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A COURT OF DIRECTORS AT THE BANK

THURSDAY 7 JANUARY 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the Court of 17 December and the Meeting of 24 December were confirmed, and those of last week's Meeting, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Plenderleith spoke about the foreign exchanges, including the Official Reserves figures for December, and the state of the domestic markets.

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Under the weekly executive report:-

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2 Mr Harris, Chairman of the Trustees of the Pension Fund, said that the Secretary of State was required by the Social Security Pensions Act 1975 to review every five years the reduced rates of National Insurance Contributions in respect of employees who were contracted out of the State Earnings-Related Pension Scheme. The rebate, calculated by the Government Actuary, was intended to be sufficient to cover the cost to occupation pension schemes of providing the Guaranteed Minimum Pensions.

From April 1993 the rebate would be reduced to 4.8% (split 3% employers, 1.8% employees) from 5.8% (3.8% and 2%) and the Pension Fund Trustees had considered whether this still represented good value. The Fund's Actuary had compared the assumptions used by the Government Actuary with those that he himself had used for the last valuation of the Fund, and had concluded that there was still a margin of profitability in the Fund continuing to contract out. His advice, which the Trustees and the Governors had accepted, was that there was no need to change the present contracted-out status. The level of the rebate would be reviewed again in three years' time rather than five, because of the uncertainty over equalisation of the State Pension Age for men and women.

At the Governor's invitation and with the agreement of Members of Court, Mr Clark, the Head of Financial Markets and Institutions Division, Mr Mortimer-Lee, a Senior Manager in that Division and Mr Beverly, the Head of Wholesale Markets Supervision Division attended Court for the ensuing discussion.

In introducing the paper "Future Regulatory Structure" Mr Kent said that there were two basic regulatory objectives: to guard against "systemic risk"; and to protect the individual depositor or investor. At present, however, the structure and statutes did not fully match those tasks. They were based on institutional boundaries which had become outmoded because they had not kept pace with the market place, new products and the views of the consumers. For example, life products were being sold by people who could come under any one of at least four different regulators, whereas the expectation of the consumer would seem logically to be that regulation should relate to functions rather than institutions.

There were three key underlying issues:-

(i) have financial liberalisation and innovation yet gone far enough to eliminate the boundaries between institutions and the products they sell and is the situation stable enough to consider changes now?

(ii) are banks, or at least large banks, sufficiently different from other financial institutions to justify keeping their regulation separate, at least so far as financial safety and soundness is concerned? and

(iii) is the current Financial Services Act (FSA) system fatally flawed? In the main, problems with the FSA system have been at the retail end. The regulatory approach at the wholesale end seems now to be accepted.

Having considered these issues, Mr Kent suggested that Court might wish to focus on four broad models of how the institutional structure of regulation might look in the future:-

(i) the status quo (but not quite) - continue the current reliance on voluntary membership of Self-Regulating Organisations (SROs). In principle it could mean continuing with the current SROs or a FIMBRA/LAUTRO merger, but there is a strong political impetus to establish the Personal Investment Authority (PIA) on a "voluntary" basis;

(ii) direct statutorily-based regulation at the retail end across the board; SFA and IMRO would continue as separate SROs for wholesale securities business; banking regulation and the Section 43 (of the FSA) regime would remain with the Bank;

(iii) direct statutorily-based retail regulation, as in (ii). Combine the financial regulation of wholesale securities firms and banking supervision (and building societies regulation) in a regulator separate from the retail regulator;

(iv) a Financial Commission. A regulator covering on a comprehensive basis banking, building societies and securities, whether wholesale or retail, and covering conduct of business and financial soundness.

That said, Mr Kent entered two caveats. First there was no appetite in Government for new legislation and second, there was evidence of "regulatory fatigue" ie a reaction to constant changes. It was probably desirable to ensure a fair degree of stability into the second half of the 1990s. However some changes would be needed sooner and one of the reasons for discussing this issue now was the proposed Personal Investment Authority.

In the initial discussion, a question arose about the responsibilities of Independent Financial Advisers (IFAs) and particularly their relationship with customers on the one hand and life offices etc on the other. Sir Brian Corby explained that there was a difference between an independent IFA who had a primary duty to the customer who in effect engaged him and a tied agent whose duty was to the company employing him.

Sir Brian said that the main thread of the Gower Report had been consumer protection and legislation had been conceived to that end. It had caught up, however, other areas most notably the wholesale market. In practice - as he and others had warned - it did not serve the retail end well. The Government was now in a difficult position saying in effect that "if you don't regulate yourselves then legislation would be imposed". Many affected believe that would be preferable. He asked why the banks and those life offices not using IFAs should bail them out?

The Governor said that part of the problem was the large number of IFAs, few of whom had adequate resources to help meet compensation claims. This was why FIMBRA was in difficulty having to be cross-subsidised and why there was a need and pressure for the PIA. Indeed the Bank may well come under strong pressure from Government to bring the banks and life offices into the PIA.

Sir David Walker said that it was important to identify what needed immediate action. The immediate pressing dissatisfaction was at the retail not the wholesale end. The whole subject had been given a particular twist by the Maxwell saga. However it was important to place this in perspective. It would be very difficult to stop a determined fraudster and it could not be said with confidence that a wholly statutory system would necessarily have worked better. The present dissatisfaction at the retail end was more because of the compensation arrangements and the cost to life offices in funding claims. This was resented and cross-subsidy was not sustainable. It was therefore not surprising that large life offices and banks were not comfortable with the cost of supporting the PIA.

Sir David said that in his view it was very difficult to do anything immediately on a voluntary basis and so some modest legislation may be necessary. He had two proposals: he suggested that a transaction levy should be introduced on all relevant products (or at least those sold through IFAs) which would deal with the immediate FIMBRA/PIA funding problem. He believed that such a levy might be well received by the practitioners. Secondly, he said that firms had too much freedom of choice as regards SRO membership. The SIB should therefore be given the power to mandate the appropriate SRO for retail firms.

On broader issues, Sir David said that the attempt to bring retail and wholesale regulation together had proved even more difficult than the Bank had expected. He suggested that they should be separated but that there was a need for caution in defining what was retail. Regulators there needed wider authority beyond purely investment matters to cover consumer expectations such as the enforcement of a banking code of conduct and other codes such as that for building societies. He would like to see the whole of retail regulation in one place.

At the wholesale end, Sir David said it was necessary to recognise and identify the importance of banks in the stability of the financial system. He was against separating prudential regulation and conduct of business: there were important interlinkages, for example on systems, and both should be carried out by one regulator. He also suggested that it would be advantageous to complement criminal with civil offences. As Chairman of the SIB, he would have liked powers to deal with insider dealing offences etc as civil rather than criminal offences. Overall the system of wholesale regulation was a cats cradle which he felt was unsustainable in the longer run because it involved a needless extra burden and expense: there was a case for one wholesale regulator.

Sir Brian Corby said that Professor Goode's inquiry would report later this year and Government would need to consider limited legislation as a result. He supported the need to bring retail supervision together and to separate the wholesale end. In focusing on the problems of functional and institutional supervision, Sir Brian said that banks and insurance companies were different but nevertheless could be supervised by one body. The relevant systemic risks were rather different and he compared a crisis in the banking sector on the one hand and on the other the problem of the capacity of the insurance market (including Lloyds) not perhaps being sufficient to cover perceived risks.

Sir David Scholey said that liberalisation and innovation still had a lot further to go. Retail and wholesale business were different in the way they had developed and these differences would continue, so the distinction between wholesale and retail was important. There must be scope for development and innovation in business without the restrictions that were imposed in, say, the USA and Germany and modification to the present system was necessary particularly in the retail area. Wholesale supervision was working reasonably well but does also need some modification. Some of the old institutional boundaries between different types of firm had been washed away by innovation and banks were no longer as different as they were from other financial institutions. He argued that there was a need to distinguish between supervision of general soundness, fitness and properness on the one hand and conduct of business on the other. These should probably not be regulated by the same body. Sir David did not feel that the FSA system was fatally flawed but some modification was necessary with legislation in the retail area. It was important that there should be scope for modification and adaptation for the sake of the City's reputation and London's international standing.

Sir Colin Southgate raised a question about the responsibilities of the "product manufacturer" and Mr Laird suggested that a life office should be responsible if its product was faulty. The Deputy Governor suggested that managing this was a question of commissions and fees. In principle, the IFA should return commission to the customer and charge the customer a fee. Sir David Walker said that in his view this would be appropriate. Sir Christopher Hogg said that in his view the regulated firms were able to divide and rule by playing the regulators off one against another. He was very sceptical about self-regulation and questioned whether it was ever likely to work.

The Governor said that he wondered how far we had self-regulation. Practioners were involved in rule making but not necessarily in monitoring. Sir David Walker argued that this was inevitably so. He added that on the whole the SFA worked well and had proved very effective. The retail end needed statutory enforcement as self-regulation had broken down.

In introducing the monthly Economic and Financial Report for December, Mr King said that in the run up to the Budget, the two key questions for policy were once again, was policy too tight or too loose overall, and was the mix between monetary and fiscal policy correct?

Ideally, the answers to both questions would reflect a medium-term assessment of policy but in present circumstances those arguing for a further loosening of policy had focused on the current state of the real economy. Those arguing for a change in the mix of policy had been concerned, on the one hand, with the medium term prospect for public borrowing, and on the other, were relaxed about the implications for inflation of a further relaxation of monetary policy. He proposed, therefore, to comment first on the real economy and second on the outlook for inflation, and in particular, the impact of sterling depreciation.

Following Britain's departure from the ERM in September, there had been a striking divergence between measures of confidence which all fell very significantly, and the statistics on the real economy which changed very little. In recent weeks that picture had started to change. Measures of confidence had started to improve and the data for the real economy had provided suggestions that an upturn in spending had begun.

The true size of the post-Christmas increase in retail sales would not be known until later in January when the figures for December would be published. A survey using the Bank's Agents, supplemented by enquiries with the CSO, CBI and the Retail Consortium, indicated a general agreement that there was a marked pick-up in post-Christmas spending but most contacts believed that the reports which attracted the headlines were somewhat misleading and there was little expectation of buoyant spending in 1993. While some of the examples of increases in spending were very striking there were reasons for doubting the validity of these. For example, the first day for most sales corresponded with a Bank Holiday and many contacts had reported that although the number of customers had been very significantly up on a year ago, the average value of transactions had been lower. Contacts had also suggested that there had been a marked preference for the use of cash rather than credit.

There had been a 29% increase in new car registrations in the first twenty days of December relative to the corresponding period in 1991. But it would be unwise to infer a simple relationship between demand and domestic production. If households wanted to take more advantage of discounts and sales than hitherto, one might expect a more volatile pattern for spending in the coming months, and it was quite possible that there would be news of further falls in manufacturing output in the early part of the year.

In the housing market there were clear indications of increased turnover. An inquiry of estate agents showed that many felt that December saw a higher turnover than for several years and levels of activity were much higher than had been anticipated. The Abbey National reported that most of the transactions were due to new entrants into the housing market, which was exactly the type of transaction which would be expected to bring about the end of a debt deflationary process, but this might take some time to have an impact on prices. The latest Halifax house price series, to be announced shortly, was likely to show a further fall in house prices for December, which would imply that over the last year, as a whole, house prices had fallen by almost 8% for the country. The mixed pattern of developments in the retail and housing sectors suggested that it would be premature to undertake any further relaxation of policy overall, until the impact of the easing to date could be more adequately assessed.

As far as the mix between monetary and fiscal policy was concerned, the ceiling of 4% for the target range for inflation would provide a constraint on the extent to which monetary policy could be eased. But there was clearly an argument for putting in place a series of measures, to be implemented over time, to reduce the very large public sector deficits that were now in prospect. On the first issue, an inquiry using a sample of 100 firms through the Bank's Agents and other contacts, of the impact of sterling depreciation on domestic prices had been carried out. Most respondents believed that the main impact of the depreciation had yet to be seen. On

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both input and output prices, and especially on the latter, the main impact of depreciation was expected to come later in 1993. Hence some further easing of monetary policy would risk breaching the ceiling of the target for inflation. Court would have an opportunity to discuss this is in more detail later that month when the draft Inflation Report would be presented to Court.
In conclusion, Mr King said that if we were serious about locking into low rates of inflation, then not only was there no scope for a discussion of a loosening of policy, rather the Chancellor and his colleagues at Chevening this weekend should be considering ways of tightening fiscal policy.

Mr Coleby, in introducing the regular discussion of monetary policy said that the latest figures for broad and narrow money gave divergent messages. M4 and M4 Lending were both negative in November with the year-on-year increase down to 4 1/2%, the lowest since the series began. This compared with the target range for M4 of 4% - 8%, as announced by the Chancellor of the Exchequer in the Autumn Statement, and suggested that the economy was being too tightly squeezed.

Narrow money, on the other hand, was expanding rapidly. December has been the sixth consecutive month of strong growth of currency in circulation, at around 1/2% per month, seasonally adjusted. The year-on-year increase had risen to 3.4%, towards the top end of the target range of 0-4%, suggesting that policy needed tightening. The statistics for narrow money confirmed a stirring of activity at retail level as indicated by sales figures and anecdotal evidence.

The message from the broad money statistics was that there was no increased demand for credit particularly from corporates, many of whom were quite liquid, and using their liquidity to repay debt rather than to acquire assets. Others, especially the smaller corporates, were still finding it necessary to retrench quite hard.

Overall, this divergent story was consistent with other economic indicators. Collectively, the indications were as positive as could be hoped for in response to the policy stance which had been in place since September, and that optimistic assessment was reflected in the foreign exchange and equity markets. This all suggested that it would be untimely to adjust the policy which was set in November at the time of the Autumn Statement.

E. A. J. George

G. A. Croughton.
Secretary.

14th January 1993

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Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

There were no items for discussion under the weekly executive report.

At the Governor's invitation and with the agreement of Members of Court, Mr Trundle, the Governor's Private Secretary, attended Court for the ensuing discussion.

With reference to Minutes of Court of 12 November, 3 December 1992 and 7 January, the Governor thanked those Members of Court who had responded to his letter of 23 December and provided comments for the discussion on Independence for the Bank of England. He drew attention to the main issues outlined in the paper entitled 'Operational Autonomy for the Bank of England' and suggested that it might be appropriate to deal with each of the main issues in seriatim.

In addressing the first issue - *"Does Court agree that the prospects of achieving meaningful autonomy are more promising through the "evolutionary" rather than through the "statutory" route? And, would the approach enhance the credibility of policy sufficiently to have the desired effect on market expectations?"*, - the Governor said that there had been general agreement among the Non-Executive Directors that the evolutionary approach was preferable, at least in the first instance, but that it should lead to a statutory authority in due course. He noted that such a proposition did not satisfy Sir Christopher Hogg's concern that there was no role for Non-Executive Directors at Court if they were not involved in the formulation of monetary policy.

Sir David Walker supported the evolutionary route at the present time but felt that some work should be done now to identify the Bank's preferred statutory position, and Sir Colin Southgate, supporting the evolutionary route suggested that the Bank should attempt to win over opposition parties as well as Government to such a proposal.

Mr Laird supported the evolutionary method at the present time but felt that it would not last. The arrangements would be challenged on the first occasion that the Bank made a politically unpopular move so the Bank's independence would need to be backed by statutory powers. This point should be made from the outset. The constitution of Court, he felt, was a separate issue.

The Governor asked how practical the evolutionary route would be. Was it realistic in those circumstances to expect the Chancellor to defend the Bank's actions in the House of Commons even if he did not agree with them? Mr Crockett said that it was important to distinguish between the long and short term objectives. The long term objective must be statutory authority but he was sure that it could only be achieved by going down the evolutionary route initially. The Governor said that the longer term objective might be driven by the Maastricht Treaty which required that countries which were to take part in stage 3 should have independent central banks. The announcement that the central banks in France and Spain were to have greater autonomy followed from the Maastricht Agreement and there was a general feeling amongst the Governor's European colleagues that central banks should become independent as soon as possible - it was not something that should be left to the last minute.
Sir David Scholey suggested that while the need for statutory changes may be self-evident, the political reality of making progress was to adopt an evolutionary stance at the outset. Mr Quinn added that it was very evident from the Chancellor's response the previous week, that Government were in no hurry to consider the independence of the Bank. In those circumstances he felt that the evolutionary route was appropriate, and that the Bank should not force the pace because once change began to occur the Government would have great difficulty in reversing the position.
Sir Brian Corby's view was that the full benefits of independence could only be achieved through statutory authority and he thought it naive to put forward a paper that did not anticipate statutory authority in due course as a natural consequence of the evolutionary process. He accepted, however, that neither the Chancellor of the Exchequer or the Prime Minister had any enthusiasm for independence at the present time. If the Government showed no inclination to relinquish their position, Sir Roland Smith said there was clearly no alternative to the evolutionary approach.
Sir Colin Southgate agreed but argued it would be tactically wrong for the Bank to hide its true view.

Sir Adrian Cadbury argued that it was necessary to be clear as to what meaningful autonomy involved before deciding whether it was possible to achieve it through an evolutionary process. Sir Roland Smith observed that independence for the Bank would have an impact on the role of the Chancellor of the Exchequer and HM Treasury even if only at the margin. That would affect their attitude to such a change. He enquired whether the Bank had addressed that issue and had taken cognisance of the higher profile that would result for the Bank and the Governor in particular.

The Governor said that the Bank were aware of the change in profile that independence would bring and accepted that central bankers in the form of Messrs Greenspan, Poehl and Schlesinger were very much household names. However, they had achieved that position by building up public confidence and acceptability. It would be important and necessary for the Bank to do likewise in achieving credibility and winning over public opinion.

In supporting the evolutionary route Sir David Walker commented that it was a very difficult balance but he accepted that it was better to aim for what was achievable. He suggested the Bank should aim for as great a measure of independence as possible and hope to extend this in the future. He would prefer a robust discussion with Ministers setting out the Bank's ideal objective rather than to finish up with a fudged situation. It would be wrong to start on a false premise. Nevertheless he took note of the argument that nothing would happen without the agreement of Government and he accepted the evolutionary approach would involve some fudging. The Bank, however, should be clear in its thinking on what it wanted to achieve and he believed it would be sensible to let Ministers know our current thinking. Sir David Scholey suggested that other central banks had achieved their independence largely as a result of crises or other external pressures. Governments would not willingly give up the power to determine monetary policy. It was important therefore for the Bank to build up a broad measure of support. He felt that if the Bank emphasised too heavily the ideal statutory position, Government was likely to resist strongly.

The Deputy Governor said that he thought it would be quite difficult for the Government to commit itself, despite the Maastricht condition which, he agreed, was helpful. To commit itself the Government would need to explore thoroughly all the related issues; for example as to the appropriate functions of the Bank, and this would be both difficult and would take time. A statutory arrangement with accountability directly to Parliament worked most obviously in countries with a written constitution. In the UK such arrangements could be changed by any Government with a Parliamentary majority. Sir David Lees suggested that the other relevant factor was the attitude of markets. He favoured the evolutionary route but noted that the first step would involve considerable autonomy. Mr Laird felt that it was important that the Bank should spell out clearly in the initial paper what it really felt should be achieved or the Bank would have the worst of both worlds. He was concerned that under the evolutionary process, the first unpopular decision by the Bank would prompt Government to rescind the Bank's authority.

Mr Kent said that he was concerned about the tactics of convincing a highly sceptical Government that an independent Bank could deliver the result which we claimed justified the change. He wondered whether the instruments the Bank had available were sufficient to control inflation. The countries with the best inflation records, Japan and Germany, had the least open and most illiberal financial systems which seemed to make them more controllable. Our instinct, rightly in Mr Kent's view, was to go the other way but that made the problem of controlling the money supply and inflation more difficult. There were many alternative forms of money and credit, for example, through the overdraft system. Moreover people's behaviour appeared to have changed in the recent economic cycle. Could the Bank be sure it could deliver stability? Mr Coleby, noting this argument, said the Bank should be careful not to suggest that greater autonomy for the Bank would be a sufficient condition to provide lasting non-inflationary growth.

Sir Martin Jacomb favoured the evolutionary route but not to the exclusion of advocating statutory authority which was what was really required. He agreed that it was important to set out what the Bank wanted by way of authority but suggested that it would be inappropriate to press Government for a commitment, certainly in the present climate. In summing up, the Governor felt that any approach to the Chancellor at the present time would not be well received because of the problems the Chancellor faced in seeking Parliamentary endorsement of the Maastricht Treaty. He suggested, however, that the Bank should advocate the evolutionary approach with the aim of achieving statutory authority perhaps via the Maastricht Treaty.

Moving on to the second issue *"Do Directors feel that the continuation of the Bank's present range of functions is consistent with the proposed new role in monetary policy? and are there functions that the Bank should be willing to give up if this became a condition of operational autonomy in monetary policy?"* - the Governor said that Directors' responses had indicated no strong feelings to hive off Banking Supervision as a matter of principle but had accepted that it might have to be relinquished as part of the price for achieving statutory independence. As Court were aware from the discussion the previous week and as brought out in Mr Quinn's paper "Central Banking and Supervision" which Members had before them, there were two main objectives of supervision; systemic stability and consumer protection. The Bank's involvement in supervision stemmed from the former but it had become involved in the latter.

Mr Coleby said that the arguments against the Bank undertaking other functions were spelled out in the paper, they were four in number, namely, that other functions may (i) create a conflict of interest with monetary policy; (ii) divert the attention of senior management from monetary policy issues; (iii) adversely affect the reputation of the Bank; and (iv) weaken support for the Bank's autonomy if the Bank was perceived by some to promote sectional rather than national interest. Mr Coleby said that the first two arguments were regularly overstated - these conflicts were not a serious problem. Moreover, monetary policy had to be concerned with financial fragility and so it was important that the Bank was concerned about systemic risk. The last two arguments were more relevant. Supervision by the central bank led to exaggerated expectations so he would endorse Mr Quinn's desire to separate the systemic and consumer protection interests.

Mr Crockett agreed that banking supervision did not create an irreconcilable conflict with the monetary policy role. Under the statutory route he thought the Bank would have to give up certain functions but the evolutionary route offered the chance to reflect on how best to tackle this issue.

Sir Brian Corby said that there was a lot to be said for hiving off the retail end of supervision. The discussion the previous week had identified that need but had ruled it out because of the lack of any enthusiasm on the part of Government for further legislation. He suggested that the Bank should not enter into any "horse trading" but should argue for what it believed to be the appropriate mix of functions. If others felt this made the Bank too powerful this should be debated.

The Governor said if our progress towards independence was built up through the evolutionary to the statutory stage we would need to consider how our ancillary functions might be affected. He did not feel that they should necessarily be surrendered. He noted also the difficulty of distinguishing between the systemic and consumer protection interests. Certainly it would not easily be done by size of banks. Some small banks posed systemic risks while larger ones did not.

Sir David Walker agreed with Sir Brian Corby. In articulating our own views he suggested that we should identify those functions that it was necessary to retain and those we regarded as desirable. He said that in his view banking supervision was not a function the Bank should seek to keep but he did not think it was by any means the most important issue to be settled. Mr Laird also felt the Bank should argue for the mix of functions it believed to be correct and sustainable but warned that this may well appear self-interested. The consequence might be that the Bank would have to give up supervision.

The Deputy Governor suggested that it might be helpful to look at those functions that were necessary to conduct the business of a central bank. Few were essential, for example, funding operations, note printing and the consumer protection aspects of supervision did not fall in that category. These were issues that we should look at on their merits. They could be discussed discreetly and were for others to raise. Those questions had indeed been raised at regular intervals in the past.

Sir Colin Corness agreed with Sir Brian Corby and the Deputy Governor but said that the subject of Mr Quinn's paper was really a separate subject altogether. He commented nonetheless that the regulatory system was not in an orderly condition and needed attention. In his role as chairman of a building society he had been concerned at the volume of complaints - 77,000 outstanding at one time. These complaints had not all been appropriately addressed to the building society but they were indicative of the complete confusion in the minds of the public as to whom they should address their complaints. His view was that the supervisory role was not a negotiating tactic and the Bank should not let Government raise this as an issue in the independence debate.

Sir Roland Smith said that he felt all the Bank's functions should be tested against the list, which had been discussed earlier, of possible conflicts with monetary policy.

Sir Martin Jacomb said that the Bank must accept that it was impossible to accept any duties which might conflict with its monetary policy role.

The Governor questioned the nature of this conflict. The Bank should beware of becoming too remote from reality in administering monetary policy. The Bank needed to be close enough to the real economy to be able to manage monetary policy effectively. Mr Kent's area for example provided useful insights on the real world. There was general agreement to this proposition.

Sir David Lees said that what was lacking in the papers to date was an analysis of where the Bank hoped to end up. It was necessary to establish the end position at the beginning of any discussion or debate with Government.

Mr Quinn said that the core functions of the Bank included the stability of currency and the stability of the payment system.

To carry out these functions effectively the Bank did not have to do all that it currently did in supervision but it had to do some of it. The evolutionary approach, however, was not the way to achieve change in this context as the Bank has statutory authority for supervision. A change would require statutory change and that would be likely to go much wider than the Bank.

In looking at this issue from the point of view of the Bank as an employer, Mr Harris said that by off-loading various functions there would be less interesting work to attract good new staff. Moreover when the European Central Bank was established there would be little role for staff in the Bank of England in the field of monetary policy. The demand for staff had to be planned a considerable time ahead.

In focusing on the third issue *"Do Members of Court believe it would be feasible/appropriate to adapt the existing structure of Court in the manner described?"* the Governor said that in essence there were two alternative structures. In the first he envisaged Executive Directors alone determining monetary policy with Court acting in its current advisory and monitoring capacity. Court could not be involved directly in taking decisions of detail as to the amount and timing of any change in interest rates as this would inevitably create a conflict of interest for some if not all Non-Executive Directors. Court would have an input in advising and formulating policy during discussions of the monetary situation when Non-Executive Directors could press their views on the Executive. However they would be spared the embarrassment of knowing precisely details of timing and changes in interest rates which might take place.

An alternative structure would place the power of deciding monetary policy in the hands of the Executive who would be joined by two or three Non-Executive Directors for whom there would be no conflict of interest. The Governor accepted that this proposition would be unacceptable to some Members of Court as it appeared to create first and second class membership.

If the move towards independence went down the evolutionary route we would of course have to live with the current Court structure but if the move was statutory, changes could be brought about in the Bank of England Act.

Sir David Lees asked whether it was anticipated that the discussions on monetary policy would continue to be of a general nature as at present or whether it would be appropriate to offer precise proposals and ideas. The Governor said he would not think it amiss even now if Members suggested precise proposals. He enquired what Members' position would be if they knew precisely what was going to happen in the financial markets and when. Sir David Scholey responded that he would not be able to attend any worthwhile discussion of monetary policy. Sir Martin Jacomb endorsed this stance saying that if decision-making involved confidential material then Non-Executive Directors with outside interests could take no part in it. He reminded Members of the Bank Rate Tribunal. The Governor wondered whether much information was withheld from Court to avoid given them a conflict. The Deputy Governor said that greater openness now meant that the statistical information was generally available to any interested party with only modest delay. He agreed with Sir Martin Jacomb that Non-Executive Members of Court could make an active input to discussion of the arguments and counter-arguments; but the Executive would then have to take the final decisions, explaining subsequently those decisions to Court.

Sir Brian Corby said that it was not just a question of actual conflict but of perceived conflict. If a company which had a connection with a Non-Executive Director appeared to act on profitable information even though acting independently, the public reaction would be particularly adverse.

Sir Adrian Cadbury said that because the Bank would be under political pressure in deciding monetary policy it would be necessary to have two separate bodies, a decision making body and one to whom that body reported. The second body could be Court as presently constituted and although it would be advisory it could provide a measure of protection to the Executive. It would not need to meet so frequently but would have to do so sufficiently frequently, say monthly, to be able to test the Executive's thinking. Under this structure however in the event of the Executive consistently ignoring the advice of Court it might be more difficult for Court to support the Executive publicly.

Sir David Walker in agreeing that conflicts of interest should be avoided favoured a variant of the Governor's second model. He felt there were those with relevant expertise and who did not face a conflict who could be involved in setting the parameters of policy - though not the day-to-day tactics. Sir David said he advocated this approach as he had a distaste for undue concentration of power. He suggested that it would be hard to envisage a structure involving only the Executive in which the Governor would not be seen as the sole effective decision maker. He also questioned whether it was satisfactory for the Executive not to have formal voting rights. The Governor noted that Sir David Lees felt likewise.

Drawing on his overseas experience, Mr Crockett said that he doubted whether it was practical to adopt the existing structure of Court. Those empowered to take decisions would have to have sole allegiance to the Bank. The role of the Non-Executive Director would therefore be confined to participation in an advisory board. Moreover the Executive could listen but not explain why their thinking differed - that would itself constitute inside information. Decisions on monetary policy would have to be an executive decision, but not necessarily by an Executive as currently constituted. He suggested that within the Executive, responsibility should be collective and not personal given the nature of the public policy responsibility. A voting structure would also better protect the Executive.

Mr Laird said that he had not begun by favouring a structure where only the Executive took the decisions but he now understood the nature of the potential conflict between monetary policy decision-making and other responsibilities. He disagreed with having two types of Non-Executive Director and so concluded that there should be an Executive group with voting powers who should confine their thinking to monetary issues only with other topics, including the wider economy, staffing matters etc continuing to be brought before the whole Court.

Sir Colin Corness said that in his view it was not possible to adapt the present Court. He did not agree with having two classes of Director, one being the decision takers and the other being purely advisory. For this reason he would support a system with two Boards so that it would be obvious to all where the decision-making process lay. It remained essential to have outside advice from people such as the current Non-Executive Directors (it was in this area that HM Treasury had gone wrong). He believed it would be difficult to establish an extended executive body with executive powers but no conflicts of interest, as proposed by Sir David Walker; Sir Colin suggested that such people, who by definition could neither be Chairman or Chief Executive, would be yesterday's men.

The Governor said that if the first steps towards independence were to be evolutionary rather than statutory, it would be necessary to work within the present Court structure. Court need to consider how it would operate in the intermediate stage.

Sir Colin Corness said that each Non-Executive Director would have to make his own decisions. Comparisons with public companies were not valid. In a public company a Non-Executive Director was free to resign if he did not agree with the Company's policy or decisions, but this would be wrong for Non-Executive Directors of the Bank: they were therefore locked in for four years and would be accountable for ensuring decisions were properly taken even though they would not be the decision-takers.

The Deputy Governor said that in his view the model that Sir Colin was proposing with two Boards was in fact the structure that the Governor had suggested earlier, namely, with the Bank's Executive taking the decisions and the wider Court providing advice. Sir Colin Corness, however, said that under the present arrangements it was widely known that Government was responsible for monetary policy and that the Bank acted only in an advisory role. Once it was known that the Bank had responsibility for monetary policy the general public would assume that Court had that responsibility. The Deputy Governor said that this pointed to the need to make absolutely sure that the public were fully aware of the respective roles and responsibilities of the two "Boards" within the Bank. This was essential for credibility.

Sir Brian Corby endorsed this view but questioned the need for the Executive to have voting rights as suggested by Mr Crockett. If the voting was not unanimous it would be necessary to make it known publicly. Mr Crockett responded saying that he did not have strong views about publication, it was not necessary - the Bundesbank did not publish the voting although the Federal Reserve did, albeit with a delay. The Deputy Governor said he had strong reservations on voting. In practice, the Governor would always have to take the Executive with him and would have to maintain the confidence of Court. This was why there would be a need to explain to Court how and why the Executive took the decisions. There was always a danger that voting results would become known and split decisions could be damaging. The credibility of the Executive would be weakened if it was known that there were deeply divided opinions within that group. Secondly, he suggested that voting was totally alien to the Bank's tradition and whilst he was not against change he felt that the introduction of voting arrangements would change the character of the institution. The Governor too said that he was against voting as he preferred to be able to listen to a minority.

Sir David Walker explained that he envisaged there would be a very large range of issues on which there would be no vote.

The Governor suggested that the fourth issue, *"Should accountability to Parliament continue to be through the Government, as at present? Should other means of strengthening the democratic legitimacy of the Bank's operational autonomy be pursued?"* might be considered under two headings. These were immediate accountability under the evolutionary route, and accountability under the statutory provisions. The Governor said that Members' views centred around accountability to Government and through Government to Parliament. This would mean that the Government would retain its existing authority to override the Bank on policy matters. Such an override need not nullify the Bank's autonomy. An override exists in Canada and the Netherlands, among others,

and enables the Minister of Finance to be answerable to Parliament for the central bank's actions, but does not require him to endorse them. He may respond, in effect, "this is why the Bank acted as it did; and while I did not agree with the reasons, I did not believe the public interest would be served by overriding the bank's judgement". The Governor questioned, however, whether a Minister would ever speak in such terms to the House of Commons. He could also say "I believe that it is in the public's interest that the bank's decision should be overridden". But this would bring into the open a conflict between the Chancellor and the Governor, with the possibility of a resignation of one or the other being the result.
Mr King said that the question of accountability was the key issue. He was uneasy with the evolutionary route because in those circumstances the question of accountability was difficult. The Chancellor could not delegate his responsibility, which was clearly to Parliament, so unless Parliament itself delegated responsibility to the Bank, it would not work for long. The question was whether the evolutionary route would survive long enough for statutory change to be introduced. He was also concerned about the conflicts of interest. Problems could arise if an institution had too many responsibilities. In his view there was a need to be explicit in explaining who was responsible, and to whom and for what. The Executive would not be responsible to a non-executive board but to Parliament through the Chancellor. The Bank would need a clear remit for monetary policy. If the evolutionary route were adopted the Inflation Report - to be discussed by Court later that month - would be a very important first step in establishing the Bank's credibility. The Governor said that if we could reverse the presumption as to who made the decisions and who had the override in exceptional circumstances, the Bank would have gone a long way towards achieving its objectives. But how could we achieve this?
Mr Crockett said that the accountability question was difficult. We should be perfectly open to the public - and not just to an internal board or Court - in explaining what we had done and why. On the question of the override, Mr Crockett said that the Chancellor had responsibility to

exercise the override. If that override did not exist and the Bank had statutory authority, it would have to be responsible directly to Parliament. In the short term the task was to convince the outside world that the Bank was legitimately exercising the de facto power. This could be achieved by giving direct responses to Select Committees and by being seen to be subject to democratic processes for example through public scrutiny of appointments to the Bank's Executive.

Sir Adrian Cadbury questioned the statement that the Executive Board should not be responsible to Court. Surely the ultimate responsibility to ensure the process was conducted properly would be that of Court. The problem was that the existing membership of Court was unlikely to be acceptable.
The Governor said that in those circumstances Court could end up with very considerable authority. If the Governor and Executive team operated in a perverse or incompetent way, the senior Non-Executive Director should make it clear to the Governor and the Executive that they no longer enjoyed the confidence of Court.
Sir Colin Southgate questioned whether the Executive would be prepared to work within tight terms of reference and questioned whether the Non-Executive Directors would ever have an opportunity to exercise responsibility in the way the Governor had outlined. The Governor said he did not envisage Court taking the decisions but he thought the Executive would have to be open with Court. Sir Colin said this was not the same as Court being equally and severally responsible as the Board of a public company would be. The Governor said the Bank was bound to be different, Court was more like a council or advisory body.
Sir Martin Jacomb said that Parliament would require accountability to it in some form for the exercise of monetary policy. At present this was achieved by the Chancellor of the Exchequer responding to questions in the House of Commons. Some such mechanism would be needed through the evolutionary period and he questioned whether there was any other way of achieving similar accountability. The accountability was likely to remain with the Chancellor and through him to

Parliament. A solution might be for the Bank to be accountable to a Select Committee but this was likely to be very difficult to achieve in the British constitution.

The Governor then drew attention to the fifth issue "*Is it agreed that the case for greater autonomy for the Bank should be made by means of a paper sent by the Governor to the Government (to the Prime Minister copied to the Chancellor?) on behalf of the entire Court. How would the Bank overcome accusations that it was promoting its self interest? Would it also be agreed that formal lobbying of outside opinion would not be appropriate until the Government had been given an opportunity to respond to this paper?*"
There had been general agreement on this issue and the Governor proposed that a draft paper taking account of the points raised at Court that day should be prepared and re-submitted to Court with a view to it then being addressed to the Chancellor of the Exchequer.
Finally, the Governor said that he hoped Members of Court would regard these discussions as confidential. He had been concerned to read reports in the press that the Bank was discussing this issue, even to the extent of one paper identifying the date of the discussion.

R. D. Hoffmann
Assistant Secretary
28th January 1993

E. A. J. George
28th January 1993

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 21 JANUARY 1993

Present

Edward Alan John George, Esq, Deputy Governor
Brian Quinn, Esq
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mervyn Allister King, Esq

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

(i) With reference to a Minute of 23 July 1992, Mr Kent informed Court that agreement had been reached on 18 January to sell the Agricultural Mortgage Corporation to Lloyds Bank. Completion of the sale would not take place until the result of the review by the Office of Fair Trading was known but confidential

[redacted]

guidance suggested that referral to the Monopolies and Mergers Commission was not anticipated. It was likely, therefore, that completion would take place around the middle of February, before the end of the Bank's year.

Lloyds Bank were paying £31.4 mn for AMC as a whole, representing 55% of net asset value as at end-December 1992. The gross realisation for the Bank was £8.5 mn against an investment recorded in the Bank's books at £205,000.

In response to a request from the Deputy Governor that the Bank should take professional advice before accepting Lloyds Bank's offer, Mr Kent said that Morgan Grenfell were of the view that there would be considerable difficulties in implementing any alternative solution and had therefore recommended that the Bank should accept the offer from Lloyds Bank.

(ii) [redacted]

[redacted]

(iii) [redacted]

R.A. Hoffmann
Assistant Secretary
28 January 1993

E.A.J. George
28th January 1993

A COURT OF DIRECTORS AT THE BANK

THURSDAY 28 JANUARY 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 14 January were confirmed and those of last week's Meeting, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

1 With reference to the Minutes of 19 and 26 November the Governor brought Court up to date with regard to the replacements for the three Non-Executive Directors who were retiring from 1 March.

[redacted]

2 [redacted]

3 The Deputy Governor spoke about the arrangements for the Central Bank Symposium in 1994 which is to act as the centrepiece of the Tercentenary celebrations. The Bank have in mind inviting all Central Bank Governors from around the world. It is proposed the Symposium should comprise three sessions - the evolution of central banking; comparing central banks around the world; the philosophy of present day central banking. It is the intention to invite two distinguished academics to submit formal papers to cover the first two sessions. Those the Bank have in mind are
Professor Charles Goodhart of the London School of Economics and Professor Stanley Fischer of the Massachussets Institute of Technology. The Deputy Governor said he was seeking Court's agreement in principle to the commissioning of the two papers. This was duly given.

At the Governor's invitation:-

1 In introducing his Report to Court, Mr Smith, the Head of Industrial Finance Division, said that there were a few points he would like to highlight. Firstly, as Mr Kent had outlined last summer when the Head of Financial Markets and Institutions Division had made his report, IFD represents the other "arm" for a range of issues which derive from the flow of saving through the City to users of capital. In IFD's case, there is as great an emphasis on the users in that the Bank's industrial liaison function is a direct responsibility of the Division. The value derived from this function is considerable and they had made a number of changes in the last three years to the way in which the information collected by the Agents was processed, with the aim of meeting the needs of senior management and other users in Head Office. The process of adapting to ever-changing needs would, of course, continue.

Secondly, the nature of the Division's functions required them to build bridges with both sides, that is providers and users. Mr Smith said he believed it was important to create opportunities for them to listen to the views of others, whether their views related to the effect of policies on sectors of the economy or to the ability of the financial system to meet the needs of their customers. He placed considerable emphasis on ensuring that his staff saw these contacts, whether in the City or in industry, as an important element in developing their ability to contribute to their output, whether it be on the economic environment or on a topic such as the financing of small businesses.

Third and lastly, Mr Smith believed that the nature of the Division's work, much of which could be driven by external events, provided a useful developmental opportunity for Bank staff. Whilst their role might not relate in a major way to the Bank's Core Purposes, there were many indirect benefits for the Bank in the roles they played. Mr Smith said he had provided his own assessment of the effectiveness of the Division in the report and would add that the last year had brought a continual stream of issues for them, placing at times considerable strains on their resources.

Sir Christopher Hogg opened the discussion that followed by enquiring to what extent the Division were pro-active with their own agenda as opposed to reacting to their in-tray. Mr Smith responded by saying that they sought to be pro-active but the problem was the pressure they were subjected to from external events beyond their control. They found themselves having to react more than they would wish. Nevertheless they tried to identify topical issues especially those with which the City saw the Bank were involved. They were currently carrying out a survey of issues that were surfacing as the economy picked up. They were examining the way the Insolvency Act was operating and what could be done to facilitate the process of preserving companies. Also they were involved in the short-termism debate. They recognised the importance of being pro-active and in this context sought to identify trends which the Governor could include in his speeches, of which the property sector was a recent example. Lord Haslam said he wished to pay tribute to the Agents and their reports which he found had become most perceptive. He went on to mention export finance and in particular ECGD which he considered a very tame operation. It was very important that they should provide cover for the costs of contracting companies. On this subject Sir Martin Jacomb said there was a misconception in the Treasury of the inflationary effect of such expenditure. In his view it did not exist and the Bank should try and correct the misconception. Sir David Scholey expressed his support for IFD. There were three questions he wished to pose. Much of their performance depended on leadership and the quality of people involved - were the best people keen to work in IFD? From the aspect of cost benefit - what was the cost? Was it right? Co-operation with the DTI was not always productive and constructive - what was the potential for duplication? In responding to the first and last of these questions, Mr Smith said IFD had a good reputation in the Bank amongst staff and he had no difficulty in getting the right people. In answer to Sir David Scholey's further question of whether or not it was a positive place to go in career development, Mr Harris said that whilst not a natural home for the top flyers, because there was less emphasis on economic skills, it attracted a wider spread of talent. With regard to relationships with the DTI, Mr Smith said there had been a significant change in their interest in topics which in turn had led to closer contacts.

On the question of cost benefit the Deputy Governor said it was a pragmatic decision within the context of the overall budgetary work. As regards on-going functions, the Bank-wide expenditure constraint meant that Budget Centres were required to ask themselves if everything they did was necessary and if so were they doing it in the most effective way. Any inconsistencies that arose as a result were discussed in the Deputy Governor's Committee. It was not possible to measure output, only the cost of input.

In conclusion, the Governor mentioned that at the Chancellor's behest IFD had prepared a paper on lending margins to small firms. This had been well put together answering the questions raised in a succinct manner.

2 Mr King spoke about the draft Inflation Report which would appear for the first time in the next Quarterly Bulletin, due to be published on 16 February. The Report had two objectives. The first to satisfy the commission given to the Bank by the Chancellor "to provide a regular report on the progress being made towards the Government's inflation objective". To meet this objective required a fairly punchy report with a clear message about the direction in which inflation was headed. The second objective was to make the Bank the

authority on developments in, and understanding of, inflation. Over time, as the Bank became recognised as the authority on inflation, it was hoped that we would also become the authority on policy towards inflation. It was perhaps in this way that the Bank might acquire greater independence. It was not easy to reconcile these two objectives, perhaps a combination of summary and full report was the answer.

Inevitably, to provide an authoritative report required an exhaustive treatment of inflation. Mr King said he thought the detail was important if the Bank were to establish their reputation as the authority on inflation. An example of this had been a continuing debate about which was the "right" measure of inflation. Was it the headline RPI; the RPI excluding mortgage increases which was the basis for the Government's target for inflation; was it a new measure of "core" inflation, or was it a new measure altogether which treated housing in a very different way? In our opinion, the debate about which was the right measure was fruitless. There was no need to choose between them. The Report presented the information necessary to assess all of these various measures. When the measures moved together we could point to the robustness of certain conclusions, and when they did not we could try to explain why.

This, Mr King said brought him onto the question of the audience for the Inflation Report. There would of course be a summary at the beginning of the Report which would bring together the main findings and conclusions. But most people would learn of the Inflation Report, not by reading it directly, but by reading reports of it interpreted by newspaper and other communicators. To some extent, therefore, the Report had to convince this audience.

Turning to the main findings of the Report, underlying inflation - measured as the increase in the RPI excluding MIPS over the previous twelve months - was just below the ceiling of the Government's target range of 1-4%. It was expected to remain there, although there was some possibility that it might rise above the 4% level for one or more months later in the year. Such an outcome would clearly be more likely if sterling were to depreciate further. But the length and depth of the recession meant were was a continuing downward pressure on inflation - the annualised rate over the past three or six months - and other ways of constructing indices of inflation all showed that inflation was currently below the 4% ceiling.

When assessing the stance of monetary policy, it was not current inflation but anticipated inflation one or two years ahead which was relevant. One of the main contributions of the Inflation Report was to stress the need to look forward. In the absence of unexpected shocks, it was likely that inflation would fall very slightly during the course of the next year. But of course unexpected shocks always materialise. That was why forecasts were never accurate. Indeed we did not see the value of such forecasts in terms of their predictive ability, rather that they provided a benchmark against which the actual outturn might be evaluated. It was then possible to compare the outturn with the forecast range in order to discover what had been the "news" contained in the actual outturn for inflation.

It might appear a relatively reassuring outlook. But there were many ways in which inflation could turn out to be higher than anticipated, and most of the risks were for inflation to be higher not lower than the central outlook. There was as yet no sign that private sector expectations of future inflation were compatible with a target range for inflation of 1-4% and a long run target of 2% or less. A real test of whether the strategy was successful would be seen in terms of the rates of increase of wage settlements and earnings over the next year or so. But the message for the moment was so far so good.

In opening the subsequent discussion Sir Adrian Cadbury said he thought the Report had been well set out. It was essential at the moment that the Bank should be shown as an authority on inflation. He was concerned however that the supporting charts gave a more comfortable impression than the text - perhaps a health warning should be attached to the former.
Sir David Lees thought there was a lot of emphasis on real wages. He was unclear whether the adjustment in real wages was more or as important as the pressure on unit labour costs in the terms of inflation. If unit labour costs were low and productivity high absolute amount of wages were less important. He asked why the emphasis in the conclusion was not perhaps on unit labour costs as opposed to the need to suppress real wages. Mr King responded by saying that when unit labour costs were held down primarily by firms shedding labour, leading to rising unemployment, the resulting growth in productivity was likely to be unsustainable.

The Governor asked if the impact of real wages in the industrial and service industries was the same question. In the long run a lower exchange rate would see a higher price level. In the short term a rapid pass-through of depreciation to inflation could be avoided if real wages were adjusted.
Sir Christopher Hogg enquired what impression the Governor had of the Government's appetite to control inflation. The Governor said he had noted strong protestations but if the moment came to tighten policy he wondered what affect parliamentary opinion would have on their resolve.
Sir Colin Southgate felt the summary should be distinct from the main body of the paper. He had the impression there was more comment on areas of inflationary pressure.
For his part Sir David Scholey made a plea with regard to the communication of the Report. He considered there were three audiences the Report needed to hit - informed

commentators; the wider and intelligent consumer audience via Bank Briefing and the broad range of business people who could benefit from constructive interpretation of the Bank's viewpoint. It was important not to rely on intermediate agents.

In response Mr King said that in addition to the normal distribution it was intended that there should be a major drive towards educational outlets with the Report being sent to Universities, Schools and bookshops. Also, it was intended to give journalists longer to absorb the contents as well as giving the Report to Bank staff to take on visits outside the Bank.

In accordance with Section 10 of the Charter, the Governor, Messrs Quinn, Coleby and King withdrew, together with Mr Harris. In accordance with Section 6 (2) of the Charter, Sir Adrian Cadbury, in his capacity as Chairman of the Remuneration Committee, then took the Chair.

Sir Adrian Cadbury said in this role there were two matters he wished to bring to Court. Firstly, Members would recall that with Court's approval the Remuneration Committee had implemented the final stage of the revised structure for the remuneration of the Bank's Executive, achieving parity as at 1 January 1992, with the market salaries at Executive Director level - their identified benchmark. The Committee had an ongoing responsibility to review these salaries annually. At a meeting on 26 November, the Committee came to the conclusion that taking into account current market salaries and the introduction of a ceiling of 1 1/2% for increases in public sector salaries, it would be inappropriate to enhance the salaries of the Bank's Executive further with effect from 1 January 1993. It would be the advice of the Remuneration Committee that the salaries of other bodies, such as the SIB and Board of Banking Supervision, should be treated similarly this year. Accordingly, it was proposed that the Governor's salary

and the salary ranges for other members of the Executive remain unchanged. This was approved.
Sir Adrian Cadbury mentioned that the remuneration for the incoming Governor and Deputy Governor, who would assume office on 1 July, would be a matter for a further discussion and proposals would be brought to Court in due course.

The second point Sir Adrian Cadbury said he wished to raise was in connection with the provision for performance related increases within the prescribed salary scales for members of the Executive. He had met the Governor earlier in the month to discuss the matter and subsequently had consulted his colleagues on the Remuneration Committee. As a result, he wished to recommend two performance related increases with effect from 1 January 1993. The recommendation was approved.

R.A. Hoffmann
Assistant Secretary
4th February 1993

E.A.J. George
4th February 1993

[redacted]

A COURT OF DIRECTORS AT THE BANK

THURSDAY 4 FEBRUARY 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Sir Christopher Anthony Hogg
Mervyn Allister King, Esq
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges, including the Official Reserves figures for January, and the state of the domestic markets.

Under the weekly executive report:-

(i) [redacted]

[redacted]

(ii) Mr Harris mentioned that normally he would not be bringing pay as a topic to Court at this stage of the year. However, it would be helpful to have Court's endorsement of the Bank's stance vis-a-vis the Chancellor's policy of pay restraint in the public sector. The Bank needed to address the issue now as there were two settlements due on 1 March - those for the Registrar's Department and BE Services. These would be followed by Debden on 1 May and the main bargaining units on 1 July.

The executive considered that the Bank had no option but to follow the policy which restricted settlements to between zero and 1.5% for settlements during the current year. The one debate had been about the situation at Debden where the Bank traditionally followed the nationally negotiated trade increase. This had been seen to have worked to the Bank's advantage in that, certainly over the past 10 years, the cumulative increases had been less that those negotiated for Banking Staff, whilst maintaining industrial peace. However, the Governors recognised that the Government's policy was intended to override traditional arrangements this year, and Mr Kent and his senior management would be discussing this through normal channels during the next few weeks.

Mr Harris said that with Court's agreement he would like to send BIFU a letter now which related specifically to the Registrar's Department and BE Services, although implicitly the other bargaining units would follow suit in due course unless anything extraordinary happened in the meantime. Court's agreement was duly given.

At the Governor's invitation:-

1 Mr Quinn in introducing three Resolutions delegating various authorities reminded Court that the powers conferred on the Bank by the Banking Act and other legislation rested in the Court of Directors and could not be exercised by officers of the Bank unless Court delegated authority to them.

Mr Quinn reminded Court that on 13 July 1989 it resolved to authorise the persons for the time being holding the positions of Governor (as defined in the Regulations), Head or Deputy Head of Banking Supervision Division or Head of Wholesale Markets Supervision Division (or any successor positions to such positions) to exercise severally on behalf of the Bank the powers, duties and functions of the Bank under the Banking Act 1979 and the Banking Act 1987. The persons described in the 1989 resolution were also authorised to delegate their powers to other officers of the Bank.

With effect from 1 January 1993 the Banking Co-ordination (Second Council Directive) Regulations 1992 had conferred various new powers, duties and functions on the Bank in connection with the implementation in the United Kingdom of the EC Single Market. The new powers, which were somewhat technical in nature, would apply in respect of UK authorised institutions which were seeking to passport into other EC countries and European institutions which wish to operate in the UK. The first draft resolution, before the Court for consideration had the specific effect of extending the delegation which was conferred in 1989 in respect of the Banking Act to the new powers conferred in the 1992 Regulations.

With regard to the second draft resolution Mr Quinn reminded Court that the Financial Services Act 1986 conferred on the Bank various powers and functions in relation to the wholesale money markets and that the Bank also exercised certain powers and functions in respect of operators in the gilt-edged market. It was considered important that the delegation of these powers to officers of the Bank should also be formally recorded. Accordingly, the second resolution provided for Court to delegate to the Executive Director responsible for Monetary Policy and supervision of the Wholesale Markets, authority to exercise on behalf of the Bank any and all of the powers conferred on the Bank under the Financial Services Act 1987 and the powers of the Bank in respect of the operation and supervision of certain institutions conducting business in the gilt-edged market. In this and all other respects, the delegation which would be effected by making this resolution was identical to the delegation which was put in place by the 1989 resolution in respect of the Banking Act 1987.

The purpose of the third and final draft resolution was to clarify that the officers who were already authorised to exercise the Banking Act powers - and those who would receive new authority if the Court made the two draft resolutions already described - were properly authorised to take any action which was ancillary to the exercise of the powers themselves. The practical need for this resolution arose mainly in relation to affidavits. Exercising some of the Bank's powers under the Banking Act involved an officer of the Bank in giving an affidavit on behalf of the Bank. It was felt important that incidental action of this kind should not be impeded through a challenge to the authority of the officer concerned.

Mr Quinn went on to say that he would also like to remind Court that when it delegated authority for the exercise of the Bank's powers under the Banking Act it was established that Court should be informed of the exercise of this delegated authority at the time when the Annual Report under the Banking Act was submitted. At the time Court also agreed that the names of those persons to whom the powers were subsequently delegated should be reported periodically. Mr Quinn said he felt it was appropriate that similar reporting requirements should apply in respect of delegated authority to exercise the Bank's new powers under the Banking Co-ordination (Second Council Directive) Regulations 1992 and the Financial Services Act 1986, and in relation to the supervision of institutions in the gilt-edged market. He suggested it would also be convenient if Court were to receive all reports in respect of the Bank's supervisory functions at one time, and therefore sought members' agreement that these additional reports should be made at the time when Court received the Annual Report under the Banking Act. This was duly agreed.

Court then resolved that with immediate effect the resolution of 13 July 1989 should apply to any and all of the powers, duties and functions conferred on or vested in the Bank by or under The Banking Co-ordination (Second Council Directive) Regulations 1992 as it applied to the powers, duties and functions conferred or vested in the Bank by or under the Banking Act 1979 and the Banking Act 1987.

Court also resolved that with immediate effect the person for the time being holding the position of Executive Director responsible for Monetary Policy and Operations and the supervision of the Wholesale Markets (or any successor to such position) be authorised to exercise on behalf of the Bank any and all of the powers and functions conferred on or vested in the Bank by or under the Financial Services Act 1986 (as amended) and all powers duties and functions of the Bank in respect of the operation of, and the supervision of institutions conducting business in, the gilt-edged markets, with power to delegate at his sole discretion and on such terms as he thinks fit any and each of such powers, duties or functions to any officer, servant or agent of the Bank. The authority hereby conferred shall with immediate effect supersede and replace any or all previous authorisation in relation to the same matters, without prejudice to anything done pursuant to any such previous authorisations prior to the passing of this resolution.

Finally, Court resolved that each of the persons authorised by the resolution of the Court dated 13 July 1989 (as extended) or by the immediately preceding resolution to exercise on behalf of the Bank the powers, duties and functions therein referred to be further authorised on behalf of the Bank to do anything and to execute any document (including without limitation the giving of evidence by affidavit or otherwise in connection with any proceedings) which might appear to him to be necessary or expedient for the purposes of any matter arising under, as a result of or in connection with the exercise of any such power, duty or function, with power to delegate at his sole discretion and to such extent and on such terms as he thinks fit such further authority to any officer, servant or agent of the Bank.

2 The Governor having declared his actual interest in the Court Pension Scheme and the potential interests of the Deputy Governor, Messrs Quinn, Crockett, Coleby and King, invited Sir Adrian Cadbury to present a Report of the Bank of England Court Pension Scheme which was laid before Court.

3 Mr Crockett introduced a report from the Heads of the three International Divisions: Mr Foot responsible for the European Division, Mr Collins, in Mr Latter's absence on secondment in the Ukraine, for the Industrial World Division and Mr Page for the Developing World Division. He went on to say that the main functions of the International Divisions could be grouped under three heads:-

(a) information and analysis concerning developments abroad;

(b) representing United Kingdom interests abroad through contacts;

(c) the improvement of international economic and monetary conditions through co-operation with the monetary authorities of other countries.

In introducing his area of responsibility, Mr Foot said the paper spoke for itself. He had been Head of the Division for most of the three years or so that it had been in existence. Covering both West and East Europe had provided his Division with fascinating cross-continent insights. Their work had moved rapidly during their existence. Now they were still interpreting the Maastricht Treaty and, with other areas of the Bank, working on preparations for the EMI scheduled to begin on 1 January 1994. There was also a steady diet of work on major West European economies, EC Directives and Studies of financial centres and markets in Europe. They had as well had to place additional analytical resources on to Eastern European issues. As the Governor commented, they had a heavy workload.

In opening the discussion that followed Sir David Scholey enquired about the relationship between members of the Division and their peers in Europe. Mr Foot responded by saying that members of his Division visited Europe on a fairly frequent basis both generally and specifically for meetings of European Committees. Such visits helped form close relationships. They also ensured that new members to the Division got to know their counterparties in European banks quickly. Mr Page endorsed these remarks adding that the Senior Advisers in his Division spent on average 20 to 30 days abroad a year. The Bank also welcomed many visitors to London. Sir David Scholey said he remembered from a visit to the Division some 5 years previously how few members of the staff had travelled but that now appeared to have changed. By way of illustration Mr Foot mentioned that he visited Basle once a month, undertook 3 or 4 short parish visits and 2 or 3 longer trips a year. In the European Division, out of a work force of 25 or so professionals, one man year was spent on travelling. Sir Colin Corness wondered how this activity compared with that of the French and Germans. He asked this question because he had noticed in the context of the DTI the British input was low. In similar vein the Governor asked how the French and German Central Banks' contacts with industrial countries compared with our own. Was it true or not that we had better contact with the rest of the world than other industrial countries had as witnessed by the annual meeting we held of Central Bank Governors from the former sterling area? Mr Page thought this to be true, with the possible exception of the French with their former colonies, although this was the French Treasury not the Central Bank. Mr Collins added that he was sure that he and his team visited the FRB more frequently than those from other Central Banks (although the Banque de France had an official actually situated in the FRBNY), and Mr Foot instanced the Centre for Central Banking Studies which had helped considerably to develop relationships through their courses for developing countries.

Sir David Lees observed that he saw the work of the International Divisions as essentially one of co-ordination, co-operation and assistance. As a result it was difficult to assess the appropriate size of the Divisions, how to measure success and the quality of advice that was given. Mr Crockett said this issue could be addressed at two levels. Firstly, in terms of the value of the briefing received by the Governors, himself, and others. In this regard he considered what he received was about right. He regarded the resources of the Divisions as being adequate. On the second level it was a question of what the objectives of the United Kingdom should be. In part, the answer to this was to promote the satisfactory evolution of the world economy. In this regard the Bank compared favourably with their peers. The Governor commented that he was kept well informed. He saw as one of the problems of the Divisions the need to undertake work that out of necessity had to go into store for the future. He wondered if, as a result, some of the analysts felt their work unnecessary and to what extent information needed to be stored. In response Mr Page said they aimed to build up a body of expertise. The value of this had been shown, for instance, when Iraq invaded Kuwait, when their knowledge had proved helpful. Mr Quinn agreed and added that users in the Banking Department and Banking Supervision Division were helped by the information they received from the International Divisions. In recent years, the International Divisions seemed more attuned to the needs of users elsewhere in the Bank than had been the case in earlier years.

Sir Brian Corby felt that one of the objectives of the Division should be to enhance British opportunities overseas in unison with the Government. Referring to the Divisions' objectives, he questioned the effectiveness of the Divisions in promoting the UK financial services sector abroad. Mr Crockett responded with two examples of the Divisions' work in that field. He had been in Tokyo the previous week identifying areas where the United Kingdom had insufficient market access. One of these had been Pension Fund management and subsequently discussions had been set up. Also the Division promoted inward and outward missions of British Invisibles as well as providing help with staffing and funding. Mr Page gave a third example that of the Divisions' role in acting as an intermediary between institutions and foreign governments in order to help resolve problems.
Sir David Scholey commented he found the Bank support for financial services overseas very consistent and active.
Sir Christopher Hogg said this presupposed the monitoring by the Bank of City firms and their effectiveness.
Mr Foot answered by saying that they did not push the merits of one firm over another.

Mr Kent added that concerns about the competitiveness of British firms was essentially a question for the Financial Markets and Institutions Division. The International Divisions essentially dealt with the external implications. For example, they were concerned with the extra-territorial result of US legislation which was posing a threat to our institutions and their markets. But we were repulsing such threats by collective action. Answering a comment from Sir David Scholey that the Bank did not appear to say to groups of firms that they were not doing well in a particular area, Mr Kent said firms generally preferred we left it to those with a market interest to make the running. The Governor asked if on one of our overseas visits we heard British companies were not as competitive as their rivals, what did we do about it? Did we speak to companies on our return? Mr Crockett responded by saying that when we picked up any criticisms we passed them on through the relevant channels trade committees, in any of which we were involved, or, to British Invisibles. Mr Kent mentioned in the context of Eastern Europe that when we had been concerned that the City were not responding adequately we had taken the initiative. However many City institutions did not want to pool their knowledge. We had also arranged for someone to be seconded to British Invisibles to set up a clearing house for information on Eastern Europe.

The Governor then asked Mr Collins if there was anything he wished to add specifically in his role as acting Head of the Industrial World Division. Mr Collins said his Division had been formed as a result of an amalgamation of two Divisions and one of the most challenging aspects of his work had been welding together their two different approaches into an able and well-motivated consistent whole. Posed the same question, Mr Page said the main issues affecting the Developing World Division had already been discussed. He noted that as well as covering a number of developed countries such as Australia, his Division were also responsible for relationships with the

IMF and the International Development Banks such as the World Bank and EBRD as well as for international debt issues. He referred also to his responsibilities for administration, staff and budgets within the Division and in this context had been responsible for the priorities and training reviews.

In making a general observation Sir Christopher Hogg said he was uneasy about the international consciousness of the Bank as a whole and for that matter the Treasury. He hoped that the Bank response in this field was not just delegated to the International Divisions. In answer Mr Crockett said he saw every month details of the overseas travels of staff throughout the Bank and 75% was from outside the International Divisions.

On the subject of international awareness of the Bank as a whole, Mr Harris instanced that a member of his Division had just returned from running a course at the National Bank of Poland and the Bank's Premises Division had provided advice to three Commonwealth Central Banks on the building of their banks.

Sir Colin Southgate questioned the organisation of resources devoted to helping Eastern Europe. He was informed that prior to the Berlin Wall coming down there had been five undertaking such work, there were now nine not to mention the secondment of Mr Latter to the Ukraine and a member of staff to the British Council in Moscow.

Professor Sir Roland Smith enquired if the Heads of the Divisions saw themselves as sophisticated researchers or managers. In response to an answer on the latter he asked if they had time to manage. He questioned whether they had sufficient resources. There were differences in the responses. In the Developing World Division, the Head of Department's role was more a manager with senior advisers available to help them, however the other Divisional Heads did not feel they had the time they would wish to devote to management.

Secretary
11 February 1993

A COURT OF DIRECTORS AT THE BANK

THURSDAY 11 FEBRUARY 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Sir David Gerald Scholey, CBE
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

[redacted]

[redacted] 55

Under the weekly executive report:-

1 [redacted]

[redacted]

[redacted]

Sir David Scholey, having declared his interest in that S G Warburg were advising the Bank on this issue, reminded Court that in the Bank's Annual Report and Accounts of the previous year certain provisions had been absorbed in the accounts and were not readily identifiable to the reader. This had been covered by a note in the accounts to the effect that they had been prepared in accordance with the Companies Act "insofar as they were appropriate to a central bank". In the current accounts there were larger provisions and it was felt that it would be inappropriate to absorb them as in the previous year and they were likely to be disclosed. Sir David questioned, therefore, whether such a disclosure would undermine the very purpose of the support operation. The Bank may well be challenged about them and this could aggravate the very problem we sought to prevent.

Mr Quinn responded that even if the Bank made a full disclosure of the scale of the operations there would be no intention of disclosing names. He recognised the risk Sir David mentioned and we were working on a suitably worded statement. The Governor confirmed that work was in hand in producing a statement for the Annual Report, the tone of which would be vital. We intended to convey a positive message. He accepted that it

[redacted]

would probably be necessary to disclose a global figure for these operations which would be a serious break with tradition but this was inevitable following the decision of the Bank some years ago to comply with the requirements of the Companies Acts in preparation of our accounts.

On that point, Sir David Scholey said that the introduction of certain EC Directives may provide an opportunity for the Bank to reconsider this in the near future.

[redacted]

In declaring his interest as a commercial banker, Sir David Walker pursued Sir Brian Corby's comment and suggested that high leverage had been the problem behind a number of institutions who had received support from the Bank recently. This should be taken into account when looking ahead to restructuring.

In noting Sir David's comment, the Governor said that in the case of [redacted] the problem was one of unwise diversification because the core business had been unrewarding.

Mr Quinn said that there was little doubt that the system would be more secure following the restructuring. The houses would occupy a much reduced position at the centre of the system and reduced dependence on them would therefore strengthen the system. That is not to say that the houses might find themselves in an exposed

[redacted]

position in the short term when the components were being altered. The Governor said that much work had already been undertaken in this direction and he was confident that the new system would work satisfactorily. The main issues remaining were when and how to implement it, and the impact it would have on the existing houses. The new system would be easier to operate but the transition to it would be difficult and delicate. Reverting to Sir Brian Corby's question about the net asset value, the Governor said that the purpose of such a covenant was to keep the pressure on [redacted]

As regards the capital injection the figure reflected the higher gearing [redacted] Mr Quinn added that any additional capital that could bring further support for depositors improved their position.

Sir David Lees said that without a sight of the balance sheet it was not possible to offer an opinion on the amount of the proposed standby facility but he questioned whether, in view of the impending disclosure in the accounts, the figure could be reduced, say, to [redacted] In response Mr Quinn said that the last audited balance sheet was at end-December 1991 and accepted that it was not possible to identify the appropriate facility with any precision until a further audited balance sheet was available.

Sir Roland Smith commented about the ripple effect of the failure of [redacted] extending to other institutions and suggested that, surely, in that event people would realise the situation and dismiss [redacted] as a badly managed institution. In response, the Governor said that there was a fundamental difference between weakness in the manufacturing and financial sectors. The loss of a competitor in the manufacturing sector benefited survivors whereas a loss in the financial sector could be critical for them too.

[redacted]

[redacted]

[redacted]

2 Following the announcement earlier that week of Mr Barnes' retirement at the end of August and the appointment of Mr Foot as his successor as Head of Banking Supervision Division, Mr Harris outlined the further consequential staff changes.

3 With reference to a Minute of 14 January and earlier, the Governor said that despite the Chancellor of the Exchequer's comments when announcing the appointment of Mr George as Governor, he proposed, subject to Court's approval, to commission a further paper on "Independence" on the basis of the last discussion at Court and to submit it to the Chancellor of the Exchequer and Prime Minister in due course. Court endorsed this course of action.

At the Governor's invitation, and with the agreement of Members of Court, Mr Farrant, a Deputy Head of Banking Supervision Division and a member of both the Basle Committee and EC Governors' Sub-Committee, and Mrs Jackson, a Manager in Banking Supervision Division who was a member of the Financial Fragility Working Party and the principal author of the papers before Court, attended for the ensuing discussion.

In introducing the paper entitled 'Involvement in International Supervision' which had been deferred at Court last November, Mr Quinn said that the paper described the Bank's involvement in international banking supervision and also outlined some of the major contemporary issues in this area. The Bank had had a very significant role in the various Committees and working groups and had devoted a good deal of time and resources to the work. We had been one of the leading countries in the evolution of international banking supervision over the best part of 20 years.

The work continued to grow and the issues become more complex and difficult. The early gains in co-operation were very important in developing momentum and a coherent institutional framework. Much bilateral day-to-day contact goes on. Banking supervisors had uniquely developed a real common interest and capacity to work together. As the world in which international banks operate becomes less forgiving, and as the supervisors sought to keep pace with market and institutional change, that co-operation was invaluable.

Each successive international banking failure or problem brought demands for tighter and higher standards. That represented a real challenge to the various committees in producing and implementing sensible responses. As in the domestic sphere, the risk was of over-reaction but, so far, the Basle Committee had struck the right balance.

In introducing the discussion, the Governor remarked on the tremendous progress made in supervisory co-operation in the past ten years in which the Bank had had a leading role. The Basle Accord, which was now accepted on a worldwide basis, had been precipitated by a bilateral agreement between the Bank and the Federal Reserve in the USA.

Sir Brian Corby raised several questions on the paper. He was surprised by the reference to customers taking false comfort from a belief that supervision was there to protect them. Surely this was what supervision was for. Mr Quinn said that this referred to the customers of the non-regulated entities within a group, drawing such false comfort from the regulation of part of the group. Sir Brian Corby was also surprised by the reference to the need for convergence in supervision of insurance companies and banks. The types of business were too different. Another way round the problem would be to prevent guarantee arrangements between these disparate financial entities. Mr Farrant said that the main issue was the effect on confidence: customers might well expect a group to hang together. Supervisors either have to make clear that they do or do not take a global view of the group.

Sir Brian Corby accepted this and said that if a steel company set up a subsidiary insurance company it could walk away from problems in that company but the same would not be true if a financial company were the owner. The question was how the entities could be ring fenced.

Mr Quinn said there was no intention to shoehorn different types of business into the same requirements but risks were becoming more similar, which raised the issue of competitive advantage if they were treated differently by different supervisors.

Sir David Walker raised the issue of whether the Basle Committee should start to police standards. He felt that the Basle Committee had acquired immense authority in comparison with, say, the grouping of securities supervisors but a large number of issues were still to be tackled. The best allocation of scarce resources would be to focus on those issues, as it had been doing, rather than to move into the new area of policing.

He also raised the issue of how banking supervision should relate to those in other areas such as insurance. His experience with securities regulation showed how difficult it was to make progress because of the structure of regulation in different countries. In the US the banking supervisors had extreme difficulty communicating with the securities regulators and there was almost no communication with insurance regulators. It was important in the UK that there should be a continuing constructive discussion, rather than turf battles between the Bank, SIB/SROs and the DTI.

Sir David Scholey said that he agreed particularly with two issues raised in the paper. One was the recognition that high quality credits would move to securitised form and the implication this would have for both the banks and the securities houses. The other was the issue of foreign securities houses owning banks in the UK. In 1987 he had spoken to Mr Corrigan who was convinced that the ultimate saviours of the securities houses, in case of systemic problems, would have to be the central banks.

Another issue was universal banking and integration of securities and banking supervision. The failure of IOSCO to reach agreement the previous day was not surprising although disappointing. He asked if the Bank was developing an approach toward integrated supervision and the implications it might have for firms' structure.

In response Mr Farrant said that so far as insurance supervision was concerned headway was being made by the supervisors to understand each others' regimes. So far as securities supervision was concerned the Bank did not want to push the firms in any particular way as regards their structure. The IOSCO meeting was a disappointment but Basle had a fallback position which would enable progress to be made and for IOSCO to catch up later.

Mrs Jackson said that Europe was on the threshold of a new era in terms of common standards in regulation between the banking supervisors and the securities regulators. The introduction of the new Capital Adequacy Directive in January 1996 would provide for the first time an identical treatment for the securities held in the bank's trading book and those held on the book of securities houses.

In focusing on the issue of the US securities houses owning banks Mr Quinn said that the gaps in US regulation, which meant that no one supervisor was looking at the risks of the securities house groups even when they owned banks, was unsatisfactory and needed to be tackled. There was pressure to do so because of the increasing emphasis on consolidated supervision particularly with the new Basle Minimum Standards for the supervision of international banking groups. On the question of convergence in supervision of securities activities whether carried out by banks or non-bank securities firms, he said that there had been concern in Europe by those countries without universal banking that the move would push them in that direction and the universal banking countries had been concerned about the unlevel playing field if requirements were not identical - thus endangering universal banking. The trading book approach was an ingenious solution to both fears - the common activities of the two types of firm would be treated in like manner.

Sir Christopher Hogg asked whether the fact that Rosalind Gilmore was on the EC's Banking Advisory Committee (BAC) meant either that the UK or Europe regarded building societies as banks. Mr Farrant said that the BAC's prime role was in terms of EC legislation and so far as that was concerned building societies were deposit-taking institutions and therefore treated as banks. However, we did not regard them as such in the UK.

Sir Christopher also raised the question of upward consolidation and asked whether it was possible to insulate a banking subsidiary from problems in a holding company. Mr Farrant said that the problems with British and Commonwealth Merchant Bank showed that this could not necessarily be done. It was possible in some cases but one could not be sure of it. Mr Quinn referred to the case of a bank in the UK which was owned by a New Zealand holding company involved in a wide range of activities in Australia. The Bank applied the fit and proper criterion to the holding company and had to keep close to the institution and look at the role of firewalls but this proved very difficult in practice given the distances and different kinds of businesses involved. If problems developed the supervisors had to react.

The Governor said that in such cases there could be a question whether the bank should be regarded as unsupervisable, a point that had been made in Lord Justice Bingham's Report.

Sir Colin Corness said this raised the question of whether a bank should be part of a non-financial group because, however good the supervisors, they would not understand the industrial activities. He noted that building societies cannot go into unrelated areas without agreement from their supervisors.

Sir Brian Corby mentioned that the Bank had expressed the view some eight years ago that ownership of a bank by an insurance company was only satisfactory if there were a large discrepancy in size between the two.

Sir David Scholey raised the function of rating agencies which were only embryonic in the UK and said that any questionable activity would reflect adversely on their rating.

Sir Roland Smith referred to the possibility of European supervision replacing local supervision. He said that in his view European supervision should build on the rigour of national supervisors and not replace them.

The discussion then turned to the second paper "Pressures on the World Banking System". Sir Roland Smith asked to what extent the problems came from the banks' own management decisions and therefore management quality, and how much from the economic climate. He thought that the experience of the 1980's was one of how not to manage ie the dash for growth etc.

Lord Haslam thought that the herd instinct was bad in manufacturing but was far exceeded by banks. He was interested in the references to how German banks' more positive experience may in part have reflected customer relationships. One disadvantage for the UK economy was that these relationships did not exist and therefore the UK could not get away from short-termism.

Sir Brian Corby agreed with Lord Haslam's comment about long-term relationships which were essential in some businesses, not least re-insurance.
He focused on the question of the initial under-provisioning by the banks against ldc debt. If they had provisioned adequately, initially, would they have been bust, in which case the accounting standards must be wrong. The Governor said that part of the problem was that the severity of difficulties in those ldcs was not fully realised initially. Mr Farrant added that there had also been a strong element of turning a blind eye.

Sir Brian Corby then asked if the supervisory process was sufficiently forward looking or whether it was retrospective. There was a need to reflect on the future. In response, however, the Governor highlighted the dangers of the supervisors becoming managers of the banks or of acting as the board.

Sir David Walker said that the late 1970's and early 1980's had been characterised by over capacity in banking and that deregulation had exposed the problem. This over capacity was now being squeezed out in a messy way. Bad decisions were taken and there had been a cutting of corners by bank managers. There was a trade off between regulation and competition policy. One question was whether the regulators should not have a more active dialogue with those setting competition policy with regard to the need for rationalisation. He instanced that Lloyds Bank had chosen a route to reduce over capacity but this had not been accepted by the competition authorities. Rationalisation will now happen but in a more untidy way. US banks in contrast had been able to rationalise. In the UK if the right balance could not be struck between regulation and competition then the regulation would have to be tougher. There should be a greater readiness for the supervisors to tell a bank to think again about, or even to avoid, diversification into certain new areas. In response to the Governor's question, Sir David said that this could be achieved under the Banking Act in relation to the protection of depositors' interests if diversification might weaken the position of depositors.

Mr Crockett accepted that bad decisions had been made but the financial industry was very vulnerable to the economic climate. In a stop go environment it was difficult to make long term decisions. Extrapolating from the 1970's, developing country lending would have looked sensible but the reaction of industrialised countries to mounting inflation had changed this. Likewise in the 1980's property seemed safer than other forms of lending. The answer lay in greater stability of policy.

Mr King reverted to the discussion of relationship banking in Germany and pointed out that it had not helped in Japan which had had a very unstable period in banking. The question was what would German banks have done in a UK monetary policy environment and what would the UK banks have done in a German environment? Mr Quinn said that German banks in the UK had been as much part of the herd as anyone else which highlighted how important the macro-economic environment was. On the question raised by Sir Brian Corby with regard to provisions, it highlighted a difficult issue - how to value assets without a ready market. On the question of retrospective supervision; supervisors had to crawl over the entrails and learn from the experience. But the Bank was also forward looking and had warned about gearing, developing country debt and property exposures. However, it had stopped short of intervening. He also pointed to a rationalisation of banking institutions in the UK, reduced in number from 630 to 510, without great traumas. This reflected our approach: to allow market forces to work within a framework which protected deposits.

Mr Kent referred to the great new innovation in banking - the degree of maturity transformation taking place with banks using other instruments to hedge the risk. Disintermediation had started with a secondary market in developing country debt but this was spreading to other forms of debt. The total risks in the market had become scattered, borrowers would not know lenders and lenders would not know where the risks were.

Sir David Lees said that he thought the paper had been generous to bank management. Conditions were no different in industry - difficulties of margins and the economy were the same. The better industrial companies managed their way through it. However he agreed with Mr Quinn's prescription and would be reluctant to see banking supervision involved in banks' decision making. The supervisor should consider whether the regulations were right and then enforce them: he should not be a back stop for poor management.

Finally Sir David Walker said that the consequence of bad management in a bank was liable to be very serious. It was prudent therefore for the Bank regulator to consider whether in those circumstances he should step in.

G. A. Croughton

Secretary 25 February 1993

David Scholey

A COURT OF DIRECTORS AT THE BANK

THURSDAY 18 FEBRUARY 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mervyn Allister King, Esq
Brian Quinn, Esq

Pendarell Hugh Kent, Esq

The Minutes of the last Court, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

There were no items for discussion under the weekly executive report.

G. A. Croughton. David Scholey
Secretary
25 February 1993.

A COURT OF DIRECTORS AT THE BANK

THURSDAY 25 FEBRUARY 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Anthony Laurie Coleby, Esq
Sir Frederick Brian Corby
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Lord Haslam of Bolton
Sir Christopher Anthony Hogg
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Sir Colin Grieve Southgate
Sir David Alan Walker

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 11 February were confirmed and those of last week's Meeting, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

1 With reference to a Minute of 14 January and earlier, the Governor drew attention to the paper "Operational autonomy for the Bank of England" which had been made available to Members together with a copy of a draft letter to the Prime Minister. This paper reflected the latest discussions of Court focusing on the evolutionary approach towards operational autonomy but moving to a statutory base in due course.
The Governor invited comments in advance of Court the following week when he hoped that the document might be finalised, and if not on that occasion then certainly no later than 11 March.

2 The Governor mentioned that the Treasury and Civil Service Committee Report "Banking Supervision and BCCI: the implications of the Bingham Report" would be published that morning. The Committee's Report offered no factual material that could not be found in the Bingham Report. The Bank did not accept either the judgements or the conclusions which the TCSC Report drew from Bingham and, furthermore, did not believe that there was any case for giving additional compensation to UK depositors over and above that already provided by the statutory Deposit Protection Scheme.
It was agreed that copies of the Report should be made available to Members of Court.

3 [redacted]

[redacted]

At the Governor's invitation, Mr Harris spoke about a Governor's Recommendation arising out of the recent Annual Review of Senior Officials. It was agreed that with effect from 1 March 1993:-

[redacted]

be promoted from Point C to Point B

be promoted from Point C to Point B

be promoted from Point C to Point B

[redacted]

be promoted from
Point C to Point B

be promoted from
Point D to Point C

be promoted from
Point D to Point C

be promoted from
Point D to Point C

be promoted from
Point E to Point D

be promoted from
Point E to Point D

be granted £2,500
personal pensionable salary

be appointed a Senior Official
Point F

be appointed a
Senior Official Point F
and a Deputy Head of Banking
Supervision Division

be appointed a Senior Official
Point D

Sir Christopher Hogg questioned the need for such promotions to be submitted to Court for approval. It was agreed that this would be re-considered in the context of the review of Court procedures to be discussed on 8 April.

Sir David Scholey introduced a Report of the Audit Committee and drew particular attention to the developments on the theft of used bank notes from the Printing Works. He noted that a detailed report on the incident would be submitted to Court in April. The Committee had also agreed that the internal auditors should undertake the majority of work on the end-year asset count, thus reducing the fees of Coopers & Lybrand, the external auditors, by £6,000. The Committee had also discussed the need for the provision of support operations to be disclosed in the Bank's Annual Accounts and had indicated their preference for explicit disclosure. However in the event of non-disclosure being the preferred option the Committee suggested that such a course should be discussed and agreed with HM Treasury in advance. At the same time, the Committee had recommended that in light of the new requirements of the Companies Act which gave statutory force to the EC Bank Accounts Directive, the Bank should reconsider its non-statutory compliance with the Companies Act.
In connection with the accounting treatment of the Bank's properties, Sir David drew attention to the Committee's recommendation that in respect of Southgate House consideration should be given to the liquidation of the subsidiary company, BE Property Holdings, to enable the valuation of Southgate House to be absorbed in the general revaluation reserve. Finally, Sir David asked whether Court felt that the Reports of the Audit Committee were appropriate and sufficient or whether copies of the Minutes of their meetings would be more helpful.

After some discussion about the alternative ways of treating the valuation of Southgate House, Mr Harris said that he had undertaken to reconsider the current practice in the light of the Audit Committee's comments. He also mentioned that the Trustees of the Pension Fund had agreed that the Bank's contribution for 1993/94 to the Pension Fund be delayed until the Actuary's valuation report was available later that year. The Report was approved.

The Governor thanked Sir David Scholey and his colleagues for their contribution to the work of the Audit Committee: Sir David said that particular thanks were due to Sir Brian Corby for his involvement over a number of years.

In presenting the Economic and Financial Report for February Mr King said that the Bank's first Inflation Report had been published just over a week ago. Since the report went to press several statistics had been released.

First, the new figures for inflation itself had shown a further fall in underlying inflation - measured by the RPI excluding mortgage interest payments - to 3.2% in January, well below the expectations of outside analysts and about a quarter of a percentage point lower than the Bank's own expectation. The headline rate of inflation had fallen to 1.7% and the tax and price index - which measured the increase in pre-tax earnings necessary to maintain the same level of real take-home pay as a year ago - had risen by only 0.5%. Wage settlements in the economy as a whole were at a significantly higher rate than this - 3.2% in January down from 3.6% in December. The increase in unemployment was lower than anticipated at 22,000 in January, but employment in manufacturing continued to fall rapidly. The latest figures for GDP showed an interesting picture, especially when taken in conjunction with the revisions to earlier figures. The data now suggested that total non-oil output was completely flat during the first three quarters of last year, falling very slightly in the final quarter. Including North Sea output, total GDP had risen in both the third and fourth quarters. This confirmed a clear pattern of the recession - with a sharp and rapid fall in output from the middle of 1990 until the autumn of 1991 - followed by a completely flat level of output from then on. Retail sales had been rising slowly over the past six months, with the sharp rise in January offsetting a large fall in

December, probably the result of an inappropriate seasonal adjustment.

Current implied futures rates suggested that the markets anticipated further interest rate reductions of between 0.5 and 0.75 percentage points over the next six months or so. But interest rates overseas were also likely to change, with German rates expected to fall by up to 1.75 percentage points by September, and US rates to rise by around 0.5 percentage points.

Taking the current and prospective levels of interest rates together it was possible to infer the markets' expectation of the likely future course of sterling. Broadly speaking the pattern of interest rates was consistent with a slight appreciation of sterling from its current level.

As had been noted in the Inflation Report, any sustained further depreciation would raise the probability of breaching the upper end of the inflation target range. That concern clearly affected our attitude to the proposition that interest rates should be cut further.

The Report of the Treasury's Independent Panel of Forecasters broadly endorsed the current stance of monetary policy. The average of their forecasts suggested that inflation would remain inside the target range over the next two years, and that this would be consistent with some modest recovery in output, of 1% this year and 2 1/2-3% next year. An interesting lesson from the US was that the announcement of President Clinton's budget package had led to a rally in the bond market, with long bond yields falling 30 basis points in three days, and long yields down 90 basis points from their level last autumn. This was despite the fact that the deficit reductions would not come through until two or three years hence - a lesson for the UK perhaps?

Mr Coleby, in introducing the monthly discussion of monetary policy, said that the monetary indicators continued to diverge. M0 had recorded an increase of 4.1% year-on-year in January and was now above the target range of 0-4%. Provisional estimates for February suggested that it might be of the order of 4 3/4%.

Currency in circulation had increased year-on-year by 4% in January and might be as much as 4.5% in February. The January data were more easily reconciled with the retail sales figure for that month than had been the case with December but seasonal adjustment over the Christmas period was always especially problematic.

Broad money, M4, continued to fall further below the bottom of the monitoring range, with a year-on-year increase of 3.2% in January despite a stronger growth of sterling lending in the private sector of 0.7% taking the year-on-year figure back up to 4.2%. This was largely to companies, probably reflecting the bunching of heavy tax payments, which had produced a PSDR for the month as large as that in January 1992. It would be premature to conclude that lending had embarked on a firmer trend than in the recent past.

So far as the policy implications were concerned the interest rate reduction a month ago reflected the improved inflation outlook which had since been confirmed by the January RPI, excluding mortgage interest payments. It also reflected the risk that the fragile state of confidence could have been damaged by the weak real economy data at that time, such as the unemployment statistics. The effect of the rate cut on the exchange rate had been rather greater than expected and was capable of adding to future inflationary pressures. The conclusion was that any further cut now could be dangerous, and in any event looked less necessary to sustain the recovery. We must, moreover, hope that the exchange rate does not fall further because that might pose the question of needing to raise interest rates. Looking further ahead prospects would depend upon developments, notably the Budget and its reception, the behaviour of the exchange market and possible interest rate changes elsewhere.

Lord Haslam said that on his last opportunity as a Member of Court, he would like to repeat his wish for lower interest rates, perhaps, to US levels. Mr King replied that he agreed with the proposition that the UK faced similar problems as the US, and in particular high debt burdens, but that it had to be remembered that the interest rates charged by banks to corporate customers were not dissimilar in the US and UK now that base rate had fallen to 6%. Differences in official short-term interest rates exaggerated the difference between bank lending rates in the two countries.

The Governor paid tribute to Sir David Walker, Sir Brian Corby and Lord Haslam on the occasion of their last appearance at Court. He said that they had given valuable service to the Bank and we were very grateful for the wide and authoritative advice we had derived from them during their period in office.

Gavin H Laird

Secretary.
4 March 1993

12A110/2

COURT OF DIRECTORS

For the year ended 28 February 1994

Declaration Made before	Date	
		The Rt Hon Robert Leigh-Pemberton, Governor
		Edward Alan John George, Esq, Deputy Governor
		Sir George Adrian Hayhurst Cadbury
		Sir David Gerald Scholey, CBE
		Gavin Harry Laird Esq, CBE
		Sir Martin Wakefield Jacomb
		Sir Colin Ross Corness
		Brian Quinn, Esq
The Governor	3.3.93	#Andrew Duncan Crockett, Esq
		Anthony Laurie Coleby, Esq
		Mervyn Allister King, Esq
		Sir David Bryan Lees
		Professor Sir Roland Smith
		Sir Colin Grieve Southgate
		Sir Christopher Anthony Hogg
The Governor	3.3.93	*Mrs Frances Anne Heaton
The Governor	8.4.93	*Sir John Chippendale Lindley Keswick
The Governor	11.3.93	*Sir Christopher Jeremy Morse, KCMG

Reappointed 1 March 1993

* Appointed 1 March 1993

A COURT OF DIRECTORS AT THE BANK

THURSDAY 4 MARCH 1993

Present

Sir George Adrian Hayhurst Cadbury
Gavin Harry Laird, Esq, CBE
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Brian Quinn, Esq
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

In the absence of the Governor and the Deputy Governor, Sir Adrian Cadbury was appointed Chairman pursuant to the provisions of Clause 6(2) of the Charter of 1 March 1946.

The Chairman extended a welcome to Mrs Heaton who was attending Court for the first time following her appointment as a Non-Executive Director.

The Minutes of the last Court, having been circulated, were approved.

Mr Quinn commented on the weekly figures and Mr Coleby spoke about the foreign exchanges, including the Official Reserves figures for February, and the state of the domestic markets.

Under the weekly executive report, Mr Crockett spoke about the recent G7 meetings which the Governor had attended. They had been informal and useful in providing an opportunity for the participants to become acquainted with Mr Bentsen and Mr Hayashi. The meetings had also been unusual in that no communique had been issued. Particular topics of substance that had been discussed were the world economy - the signs of recovery in the US and the deteriorating situation in Japan and Germany - and Russian and FSU debt - with the need for conditionality attaching to further assistance.

At the Chairman's invitation Mr Harris introduced a Recommendation of the Governors relating to the composition of the Standing Committees of Court for 1993/94.
The Chairman advised Court that Mr Bridger had been appointed to the Board of BE Services Ltd on 10 November 1992 and introduced a further Recommendation of the Governors that in accordance with Section 375 of the Companies Act, Mr Bridger be authorised to act as a representative of the Governor and Company of the Bank of England at any meeting of BE Services Ltd.
The Recommendations were approved.

The Chairman drew Court's attention to some further matters relating to the Staff and Court Pension Schemes and to two of the Bank's subsidiary companies:-

1 Sir Chips Keswick had agreed to become a Trustee of both the Court Pension Scheme and the Staff Pension Fund, in place of Sir Brian Corby, and the necessary Deeds of Appointment would be drawn up and sealed in due course.

2 Lord Laing had agreed to serve as Chairman of BE Services Ltd for a further year from 1 March 1993.
It was noted that Lord Laing was approaching his 70th birthday and that it would be necessary, to comply with the requirements of the Companies Acts, for BE Services Ltd to pass a special resolution agreeing to his continued service on their Board.

3 Mr King had resigned from the Board of BE Museum Ltd and it was not proposed to replace him on the Board at this stage.

At the Chairman's invitation and with the agreement of Members of Court, Mr Trundle, the Governor's Private Secretary, attended Court for the ensuing discussion and, with reference to a Minute of 25 February and earlier, reminded Court of the genesis of the latest draft letter to the Prime Minister, copies of which had been made available to Members that morning. Mr Trundle explained that the Governor wished to take advantage of his forthcoming retirement to speak freely to the Prime Minister on the subject of operational autonomy for the Bank. A number of comments from Members of Court during the previous week had indicated that the balance between the proposed letter and paper was not right. Opinion suggested that they should be amalgamated into a single document in the form of a letter to the Prime Minister and this was now before Court. The Governor did not wish to hold up discussion of this issue and had said he would be very grateful for reactions to the latest draft from Members of Court.

In commenting on the text of the letter, Mr King said that the Governor had asked for a new draft because serious reservations had been expressed by some Members of Court about the evolutionary route. The difficulty with that route was that it would put either the Chancellor of the Exchequer or the Bank in an impossible position: either the Chancellor would give away operational power but retain responsibility or alternatively, the Bank would appear to have the responsibility but would not have the power to act. As a result, more emphasis had been given to the statutory route. The second substantive change was the proposal that, in the knowledge that statutory independence for the Bank could not be achieved at the present time, a special Commission or review body should be set up to examine the case for operational autonomy. This suggestion had been made by Sir David Lees. Mr King said it would be helpful to have comments on the length and style of the new draft and to distinguish carefully between tactics and objectives.

Before inviting comments from Members of Court, the Chairman suggested that Court should focus on the tactical approach to obtain a proper hearing and the two substantive questions of the statutory commission and the question whether the Bank would be in a false position in the evolutionary stage. The concern about the evolutionary route was whether the degree of delegation to the Bank might be unclear.

Sir Colin Corness agreed that the previous letter and paper had been too long and favoured a shorter presentation. His particular concern however was that there appeared to have been a major shift in the substance of the letter. It had been the view of Court that, in the light of Government comments at the time of the announcement of the Deputy Governor's appointment as Governor-Designate, an explicit request for the granting of statutory powers would have been rejected firmly by Government. The current draft seemed to be pushing too hard in that direction. The Prime Minister was preoccupied with getting the Maastricht Bill through Parliament and was likely to reject such an approach out of hand. He questioned, therefore, whether it was wise to approach the Prime Minister in such terms and at this time. He was also concerned that the Deputy Governor was not present for the discussion as he would have to take the issue forward in due course.

In response, Mr King said that the Governor had been anxious that the papers should be redrafted before his departure to China later this month and the Governor was therefore keen that there should be a discussion this week and/or next. Mr King had redrafted the letter to reflect comments from Members including those not present that morning. There did indeed appear to have been a sharp change of view by a number of Members. Several had said that the long-term objective, with which all Members agreed, was not stated clearly enough.

Mr Crockett said that this issue was the most important discussion that had been before Court during his period in office. He noted that views remained very fluid and in his opinion the discussion should be pursued until a settled view was reached among Members. He argued for a period of reflection. His own view was that the evolutionary route had certain virtues, as evidenced by the position in the Netherlands and Canada, and so he would not like to exclude it as a realistic option. But he also thought it relevant that others had changed their view and so the substance needed careful debate. He agreed that any letter sent to the Prime Minister should be kept brief.

Mr Laird said that he thought it was important that the Deputy Governor should attend the discussion and this pointed to the matter being considered further the following week, indeed he thought the Deputy Governor should also attend any discussion with the Prime Minister. He said he liked the directness of the single letter. He supported the view that the Bank should press for statutory autonomy. Mr Laird said he was also very sceptical about the value of Royal Commissions which seemed to take a long time to achieve very little. He would prefer that the Government should be encouraged to commit itself to statutory change in due course.

Sir Martin Jacomb said that he preferred a shorter letter and also believed statutory authority was the only way ahead. So far as timing was concerned, it should be achieved while the Government still had a long period in office but this should be balanced with the Governor's position, coming towards the end of his term of office, when in one sense, he had greatest authority to speak his mind. However Sir Martin's view was that there was no point in sending a letter which argued only the case for statutory powers unless there was an indication from Government that this might succeed. The fundamental question was one of accountability. Another important change in the current draft was on the question of accountability. The draft did not make clear with whom accountability would rest. He was concerned that accountability might not be vested in the Bank.

Sir Roland Smith suggested that the Bank should make enquiries to ensure that any approach would be received sympathetically.

In his view the letter should be short and state simply the Bank's interest in the independence issue, that the Bank had considered it at length, and invite discussions. We needed to recognise that much more work would need to be done with Government. The letter as currently drafted was too abrasive and naive. The objective should be to create a dialogue.

Mrs Heaton said that she had very serious reservations about the Prime Minister's reaction on receiving such a letter. She felt that it was hardly the right time to be launching such a letter. The Government was in considerable difficulty on a number of issues and would see no advantage in considering such a major change now. Moreover, the overall perception of the Bank at present was not as good as it had previously been. It was not a good time for the Government to be seen to give greater authority to the Bank. She recalled that Lord Lawson, when Chancellor of the Exchequer, had approached Lady Thatcher, then Prime Minister, with a proposition that the Bank should become independent but the suggestion had been rejected out of hand because of its political unattractiveness. It was important that any approach from the Bank must be couched in terms that would convince Government that it was in their own best interest. Mrs Heaton felt it would be damaging to the Bank's ability to pursue its case to be turned down flat by the Prime Minister.

In commenting on the procedural issues Mr Quinn said that it was important that all Members of Court should be comfortable with the proposals being put to Government and that as the Deputy Governor would have to carry them forward it was important that he should be entirely content with the final draft. He thought the issues were difficult and it would be premature to agree the draft letter. On the question of substance Mr Quinn said that the proposition of establishing a Commission needed further thought to consider the possible repercussions and the likely time scale. He had been of the view that the evolutionary approach was preferable but he said that he now had reservations about this approach. Further thought was needed. The Bank needed to be clear on its objectives. Tactically, he suggested that a shorter document focusing on issues of principle was preferable. Mr Coleby endorsed Mr Quinn's comments. Without conceding the aim of achieving statutory powers he thought the Bank should reveal an openness to consider ways of achieving the objectives in the interim. He agreed with Mrs Heaton on the need to avoid a head-on clash with Government and to this end it might be appropriate to take informal soundings. The merit of the evolutionary route was that it would soften the chance of total rejection of the issue by Government.

Mr Plenderleith supported the views expressed by Mrs Heaton acknowledging that legislation would be unwelcome to Government at the present time. He thought the tone of the current draft was too ferocious - it would fall on stony ears. He therefore supported Mr Coleby in suggesting that the key objective was to keep the debate going. We could not expect statutory change to be imminent. The proposition should be put in a form in which it could not be rejected. Mr Harris also agreed and said that it was important to look at the Bank's presentation from the point of view of the recipient. If the Bank's approach was ill-judged it would be rejected immediately. The objective was to keep the ball in play.

Mr Laird said that we were in danger of becoming overwhelmed by criticisms of the Bank. In practice the Bank, by its nature, was always under criticism on one issue or another: the right timing would therefore be difficult to judge. He would add to his earlier comments that he agreed the Governor should approach the Prime Minister before he retired.

Sir Martin Jacomb agreed saying that the letter should be very brief. It would note only that the Bank had undertaken a lot of work on this subject and that in our view independence would have major advantages. The letter would add that it would be very complicated to make such a change and the Governor would like to discuss the subject with the Prime Minister. He suggested that we should say nothing at this stage about the means of achieving independence, just the reasons why, in our view, it was a good idea. Sir Roland Smith and Sir Colin Corness expressed agreement with this proposal.

Mr King said that there were two objectives which were relevant to the question of timing. Following the earlier discussions at Court the Governor had agreed he should speak to the Prime Minister and do so with the unanimous support of Court. He might also wish to make a personal public statement in favour of independence but may not feel able to do so until he had spoken to the Prime Minister. In addition the Bank wanted to adopt tactics which would ensure that the debate continued. On the substance of the question, Mr King argued that as HM Treasury and Government were both against independence of the Bank we must act to shift public opinion in our favour. The press and academia were supportive of independence for the Bank and we should take advantage of that and persuade political parties of the advantages, with the objective of getting the proposition into their manifestos. The problem was the best way to achieve this. There were many different ways of doing so and it was unlikely that Court would agree on a single blue-print. There were differences of view and indeed some Members had changed their view. He said that on the evolutionary approach he agreed with Sir Martin Jacomb that the critical issue was that, in that situation, accountability would remain with Government. It was very important to avoid a fudge. Mrs Heaton said that she agreed on this question of substance with Mr King. The proposition must have wide public support as this was the way to win the politicians round. On the tactics, she argued we should avoid an approach which risked a firm rebuttal as this would make it difficult for the Bank to generate further public support. We should therefore avoid confrontation but widen the public debate.

In summing up, Sir Adrian Cadbury said that the advice to the Governors arising from the discussion that morning was that the letter should be redrafted with greater attention given to the way it would be received by the Prime Minister. The letter should identify the ends rather than the means of achieving independence and should be drafted with a view to keeping the debate on the detail going: ideally the letter should have the support of all Members of Court. It should suggest how the Bank could help the Government meet its objectives. We should also aim to generate greater public support which would ultimately be in the politicians' interest. Government would be faced with this issue if and when the Maastricht Treaty was approved, and the Prime Minister would need then to draw on the Bank's help and advice.

Picking up Sir Adrian's last point, Sir Roland Smith said that the letter should draw on the points of unanimity among Members of Court, namely, the desirability of independence and the need for it to be statutory in due course. The differences were about the process of getting there. Court should not be too prescriptive about this; if we were successful in generating a debate with Government they would have their own different ideas. Mr King said he agreed the letter should be very brief - simply asking for a discussion with the Prime Minister.

G. A. Croughton.
Secretary.

E.A.J. George
11th March 1993

A COURT OF DIRECTORS AT THE BANK

THURSDAY 11 MARCH 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Mervyn Allister King, Esq
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Governor extended a welcome to Sir Jeremy Morse who was attending Court for the first time as a Non-Executive Director, having served previously as an Executive Director from January 1965 to September 1972.

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

Under the weekly executive report:-

(i) Mr Kent informed Members that at a Board meeting that morning the Stock Exchange were likely to decide to halt the development and testing of TAURUS and had asked the Governor to establish a Task Force on Securities Settlement which the Governor had asked him to chair. Work would start immediately and there would be a press conference later that day. The resignation of the present Chief Executive of the Stock Exchange would also be announced at the same time.
The Governor said that he had been concerned that the abandonment of TAURUS may be seen as a set back for the City and accordingly he had agreed to set up the Task Force immediately.

This announcement prompted a number of questions from Members of Court: Sir David Scholey said that this news was a tragedy for the City but, having been closely associated with the workings of the Stock Exchange for a number of years, he had always been aware that the Stock Exchange was a long way behind on technological issues and, as one of the largest users of the Stock Exchange, he was concerned that they did not take note of the wishes of users. He said that it was a sad reflection that only an American and Swiss bank were represented on the Task Force and asked when the Bank had first heard of the crisis with TAURUS.

Sir Colin Southgate in endorsing Sir David's comments on the Stock Exchange's past technological record said that they had employed external computer service experts since the mid-1960s and enquired how long ago their professional advisers had notified them that TAURUS had problems. Sir Christopher Hogg said that the news raised questions about how effective the Bank had been in pursuing the third of its core purposes. Should the Bank have kept a closer eye on this project?
Sir Jeremy Morse was concerned about the impact of

calling off the project at this stage and asked if the decision would rebound on other areas that might have been changed already in anticipation of the implementation of TAURUS. Mr Kent explained that no part of the TAURUS project had been implemented and the existing TALISMAN system would continue unaffected.

In response to the other questions Mr Kent said that the Bank had first been made aware of the problems the previous week. Various consultants had been involved at different times during the genesis of TAURUS but it had been Ernst & Young, who were also advisers to HM Government on the integrity of the system, who had identified the severity of the situation. Until then there had been concerns about the speed of progress but no one had been aware that the project could not be delivered in any realistic time-scale or budget. So far as membership of the Task Force was concerned Mr Kent explained that Mr Cormack, although Managing Director of Citibank, had been appointed to the Task Force because he was Chairman of the TAURUS Monitoring Group and so knew a great deal about the project and its problems. Mr Mueller, UK General Manager of UBS Phillips & Drew, had been appointed because he was also Chairman of the BMBA Securities Trading Committee. Mr Kent also mentioned that Denis Child who was Chairman of ICCH had been Chairman of APACS and remained a Director of National Westminster. With that experience he would be an important member of the Task Force. In addition, Mr Kent mentioned that the Task Force had the power to co-opt members but he proposed to use that facility sparingly.

In response, Sir David Scholey suggested that it would be better to describe these members of the Task Force by the roles which had led to their choice rather than those that had been mentioned earlier. Sir Martin Jacomb said that he and others had always been sceptical about the concept of the Stock Exchange owning the settlement system. There were many examples around the world where this was not the case and it would be preferable for this function to be carried out by a body which had this as its sole responsibility. He urged Mr Kent and his Committee to reject any idea that the TAURUS substitute should be owned by the Stock Exchange. In response Mr Kent said that the Task Force's terms of reference included the question of ownership, as well as governance, financing, and structure. In practice one option might be to combine the settlement with the London Clearing House which provided settlement for the derivative market. In responding to Sir Christopher Hogg's question Mr Kent said that it was always difficult to identify the extent to which the Bank should impose solutions or go with the grain of the market and/or combine the two. He had followed closely the development of TAURUS from the start some four years ago and had been a member of the Settlement Board which had provided outside influence on the project. As he saw it, the City must have a payments system of international quality but it was up to the City with the Bank's help to achieve that. It was not the Bank's role to impose a system at the outset; one could not be sure that that would have been any better.

The Governor said that the Bank's message to the Stock Exchange four years ago was that they should introduce as soon as possible an effective settlement system meeting international standards as this had been identified as one of the weaknesses of London as a financial centre. He had spoken regularly to the Chairman of the Stock Exchange and had been concerned at the apparently slow progress of TAURUS but the Bank had not been aware of the extent of the underlying problem. It appeared that the senior management of the Exchange had not been aware either.

Sir Roland Smith asked whether Mr Kent saw a clear solution to this problem given that the Task Force had to report by the end of June 1993 at the latest, or whether it would be an ongoing problem. In response Mr Kent said that he foresaw a number of ways forward, either by building on the existing wholesale system or by buying a system off the shelf. He also thought that this presented an opportunity to introduce a rolling settlement system possibly also building in delivery versus payment arrangements. The emphasis would be on establishing an effective settlement system for wholesale transactions while the retail sector was likely to be left much as it was at present. The system might be based on the immobilisation of paper certificates in a central depository rather than on dematerialisation. It would be possible for investors to hold them personally if they wished to do so.

Also in response to Sir Roland's question, the Governor said that there were precedents for the Bank identifying solutions and then leaving projects to others to manage in the longer term. In particular he drew attention to the Legal Risk Review Committee which had preceded the Financial Law Panel and was now under the Chairmanship of Lord Donaldson. The Governor went on to say that when the Stock Exchange established a Board he had been asked to appoint four Non-Executive Directors. The Board was still in place, the Members were well qualified and he was confident that the Board was competent. In endorsing the Governor's comments, Sir Jeremy Morse said that although TAURUS had not been successful there were a number of projects that had been very successful and where the Bank had made a particular contribution: in particular the establishment of APACS fell within this category and he noted Denis Child had also played an important role in its establishment.

(ii) The Governor said that he was aware of the extent of discontent among the Non-Executive Directors about the lack of consultation over the recent appointments of the Governor and Deputy Governor-designate. Traditionally

two Senior Directors had been invited by the Chancellor of the Exchequer to express their views and had indeed done so on this occasion. They had not, however, been made aware of Government thinking on the appointments and in particular had not had an opportunity to express their views on the possibility of an external appointment as Deputy Governor. Similarly he had not been consulted on that aspect. That was not to criticise the particular appointee but the Governor said that he felt that the complaints of the Non-Executive Directors about the procedure were fully justified. The Chancellor should have consulted both the Governor and Non-Executive Directors more explicitly about the possibility of appointing the Governor from within and a Deputy Governor from outside the Bank.
The Governor said he proposed to write to the Chancellor to place on the record his view that in future there should be fuller consultation on such appointments and that a procedure should be developed to provide for this. Sir Adrian Cadbury endorsed the Governor's summary of the Directors' concern and his proposed action.

1 There being no comments on the Accounts of the Houblon Norman Fund for the year ended 30 June 1992, the Governor invited Mr King, in his capacity as a Member of the Houblon-Norman Advisory Committee, to comment on the Report of the Committee.
Mr King reminded Members that the Fund had been created almost 50 years ago, in commemoration of the Bank's 250th anniversary, with the object of promoting economic research, especially into financial and business institutions. The Fellows who were reimbursed their normal university salaries by the Fund carried out their research in the Bank which they visited on leave from their home academic institutions. The selection of Fellows was made by the Trustees on the recommendation of an Advisory Committee.

During the period covered by the Report, the Fellowship had been shared between two Fellows. The first was Prof. Peter Kenen of Princeton University who had carried out research on "Macro-economic Policy: Co-ordination and Exchange Rate Management", and Dr Patricia Fraser from the University of Dundee who had worked on "The Econometrics of Stock Returns in the UK". For the current year the Houblon-Norman Fellow was Prof. Michael Devereux who was carrying out research into the efficiency gains from corporate mergers in the UK, using a large panel data set for individual companies.

During the course of 1992, the Advisory Committee had recommended that the nature of the Fellowship be changed in order to encourage senior Fellows to visit the Bank for shorter periods - it being recognised that senior researchers would be likely to visit the Bank only if it were possible to be flexible about the length of their stay - and also to encourage more junior researchers embarking on post-doctoral work. It had also been felt important to emphasise the benefits of selecting Fellows who would research topics on which economists in the Bank had both an interest and an expertise, thus benefiting both the Fellows themselves and also the work of economics in the Bank. Under this new arrangement, the Advisory Committee had recommended three names for the year 1993/94 to the Trustees who would make their final decision shortly.

2 In accordance with the terms of reference of the Sealing Committee, the Minute Book of that Committee was laid before Court for inspection.

3 With the agreement of Members of Court, [redacted] the Governor's Private Secretary, attended Court for the ensuing discussion.

With reference to a Minute of 4 March and earlier, the Governor said that he was sorry that he had been unable to be present for the discussion the previous week but was grateful to Members of Court for their very thorough debate. It was evident that there had been some shifts of opinion and that some Members saw the evolutionary approach to operational autonomy as the only practical way forward at present whereas others were concerned of the dangers of a half way house. The Governor said that he was also grateful for much practical advice about tactics that had come out of the previous meeting. In the light of that discussion, the Bank's Executive had met to consider a draft letter to the Prime Minister, copies of which had been made available to Members that morning. The Governor said that he would propose to follow up the letter by speaking to the Prime Minister along the following lines:-

Statutory independence for the Bank was an issue that was very much in the public domain. He would hope that the Prime Minister would accept that this was a current issue and one that should be considered during the lifetime of the present Government. It was in the national interest and right for the central bank to be independent. In making this point he would emphasise that he had the unanimous support of Court.

The Governor said that he would take advice from the Prime Minister on the extent to which it would be possible for the Bank to proselytise for this case or whether the Bank should desist. The Governor added, however, that he would make clear he would not refrain from confirming his view on the matter.

Whether or not the Bank promoted the case he would make the point that there must be a better understanding about political influences on interest rate decisions, particularly relating to the timing of interest rate changes. Although the timing of recent interest rate changes had not necessarily been wrong in substance they had on occasions been made to look discreditable because of their timing in relation to political events. It was important that interest rate changes were seen to be based on valid reasoning.

The Governor said he would welcome advice on these issues.

Sir David Scholey said that he thought the new draft letter was an eminently useful way forward. It was a very good way to start the ball rolling. He asked if the Chancellor of the Exchequer and Prime Minister expressed total lack of interest in the issue, whether the Governor proposed to put on record with them the earlier discussions of Court? The Chancellor had made clear his opposition to independence when the new Governor was appointed. In response the Governor said that he felt that this might be very wise. He did not think such an approach should affect the relationship with Government, they could hardly be unaware of the general interest in this topic. He hoped it would be possible to discuss it in an objective and unemotional way. He could note the success the Government had had in reducing inflation and suggest they could cement that and improve their credibility by involving the Bank.

Sir Adrian Cadbury said that the latest letter encapsulated admirably the tone of the previous week's discussion. Sir Martin Jacomb endorsed that view but said that it was important that the issue should be carried forward publicly; it should not rest and gather dust, a point endorsed by Sir David Lees. Sir David commented that the third draft was very soft. It was important that the Governors should not leave the meeting in a position where any further promotion would be seen as disloyal. Sir Colin Southgate said that it might be appropriate to remove the reference to Stage 3 of EMU from the letter, particularly at the present time, but he suggested that the Governor should measure the tone of the Prime Minister's response and respond in similar vein. Sir Adrian Cadbury argued that the

reference should stay. He said that one of the points that arose from the previous week's discussion was that in the end it was to Government's advantage for the central bank to have operational autonomy; the Maastricht Treaty meant it was an issue that the Government would have to face in due course. In the course of the discussion with the Prime Minister, it would be important for the Governor to emphasise that much work had already been done and this could be placed at Government's disposal. Sir Colin agreed it could be a timely moment for the Government to pass the responsibility.
Picking up Sir Adrian's point, Mrs Heaton said that any acrimonious discussion on this issue would be damaging not only to the economy but also to the Government. So the Bank had quite a strong case. It was already known that the Bank favoured independence and the Government did not. The Bank should therefore emphasise the need for a constructive public debate in such a way that would avert such damage.
The Governor thanked Members for their contributions on this subject and said that he would hope to take the matter forward with the Prime Minister on his return from his forthcoming trip to China.

4 With the agreement of Members of Court, [redacted] an Adviser on the Economic Analysis Group in Economics Division and [redacted] Mr King's Personal Assistant, attended Court for the ensuing discussion.

Mr King suggested that, in advance of Tuesday's Budget, Members of Court would wish to discuss the monetary and fiscal strategy which the Chancellor should pursue. There would be an opportunity to discuss the Budget measures themselves at Court on 25 March. The Budget on 16 March would be the last of the Spring Budgets. The first unified budget, combining tax and expenditure announcements, will be presented in November or December.

Mr King went on to introduce two papers which had been prepared by the Economics Division. The first paper focused on monetary policy, and the macro-economic backdrop against which the budget was framed. In particular, it assessed economic developments since the Inflation Report was completed in mid-February. In turn, since that paper was completed, sterling had recovered back to the level which held when the Inflation Report itself was written. The most notable development since the paper was completed was the change in the differential between UK and world interest rates, reflecting falls in Deutschemark market interest rates in recent weeks. UK interest rates were now almost in line with trade-weighted world interest rates, suggesting little expectation of a rise in sterling's ERI in coming months.

The second paper concerned fiscal policy. It aimed to provide Members with background briefing on the state of public finances. These were not in good shape. Consider, for example, the PSBR for the coming year, 1993-94: two years ago, in his 1991 Budget, the Chancellor forecast the PSBR for 1993-94 would be £7 bn. but in last year's Autumn Statement that forecast had risen to £44 bn. Many private sector forecasters were talking of numbers of £50 bn or more. As a proportion of GDP, the anticipated PSBR excluding privatisation receipts had risen from about 2% to around 9%.

With this situation in mind, the paper made three main points. First, it explained why there were many ways of measuring budget deficits, including or excluding privatisation receipts, adjusted or unadjusted for the cycle, inflation-adjusted, including or excluding capital expenditures. No single definition provided the answer to every question, although none could conceal the surprisingly rapid deterioration in the public finances. Second, it discussed the question of whether the current and projected levels of the PSBR were primarily cyclical or structural. Not surprisingly, there was great uncertainty about the extent to which the deficit could be thought of as structural, although there was clearly a structural element in it. This was probably between a quarter and a half of the current deficit. Third, however one measured the deficit, and whatever the relative contributions of structural and cyclical components, the inevitable conclusion was that there was likely to be an upward trend in the ratio of public debt to GNP. This would be the first time for many years that there had been a significant increase in the ratio of national debt to GNP. And it was this which underlies the Bank's concern that continuing fiscal deficits on anything like the current scale would undermine the credibility of counter-inflationary policy. Part of the medium-term financial strategy of the 1980s was the belief that putting the public finances in order was a necessary part of a successful policy to contain inflation. Nothing had happened to change that view, and, although the UK government did have credibility in dealing with fiscal problems, it was important to make a start now in dealing with the level of deficits. That was why the Bank's view on the Budget was that there was a need for a small - but visible - fiscal tightening in 1993-94, supplemented by the need to introduce, and lock into, now substantial reductions in future deficits by announcing measures that would take effect in 1994 and subsequent years.

In opening the discussion, Sir David Lees said that he sought three elements in the Budget. First, no change in interest rates. The exchange rate was already much more competitive than industrialists could have hoped for eight months earlier, and he was struck by Mr King's observation at the previous Court that borrowing costs in the US were currently only marginally lower than in the UK. Given both of these, it was now important that the authorities demonstrate the strength of their commitment to lowering inflation. Second, a "small but visible fiscal tightening", as the paper suggested - perhaps of the order of £2 billion, but not raised through a tax on business. It was important to couple this to a clear commitment to fiscal action in the future. Third, cuts in public expenditure. In response to the Governor's question, he agreed that there was a case for measures to stimulate industry, and in the first instance he would extend the period of enhanced investment allowances beyond the proposed October deadline. There should also be support for small businesses. It was important that the recovery be export and investment led, not consumption driven.

Sir Jeremy Morse asked what motivated the suggestion that fiscal action be "small" - was it because the scale of the structural deficit was unknown, or because of the fragility of recovery? Mr King replied that it was the latter, but he agreed with Sir Jeremy that future action to reduce the deficit had to be announced at the same time. That such a strategy could be credible was evident from the reception of the Clinton plan in the United States. Reverting to this discussion later, the Deputy Governor asked why further action on the fiscal deficit would have to be delayed. If it were likely to have a beneficial effect on the markets, why not do it now? Indeed, if there were no firm indications of how the funds were to be raised, might there not be a worsening of confidence? Sir David Lees and Sir Colin Southgate both suggested that if the intention were to raise revenues through VAT extensions, then early announcement would have the effect of bringing forward expenditures, thus aiding the recovery.

Sir Jeremy wondered whether the depreciation of sterling since last September might encourage others to think in terms of competitive devaluations. Mr King thought not, given that the depreciation had been forced on the UK, and that we were not looking to lock in the gain in a fixed exchange rate regime. Evidence of our disinclination to pursue such a strategy would come from our willingness to acquiesce in the recent rise in sterling, and also in future rises. Furthermore, other countries were probably troubled more by their own high interest rates than by worries of competitive devaluation. Mr Coleby agreed that other countries concerns stemmed primarily from their high interest rates. He emphasised that it was important to be willing to see the exchange rate rise as interest rates elsewhere declined.

Sir Roland Smith asked if there were any signs of a recovery in exports since suspension of sterling's ERM membership. Mr King replied that the beneficial impact of depreciation was likely to be masked by deteriorating conditions in some of our overseas markets, especially Europe. [redacted] noted that, while the figures for European trade would not be available for some months, it would be possible to get some idea of the effects of depreciation from trade with North America, where markets were picking up. [redacted] said that, while no effects were yet evident on the volume side, export prices had risen sharply, and this would have implications for export profitability, and thus future exports.

Sir Colin Southgate said that evidence from his own company suggested that exports were rising, and this was likely to be aided by the trend towards standardisation of products within the internal market. Indeed they were moving to concentrate more of their manufacturing effort within the UK. On the question of the Budget he agreed with Sir David Lees' suggestions: interest rates should not be lowered, fiscal action should be small, and public expenditure should be cut. Indeed, straight-line targets should be set for reductions across all departments. The Governor asked how far the exchange rate could rise against the DM before becoming a problem. Sir Colin replied that DM2.60 would be comfortable, and even DM2.80 would be bearable. He had always felt that the real competitive difficulties had arisen because of the decline in the dollar.

Sir Martin Jacomb argued that the government faced a number of problems and its options were severely restricted. The balance of payments deficit was still significant, despite the depth of the recession, the fiscal deficit had risen sharply, and the depreciation had raised the possibility of an increase in inflation. He stressed that, to prevent the balance of payments deficit rising in the event of recovery, it was important to lock-in the competitive gains from depreciation. This could only be done by keeping personal sector demand depressed, and by placing no additional fiscal demands on productive industry and commerce. No demand-side recovery could be contemplated before the supply-side recovered.

Mr Crockett was hawkish on the fiscal deficit. The Clinton proposals had shown that credibility could attach to promises of future action, and against that background there was an overwhelming argument for limited action now, but with a clear commitment to further action in the future. Returning to the question of competitive devaluation, he noted that he had heard concerns over competitive devaluations expressed in a number of international fora. He did not expect that countries would retaliate in a similar fashion: rather they would respond by slowing the GATT negotiations, or backsliding on questions of market access. But the UK could argue strongly that it had simply readjusted policy, and the credibility of this argument would be enhanced if interest rates were lowered no further, and the sterling exchange rate were permitted to rise.
The Governor said that overseas concerns had been raised mainly by the last interest rate cut, which had been misinterpreted by the markets as a signal of benign

neglect of the exchange rate. The Committee of Governors in Basle was working towards proposals to stabilise exchange rates, and it would be important to ensure that this work was taken forward.

Sir Roland Smith asked whether the Budget was likely to incorporate measures to reduce unemployment, as had been suggested by many commentators. Mr King replied that the issue was bound to be raised, but it was likely that the Chancellor would argue that in addition to pursuing the right macro-economic policy, reduction in unemployment would depend on specific micro-measures to enhance the efficiency of the labour market (and reduce the natural rate of unemployment).

Mr Quinn was sceptical of "token" attempts to reduce the deficit in the short-run, since tokenism would be seen through very quickly, particularly by the financial markets. Furthermore, he was concerned that, at the time of sterling's departure from the ERM, there had been suggestions that policy needed to be rebalanced, but that all we had had so far was a significant easing of monetary policy, with no corresponding fiscal tightening. Given the estimates of the discretionary component of the fiscal deficit, and the falls in exchange and interest rates, was there not a significant risk that there was a great deal of stimulus in the pipeline? Certainly recovery was fragile, but all recoveries were fragile in their early phases, and it was important not to overstimulate at this point. He agreed that firmer fiscal action was required in the medium-term, but was not sure that the Clinton plan - promising joy today, and pain tomorrow - was the route to follow.

Mr King replied that the "token" element referred only to the revenue which would be raised by Budget measures in the first year: it was important that any such measures had clear revenue-raising implications in future years. But one factor which had to be borne in mind was the degree to which the structural deficit was unknown. If the cyclical portion were much larger than currently thought, excessive revenue-raising measures would lead to an unbalanced fiscal policy in the future. So there must be an element of contingency in any Budget proposals. On the question of the rebalancing of policy he said that it had become evident in recent months that the overall stance of policy had been too tight during ERM membership, and that the rebalancing had to be accompanied by an overall loosening.

Sir Christopher Hogg asked how the deficit was to be funded. The Governor noted that the Bank had been engaged in discussions with HMT over funding policy, and that it was difficult to explore the question given the confidentiality surrounding Budget discussions. But Mr Coleby replied that the overall funding strategy would remain unchanged, in that there were particular forms of financing adopted in other countries (eg Italy) which we would continue to avoid. Nevertheless, there had been consideration of funding tactics. The Governor assured Court that a considerable amount of effort had been expended by the Bank on this question.
The Deputy Governor commented that HMT were well aware of the concerns in the market-place surrounding the scale of the funding requirement, but were equally well aware of the impact of the deficit itself on confidence and expectations. He agreed with Sir Christopher that on some occasions HMT could be less sensitive to the market implications of its actions than it ought to be.

Sir Colin Southgate asked how much of the public sector deficit was contributing to the maintenance of private sector employment. He had in mind particularly direct contracts with the private sector (such as infrastructure contracts with private companies etc) rather than the general effect of public expenditure in holding up aggregate demand. Mr King replied that no such breakdown was available, and it was not clear that economically such a separation would be very meaningful. Sir Colin said that he was not sure that the consequences for unemployment of various policy actions had been fully addressed. In particular, the government should not believe that measures focused on small businesses and training would be sufficient to stem the rise in unemployment in the coming year.

In his conclusion, Mr King responded to two questions which had been raised in discussion. The first was the balance of payments. He said that a deficit could reflect four things: overheating of the domestic economy (implausible at present); an uncompetitive exchange rate (similarly implausible given the depreciation); supply-side problems (possible, but they were likely to be much less than in the past); and an insufficiency of national savings relative to investment. His view was that the last of these was currently the most likely, in which case the most appropriate action the government could take would be to enhance national savings by lowering the public sector deficit. But it was important to be clear that, following the Lawson-Burns doctrine, if the deficit represented the willingly-held deficits of private sector agents then there was no obvious need for corrective policy actions.

Second was the issue of competitive devaluations. The French strategy in the ERM was one of competitive disinflation, and this was a strategy which was emulated by many other countries in the ERM. It was arguable that this was the glue that had held the system together in recent years. Their present worries focused on whether recent changes signalled an end to the low-inflation consensus in Europe. But there was no evidence that this was the case, nor, indeed, that there had even been any weakening in anti-inflationary commitment. And it was important that the UK signalled its intention to adhere to that commitment in the future.

E. A. George.
Secretary
26 March 1993

Doris Schulz

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 18 MARCH 1993

Present

Brian Quinn, Esq
Anthony Laurie Coleby, Esq
Mervyn Allister King, Esq

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

In the absence of the Governor and the Deputy Governor, Mr Quinn was appointed Chairman pursuant to the provisions of Clause 6 (2) of the Charter of 1 March 1946.

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report, Mr Quinn said that following two written Parliamentary questions from Lord Spens on Tuesday asking whether HMG could confirm that the Bank had given support to City Merchants Bank and how many other authorised banking institutions had received support from the Bank, the Bank had had discussions with HMT and it had been agreed that the Bank should, within the next few days, issue a public statement on the support operations it had undertaken. This would explain the general circumstances under which support had been made available to a few small banking institutions, the reasons why it had not been revealed before, and the fact that while it had been made available with the knowledge of Government, it had been undertaken without a Government guarantee. The statement would not identify any individual institutions and the Bank would refuse to identify them in response to queries for reasons of commercial and Banking Act confidentiality. Mr Quinn said that a copy of the Bank's statement would be circulated to Members of Court as soon as it had been approved for publication. Members of Court would also receive copies of the Bank's answers to prospective queries from the press.

Secretary.
25 March 1993

A COURT OF DIRECTORS AT THE BANK

THURSDAY 25 MARCH 1993

Present

Sir George Adrian Hayhurst Cadbury
Sir David Gerald Scholey, CBE
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Martin Wakefield Jacomb
Sir David Bryan Lees
Sir Christopher Jeremy Morse KCMG
Brian Quinn, Esq
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq
Ian Plenderleith, Esq

In the absence of the Governor and Deputy Governor, Sir Adrian Cadbury was appointed Chairman pursuant to the provisions of Clause 6(2) of the Charter of 1 March 1946.

The Minutes of the Court of 11 March were confirmed and those of last week's Meeting, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report, and with reference to the Minutes of the previous week, Mr Quinn reminded Members that the Bank and HM Treasury had agreed that the Bank would issue a statement in response to Lord Spens' Parliamentary questions. It had not been issued the previous week because of other Government business and the Chancellor's involvement in the

Budget debate. Since then, however, the need to issue such a statement had been reinforced by subsequent events. The Equatorial Bank had gone into administration the previous Friday and this had prompted further Parliamentary questions from Mr Vaz in the House of Commons concerning the failure of that bank and asking whether the Bank had considered offering support. In addition, Mr Quinn said that other ethnic banks serving the Asian community were also experiencing difficulties.

Mr Quinn said that the Bank's Statement, copies of which had been made available to Members that morning together with a question and answer briefing, would be issued at 4 pm that day and that he proposed to brief a number of selected journalists. He also drew attention to the speech he had delivered the previous day, copies of which had also been made available to Members: it provided background to the Statement and set out the broad principles for support facilities.

A number of questions arose concerning the text of the Statement and the briefing. Sir David Lees asked what the results and cost of support operations had been to the Bank over the past decade, and how it was proposed to respond to questions about the disclosure of these activities in the Bank's accounts.

Sir Jeremy Morse questioned the principle of making any announcement about support operations and was certainly against pointing to the success of any such operation.

In response to these questions Mr Quinn said that no analysis of costs of the Bank's support operations over a period of time had been undertaken. To his recollection, however, the only previous case within the timescale mentioned - apart from the recent cases of which Court were aware - was Johnson Matthey Bankers where the capital cost of the Bank's support had been recovered in full; but not foregone interest. So far as the Bank's accounts were concerned Mr Quinn said that consideration was being given to making provision in the accounts this year, with an explanatory note to that effect. In practice the provision for the year to end February 1993 was of the order of £70 mn making a total of approximately £95 mn overall.

Referring to the text of the Statement, Mr Quinn said that the Bank and HM Treasury had agreed the Bank should volunteer a Statement, given the Parliamentary questions. The wording and

extent of the response entailed a difficult judgement. There had been indications that the press had knowledge of the Bank's operations and that the story would break the previous weekend. In practice it had not. Nevertheless it was the Bank's view that rather than adopt a defensive posture we should now take the initiative in issuing the Statement in its present form ahead of any leak in the press. This would be preferable to responding subsequently to press questions.
Sir David Scholey commended Mr Quinn's speech as both excellent and interesting and said that so far as the Statement was concerned he thought it would be appropriate for the Chancellor or HM Treasury to respond rather than the Bank. If Government had granted the Bank autonomy then that would be a different matter and the onus would clearly be on the Bank to respond.
Sir David added that there was not a clear cut case for disclosure of the Bank's support operations in the Annual Accounts. It was a matter requiring careful consideration by the Governors and by Court. He would certainly have preferred to leave any announcement until the publication of the Bank's Annual Report and Accounts. In endorsing Sir David's comments, Sir Martin Jacomb said that by issuing the Statement the Bank could be drawn into some very difficult questions and additionally it might make it obvious that other banks were currently receiving support.

Mr Quinn said that he took note of the concerns of some Members of Court. There were two issues involved, content and timing. He accepted the need for brevity while on timing, he said that the Bank's preferred solution had been to use the publication of the Annual Report and Accounts. However, the announcement had been accelerated by the Parliamentary questions which required a response within a prescribed timescale, and the Bank's preference to lead the debate.
The Chairman said that he accepted that the Bank's hands had been tied so far as timing of the announcement was concerned but he would prefer a brief general statement on the grounds that the more that was said the more it would encourage questions. He felt that it was appropriate that Court should decide in due

course what should appear in the Annual Report and Accounts and that nothing should be said at this stage to pre-empt that. Sir David Scholey said that if the question of non-disclosure in the accounts was raised it would be appropriate to respond that the accounts had been considered fully by Court and the Auditors with full knowledge of all the circumstances and the accounts prepared in accordance with the Companies Act so far as it was relevant to a central bank.

At the Chairman's invitation and with the agreement of Members of Court, Mr Price, the Head of Economics Division and [redacted] Mr King's Personal Assistant, attended Court for the ensuing discussions.

In the absence of Mr King, Mr Price introduced two papers concerning the recent Budget. The first provided a synopsis of the Budget and was prepared by [redacted] in the Economics Division and the second was the Financial Statement and Budget Report 1993-94 - the Red Book - which had been laid before the House of Commons by the Chancellor of the Exchequer when opening his Budget speech.

In introducing the papers on the Budget, Mr Price remarked that according to the press the Chancellor was now apparently the least popular Chancellor ever. This may have been due to the technical nature of the Budget, coupled with the commitment to extending VAT to domestic fuels. But in practice the Chancellor's measures had gone a long way in the direction suggested by the Bank in the Governor's letter to the Chancellor prior to the Chevening discussions. The Bank had argued for a small fiscal tightening of around £3 billion but with a commitment to further tightening in future years. While the tightening this year was less than suggested this was more than offset by the concrete steps the Chancellor had taken to reduce the deficit in future years. Other measures which the Bank had proposed had also been implemented, notably the extension of the VAT base, the underindexing of tax allowances, the reduction of mortgage interest relief and increases in employees' national insurance contributions.

However, there were two questionable decisions. First, the change in ACT which, while welcome in terms of cash-flow effects in the short run and to the advantage of many companies with foreign income, implied an increase in the cost of equity capital to companies paying mainstream tax. Second, it was not clear that the Chancellor had yet done enough to fill the gap in the Government's finances. Clearly he had moved in the right direction but the longer he delayed in reducing the deficit the greater would be the burden arising from debt interest payments.

Sir Adrian Cadbury said that he had heard the suggestion that HM Treasury might be underplaying the prospective tax revenue from the announced measures. Did the Bank have a view on this? Mr Price replied that, given that the swings in public sector borrowing in recent years had been much greater than anyone had envisaged, it was difficult to be certain about the likely impact of any specific tax changes.

Sir David Lees said that the Budget had delivered a welcome small fiscal contraction this year, and had produced three of the four elements that he had been looking for. The first was the change in ACT, the second was the support that had been offered to exporters and the third was the range of measures for small firms. But he was disappointed that no reference had been made to the enhanced investment allowances which were due to expire in October, and also that so little reference had been made to investment in the Chancellor's speech.

Sir Martin Jacomb said that, as he had noted before, the Chancellor faced three significant, and conflicting, problems - the PSBR, the rising balance of payments deficit, and the level of unemployment. The Chancellor's measures were generally helpful (except the ACT change, which raised the rate of investment tax) but failed to go far enough. The longer-term outlook for sterling was still very fragile given the prospective size of the balance of payments deficit. More measures were required to address investment and the supply-side.

Sir David Scholey asked if the Budget had made the funding of the deficit any easier. Mr Coleby replied that the scale of the deficit was daunting, especially this year, when the Chancellor's measures had fallen a little short of what we had hoped. But he had exceeded our expectations for future years, and thus the markets should be encouraged by the steps he had taken. The Chancellor had also addressed the funding objective, and it was helpful that he had removed the sectoral distinction on what counted towards funding, in line with expectations. On balance the Budget had also made gilts a little more attractive vis-a-vis other assets, so in total the impact on the funding task was generally favourable.

Mr Plenderleith agreed. The funding total was undoubtedly a challenge, but was achievable as long as appropriate policies remained in place. Indeed, he felt less intimidated by this year's funding task than last year's, firstly because we already had something of a head start, but also because monetary policy was now more appropriate for domestic conditions that it had been a year earlier. He also felt that funding policy was now described in a more sensible way, and one which would enable funding to proceed at a pace which would be acceptable to the markets.

Turning to the monetary policy discussion, Mr Coleby noted that we were still receiving divergent signals from the key monetary indicators. M0 was still growing above its monitoring range and evidence from this month's Bank figures on note circulation suggested the buoyancy was continuing, but M4 growth remained weak, just above the lower end of the new monitoring range of 3% - 9%, although growth had picked up slightly last month. These indicators were consistent with the evidence obtained from output and demand, which pointed to some recovery in demand satisfied partly from stock drawdowns and partly from imports. But extension of credit to the corporate sector remained weak - perhaps reflecting borrowing from the capital markets, or strong cash flow due to companies' success in holding down domestic costs - and some recovery in that area would be an encouraging sign.

He said that the exchange rate had recovered much of the decline which had followed the January rate cut and that to be sure of remaining within the target inflation range, especially given that the Budget measures would raise measured inflation this year and next, it was important that the exchange rate remain firm. There was no obvious need for further stimulus at the present time and indeed there were risks of disturbing the inflation outlook via the exchange rate if we were to ease further. Wider options may present themselves if interest rate reductions elsewhere gather pace, but for now no change was indicated. Responding to Sir Martin's earlier comments on the lack of supply-side measures in the Budget, Mr Price said that it was not clear what other measures might have been taken by the Chancellor, especially since further extension of the temporary enhancement of investment allowances would call into question the credibility of any future announcements of temporary tax changes. Of course, one recent "supply-side" measure was the fall in the exchange rate, and there was some evidence from the most recent (non-EC) trade statistics that exports were expanding as a result (although, worryingly, imports had recently grown even more rapidly). Mr Coleby noted that some encouragement should be drawn from the manner in which producers had restrained the growth of their domestic costs. This suggested that rates of return would be raised, which was in turn likely to raise the rate of investment. Sir Adrian replied that he, too, had been encouraged by the Chart in the papers on manufacturing productivity and unit wage costs. Sir Roland Smith, however, was concerned that the manufacturing sector might have shrunk below its optimal level. He also cautioned that increases in activity should not be confused with increases in profitability. The latter also depended on a recovery in prices and profit margins, which had been excessively squeezed during the recession.

[illegible]
The Secretary.

E.A.J. George
8th April 1993

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 1 APRIL 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

Mr Coleby commented on the weekly figures and then spoke about the foreign exchanges and the state of the domestic markets. He mentioned that the Bank would be publishing a new free guide to increase the small investors' understanding of gilt-edged securities. In response to a concern voiced by Sir Colin Corness, Mr Plenderleith said that the booklet had been produced in response to requests for information rather than as part of a marketing campaign.

Under the weekly executive report:-

(i) [redacted]

(ii) The Deputy Governor said that we had also received a writ and a Statement of Claim against the Bank from Lord Spens in relation to his dismissal from Ansbachers in January 1987. The writ had originally been issued against the Governor in December 1992 but when it was served on the Bank in February 1993 it had been amended, naming the Bank as the defendant. A similar writ had also been served against Ansbachers.
The Bank has been advised that it had a strong case against the claim but, again, it was likely that mention

would have to be made of the claim in the Annual Report and Accounts.

(iii) With reference to a Minute of the previous week the Deputy Governor said that the notice on support operations which had been discussed at Court had been issued later that day. Following the comments from Members of Court, Mr Quinn had discussed with the Executive Directors the best way forward and had decided to issue the notice as it stood but to cut down the detail in the question and answer briefing and not to give any background briefing to the press. Mr Quinn had consulted the Governor who agreed with this approach.
The press reaction to the issue of this statement was muted but generally favourable overall and the announcement had had no effect on the wholesale funding market.

At the Governor's invitation:-

1 the Deputy Governor said that the interim payment in lieu of dividend was due to be made to HM Treasury on 5 April. He reminded Members that the calculation of the payment was governed by a formula under which the Bank and HM Treasury shared post-tax profits equally.

After making a tentative provision of £70 mn in respect of support operations, the operating profit for 1992/93 was estimated at £104.6 mn. The application of the dividend formula gave a dividend of £43.7 mn, tax of £17.2 mn with a further £43.7 mn being retained. This year's tax charge benefited us slightly because the dividend from Minories Finance Ltd was not subject to tax and because the tax on the sale of the Agricultural Mortgage Corporation was computed according to Capital Gains Tax rules which gave a lower effective rate of tax.

The proposed dividend was significantly lower than for the previous year, 1991/92, which was £67.6 mn in total. The major reason for this was the provision for support operations although lower interest rates had also contributed to the reduced profit.

The Governor said that with Mr Quinn's endorsement of the proposed payment having been received it would be appropriate for those present to approve the payment. Accordingly it was agreed that, pursuant to Section 1(4) of the Bank of England Act 1946, an interim payment of £21.85 mn be paid to HM Treasury in lieu of dividend on 5 April.

2 In introducing his Report to Court, Mr Hewitt, the Director of Central Banking Studies said that there was little scope to expand further our training and technical assistance for foreign central banks. We might be able to offer more specialist training courses eg in financial statistics. It was hardly possible to do more technical assistance than we were already doing with present resources but it might be possible to make greater use of Bank pensioners in providing assistance overseas. The CCBS had run a number of particularly interesting courses during the past year including one in South Africa for non-central bankers, one in London for the chairmen of the central banks of the former Soviet Union and three parallel courses in St Petersburg for the Central Bank of Russia.

In commenting on the financial aspects, Mr Hewitt said that the CCBS had a budget of £1.75 mn for the coming year. In addition financial assistance was forthcoming from the Government Know-How Fund in respect of accommodation for overseas personnel attending courses in London and in covering some accommodation and travel costs for Bank staff when running courses abroad. Mr Hewitt explained that he had also taken up contracts under the EC PHARE Programme in which we were paid fees as well as expenses for conducting courses for the National Bank of Poland.

In comparing the Bank's activities with other central banks, Mr Hewitt said that overall the Austrian National Bank were more active than the CCBS in their training programme but they extended their training facility to commercial bankers as well. The National Bank of Belgium were also heavily involved in training but the Bank of England was the only one besides the Austrians providing training on a continuous basis. Several other central banks, the US, German, French and Dutch in particular, provided as much or more technical assistance to Eastern European and former Soviet Union countries as we did, but our world-wide commitments were probably greater than theirs.

Mr Laird congratulated the Bank on providing what was clearly a very valuable and greatly appreciated training facility which would do much to enhance the Bank's reputation in the longer term. He asked whether consideration had been given to running training courses on a joint venture basis with commercial banks. Mr Hewitt replied that there was close co-operation with some commercial banks, and Barclays Bank in particular, in providing speakers for their courses. He had regular contact with them and although he was ready to co-operate he did not think that there was much scope for joint ventures.

Sir Colin Corness said that he regarded the cost of running the CCBS as a good investment. Ventures such as this which would raise the standing of the UK abroad were to be welcomed but he wondered whether there was scope to re-coup costs by charging fees? Mr Hewitt replied that this was not something that the Bank had sought to do and the Governor commented that in practice many of the central banks would not be in a position to pay.

In response to the Governor's enquiry about the element of competition between European central banks in the training field, Mr Hewitt explained that while there was an element of competition between the banks there was also a degree of openness and co-operation in that the co-ordinators of technical assistance from G10 Central Banks met regularly at the BIS in Basle and were aware of each other's programmes and activities.

Sir Adrian Cadbury said that he hoped that the CCBS would press ahead with their plans to produce a Central Banking Manual. Mr Hewitt said that the material, in the form of course notes etc, was being collected but it would take time to put it together in the form of a manual. Nevertheless, he agreed that it was desirable to pursue this.

In noting that [redacted] a Bank pensioner and formerly a [redacted], was currently providing technical assistance on administration issues in Slovakia, Mr Harris enquired whether the Bank should encourage more pensioners to undertake this sort of role. Mr Hewitt said that although some had the necessary skills and ability they had not shown much interest in these opportunities although one or two had undertaken short-term commissions. Mr Crockett said that there was a growing demand for technical assistance but we had to turn down a significant number of requests because of a lack of resources: the demand was certainly there if it was possible to persuade pensioners to undertake these commissions.

3 Mr Harper, the Chairman of Minories Finance Ltd, attended Court and introduced the Report and Financial Statements of Minories Finance Ltd for the year ended 31 December 1992, which were laid before Court. Mr Harper commented on the progress being made on various fronts and the Governor congratulated and

thanked him for his continued enthusiasm and vigilance in pursuing the recoveries.

G. A. Croughton.
Secretary.

E. A. J. George
8th April 1993

A COURT OF DIRECTORS AT THE BANK

THURSDAY 8 APRIL 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The Governor extended a welcome to Sir Chips Keswick who was attending Court for the first time following his appointment as a Non-Executive Director. The Governor also informed Members that Mr Geoffrey Drain, who had been a Non-Executive Director of the Bank from 1978 until 1986 died suddenly the previous week.

The Minutes of the Court of 25 March were confirmed and those of the Meeting of 1 April, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges, including the Official Reserves figures for March, and the domestic markets were laid before Court.

[redacted]

[redacted]

Mr Quinn went on to mention that the previous week Mr Vaz, MP, had called on him. Mr Vaz had explained that the purpose of the approach was not to raise the profile of the issue of this group of banks but, as there was some feeling in the local community that the Bank was being discriminatory against these banks, he wanted to learn what the Bank's principles were in supervising such institutions and in providing financial support. Mr Quinn had been as helpful as he could. Subsequently however Mr Vaz was reported in the Independent and Guardian as having been to see Mr Quinn and his comments to the press had not accurately reflected the discussion - in practice they had also escalated the issue.

The Governor said that it might be helpful for Court to understand that a high proportion of the deposits placed with these banks were "community deposits" which had been collected in Swiss banks and then placed in generic accounts in these ethnic banks in London. Neither we nor the other banks concerned knew who the individual depositors were by name and much of the banking of this nature may be by way of tax or exchange control avoidance. Consequently, these deposits could be rather volatile.

In response to Sir David Scholey's question, the Governor said that these deposits were protected under the arrangements of the Deposit Protection Board but in practice it was unlikely that most depositors would come forward to make a claim. Mr Quinn said that these community accounts, [redacted] were tailor made for misappropriation and abuse, for example by money launderers. One of the distinctions about [redacted] was that they did not hold community accounts.

[redacted]

Sir Chips Keswick enquired whether the Bank had placed non-executive directors on the boards of any of these banks and in particular [redacted] as it was the general view that such action uplifted the status of a bank. Mr Quinn was unable to recall that the Bank had placed non-executive directors in these particular banks, but thought it unlikely.

Sir Jeremy Morse enquired when these banks were granted authorisation, whether they would be granted a licence now, and, if so, what safeguards the Bank would take? In response, Mr Quinn said that these banks had been licensed in the early 1980s and certainly if they were seeking a licence now they would be subjected to a far wider range of questions than hitherto.

At the Governor's invitation:-

1 Mr Coleby, in his capacity as a former member of the Charitable Appeals Committee, introduced the Report of

that Committee which covered appeals considered in the period to 28 February 1993. In addition the Report highlighted the increased number of appeals received by the Bank and the difficulties experienced in responding to them. However, the Committee had postponed detailed consideration of these issues pending the outcome of the wider review of the Bank's community involvement generally.
The Report was laid before Court.

2 With the agreement of Members of Court, Mr Rumins, the Head of Finance and Resource Planning Division, Mr Sharp, the Head of Personnel Division and Mr Sweeney, who was responsible for Officials' Career Development, attended Court for the ensuing discussion.

The Deputy Governor introduced 'The Financial Framework' which incorporated papers on Current Expenditure, the Banking Department Profit and Loss, Staff Numbers, the Cash Limit Position, and Capital Expenditure. He explained that the framework had been devised to provide guidelines on expenditure and took account of the Bank's financial responsibilities to Government on the one hand as the Bank's shareholder and a user of our services, and banks who provided us with much of our income through non-interest bearing cash ratio deposits, etc, on the other. The Framework had suggested that we needed to contain our current expenditure and in fact to reduce it modestly in real terms by about 1 1/2% per annum over a five year period from 1990/91 in the case of on-going functions which would also enable us to accommodate new areas of emphasis. The effect of this had been to require all Budget Centres to address two questions - was what they were doing necessary, and was it being done in the most effective and cost efficient manner? This had been a helpful principle and had imposed a degree of pressure on the Bank overall. It had been agreed that the Framework remained appropriate again this year but without a further across-the-board reduction to expenditure in the last outline year (1996/97).

The Current Expenditure Budget for 1993/94 was almost identical in money terms to the actual costs for 1990/91. Three years' inflation and pay awards and the increases in expenditure on new and expanding functions had been offset by real reductions of expenditure.
The forecast Profit and Loss Account for 1992/93 compared with 1991/92 showed higher fixed income at £173 mn compared with £165.8 mn (partly arising from increased banking commission and fees from support operations) but lower variable income of £121.3 mn compared with £147.2 mn because of lower interest rates and bankers' balances. Expenditure not recovered from HMG was £128.4 mn, an increase of £6.7 mn.
Profit before provision was therefore lower at £174.6 mn compared with £193.9 mn. A provisional provision for support operations of £70 mn had been made at the moment in the 1993 accounts (compared with the £25 mn provision made in 1992). The resulting profit before tax and dividend was therefore forecast sharply lower at £104.6 mn compared with £166.1 mn.
There was probably a need to adjust the provision upwards, and this would be dealt with when the accounts were presented to Court in May.
The Deputy Governor completed the review of the Financial Framework papers by referring to the cash limit position where considerable reduction had been made by the Bank to the costs charged to HM Treasury for the recoverable functions. The recent forecasts suggested that forecast expenditure would fall comfortably below the reduced cash limit. However, HM Treasury had recently asked for further options for reductions of 2 1/2% and 5%. Referring to the Capital Expenditure programme, the Deputy Governor said that total expenditure was forecast to be in the range of £25-30 mn per year. The Printing Works expenditure was

currently the largest single element of capital spending.

A general discussion ensued on the original justification for the support operations. Sir Martin Jacomb wondered whether the Bank would have undertaken the support operations if it had known at the outset what they would cost. If the justification was systemic how does one take account of possible cost in assessing whether to support or not. Sir David Scholey, having declared his interest in that S G Warburg were advisers to one of companies involved, felt that Non-Executive Directors might well have not supported such an undertaking if they had known at the outset that it would cost £100 mn. For the future, he suggested that it would be helpful for Court to have a greater understanding of the consequences of systemic fragility and the need to put that in context of the cost.

The Deputy Governor suggested that a paper might be prepared setting out what had been said to Court in 1991 when the support operations had been considered, and what had been said subsequently. Market conditions in 1991 were extremely fragile and there was a real fear of the consequences to the banking system. The Deputy Governor said that estimating the costs of support operations was very difficult, not least because what starts as liquidity support can become solvency support as the economy and asset prices deteriorate. He outlined the course of events over the last two years and the present position of the institutions being supported.

The Governor said that the central bank's contribution to the financial system was an interesting question. We drew on the subscriptions from the banks and in return they would be justified in expecting us to make use of those funds in saving or supporting the financial system. Whilst he agreed that it would be helpful to produce a paper and have a general debate on the issue he suggested that it was difficult to anticipate theoretical problems of this nature and therefore the theoretical cost.

Sir Jeremy Morse suggested that central banks were inclined to play safe and provide support even if it was questionable to do so. In responding to Sir Jeremy, who had noted that the provision had risen from £25 mn to a provisional £70 mn this year and asked what the provision might be next year, the Deputy Governor said that he hoped we would be fully provided against [redacted]

Sir David Lees supported the Deputy Governor's proposal that a paper be presented to Court setting out a resume of the support operations and showing what view was taken in 1991 and how the picture had changed progressively up to the present time.

Mr Quinn suggested that there were two judgements to be made, whether or not to support and what would the ultimate cost be? He said the first question could be answered by referring to a set of principles. We did that in 1990 when we had allowed a number of institutions to go down, as well as in 1991 when we had decided that support was justified. As to cost, this was very difficult. Perhaps if we had intervened in 1990 the cost would have been less than now appears; but it is impossible to judge. The Federal Deposit Insurance Corporation does it in a more structured way but that in no way avoids the difficult question or makes the answer more obvious. He also said the final cost is also not always obvious. We could recover our provisions for loss and had done so in the past with the Lifeboat and Johnson Matthey Bankers. He recalled that there had been cases where the Bank had decided not to intervene. Although the Bank normally played safe, perhaps we should let Court know of these occasions too.

Sir Chips Keswick said that the Bank as supervisor was deemed to know all that was going on. The perception continued that if the Bank was supervising then all was well and the Bank would support if necessary.

Sir Martin Jacomb welcomed the Deputy Governor's suggestion and said it would be helpful to be able to make a comparison with the considerations at the time of Johnson Matthey Bankers. That had been a very successful operation saving London's reputation as a financial centre as well the gold market. However, he would not wish the paper to be overloaded with cases that were not thought to be systemic.

Sir Colin Southgate also supported the Deputy Governor's idea to review past experience to see what could be learned from it and also suggested that it would be wise to take the most conservative view on provisions in 1993 and pay back later if necessary.

Sir David Scholey noted that the papers on the Financial Framework did not draw out the savings that had been made to compensate for the unbudgeted expenditure in areas such as the Centre for Central Banking Studies, and the Legal and Special Investigations Units. He suggested that additional information might be provided to supplement the picture on the changes in current expenditure from 1990/91 to 1993/94. These should show the real savings made to existing functions and the cost of new and expanded functions over that period.

3 The Deputy Governor introduced a paper reviewing the workings of Court and said that following the Working Party set up in March 1991 to review the role, functions and procedures of Court and its Committees recommendations for change had been introduced from 1 March the previous year. In particular we had tried to introduce discussions of greater length and on more strategic issues, but the programme had been disrupted to some extent by necessary discussions on the Bingham Inquiry and on Independence. Nevertheless, he said he would welcome Directors' comments on how the programme for Court had worked out in practice. He also referred to the Committee structure and enquired in particular

about the future of Staff Committee and whether Directors felt that the Reports from Heads of Function, which had previously been made to Staff Committee, were now more appropriately made at Court.

Sir Colin Corness said that the discussions at Court showed a marked improvement both in substance and in quality. He very much appreciated the revised programme which provided for one long Court each month and one occasion when the Non-Executive Directors were not expected to attend. He said that the Bank made fairly heavy demands on its Non-Executive Directors which had an impact particularly on those who did not work nearby. He would therefore prefer ideally to have only two Courts a month, but accepted that this was not possible under the Bank of England Act, 1946.
Referring to the Committee structure, Sir Colin said that he felt the process should be taken further. He thought it was inappropriate for Non-Executive Directors to serve on Staff Committee - that was for management, and the presence of Non-Executive Directors dealing with such detail relieved management of its responsibilities. Nevertheless, he accepted that his presence on Staff Committee had helped to keep him in touch with what was going on in the Bank and so he would support, for that reason, the retention of Heads of Function making Reports to Court. Sir Martin Jacomb and Sir David Lees both agreed with Sir Colin's comments. Sir David went on to suggest that Heads of Function should be given more time to make their presentations. The Governor thought that sometimes the discussion was concluded rapidly.
Sir David Scholey suggested that the Reports would have far more impact if they were made at Court rather than presented in writing before the meeting. He would prefer Heads of Function to make formal presentations at Court using, if appropriate, visual aids etc.

The Deputy Governor said that there was some ambiguity about the purpose of these Reports by Heads of Function. Was it to explain the role of their particular Division and the substantive policy issues with which they were concerned, or was it to address the management and staffing problems that they faced? The origin of these Reports had been in the context of Staff Committee and so the focus had tended to remain in that direction rather than on policy problems. Sir David Scholey replied that Staff Committee had been an informal gathering and it would be more difficult to make a presentation to a larger group such as Court. However he would prefer policy presentations made at Court and, if Staff Committee was to be retained it should not involve Non-Executive Directors. Referring to the programme of Court discussions, Sir David said that he appreciated very much the change of direction and would prefer even less frequent and more meaty meetings. In particular he commented that the long Court discussions on BCCI and Independence had produced particularly interesting debates whereas the more formal discussions had been less exciting. He felt that there was less participation from the Executive Directors except perhaps on topics of supervision and suggested that more feedback from the Executive might make the discussion more vigorous.

In commenting on the balance between long and short Courts, the Governor said that the feeling among the Executive was that it was necessary to have two meetings of normal length each month in order to deal with the routine and regular business. The weekly executive report provided an opportunity for the Executive to share current issues with the Non-Executive Directors and if the normal Courts were reduced in number this practice might have to be curtailed.
Sir Adrian Cadbury said that the long Courts had been particularly helpful in fitting in discussions on Bingham and Independence. It would have been difficult

to deal adequately with such issues in a normal Court of one hour's duration. He therefore suggested that we should continue with the present programme of Courts. The one big improvement that he had noted was the introduction of the new table which enabled people to see and hear so much better than with the previous long table. Sir Adrian also advocated the retention of the Reports to Court by Heads of Function and suggested that they should focus on the work of the Division and then concentrate on the policy issues that they faced. He noted that the Premises Committee was in hibernation and suggested that it should be abolished. Building projects were a matter for management to deal with and he saw no purpose in retaining the Premises Committee.
Sir Colin Southgate said that he would prefer the Reports to concentrate on matters of policy and for them to relate to particular issues. He suggested for example that the Report from the Head of the Economics Division might be aligned to a debate on the Budget.
He supported Sir David Scholey's suggestion that a full presentation was preferable to the submission of a written report updated orally at Court. Referring to the pattern of Court agendas, Sir Colin said that he would be happy for long Courts to start even earlier and take reports from Heads of Function in groups. He was concerned that discussions on issues such as the economy were often condensed to make way for discussions on administrative issues such as charities, pensions etc. In his view these were matters for management and should only be raised at Court if management felt the need to take the mind of Non-Executive Directors.
Sir Roland Smith said that he found the long Courts helpful but did not agree with his colleagues about the use of Committees. He felt that they were important, particularly Staff Committee for those who were concerned about people. He felt that the Reports from the Heads of Function were too formal when made to full Court.

4 Mr Harris introduced a paper 'The Bank in the Community: the future of the Charitable Appeals Committee' and said that the Bank's involvement in community matters had grown quite considerably over the past five years and he felt it might be appropriate to gather together the various activities under one Committee of Court: his proposal was to change the nature of the Charitable Appeals Committee to become the Community Affairs Committee. He suggested that if Members of Court were content it might be left to the Committee to consider how best to take this forward and to revert to Court with appropriate terms of reference.
Sir David Scholey supported the proposal and hoped that the new Committee would consult and exchange views with similar committees in other companies. There was far greater focus on these issues in most institutions now and so it was important for companies to compare and consult.

Sir Jeremy Morse thought it inappropriate for the Bank to set a profit related target for its community giving, not least because it was not a profit-making institution in the accepted sense. His preference would be for the Bank to cut out most small charitable donations as the Bank was no longer expected to give a lead. With such an approach it would be easier to say no to the majority of applicants.

The Governor invited Sir Roland Smith, as Chairman of the new Committee, to take the matter forward, which he was happy to do.

5 Mr Harris went on to introduce two papers 'Staff and Pay Structures in the Bank' and the regular 'Report on Salary and Benefits 1992/93'. He said that the pressure points that had been identified the previous year remained. Staff numbers had continued to fall during the year and wastage rates for graduates continued at low levels. Recruitment had been confined

almost entirely to newly qualified graduates, although efforts had been made to recruit some "second-jobbers" on fixed term contracts. It had been quite difficult finding staff of the appropriate quality and qualifications at affordable salaries. Surplus staff numbers had reduced during the year from about 90 to less than 50. The great majority were in the supervisory and clerical grades, with fewer than 10 EDP staff. Some 40 computer operations and support staff had been made redundant in July and transferred to Hoskyns as part of a facilities management deal.
We had continued to keep under review the general salary levels of the analyst group. Data suggested that for the middle third of our 30 year old graduates our pay was comparable with the clearing banks, but significantly below that in merchant and foreign banks.
We had also continued to keep under review the way we operated our pay structure and merit awards. Over the past five years, the average salary of Bank officers, excluding the effect of the across-the-board awards, had fallen by 3.5%, whilst that of Officials had risen by 1.5% and Senior Officials had fallen by 4%. In particular, over the past year in each group the average salary had fallen marginally.
In discussion, Sir Adrian Cadbury referred to the Financial Framework and suggested that the figures quoted there for amenity meals, £3 mn, was quite substantial. Sir Roland Smith asked about the statistics relating to Housing Loans and Housing Support which, he suggested, indicated that most members of the staff were in receipt of some form of housing assistance. Sir Colin Corness said that he thought the amount of Bank capital tied up in Housing Loans was very substantial and questioned whether the Bank had considered off-loading this portfolio to a building society.
In response to these questions, Mr Harris said that it had been traditional for large City firms to provide eating facilities and the facilities that we offered

were typical of the clearing banks. Smaller companies, of course, offered luncheon vouchers. In response to the questions on housing assistance, Mr Harris said that again this was a traditional feature of the financial services sector. The figures quoted in the Report included the Printing Works staff and also a number of pensioners who could retain their housing loans for a few years after retirement. In response to Sir Colin Corness' question, Mr Harris said that we had closed the Housing Loan Scheme to new entrants in 1979 because of the growing commitment and had then introduced the Housing Support Scheme. We had looked at the possibility of selling our housing loan portfolio a few years ago, but at that time the disadvantages outweighed the advantages.

G. A. Croughton
Secretary.
22 April 1993

E.A.J. George
22nd April 1993

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 15 APRIL 1993

Present

Edward Alan John George, Esq, Deputy Governor
Brian Quinn, Esq
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mervyn Allister King, Esq

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

There were no items for discussion under the weekly executive report.

E.A.J. George
22nd April 1993

G. A. Croughton.
Secretary.
22nd April 1993

A COURT OF DIRECTORS AT THE BANK

THURSDAY 22 APRIL 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Minutes of the Court of 8 April were confirmed and those of last week's Meeting, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report the Governor said that following the discussion of the paper "A Review of the Workings of Court" earlier that month, it was clear that there was no future for Staff Committee and that the Reports from Heads of

Functions should continue to be made to Court but be given greater prominence on the regular agendas.

He suggested that in future Court might receive one Report a month at a normal Court and that the Reports should feature as the first item on the agenda before the Weekly Figures, the Markets Report, and the Weekly Executive Report, thus ensuring sufficient time for an oral presentation with the expectation of some 15 minutes or so for discussion.

Drawing on the earlier discussion he suggested that Heads of Function should explain what their area was responsible for; what their current policy preoccupations were, including staff and general resource matters if these were policy related; and how they judged the effectiveness of their area. By way of background to the presentations a short written report which might include, as at present, an organogram and a statement of staff resources etc, would be appropriate.
Court supported these proposals and agreed that in the circumstances Staff Committee be stood down.

Court noted that there was one outstanding report from the current round, Mr Price, the Head of the Economics Division, having been deferred from introducing his Report at Court on 4 March. He would now make his Report on 6 May. Arrangements for the new format of presentations would take place thereafter.

Court gave their approval to Professor Sir Roland Smith joining the Board of Harrington Kilbride PLC as a Director and Chairman.

At the Governor's invitation:-

1 [redacted]

[redacted]

[redacted]

2 Mr Crockett presented a paper entitled "Quarterly International Developments" which had been produced by the Macro-economics Section within the Industrial World Division of International Divisions. He said it was convenient to focus on this in advance of the IMF and IBRD annual meetings the following week. Mr Crockett said that 1993 was the third year of economic weakness and growth within the G7 as a whole continued at around 1.5% per annum. Nevertheless there were important differences in pressures within the group. The position in the UK and USA was one of continuing recovery but in Germany and Japan the situation was less good now than it had been earlier. Moreover the Japanese trade surplus was causing increased trading tensions. The task for Ministers and Governors therefore was to focus on how to underpin the recovery without endangering the progress that had been made on

inflation or aggravating fiscal deficits. Given the varying situations faced by individual countries, a differentiated approach was called for.

In the USA the recovery was clearly under way and the recent fiscal measures had been seen as a satisfactory and desirable package. In Germany and Japan, however, recovery prospects were not so good. The Japanese had introduced new proposals which should enable their rate of growth to become positive and reach 3% by the end of the year. In Germany, however, there was no scope for fiscal measures. It was necessary for them therefore to focus on monetary policy. Much of the rest of Europe would like to see an easing of German interest rates but the Germans themselves were concerned not to increase inflationary pressures. One of their difficulties was the different economic behaviour in different parts of the country, east and west. Mr Crockett suggested that the Germans would not move rapidly towards lowering their interest rates and would not be pressurised by other European countries.

In response to Sir Jeremy Morse's request for a paper on the Bank's views of the EMS in the longer term, say five years, Mr Crockett said that it was proposed to bring a paper to Court in June which would focus on that issue looking also at the prospects for ERM members and non-members alike. In response to Mr Laird's concern about GATT, Mr Crockett said that the perception of the new administration in the USA was that the personalities concerned were temperamentally more inclined to bilateral deal-making rather than an overall free trade strategy.

Sir Colin Corness asked to what extent the figures quoted in the Quarterly International Development paper for Germany included data from Eastern Germany. He commented that there were considerable signs of activity on all fronts in Eastern Germany. The construction industry in particular was developing and this, of course, would have a a knock-on effect within the economy generally. He felt that by not including economic data on Eastern Germany the paper might be projecting a more gloomy view than was necessary but he accepted the Governor's point that Eastern Germany provided less than 20% of GDP for Germany as a whole.

Sir David Scholey enquired about the impact of South East Asian and Latin-American economies on Europe and the UK in particular. In response Mr Crockett said that the current recession in the industrial world had not had as much of a knock-on effect on the developing world as earlier recessions had done and so they had survived better than on previous occasions. Both South East Asia and Latin America were linked closely with the USA economy which was now recovering and so that was good for them. Mexico, Chile and Argentina had made remarkable progress in economic terms and in the long-term this must be encouraging for the rest of the world as markets would open up in those areas.

Sir Colin Southgate commented that Japanese companies were withdrawing their top quality management from posts in the USA and Europe and relocating them in South East Asia where they thought the prospects were better - this was not a good sign so far as the UK was concerned.

3 The Deputy Governor introduced a paper updating Court on the arrangements to celebrate the Bank's tercentenary in 1994 and reminded Members that the events were structured around three periods, February, possibly with a European focus, early June when the emphasis would be international, and 27 July, the 300th anniversary, which would be a national occasion. The budget which included the cost of these events and the Bank's domestic celebrations totalled £1,587,600. This included the sum of £500,000 which it was proposed should be made available to the Houblon-Norman Fund to

enable the Advisory Committee to extend their scholarships. Their recommendation for the current year was for three senior Fellowships to be awarded and it would therefore be a convenient time to release the additional funds to the Houblon-Norman Fund now to enable these Fellowships to be financed.
The Governor's Recommendation to this effect was approved.

In commenting on the Bank's Tercentenary generally, Sir Christopher Hogg said that it presented the Bank with a marvellous public relations opportunity and he enquired what plans to that end were in place. The Deputy Governor outlined a number of areas which had a public relations impact but agreed to pursue the PR aspect further. In the context of PR, Sir David Scholey asked to what extent the Branches would be adopting a high profile policy locally. The Deputy Governor pointed out that provision had been made for them in this respect but Mr Harris responded that they had expressed the view at a meeting earlier that day that the provision was insufficient. The Deputy Governor said that it was important that the Branches should feature in the Tercentenary events and in this connection he hoped that Members of Court would visit the Branches during their celebrations.

Sir-David Scholey, in supporting the proposal for the Houblon-Norman Fund suggested that the contribution, roughly one third of the total budget provision, should be removed from the budget as it distorted the picture. In responding to Mr Laird's enquiry about floodlighting the Bank permanently, the Deputy Governor said this had not been overlooked. A decision would be taken later once installation and running costs were available.

Sir Jeremy Morse was concerned that the inevitable publicity of the Bank's Tercentenary would not be separated from the Independence issue and that it could either add to or subtract from the celebrations. The Governor commented that his letter was with the Prime Minister but that it was a politically embarrassing topic at the present time and it might have to take its course in the Prime Minister's timetable. Mrs Heaton suggested that it might be prudent, therefore, for the Bank to re-direct the focus of the Tercentenary onto the Bank's central role in London as a major financial centre. The Governor commented that this was an aspect that would be enhanced by the presence of the International Monetary Committee, involving the Chairmen of the 100 biggest banks, in London during our celebrations.

The Governor mentioned that he had chaired the Annual General Meeting of the Sports Club the previous day, and had been asked to convey to Court the appreciation expressed at that Meeting for the continued support given to the Sports Club by the Bank.

In accordance with Section 10 of the Charter, the Deputy Governor, Messrs Quinn, Crockett and Coleby withdrew, together with Messrs Harris and Kent.

Sir Adrian Cadbury, in his capacity as Chairman of the Remuneration Committee, introduced a Recommendation of that Committee concerning the appropriate salaries for Mr George and Mr Pennant-Rea on their appointment as Governor and Deputy Governor respectively with effect from 1 July 1993.
Sir Adrian said that the proposal that Mr George's salary be fixed for his five year term of office had been put forward and strongly argued by Mr George himself. There were, of course, pension implications with such a proposal but Sir Adrian reminded Members that Court had the power to grant an appropriate pension in the light of the circumstances at the time.

In response to Sir David Lees' question whether this would be a formal arrangement and Sir David Scholey's enquiry whether such a commitment would be given in writing, Sir Adrian Cadbury said that there could not be a formal commitment. However, there were precedents and Court could approve a pension in excess of the Inland Revenue formula of two-thirds final remuneration with the excess coming from the Bank's own funds rather than from the Court Pension Scheme.

Sir Jeremy Morse asked whether Mr George's motivation in suggesting a fixed salary was to avoid conflict year by year or to display his commitment to his primary duty as Governor to keep inflation low. Sir Adrian Cadbury said that he had discussed this with Mr George who was strongly of the view that a fixed salary was best in the circumstances and displayed his commitment to the stability of the currency. Mr Laird, a member of the Remuneration Committee, said that this issue had been discussed in depth in the Committee and with the experience of the present Governor's difficulties, resulting in the Governor not wishing to take the salary recommended by the Committee and Court, the Committee supported Mr George's request. Sir David Scholey said that it was impossible to overstate Mr George's feelings on this issue. The Governor said that from his experience it would be very satisfactory to get away from the need to waive salary.

Sir Christopher Hogg expressed grave doubts about a fixed salary and Mrs Heaton questioned whether there was some difficulty and potential embarrassment in fixing a salary but leaving the pension arrangements flexible.

Sir Adrian Cadbury said that the Court Pension Scheme arrangements were in place and it would be necessary to grant a pension in the first instance in accordance with those arrangements. Nevertheless, he would support the wish of Court that consideration be given to providing an appropriate pension at the time of Mr George's retirement, having regard to the fact that his salary had been fixed for five years.

Notwithstanding the reservations of some Members, Court agreed the recommendation that Mr George's salary as Governor be fixed for a period of five years from 1 July 1993 at the level currently in payment for the present Governor.

Sir Adrian Cadbury then explained that the Committee, having considered the circumstances of Mr Pennant-Rea's appointment proposed that the salary band for the Deputy Governor be lowered to £160,000 - £200,000, a level that would not conflict with the range for Executive Directors, and that Mr Pennant-Rea be appointed to the bottom point with his salary being reviewed, in accordance with existing practice, at the end of the year.

In response to Sir Jeremy Morse's question Sir Adrian said that Mr Pennant-Rea had not been consulted about the salary level yet but he thought that the Bank salary would be acceptable. The Remuneration Committee had asked for information about Mr Pennant-Rea's responsibilities and Mr George had provided the Remuneration Committee with a letter setting out the proposed division of responsibilities between himself and Mr Pennant-Rea.

Sir Colin Southgate said that Members of Court would like to know of the proposed split. Sir David Lees endorsed this view saying that Members of Court should be aware of the split in responsibilities in the context of the way in which the appointments had been made and to enable them to respond to questioning on the appointments from those outside the Bank. Sir Adrian Cadbury agreed and was sure that Mr George would be ready to discuss the points raised with Court.

In the past the division of responsibilities between the Governors had been a case of custom and practice but in the current circumstances it would be helpful to have it documented. The Governor strongly endorsed this point and said that in practice the Governor's role was clear in many respects, particularly with his membership and involvement with the BIS and IMF. Given these commitments and the inevitable absences associated with them, it was essential that the Deputy Governor should run the shop.

Sir Adrian Cadbury went on to explain that as Mr Pennant-Rea's pension would be capped under the provisions of the Finance Act 1989 it was proposed that his pension be governed by the arrangements set up in September 1991 when Mr King, whose pension was similarly capped, was appointed.

[These arrangements entailed the Bank giving an undertaking to provide an unfunded unapproved pension from the Bank's own resources to provide benefits on retirement in accordance with the rules of the Court Pension Scheme. Because of the implications for death in service benefit it would be necessary also to take out a separate insurance policy on Mr Pennant-Rea's life which would be held by a separate trust, the Bank of England Supplementary Life Assurance Scheme, the trustees of which were the same as for the Court Pension Scheme. Under this arrangement the Bank would pay the annual premium on which Mr Pennant-Rea would pay beneficial loans tax.]

Court agreed the amendment to the salary band for the Deputy Governor; Mr Pennant-Rea's salary on appointment on 1 July 1993 at £160,000 per annum; and the proposed treatment of his pension arrangements.

Court also noted that prior to his appointment as Deputy Governor, Mr Pennant-Rea would be working in the Bank from 4 May and that he would be paid on a full time basis from 1 June 1993.

[illegible]

[illegible]

Assistant Secretary

29th April 1993

A COURT OF DIRECTORS AT THE BANK

THURSDAY 29 APRIL 1993

Present

Edward Alan John George, Esq, Deputy Governor
Sir David Gerald Scholey, CBE
Anthony Laurie Coleby, Esq
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report, Mr Harris spoke about the repercussions of the bomb that had exploded in the City the previous Saturday. Except for a few cracked windows and a broken Meissen vase in the first floor committee room, the Bank had escaped unscathed.
The Bank had been involved, subsequently, as part of the Lord Mayor's Crisis Management Group, of which Mr Harris formed part, together with representatives of the City Police and various utilities. The function of the Group, which had been set up formally after the St Mary Axe bombing, was to manage the recovery from any such incident. His own role,

essentially, had been to deal with any problem of businesses and banking operations as reported, as well as working with the media. The latter had focused on what effect the bombing would have on London as a financial centre, to which the response had been that such an incident was not unique to London, it could happen elsewhere - as in New York - without necessarily having a detrimental effect.

The fact that he had received so few questions showed the extent to which City firms had contingency plans in place. The problems had been few and had been resolved satisfactorily. They had stemmed, in the main, from banks that had a presence in the Hongkong and Shanghai Banking Corporation building.

Mr Harris felt it had been helpful for the Bank to be seen as part of the very successful operation to get the City back on its feet. The Governor had written subsequently to the Lord Mayor and to the City Police Commissioner to thank them for their excellent efforts.

As to the future, the Corporation were concerned about traffic management, and informal discussions would take place with those in the City most closely involved.

Mr Laird, in opening the discussion that followed, said that whilst he welcomed the letter that the Governor had written, he felt it was not enough for the City to go about its business quietly. A higher public profile should be adopted and someone should say something to counteract the damage done to the City. In taking up this point Sir David Scholey said it was up to those with the option to leave to make the running such as the foreign banks. Some had done so but he felt it reasonable for others to be asked to do so as well.

The Deputy Governor endorsed the comments which had been made about the speed of the recovery that had taken place - it had been quite remarkable. However, the main question now was how such incidents should be stopped from occurring in the future.

Sir Roland Smith questioned whether the City was devoting, or had, sufficient resources to combat the problem - especially when one saw those deployed to protect Government in such places as Whitehall. The City deserved better.

In agreeing with Sir Roland Smith, Sir Martin Jacomb said this was a point on which the Government was likely to focus as in

future the cost of such incidents would fall on them as opposed to the insurance sector, where it fell at the moment.
The Deputy Governor suggested the question be pursued further outside Court with a view to the Bank's advice to the Corporation being formulated.

The Deputy Governor introduced the Governor's Foreword and Directors' Report from the draft of the Bank's Annual Report for the year ended 28 February 1993. He explained that the timetable for the Accounts was for them to be considered by the Audit Committee on 4 May prior to them being discussed at Court on 6 May, submitted for final approval on 13 May and published on 26 May. In the discussion that ensued a number of points were made and were noted.

At the Deputy Governor's invitation and with the agreement of Members of Court, [redacted] Mr King's Personal Assistant, attended for the introduction by the latter of the draft Inflation Report, which would appear in the next Quarterly Bulletin, due to be published on 18 May.
Mr King said that one of the key objectives of the Report was to look back to the previous Report and ask the question - what had happened to change our mind about the likely course of inflation? On this occasion the "news" was best understood in terms of a number of key charts and tables. First was the table of short-run measures of inflation which showed a rise in the underlying rate recently, reflecting the impact of depreciation on final selling prices. This had not previously been evident, but it was important to be aware of how the pass-through was progressing, as this would affect the probability of breaching the target rate later this year or next. As yet there was no evidence that the adjustment of domestic prices to the lower exchange rate had affected the inflation rate of domestically produced output. The best guide to this was usually the GDP deflator, but the most recently available figures - for the fourth quarter of last year - were distorted by the impact of the devaluation (because import prices do not flow immediately to the price of consumption goods).

Looking forward, inflation was determined by monetary growth in the long-run. In the short-run inflation adjusted to its long-term trend at a rate which depended on whether the economy was running above or below potential output. Monetary growth at present was conveying mixed signals: narrow money was growing more rapidly than expected (partly due to a change in velocity growth, reflecting the impact of lower interest rates), while broad money was growing slowly (although it had picked up a little). The expected stance of monetary policy was in part reflected by changes in implied forward interest rates in the future. Following our departure from the ERM expected interest rates rose reflecting a loss of credibility, but some of that had since been regained with the new monetary policy framework. Nevertheless it was difficult to reconcile expected interest rates of 9% with the stated inflation target.

In the short run, one of the most important influences on inflation was the size of the output gap - the difference between actual and potential output. At present the size of this gap was very difficult to assess. It was definitely negative, and substantially so. But whether it was 3% (as Bank estimates suggested) or 7% (as the OECD suspected) was not at all clear. Mr King said he would value Court's opinion on this question.

Bringing the various monetary and short-term real factors together, the conclusions about the outlook for inflation were presented in Section 6. In the next three months there was likely to be a small fall in the inflation rate (reflecting the switch from the Community Charge to the Council Tax), but this would be reversed by June. Beyond that inflation was expected to remain in the 3 1/2% - 4% range, reflecting the balance of the depressing effect resulting from the negative output gap and an addition to the price level resulting from the adjustment to the exchange rate. This reflected the news since February, which had been of three kinds. First, higher demand than expected; second, a 5% increase in the effective exchange rate; third, indirect tax increases announced in the March budget, which were likely to have a significant impact on inflation next year. The indirect tax increases came at an inconvenient time from the point of view of the inflation

target, and they increased the risk of breaching the upper end of the target range. But the central estimate still lay between 3 1/2% - 4%.
He concluded by noting that the real value of the report lay less in the forecast and more in the credibility that we hoped to achieve by presenting a detailed analysis, and an examination of why our views had changed since the previous Report.

Sir Christopher Hogg commended the draft, and the February Report, highlighting the clarity and authority with which they were written, as well as the comprehensive treatment of the subject. Sir Jeremy Morse said that if the function of the Report was to enhance credibility, it was important to understand how expectations were changing. There was some material on this in the Report, but not enough on the dispersion of expectations. Mr King agreed that this was an important question, and that the data presented in the Report were all that were publicly available. But we were alert to the need to extend our discussion to dispersion. [redacted] noted that some indication of dispersion could be obtained from an examination of the range of outside forecasts, as presented in Charts 6.3 and 6.4.

Sir David Scholey asked whether the main consequences of inflation were likely to be felt in the labour market, or on interest rates. He wondered whether the process of examination and analysis would be likely to have a beneficial effect on the inflation process. He also asked whether the forecast - of relatively flat inflation was plausible? When was the last time this had occurred? Mr King said that the Governor's speech at the LSE in November had set out the consequences and costs of inflation in some detail. The process of analysis embodied in the Report would be expected to ameliorate inflationary tendencies, since economic agents would be more aware of likely future trends, and the authorities' reactions to them. The responses to the first Report - which may have disagreed with some of our economics, but treated the document as a serious report - indicated that it was likely to enhance the Bank's reputation, and emphasise its impartiality. Sir David noted that even those responding must have realised that the government are responsible for dealing with inflation, and that the Bank can only offer advice. Mr King agreed but suggested that, short of independence, the Report was the best way the Bank had of building an anti-inflation reputation.

On the question of capacity, Sir Roland Smith reported that he believed the 3% output gap estimate to be closest to the truth. He was concerned, indeed, that in those areas where the UK was internationally competitive there was insufficient capacity, and that when activity rose, prices would quickly follow. He was already aware of rises in cement prices, and forthcoming rises from a major housebuilder. Firms would be keen to restore margins as quickly as possible, particularly since managers were paid increasingly by results.

Adrian Cadbury

6th May 1993.

C A Jenney

Assistant Secretary

A COURT OF DIRECTORS AT THE BANK

THURSDAY 6 MAY 1993

Present

Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

Mr Pennant-Rea

The Deputy Governor welcomed Mr Pennant-Rea, who would be attending Court prior to taking up his appointment as Deputy Governor on 1 July.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Plenderleith spoke about the foreign exchanges, including the Official

Reserves figures for April and the state of the domestic markets.

There were no items for discussion under the weekly executive report.

At the Deputy Governor's invitation:-

1 Mr Price, the Head of Economics Division, presented his Report to Court. He noted that significant changes in the work and structure of the Division had been introduced in 1991. These had involved devoting fewer resources (now only about four people) to macro-economic forecasting and focusing to a greater extent on micro-economic analysis, in particular of issues affecting the financial structure and regulation. The latter work had been well received in Banking Supervision Division.

Mr Price said that it was harder to meet the Division's objective of anticipating policy issues across the Bank, not least because this might involve challenging conventional wisdom - something that was not always easy in the Bank's culture. By early summer 1992, for instance, he had reached the conclusion that continued membership of the ERM was untenable; but had been reticent in putting this view forward. Present policy concerns were whether there was a current account problem and what the authorities' attitude to the exchange rate should now be.
Production of the Inflation Report had inevitably been a major task and one that will continue to be of the highest importance both to the Division and the Bank. Challenges for the future would be to formulate a view on the path of inflation and to consider how that view should bear on the formulation of monetary policy. The macro-economic model would have some role to play but the Division was also considering other possible inputs.

Sir Christopher Hogg recognised some of the difficulties the Division faced because of the culture of the Bank and the calibre and orientation of economists coming from universities. He was nervous about the traditional British view of economics, which he saw as rooted in macro-economic formulas and theories and not sufficiently cognisant of political and social realities. But the evidence of his year on Court was that Economics Division was thinking about the right issues in the right way.

In response to questions from Sir Chips Keswick, Mr Price confirmed that the Division had ready access to the statistics for the banking sector which were collated by Financial Statistics Division and could also access statistics from the returns which individual banks provided for supervisory purposes where this would facilitate a particular research project.

Noting the recruitment and staffing difficulties, Professor Sir Roland Smith asked about opportunities for subcontracting work to faculties which had recognised expertise in specific fields. Mr Price saw problems over confidential data being a major constraint to this. Rather than contract work out, the Bank sought to bring in academic economists for particular projects.

Mr King agreed that little of the Division's work was suitable for contracting out. Consultants could, in his experience, make a valuable contribution but only within a fairly limited timeframe. In his view the real problem was the shortage of top-class economists in the UK which, he believed, was because the best people now opted for other disciplines.

Mrs Heaton noted that those who challenge conventional wisdom can be fortified by outside contacts and asked about the Division's external links. In response, Mr Price explained that most contacts were, in practice, with London-based institutions, eg London Business School, London School of Economics. There were also regular contacts with City economists but in these the Bank was more of a giver than receiver of information.

The Panel of Academic Consultants also gave the Division's staff the opportunity for interaction with academic economists; the Panel had become rather ossified but would be meeting again soon with a changed membership.

Sir David Scholey stressed the importance of the Bank communicating the conclusions of the Inflation Report and its other economic work to as wide an audience as possible. Moreover, it was vital that this was in language accessible to businessmen and other key decision makers, so that the latter did not have to rely on their own economists and the media for interpretation and understanding. Sir David also asked about opportunities for the Bank's staff to gain experience through secondment in the corporate sector. In response Mr Price said that he was concerned to make the Quarterly Bulletin more accessible; he mentioned the summary which the Bank Briefing provided. The Division had sought to disseminate the Inflation Report as widely as possible: some 5,000 copies of the first issue had been sent to schools and colleges with an invitation for them to subscribe to future issues at a price which barely covered costs, but the take up so far had been disappointing. On secondment, he acknowledged the potential value but was constrained by the need to assure the availability of sufficient staff to meet the Bank's workload.
In reply to questions from Professor Sir Roland Smith about the freedom of the Division's younger economists to challenge conventional wisdom, Mr Price did not believe they were restricted. He had purposely included as one of the Division's objectives the aim of replacing assertion with analysis and staff were encouraged to take an open and questioning stance. Moreover, many of the staff had served in the Bank for a relatively short time and thus were not, as yet, constrained by the culture.

Sir David Lees noted that the Economics Division work he had seen had impressed him for its comprehensiveness and quality. He encouraged the Division both to persevere in seeking as wide an audience as possible for the Inflation Report and to concentrate on identifying future policy issues.

2 With the agreement of Members of Court, Mr Chapman, the Senior Partner of Coopers and Lybrand, the Bank's Auditors and Mr Rumins, the Head of Finance and Resource Planning Division, attended Court for the presentation of the Bank's Accounts.

In introducing the Banking Department Profit and Loss Account, the Deputy Governor said that published operating profit before an exceptional item was £178.3 mn compared with £191.1 mn for 1991/92. Fixed income had risen by £8.9 mn due principally to increased banking commission and fees, arising mainly from the indemnity given as part of the support operation. Variable income had, predictably, fallen by £25.5 mn as a result of lower interest rates and lower bankers' balances following the reduction in cash ratio deposits. The profit on sales of securities was largely attributable to the sale of the Bank's interest in the Agricultural Mortgage Corporation at a profit of £8.3 mn. Current expenditure had increased by £0.8 mn, which was more than accounted for by the costs of the Bingham Inquiry, but recoveries from HM Government had fallen by £2.7 mn so that expenditure not recovered from the Government had increased from £121.7 mn to £125.2 mn.

The most significant item in the published Profit and Loss Account, the Deputy Governor said, was the disclosure of a provision for support operations which had been treated as an exceptional item. The draft Accounts which had been sent to Members the previous week included a provision of a further £80 mn in addition to the £25 mn provided in last year's Accounts. However, the Audit Committee had recommended that the provision should be increased by £10 mn to give a charge for the year of £90 mn and a total provision of £115 mn. The Deputy Governor indicated that he accepted Audit Committee's recommendation but would take account of any representation there may be from HM Treasury because of the impact on taxation and the dividend.

The Deputy Governor reported that, taking account of the proposed £90 mn provision, profit before tax and dividend amounted to £88.3 mn. The tax charge of £12.2 mn benefitted from the sale of the Agricultural Mortgage Corporation, which was computed on Capital Gains Tax rather than Corporation Tax rules. Thus only the gain since 1982, subject to indexation relief, was taxable. Credit had been taken for deferred tax on the provision for support operations on the grounds that it would eventually be allowable for tax when paid. This had contributed to an overall reduction in the total deferred tax liability provision of £21.2 mn, which, when set against Corporation Tax (£32.1 mn) and other tax on franked investment income (£1.3 mn) due, produced the tax charge for the year of £12.2 mn. Under the present formula agreed with the Treasury for post-tax profit to be divided equally, the dividend and retained profit will amount to £38.1 mn. Court would be asked the following week to approve formally the payment of the dividend.

Turning to the balance sheet, the Deputy Governor noted that the total had increased by some £2.5 bn. This arose largely from a National Loans Fund deposit of £1.9 bn, the first occasion since 1987 that such a deposit had existed at year end. This reflected support to the market, which had been channelled via the Bank for International Settlements, arising from the shortages which had prevailed since September 1992 and continued at the end of the Bank's financial year. This support was also reflected in the Cash Flow Statement; the latter showed a cash inflow of £2.0 mn, essentially corresponding to the NLF deposit, while the BIS loan had been regarded as equivalent to a market advance and thus combined with discount market advances and treated as a cash equivalent item.

Moving on to the Notes to the Accounts, the Deputy Governor first explained the background to certain textual changes in Note 1: Accounting Policies. Sub paragraph d: Premises and Equipment had been amended to reflect the adoption of investment property status for New Change from 1 March 1992, because the building was effectively fully let. Sub paragraph l: retirement benefits included an additional sentence referring to post-retirement health care and other benefits following Urgent Issues Task Force abstract 6 on this matter. The Deputy Governor also explained that Note 1a included a statement that the Directors considered the Bank to be one business. This statement, included the previous year, was necessary to comply with the requirements of SSAP25, which would otherwise require disclosure of the Bank's individual activities. Court agreed to this statement.

Sir David Scholey offered some clarification of the Audit Committee's thinking on the Bank's accounting policies. The Committee believed that the opening statement of Note 1 that the Bank complied with the requirements of the Companies Act 1985 and applicable UK Accounting Standards in so far as they were appropriate to a central bank was still in order even though disclosures of support operations had now been made. However, the Bank's policy of doing good by stealth could be compromised were there a situation in the market causing concern over systemic risk. Accordingly, the Audit Committee had asked FRPD and Coopers & Lybrand to produce recommendations on the future presentation of the accounts, bearing in mind the impending changes in Companies Act requirements because of European Directives. Sir David noted that the Audit Committee had also asked for a review of the implications of liquidating BE Property Holdings Ltd, the Bank subsidiary which owned Southgate House and whose accounts were not consolidated. The difficulty

was the difference between the current market value of Southgate House and the book value reflected in the accounts. In response to a question from Mr Laird, Sir David confirmed that one of the issues for consideration would be what VAT charge would be incurred if BE Property Holdings were liquidated.
Turning to Note 2: Operating Profit, the Deputy Governor said that this reflected the new requirement to disclose separately fees paid to Auditors for both audit and non-audit work. Moving on to Note 4: Directors' Emoluments, he explained that the wording was still provisional pending discussion of two issues with the Governor: the first was whether, in the spirit of the Cadbury Report, the Bank should give a breakdown of remuneration, pension contributions and payments in respect of business travel. The second concerned payments in respect of spouses' travel on Bank business. The figure currently included was the tax paid on the notional benefit of spouses travelling on Bank business; the actual cost was not, however, included because, in the Bank's view, wives travel only when necessary and this is not therefore regarded as a benefit. (The Bank's rules governing wives' travel would be made available to any Directors who wished to see them.) But the Inland Revenue worked to a stricter definition of 'necessary' in this context; accordingly, the external auditors had asked that the position regarding these travel costs should be appropriately minuted. Members had been given a draft and a final version would be submitted for approval the following week.

On Note 6: Taxation, the Deputy Governor referred to his earlier comments about the impact of deferred taxation. As in previous years, there was only partial provision (£2 mn) for the potential deferred tax on capital allowances, with £10 mn unprovided as it was not expected to crystallise. The treatment of New Change as an investment property was reflected in Note 8: Reserves, which also showed the decrease of £10.3 mn in the value of the property arising from a valuation carried out by St Quintin as at 28 February 1993. St Quintin had also valued the Bank's other properties at some £23 mn less than book value. Because the Bank's policy was to revalue every five years this notional deficit had not been recognised in the accounts and, since the difference was not regarded as material, there was no need to refer to it in the Directors' Report. Note 11: Other Deposits had been expanded from the previous presentation to show the split between sterling and foreign currency accounts, mirroring the presentation adopted in Note 13: Advances to customers and banks. In the latter, the combining of discount market advances with advances to banks had been used as a means of making the BIS advance, which arose from market operations following the support of sterling last year, less conspicuous.

With reference to Note 14: Investments, the Deputy Governor explained that the valuation of unlisted investments was on the basis of the same method as used on previous occasions: for 3i this was a dividend yield method using 6% and for BIS 25% of net asset value. Court agreed to these valuations.

Turning to Note 15: subsidiaries, the Deputy Governor noted that Minories Finance Limited had several legal cases against it, principally those involving Mr Shamji. The most significant had recently been heard in New York and could be regarded as disposed of and MFL were advised that all the cases were without merit. The company had made a provision for legal costs in its own accounts and the Company's reserves of £9 mn provided a sufficient cushion to the Bank against successful claims. Accordingly, no disclosure of the claims was appropriate in the Bank's Accounts. The position regarding the £250 mn claim against Slater, Walker Limited was essentially unchanged from last year. Letters from the liquidator and Freshfields supported the view that the claim was without merit. Thus it was proposed that no provision should be made in the Bank's

Accounts against the investment in Slater, Walker Limited and that no mention of a contingent liability should be made. Court confirmed the statement in Note 15 that accounts of MFL and the Bank's other subsidiaries had not been consolidated because, in the view of Directors, they were not material.
Note 16: Premises included reference to the investment property and its valuation. Following a suggestion from the Audit Committee, the note beneath the table would conclude with a sentence that the deficit on revaluation was calculated after taking account of expenditure on the investment property during the year.
Disclosures of transactions with Directors and Officers required under the Banking Act 1987 were reflected in Note 18, which covered those who were Directors and Officers as at 28 February 1993. Members of Court confirmed that the second paragraph of the Note was a true statement.
The liability in respect of health care cover and other post-retirement benefits for certain pensioners, estimated at £80 mn net of tax, was reflected in Note 19. In accordance with SSAP24, it would be necessary to account for these costs in the Bank's Accounts from 1995. The wording of the first paragraph and the title of Note 21: Contingent liabilities and commitments had been amended to take account of the potential liability (significantly lower than the previous year at approximately £455 mn) in respect of the support operation without making specific reference to its existence or size. This amendment, proposed by the Audit Committee, had been derived from a suggestion by Sir Alan Hardcastle at HMT. The Accounts contained no mention of either the Spens or BCCI litigation against the Bank. The Spens case was not material and there was no formal writ as yet in respect of BCCI. Although both had been mentioned in the draft Directors' Report, the Deputy Governor was disposed to accept Audit Committee's Recommendation of not mentioning either issue.

The Issue Department Statement of Accounts had, the Deputy Governor noted, been prepared in the same form as in previous years. Income, at £1.6 bn, was lower due to the fall in interest rates while the movement on the balance sheet from Government Securities to Other Securities largely reflected the absence of a Ways and Means advance at the year end, as mentioned earlier. Sir David Scholey said that the external Auditors had had no matters of concern to raise at a meeting with the Non-Executive Directors on the Audit Committee. They had also confirmed that they would be content to receive the necessary Letter of Representation in the terms of the draft which had been circulated. Mr Chapman indicated that the Audit was almost complete and that there were no matters which he wished to raise.
In concluding the discussion, the Deputy Governor thanked Mr Chapman and his staff for their work on the Audit and Sir David Scholey and his colleagues on the Audit Committee for their work in connection with the Bank Accounts. Court would be asked formally to approve the Accounts the following week and it was intended that they should be published on 26 May.

G. A. Croughton
Secretary. 13th May 1993.

Adrian Cadbury
13th May 1993

[redacted]

A COURT OF DIRECTORS AT THE BANK

THURSDAY 13 MAY 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir John Chippendale Lindley Keswick
Gavin Harry Laird, Esq, CBE
Sir David Bryan Lees
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq

Mr Pennant-Rea

The Governor explained that the Deputy Governor had been detained at a meeting with the Vice Governor of the Central Bank of Iran and hoped to join Court later.

The Minutes of the last Court, having been circulated, were approved.

Details of the weekly figures and graphs relating to the state of the foreign exchanges and the domestic markets were laid before Court.

Under the weekly executive report:-

1 The Governor drew Members' attention to the copy of a letter from the Deputy Governor to Sir Adrian Cadbury about the division of responsibilities between himself and Mr Pennant-Rea post 1 July. The Governor reminded Court that the letter had been written at the request of the Remuneration Committee and that, at the discussion on levels of remuneration for the incoming Governor and Deputy Governor at Court on 22 April, Non-Executive Directors had asked if copies could be made available to them.

2 The Governor said as a number of Directors were unavailable for Court on 3 June he proposed to make that Court an additional "short" Court and accordingly a general attendance of Non-Executive Directors would not be expected. It was also the intention to re-arrange the lunch for the BBA which had been fixed for that day as a number of their members were unavailable.

3 The Governor informed Court that the Prime Minister had acknowledged the Governor's letter on "Independence" and a meeting had been arranged for 25 May when the Governor and Deputy Governor would meet with the Prime Minister and Chancellor of the Exchequer.

At the Governor's invitation:-

1 In the absence of the Deputy Governor, Mr Harris reminded Members that the Annual Report and Accounts for the year ended 28 February 1993 had been laid before Court the previous week. He drew attention to certain changes to the Notes to the Accounts which had been agreed the previous week. Further changes by way of clarification were agreed to Note 4 - Directors' emoluments and Note 19 - Retirement benefits.

In connection with Note 19 - Directors' emoluments, and in relation to the recent settlement with the Inland Revenue, Court confirmed that all Governors' and Directors' spouses' travel costs had been properly authorised and related to official duties requiring spouses' attendance. Accordingly, Court was satisfied that the Governors and Directors concerned had received no personal benefit therefrom.

Court gave approval for the Accounts to be signed and for the Annual Report and Accounts of the Bank for the year ended 28 February 1993 to be printed and issued; and, having noted the receipt of a letter from Messrs Coopers & Lybrand confirming that they knew of no reason why the proposed Letter of Representation should not be given, agreed to the sending of such a Letter to the Bank's Auditors stating that the Directors confirmed that the Accounts gave a true and fair view and those of the Issue Department presented fairly the outcome of the transactions.

Mr Harris then reported that a further payment in lieu of dividend of £16,210,000 would fall due to HM Treasury on 5 October, next, bringing the total payment in lieu of dividend for the year to 28 February 1993 to £38,060,000. Court approved thereto.

The Governor drew Members' attention to the draft press release, copies of which were in Members' folders, which it was proposed should be issued at the same time as the Annual Report and Accounts. The notice indicated the line the Bank proposed to take, in particular in relation to certain sensitive items such as provisions and senior remuneration.
The Governor invited Members of Court to forward their comments on the proposed notice.

2 In introducing the Banking Act Report for 1992/93 Mr Quinn said that the overall structure of the Report

was broadly the same as in previous years. The main difference this year was in the extensive coverage of three particular topics: the Bingham Report and lessons from BCCI; the Bank's supervisory involvement with small banks; and the implementation of the EC Single Market in Banking. The Overview section focused on the recessionary pressures on banks and our concerns about financial fragility. Care had been taken to emphasise the sequence in which the various difficulties occurred. Initially, wholesale-funded, smaller banks were the main focus of pressure following the collapse of BCMB in June 1990. Subsequently, the decline in asset values had also affected the large banks which had been forced to make bad debt provisions on an unprecedented scale. Notwithstanding these difficulties, the banking system had survived the recession tolerably well. This reflected in part the tighter capital standards now required by supervisors - group capital ratios of the large banks were comfortably above the Basle 8% minimum.

In referring to the paragraphs "Financial pressures on smaller banks", Mr Quinn said that the Bank felt that after the progress of the past two years and the recent parliamentary and press interest it would be a useful time to go into some detail about the Bank's work in this particular area. These paragraphs were intended to convey a positive message about our role, as suggested previously by Court, and also to tie in closely with the coverage of the support operations which were referred to in the Bank's Annual Report and Accounts. This section of the Report indicated that the Bank had kept 40 small banks under close review and described the steps we had taken to help them re-order their affairs or achieve an orderly exit. A distinction was drawn between banks which were fundamentally viable (but which hit liquidity difficulties) and which had now been placed on a sounder footing by renewed or restructured funding; those which had closed, having been inadequately capitalised as the recession deepened; and those which had surrendered because they were unable to meet EC minimum capital requirements under the Second Banking Co-ordination Directive.

The Overview section also described how the recession had affected bank-customer relations, a subject that had featured in the press; the result of the Bank's enquiry into margins on small business lending; and the measures banks were taking to improve communication with customers.

The Report pre-dated the first tentative signs of economic recovery and therefore coverage in the section relating to "Bad debts and provisioning" was inevitably coloured by the impact of the recession. Charges for bad and doubtful debts had risen on the previous year, largely reflecting the severity and length of the recession, but the Report also described steps being taken by banks, with encouragement from supervisors, to learn lessons from recent loan losses.

Under "International Developments", the Report noted continued evidence of retrenchment in international banking, with banks concentrating on protecting their domestic franchises. However, some UK banks had been able to reduce their international commercial bad debt charge because of the US economic recovery, and some writing back of problem country debt provisions.

The introduction to the section on "Policy Developments" described the step-change in supervision resulting from the Second Banking Co-ordination Directive and the Bingham Report. The post-BCCI effort to tighten supervision of banks' cross border business was placed in a longer term perspective. The Report also focused on the implementation in the UK of the recommendations of the Bingham Report and other post-BCCI work.

The section on "The Legal Framework and Operational Supervision" focused on UK implementation of the Second Banking Co-ordination Directive setting out the main changes and emphasising the new split between home and host country responsibilities.
During the year in question there had been a net reduction of 10 in the number of authorised institutions, mainly reflecting problems in the small bank sector. Against this, the number of new authorisations, 26, was the highest since 1986/87. The number of surrenders was down slightly on the previous year (33 compared with 36) and included a number of technical surrenders consequent upon group restructuring.
There had been 3 revocations compared with only one the previous year and a sharp rise in the number of restrictions, 12 compared with 4 in 1991/92, mainly reflecting difficulties in the small bank sector and the Bank's success in securing the exit of a number of institutions, and perhaps also a greater readiness on the part of the Bank to use our formal powers. The Bank had also taken action to investigate and prosecute illegal deposit-taking in a number of cases; again evidence of a more pro-active supervision on the part of the Bank.

Finally, the Report noted that staffing levels in Banking Supervision remained broadly stable, but noted the transfer of some staff from BSD to the Special Investigations Unit and the Legal Unit. It was also noted that the Division would institute training to raise alertness to fraud during the year.

In commenting on the Report Mr Laird asked whether it would have been appropriate to mention that authorisation of an institution by the Bank of England did not amount to a guarantee. The Governor responded that it would be difficult to make such a point in a formal report but it was something that could be emphasised in other ways, in speeches, etc and possibly in the press release which would accompany the publication of the Report. Mr Quinn suggested that would be appropriate, particularly as the published monthly list of authorisations now contained a disclaimer. He also supported Sir David Scholey's suggestion that the disclaimer should appear in the appendix to the Report listing authorised institutions as at 28 February 1993, and agreed that the monthly list of authorisations should be made available to Members of Court on a regular basis.

Sir Colin Corness noted that the Report stated that Government intended to amend the Banking Act to place beyond doubt the Bank's powers to refuse or revoke authorisation when a bank's corporate structure impeded effective supervision: he questioned when this would be put in place. In response the Governor said that there was such an intention on the part of Government but, at present, no sense of urgency. Nevertheless, the Bank was now taking a more robust line in such cases.

In response to Mrs Heaton's question about the impact and helpfulness or otherwise of the Second Banking Co-ordination Directive, Mr Quinn said that as a result of the Directive there had been a material change in that the Bank no longer supervised the branches of EC banks which meant that we had lost regular contact with a number of institutions in London. However, some institutions continued to maintain a dialogue with the Bank although in practice they did not need to; this was helpful.

Court noted the names of those to whom the Bank's powers under the Banking Act 1987 and the Financial Services Act 1986 had been delegated together with details of the exercise of those delegated powers.

3 In introducing a paper which illustrated the philosophy of banking supervision by reference to the case histories of twelve banks, Mr Quinn said that the case studies showed that there was no hard and fast rule in supervision - prudential problems came in a wide variety of ways and irrespective of other pressures on the Division. The case studies illustrated the types of decision that need to be taken on whether powers were exercisable and if so how; and showed that judgement was crucial and timing vital. It was also evident that it was not always correct to take prompt and hard line action and the temptation to do so as a general response in the aftermath of BCCI had been resisted.
The Governor said that these examples illustrated the value of co-operative supervision, rather than "checklist" supervision, and emphasised that such supervision was better carried out by the central bank rather than by a Government agency.

Sir Christopher Hogg enquired about the respective functions of the Board of Banking Supervision and Court - was Court a long stop to the Board of Banking Supervision? In response the Governor said that this could best be illustrated by comparing the functions of the two. In contrast to Members of Court, the Members of the Board of Banking Supervision dealt with an enormous amount of paperwork. There were monthly reports on banks with potential difficulties covering perhaps 100 institutions and some 25% of those on the checklist would be examined monthly. In addition, the Board received papers on policy issues and data on bank comparisons. He said that it would be impractical for Court to involve itself with the details of banking supervision in the same way but they should be concerned to ensure that on matters of staffing and general expertise the Bank was providing the Board with an appropriate service, and was keeping Court informed about prominent and difficult cases etc.

Mr Quinn endorsed the Governor's comments and, additionally, said that from their perspective Banking Supervision Division valued the comments and contribution of Members of Court in the discussions of recent papers on supervision. These were different from those received from the Board in nature and scope. The Governor said that he hoped that Court felt sufficiently informed to enable it to exercise its corporate duty in respect of supervision. He mentioned that the Board of Banking Supervision had been established in the aftermath of Johnson Matthey Bankers to introduce an external input into supervision and to carry responsibility for reporting to the Chancellor of the Exchequer if they felt that the Bank was not meeting its responsibility for banking supervision. Thus the Bank's Executive was responsible to the Board of Banking Supervision which in turn was responsible not to Court, but to the Chancellor. Court's responsibility was to ensure that Banking Supervision Division had the appropriate resources to carry out its remit.

Sir Adrian Cadbury said that Court's role could be summed up as having responsibility for ensuring that staff resources and expertise were sufficient and that BSD got its proper share; for seeing that the necessary structures were in place to carry out the supervisory role and service the Board of Banking Supervision; and finally to ensure the appropriate use of the Bank's financial resources in support operations.

Sir Chips Keswick said that the Bank's supervisory role was an important aspect of the UK economy and he questioned the involvement of the Board of Banking Supervision on two aspects: he suggested that the Board's access to the Chancellor could undermine the Bank's position and suggested that in view of the complexities of supervision it was inappropriate to have people serving on the Board who had retired or no longer held executive positions. In response the Governor accepted that there was a danger with the composition of the Board but said that there would, of course, be conflicts of interest to be considered if bankers with executive roles were involved. In responding to Sir Chips' comment about the role of the Board of Banking Supervision Mr Quinn said that it had been set up as the preferred way of establishing a degree of public accountability, the alternative being a Banking Commission.

Mr Laird said that he had found the paper, relating to specific cases, very helpful and enlightening and wondered whether there was advantage in giving it a wider audience to advance the case for the Bank retaining supervision. The Governor noted the suggestion saying that this might be helpful. In this context members of the TCSC would be visiting the Bank to see at first hand the scale of the supervisory operation and to meet members of the staff. A seminar on the lines suggested by Mr Laird might be incorporated in this visit.

Sir David Lees asked whether, in those cases where the Bank had concerns about a banking institution, those concerns were communicated to the board of the bank as a whole. In response Mr Quinn said that the principal counterparties were the management of the bank rather than the board but in certain circumstances the Governor had written to bank chairmen requesting that they inform their boards. As a general rule it was not our practice to speak to individual non-executive directors but this might be a useful and helpful route to consider for the future.

Sir David Scholey questioned whether banks on the Board of Banking Supervision's "watchlist" were aware that they were being monitored and whether in those cases where the Bank had specifically asked chairmen to take matters to their boards, the Bank ever followed up requesting a sight of the appropriate minutes.

In referring to the case of TSB and Hill Samuel, Sir Colin Corness said that building societies were not allowed to diversify without permission from their supervisor. He asked if, and at what stage, the banking supervisors interested themselves in diversification into unrelated fields? In response Mr Quinn said that the underlying factor was the risk to depositors' funds. If we thought that the diversification was "imprudent" we would intrude but in most cases the situation was not so clear-cut. If we were in doubt we would step up our supervision and satisfy ourselves that the diversification had been thought through. Ultimately supervisors were not qualified to make business decisions about diversification but we would intrude if there was a risk to depositors' funds. Sir Roland Smith asked whether the diversification of the clearing banks' into insurance business had been discussed with the Bank. Mr Quinn said that it had and that we had been content.

Sir Roland Smith noted that the case histories did not include any ethnic banks and asked whether the Bank took a rigorous view on the granting of licences to ethnic banks. Mr Quinn said that we had been more stringent in this respect during the past year. However in practice most institutions approached the Bank in the first instance and we were able to explain the potential difficulties. One of the main difficulties for the Bank as supervisor was that we would be setting ourselves up as a judge of local supervisors in the case of overseas banks and following BCCI there was a need to satisfy ourselves not only about the institution but also about the home supervisor.

4 A paper entitled "Bank of England Support Operations" had been made available to Members of Court the previous week as background information for the discussion on the level of provisions in the Bank's Accounts.

In commenting on the paper Sir Roland Smith enquired whether the Bank would ever provide support for an overseas bank in the UK. Mr Quinn said it would be very unusual for the Bank to contemplate such support for an institution based outside the UK but it was conceivable if there was a real and general threat to the UK banking system.

Sir Colin Corness, having declared his interest, asked whether the Bank would have supported NHL had it realised the cost involved. In his view the cost was out of all proportion to the size and importance of NHL in an "over-peopled" sector. In response the Deputy Governor said that realistically it was impossible to answer the question but even if we had known that there would have been a substantial loss, the answer would probably have been yes. What had been so difficult to assess was the scale of damage that would have been caused by the failure of NHL because of the fragility of other institutions. Additionally NHL was heavily involved in the property sector and so its failure could have had an impact on building societies too. The reality was that one knew one was taking a risk and the damage in this particular case could have been massive. In focusing on Sir Colin's concern about the "over-peopled" sector, the Deputy Governor said that a condition of the support had been that the business should be run down so that we had not stood in the way of the market process. Our decision to support had nothing to do with this particular institution - it was the risk to the system and the potential damage to others that had prompted our action.

5 Mr Quinn presented the Report and Accounts of the Deposit Protection Board for the year ended 28 February 1993, which were laid before Court.

G. A. Gaglia.
Secretary.

Adrian Cadbury
27th May 1993.

A MEETING OF DIRECTORS AT THE BANK

THURSDAY 20 MAY 1993

Present

The Rt Hon Robert Leigh-Pemberton, Governor
Edward Alan John George, Esq, Deputy Governor
Anthony Laurie Coleby, Esq
Andrew Duncan Crockett, Esq
Mervyn Allister King, Esq
Brian Quinn, Esq

Hugh Christopher Emlyn Harris, Esq

Mr Pennant-Rea

The number of Directors assembled being insufficient to form a quorum, those present proceeded to the business, subject to ratification by the next Court.

The Minutes of the last Court, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

G. A. Croughton.
Secretary.

Adrian Cadbury
27th May 1993

A COURT OF DIRECTORS AT THE BANK

THURSDAY 27 MAY 1993

Present

Edward Alan John George, Esq, Deputy Governor
Sir George Adrian Hayhurst Cadbury
Anthony Laurie Coleby, Esq
Sir Colin Ross Corness
Andrew Duncan Crockett, Esq
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Gerald Scholey, CBE
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq
Pendarell Hugh Kent, Esq

The Minutes of the Court of 13 May were confirmed and those of the Meeting of 20 May, having been circulated, were approved.

There being no comments on the weekly figures, Mr Coleby spoke about the foreign exchanges and the state of the domestic markets.

Under the weekly executive report:-

1 the Deputy Governor reported that earlier that week he had accompanied the Governor to a meeting with the Prime Minister and Chancellor of the Exchequer at No 10, Downing Street to discuss the Governor's letter on independence.

The Prime Minister was briefed fully on the issues. He was not implacably hostile but it was clear that there was no possibility of progressing the issue now as it would not be possible to get it through Parliament at the present time. However, the position could change if stability were delivered over the next two or three years and if the economic recovery continued. It might then be possible for the Prime Minister to go into an election with a proposal to pursue the necessary legislation. Meanwhile, however, the Prime Minister would have to oppose the idea if it were put to him directly. His preference was to take in public the line that the real issue was stability, not how it might be achieved or by whom. The Prime Minister hoped that the Bank would not provoke confrontation on this issue but accepted that we were obviously in favour. He was extremely concerned that it should not become known that their discussion had taken place and the Deputy Governor asked Members to respect that confidence.

The Deputy Governor said that he had been encouraged that the Prime Minister spoke of the possibility, and it was no more than that, of including the issue in a manifesto. He had also been encouraged by the meeting with some Conservative Members of Parliament the previous day, many of whom had shown a much greater interest in the subject than might have been expected. Progress so far suggested, therefore, that the Bank's approach was right and that we should continue to let our view be known if asked, but without public lobbying.

In response to Sir David Scholey the Deputy Governor confirmed that Government had an obligation to independence of the central bank under the Maastricht Treaty, once ratified, but only if the UK opted to go to Stage 3. His view was that the Prime Minister was not thinking of it in terms of the Treaty but more as a specific issue in its own right. Sir David also enquired to what extent the evidence given to the

Treasury and Civil Service Committee was of significance in helping the Prime Minister formulate his views and enquired to what extent the Bank were helping the Committee by supplying evidence. In response the Deputy Governor said that the Committee were very interested in the subject and seemed to be supportive of the Bank's position, particularly the need for statutory change. The Deputy Governor confirmed - again in confidence - that discussions had also taken place with members of the Opposition who realised that this was an issue that they needed to address.

Responding to Sir Christopher Hogg, the Deputy Governor said that he thought the Prime Minister understood the case for independence, and the role of overseas opinion and its impact on the strength of sterling in this. However, the Prime Minister had reservations about the constitutional position and the possibility of the Bank being accountable to a Select Committee rather than to Parliament. In this respect, Mr Crockett said that some MPs were attracted to the New Zealand formula whereby there was a contractual relationship between the central bank and Government; the Government in turn reported to Parliament.

2 [redacted]

[redacted]

3 the Deputy Governor said that, predictably, press reaction to the publication of the Bank's Annual Report

and Accounts had focused on two issues, support operations, and the Governors' salaries. The size of the provisions and the context of the operation had been factually covered. There were two commentary pieces one congratulating the Bank on seeing the economy through the recession "without the hint of a banking crisis" and a second giving the Bank the benefit of the doubt for mounting the operation.

Court gave their approval to Professor Sir Roland Smith joining the Board of Alexander and Alexander (Isle of Man) Ltd as a non-executive Director.

At the Deputy Governor's invitation:-

1 Mr Harris, in his capacity as Chairman of the Trustees, presented the Report of the Trustees of the Staff Pension Fund on the increases in pensions and allowances to be awarded from the Fund with effect from 1 July 1993.

The recommendations contained in the Report were then approved.

Sir David Scholey in commenting on the proposal to increase pensions in line with the Retail Prices Index enquired if and when it was last considered that the simple RPI was the most appropriate index for pension increases, given that among other items it included mortgage repayments. In response Mr King said that there was a special pensioners' RPI which represented the whole of the UK and may not therefore be representative for Bank pensioners for both geographical and earnings reasons. He reminded Members that the composition of the RPI was currently under consideration by the RPI Advisory Committee and suggested that this question might be deferred until the end of the year when the Committee was expected to make a report.

2 The Deputy Governor, having declared his potential interest in the Court Pension Scheme, together with those of Messrs Crockett, Coleby and King, invited Sir Adrian Cadbury, the Chairman of the Court Pension Scheme, to introduce certain recommendations from the Trustees of the Court Pension Scheme. These concerned increases in the pensions and allowances in payment to former Governors and Executive Directors and to widows of former Governors and Executive Directors, with effect from 1 July 1993. The recommendations contained in the Report were approved by Court.

Sir Adrian Cadbury presented a further Report of the Trustees of the Court Pension Scheme concerning the Reports of the Chief Investment Manager, and the Scheme's investments and investment policy. The Report was laid before Court.

In response to Sir Colin Southgate's enquiry about combining the two pension schemes, Sir Adrian Cadbury said that this was an issue that had been looked at from time to time. The schemes were now much closer together but it would be difficult to combine them for a variety of reasons. The Court Scheme had a number of difficult issues and individual problems to deal with and these were best dealt with within the smaller Scheme. It would not be appropriate to make special arrangements in the Staff Pension Fund to accommodate these issues. However, on the investment side the policies were now very similar.

Before inviting Mr King to present the Economic and Financial Report for May, the Deputy Governor drew Members' attention to a letter dated 20 May sent by the Governor to the Chancellor of the Exchequer, copies of which were in folders. The letter had been sent immediately prior to the first Cabinet discussion of the objectives for the public expenditure round which this year, would be undertaken in parallel with the November Budget.

In presenting the Economic and Financial Report for May, Mr King said that since the Inflation Report appeared ten days ago, there had been a new monthly round of statistics, the most striking of which related to inflation itself. The headline rate of inflation fell to 1.3%, the lowest since February 1964, and the underlying rate, excluding mortgage interest payments, fell from 3.5% to 2.9%. Virtually all of this fall was accounted for by the replacement of the community charge by the council tax. The rate was expected to rise a little in the coming months, and would increase a year from now when the effect of the council tax dropped out of the index.

Turning to the other statistics, both the monetary and real indicators had reversed their behaviour of recent months. Following two months of uniformly buoyant statistics on the level of activity, retail sales in April had fallen by 0.3% and industrial production in March by 1.3%, with manufacturing 0.3% lower: these represented a hiccup. But revised data showed that non-oil GDP in the first quarter rose by 0.7%, the first figure markedly different from "bumping along the bottom" for two years.

The most interesting development in recent months, had been in the labour market. Unemployment had fallen in April by 1,400, the third consecutive monthly fall. Although much smaller than the two previous monthly falls of around 25,000, the fact that there was a fall at all suggested that something more significant had been taking place than a change in the behaviour of the staff in unemployment benefit offices. Manufacturing employment rose by 5,000 in March, also the third consecutive rise.

The commentary in this month's Economic and Financial report focused on developments in the labour market, and on comparisons among recent cycles of the lag between changes in output and changes in both employment and unemployment. In the mid-1970s and early 1980s there had been a lag between changes in GDP, on the one hand, and changes in employment and unemployment, on the other. In contrast, during this cycle there had been little or no lag between output and employment. This difference was especially striking for unemployment: it was, of course, too soon to be sure that we had seen the peak in unemployment. There was some evidence, then, that labour hoarding during a recession - often assumed to be a structural feature of the British economy - had diminished, and that firms had adjusted the size of their labour force in response to changes in desired output more rapidly than in the past. This would be consistent with the reduction in hiring and firing costs which had followed the labour market reforms of the 1980s.

The rate of increase of average earnings had fallen again, down to 4% during the year to March from 4.5% during the year to February, and wage settlements in the economy as a whole increased by only 2.6% in the three months to April. The commentary pointed out that - as yet - we had seen no evidence that wage behaviour had changed in nature, rather settlements seemed to reflect the current state of the labour market.

These falls in unemployment may be one explanation of the sizeable jump in consumer confidence this month but the increase may also reflect the financial position of the household sector. Balance sheet positions were slowly improving and debt servicing had fallen sharply as a proportion of disposable income, as shown in the Inflation Report. Capital gearing had only just started to fall with a small increase in house prices, and the number of households with arrears of mortgages or whose homes have been possessed had started to fall. The consequence of a long period of financial fragility was that the speed of the recovery was unpredictable. But that there had been a recovery was no longer in doubt.

Mr Coleby, in introducing the monthly discussion of monetary policy, said that the data for April were evidence of a moderation in the rate of growth of narrow money. Notes and coin in circulation had fallen by 0.2% to record a year-on-year increase of 4.6%, compared with 5.1% for the previous month.

At first sight the figures for notes and coin in circulation for May suggested a further decline of 0.4% to give a year-on-year increase of 4%, and 3.5% for M0 bringing it back within the target range.

Apart from the difficulties of making comparisons with seasonal adjustments in a Bank Holiday period, the data suggested that there was a shift in personal spending habits from cash settlement for smaller items to other means of settlement for larger items. There was also some support for this from the data for broad money and lending. Personal borrowing, particularly for house purchases, was at its strongest since late 1991. Corporate borrowing was positive compared with March, but only modestly so. The year-on-year figures for both M4 and M4 lending were 3.6% and 3.7% respectively but with some evidence of a growth in personal sector borrowing. The picture, therefore, was one of credit demand being sufficiently subdued overall not to arouse fears of inflation at the present time especially given the presumed output gap which suggested that inflation might be a problem in the medium, rather than the short term. However, there was potential for a sharp increase in household spending to occur if consumer confidence continued to grow and if house prices recovered.

Overall therefore this was not a time to either ease or tighten policy. If there was growing evidence of recovery some tightening of policy could be desirable but this might be accompanied by an appreciation in the exchange rate which would be welcome in the circumstances.

During the discussion which followed, Sir Colin Southgate said his company's recent experience over the past seven weeks had been reasonably good. Sir Martin Jacomb said that he would be surprised if there was no significant improvement in consumer confidence now that the housing market was picking up, employment prospects had ceased to worsen, and with an increase in disposable income. In commenting on the invisible trade figures which were better than expected, he enquired whether this was likely to be sustained. He also questioned why there appeared to be greater concern now about the PSBR than there had been some eight weeks ago.

In response Mr King said that exports had been better than expected and this was encouraging but imports by volume had also risen since the depreciation of sterling, some of which may have been in re-stocking. He was not aware of any change of view on the PSBR: this had always been a matter of concern as evidenced by the Governors' letter to the Chancellor which had been written in advance of the discussion on public expenditure.

Sir Chips Keswick commented on the text of the Agents' National Survey saying that it mirrored precisely his own experience, a point which was endorsed by Sir David Scholey. In commenting on employment practices, Sir David said that so far as Warburgs were concerned there had been a fairly radical change. Contracts were becoming shorter-term with retraining and redundancy becoming more common. More widely he recalled that BT had introduced a severance programme the previous year which had been very substantially oversubscribed while a similar programme this year had achieved only some 33% success. He attributed the success of the earlier scheme to redundancy being seen as way to reduce personal indebtedness. This seemed to be of lesser concern now and additionally people were realising the difficulties of seeking re-employment.

Sir Colin Corness said that he could confirm from his experience the improvement in both house-building and estate agents' business. In commenting on employment trends however he said that the construction industry, which accounted for some 10% of total employment, had reacted to the recession quickly by reducing payrolls by some 25-30%. Current housing building activity however was not sufficient at present to generate further employment and indeed he felt that some capacity had been eliminated permanently.

The Deputy Governor thanked Members for their comments which he felt all pointed in the same direction confirming current policy that we should not reduce interest rates, and that the recovery would be slow.

G. A. Coughton.
Secretary.

E. A. J. George
10th June 1993