	–	4,333
Derivative financial instruments	13	–	476	–	476
		4,333	**14,334**	–	**18,667**

As at 28 February 2015	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets					
Loans and advances to banks and other financial institutions	10	–	10,131	–	10,131
Securities held at fair value through profit or loss	12	5,160	–	–	5,160
Derivative financial instruments	13	–	1,251	–	1,251
Available for sale securities	14	6,703	–	291	6,994
		11,863	**11,382**	**291**	**23,536**
Liabilities					
Deposits from central banks	21	–	14,330	–	14,330
Foreign currency bonds in issue	24	3,898	–	–	3,898
Derivative financial instruments	13	–	46	–	46
		3,898	**14,376**	–	**18,274**

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, all these financial assets and liabilities would be classified as Level 2.

30 Off balance sheet arrangements — Funding for Lending Scheme

The Funding for Lending Scheme (FLS) is designed to incentivise banks and building societies to boost their lending to the UK real economy.

It does this by providing funding for an extended period, with both the price and quantity of funding provided linked to their lending performance.

				2016		2015	
	Up to 1 year £m	1 to 3 years £m	3 to 5 years £m	Nominal £m	Fair value £m	Nominal £m	Fair value £m
Securities lent to banks and other financial institutions	7,001	34,993	15,651	57,645	57,540	56,836	56,708
Securities borrowed from the DMO	(7,001)	(34,993)	(15,651)	(57,645)	(57,540)	(56,836)	(56,708)
Total obligations	–	–	–	–	–	–	–

As of the end of February 2016, 37 banking groups were signed up to the latest part of the FLS extension, and a further fifteen groups had signed up to earlier parts of the scheme but were not participating in the extension. 41 groups had outstanding drawings as at the end of February 2016 (2015: 43 groups). Treasury bills with a market value of £57.5bn had been advanced to participants at year-end (2015: £56.7bn). The Bank has borrowed these Treasury bills from the DMO to whom they are owed back. In the year to 29 February 2016, the Bank recognised income of £160m from FLS (2015: £132m).

31 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.

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.

As a result of our shareholding and in accordance with the Treaty on the Functioning of the European Union, the Bank is required to pay a 'minimal percentage' of its subscribed share capital, currently 3.75% amounting to €56m (2015: 3.75% amounting to €56m) by way of contribution to the operational costs of the ECB. The value of this contribution will be adjusted in line with amendments to our subscription to the ECB as detailed above. In addition, the 'minimal percentage' can be varied by the General Council of the ECB, as detailed above. The Bank has not been notified of any intentions to change the 'minimal percentage'.

Notes to the Banking Department financial statements continued

31 Contingent liabilities and commitments continued

b Capital commitments

Capital commitments outstanding at 29 February 2016 amounted to £30m (2015: £37m), relating to capital works at Bank premises and to enable delivery of future projects.

In addition the Bank did not have any contingent capital commitments outstanding at 29 February 2016 (2015: nil).

c Operating lease commitments — minimum lease payments

	2016		2015	
	Land and buildings £000	Computer and other equipment £000	Land and buildings £000	Computer and other equipment £000
At the year end, minimum lease payments under non-cancellable operating leases were:				
Expiring within one year	7,768	141	7,949	171
Between one and five years	26,275	206	28,308	288
Expiring in five years or more	34,169	–	38,830	–
	68,212	**347**	**75,087**	**459**

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

32 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 financial stability objective.

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 (EEA).
- 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 23 as public deposits. The total charges made to the Government are disclosed in note 4a. A management fee of £92m (2015: £82m) was payable by HM Government in the year ended 29 February 2016 to the Bank in respect of services provided to the EEA of £8m (2015: £9m) and Issue Department of £83m (2015: £72m).

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 29 February 2016 the Bank had a loan from the DMA of £193m (2015: £193m) in relation to the provision of funding to the Bank of England Asset Purchase Facility Fund Ltd.

At 29 February 2016 the Bank had borrowed Treasury bills with a nominal value of £57.6bn (2015: £56.8bn) 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 23 as public deposits.

The fees charged in respect of DMO deposits was £1m in 2016 (2015: £1m).

HM Treasury

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

The Bank, in discussion with HM Treasury, expects to recover 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 United Kingdom'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 Prudential Regulation Authority and Financial Conduct Authority (formerly the Financial Services Authority), 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 23 as public deposits.

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 29 February 2016 the loan from the Bank to BEAPFF was £375.2bn (2015: £375.2bn). Interest on this loan is receivable at Bank Rate and amounted to £1.9bn for the year ending 29 February 2016 (2015: £1.9bn).

At the year end BEAPFF held a deposit at the Bank of £1.3bn (2015: £1.2bn), which is included in other deposits (note 23). Interest on this deposit is payable at Bank Rate and totalled £18m for the year ending 29 February 2016 (2015: £17m).

A management fee of £2m was payable by BEAPFF to the Bank in respect of the year ended 29 February 2016 (2015: £2m).

Prudential Regulation Authority (PRA)

The 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 United Kingdom's financial sector came into effect on 1 April 2013.

The Bank initially pays all of the expenses of the PRA. The Bank then recharges relevant expenditure either via the corporate services fee or a direct recharge. In the year the Bank charged the PRA a corporate services fee of £97m (2015: £97m) and recharged direct costs of £156m (2015: £139m).

Notes to the Banking Department financial statements continued

32 Related parties continued

As at 29 February 2016 the Bank was owed £26m (2015: £14m) by the PRA in respect of recharged expenditure and corporate services fee, this amount is included in note 20.

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 £29.5m (2015: £44.6m), which is disclosed as a receivable within note 20.

c Key management personnel

Members of Court are covered by an indemnity from the Bank, granted in 2000 (see page 7). Members of the FPC, MPC and PRA Board are also covered by an indemnity granted by the Bank (see pages 10–12).

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 29 February 2016, the number of key management personnel was 29 (2015: 28).

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

	2016 £000	2015 £000
Loans		
Balance brought forward	55	43
Loans made during year	2	44
Loans repaid during year	(31)	(32)
	26	**55**
Interest income earned	1	2
Number of key management personnel with loans at 29 February	3	3

No provisions have been recognised in respect of loans given to related parties (2015: £nil).

Loans and deposits repaid during the year include movements due to changes in key management.

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 twelve 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 3%) 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.

	2016 £000	2015 £000
Deposits		
Governors and Executive Directors		
Balance brought forward	271	280
Deposits taken during year	426	546
Deposits repaid during year	(504)	(555)
	193	271
Non-executive Directors		
Balance brought forward	–	6,171
Deposits taken during year	–	4
Deposits repaid during year	–	(6,175)
	–	–
Interest expense on above deposits	1	6
Number of key management personnel with deposits at 29 February	4	4

Key management remuneration

	2016 £000	2015 £000
Salaries and short-term benefits	6,017	6,043
Post-employment benefits	2,031	1,439
	8,048	7,482

Full information on the remuneration (including pension arrangements) of the Members of Court is given in the Report of the Remuneration Committee on pages 65 to 71.

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 29 February 2016 no charge was made for these services (2015: £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 £90m (2015: £87m). There were no other material transactions between the Bank and the pension scheme during the year to 29 February 2016. At 29 February 2016 the balances on accounts held with the Bank were £31m (2015: £13m).

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.

33 Events after the balance sheet date

The United Kingdom held a referendum on 23 June on whether or not to remain a member of the European Union. As a result of the decision to leave the EU, the Bank continues to consider the implications of this decision on its strategy, business plan and balance sheet. A reasonable estimate of the impact on the balance sheet cannot be made at this time due to volatility preventing use of appropriate market pricing.

34 Date of approval

The Members of Court approved the financial statements on pages 84 to 135 on 27 June 2016.

Issue Department account
for the period ended 29 February 2016

	2016 £m	2015 £m
Income		
Securities of, or guaranteed by, the British Government	243	288
Other securities and assets	299	288
	542	**576**
Expenses		
Cost of production of banknotes	(43)	(33)
Cost of issue, custody and payment of banknotes	(27)	(27)
Other expenses	(10)	(10)
	(80)	**(70)**
Net income paid to National Loans Fund	**462**	**506**

Issue Department statement of balances
for the period ended 29 February 2016

	Note	2016 £m	2015 £m
Assets			
Securities of, or guaranteed by, the British Government	3	3,604	4,451
Other securities and assets including those acquired under reverse repurchase agreements	4	64,214	59,338
Total assets		**67,818**	**63,789**
Liabilities			
Notes issued:			
In circulation	5	67,818	63,789
Total liabilities		**67,818**	**63,789**

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

Mr M Carney	Governor
Mr B Broadbent	Deputy Governor
Mr A Habgood	Chairman of Court
Mr R Coates	Finance Director

The notes on pages 138 to 140 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 26 February 2016.
- 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 29 February 2016 amounted to £47m (2015: £81m) and total deficits paid by the National Loans Fund amounted to £104m (2015: £7m).
- 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 of £80m (2015: £70m) represent charges from the Banking Department for costs incurred in relation to the note issue of £83m (2015: £72m) less amounts over-collected in prior years.

3 Securities of, or guaranteed by, the British Government

	2016 £m	2015 £m
British Government Stocks	3,234	4,081
Ways and Means advance to the National Loans Fund	370	370
	3,604	**4,451**

The Ways and Means advance earns interest at Bank Rate.

4 Other securities and assets including those acquired under reverse repurchase agreements

	2016 £m	2015 £m
Deposit with Banking Department	50,870	57,873
Reverse repurchase agreements	13,344	1,465
	64,214	**59,338**

The deposit with Banking Department earns interest at Bank Rate.

5 Notes in circulation

	2016 £m	2015 £m
£5	1,645	1,601
£10	7,767	7,371
£20	41,037	38,912
£50	13,157	11,788
Other notes[1]	4,212	4,117
	67,818	**63,789**

1 Includes higher-value notes used as backing 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 29 February 2016, the assets of the Issue Department had the following repricing period profile.

	2016 £m	2015 £m
Repricing up to one month	64,584	59,708
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 twelve months	383	823
Repricing in greater than twelve months	2,851	3,258
	67,818	**63,789**

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.

Notes to the Issue Department statements of account continued

7 Accrued interest

At 29 February 2016 the unrecognised accrued interest on the assets held on the Issue Department statement of balances was £63m (2015: £65m).

8 Events after the balance sheet date

The United Kingdom held a referendum on 23 June on whether or not to remain a member of the European Union. As a result of the decision to leave the EU, the Bank continues to consider the implications of this decision on its strategy, business plan and balance sheet. A reasonable estimate of the impact on the balance sheet cannot be made at this time due to volatility preventing use of appropriate market pricing.

9 Date of approval

The Members of Court approved the statements of account on pages 136 to 140 on 27 June 2016.

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