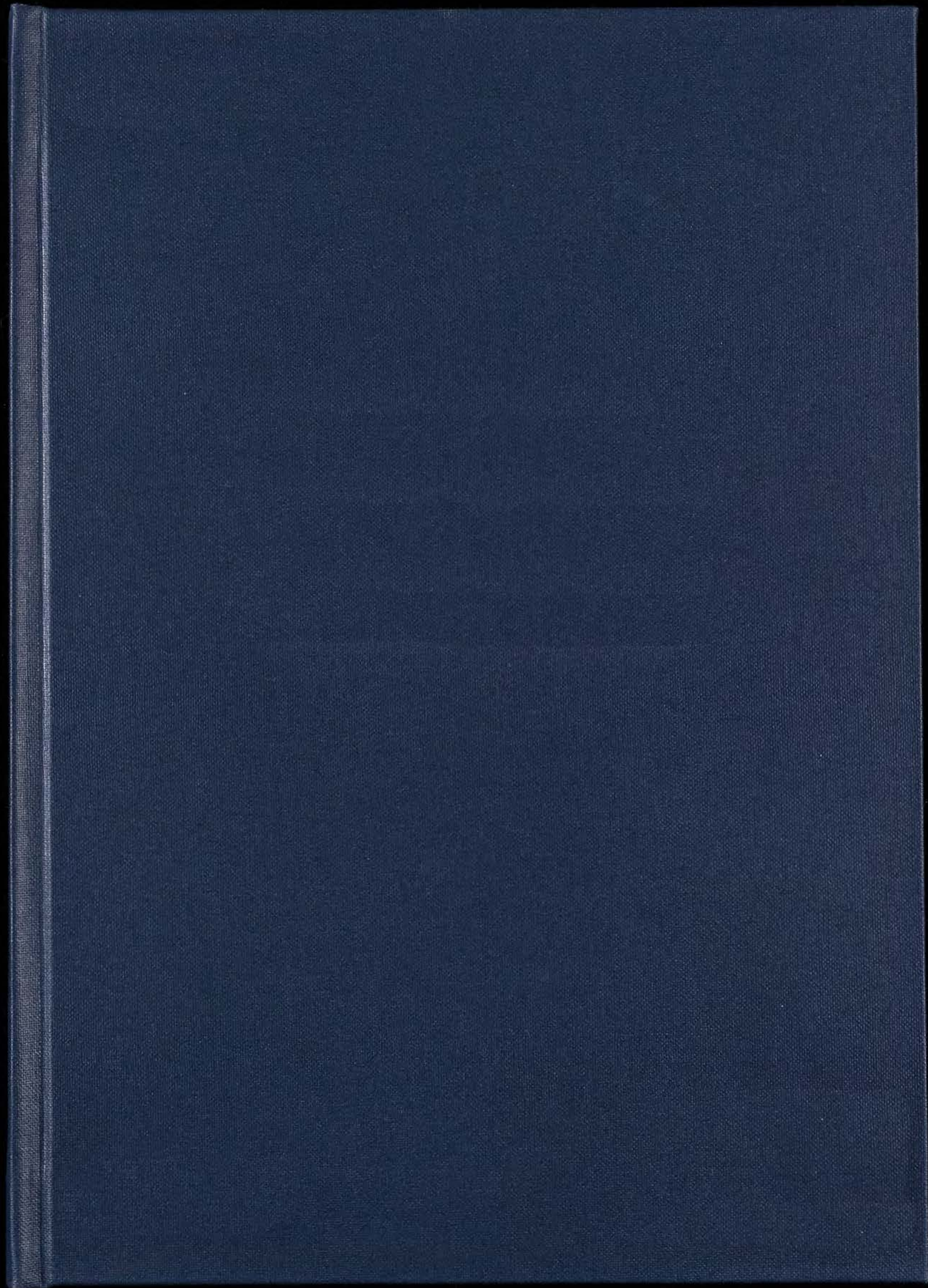

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 7 APRIL 1994

Present

Edward Alan John George, Esq, Governor
Sir David Gerald Scholey, CBE
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Ian Plenderleith, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 24 March and those of the Meeting of 31 March, having been circulated, were approved.

At the Governor's invitation, Mr Everett, the Head of Premises Division attended Court to speak about the work of the Premises Division.

In introducing his Report, Mr Everett said that Directors would be aware of the Bank's expectations from the Premises Division because most organisations had a similar operation. The Division was responsible for the supply and maintenance of services to London properties and the Branches, but did not look after the Printing Works in Essex, nor the Registrar's Department in Gloucester. However, there was an ongoing

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exchange of information between them and, in respect of the Registrar's Department, the Premises Division gave guidance when necessary. The management of the Bank's properties did not come under his Division.

The core purpose of the Division was the cost effective provision of services. Nearly all the managers had a high technical content in their jobs and were concerned to see that systems were designed and assets were installed to provide the services required by users. They were responsible for the delivery of services and each function had its own budgetary responsibility. Mr Everett explained that his role was to direct the action of the managers, especially to ensure a cost-effective approach to planning, projects and services; to bring about a reduction in overhead expenditure to the Bank; and to ensure the managers and staff worked together to achieve the core purpose, not least in a safe environment.

The pressure points for the Division's operations arose from the nature of the Bank's main tasks and the need for high technology-based information systems covering markets and banking-dealing operations, surveillance, settlement and security systems. The Division's users relied on power for their provision and this had determined the complex power arrangements which were now provided in the Bank. For Head Office and Bank Buildings, which were linked through ducts under Princes Street, the London Electricity power supply was backed up by four generators on standby which provided priority sequenced supply to users when required. Power was supplied around the building through sub-stations; and for critical users, supplies could be provided from more than one sub-station. In local areas some users had battery driven devices which provided short duration uninterruptable power supply. These were particularly useful when there were short duration power breaks, of a half a second to one second, in the grid, which could bring down unprotected computer-based systems. Security systems' support was also a very important part of the Division's operational role.

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On the building side, the re-design of offices in certain parts of Head Office had to be undertaken in the style of the architects, principally Herbert Baker. The building shape was itself uneconomic, having a very high wall to floor ratio, with the inevitable high costs of decorating; a general loss of heat; and poor space availability for the size of the site we occupied.

Most of the Division's management team were involved in projects which were numerous, various, and almost exclusively involved professional teams and contractors from outside the Bank. On the engineering side the objective of most projects was to replace plant and systems which were inefficient because of breakdown and high running costs. At the Branches we were replacing heating and ventilating systems which were around 25 years old. The replacement of obsolete security systems and the introduction of fire detection and alarm systems for fire certification purposes was also a particularly challenging project area.

Building projects were mostly office moves and major works were anticipated once the post-Ashridge re-organisation was finalised. One further project of note had been the successful completion of the cleaning and floodlighting of the Bank for the Tercentenary: this had been achieved on time despite the bankruptcy of the main contractor during the project.

The core purpose was cost effective provision of services which was Mr Everett's major pre-occupation. He explained that he was not a technician and his previous experience in the Bank had been in a number of policy management type jobs involving management techniques, and finance and budgeting. On his arrival in the Premises Division he had found a highly committed, well-qualified, technical workforce but they were pre-occupied solely with technical issues. Over the years, he had worked with the technical managers, slimming down the internal team, including management, and introducing management into their jobs. As a result the internal workforce overall

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been reduced from over 500 in the mid-1980s to under 300 by the coming year. Two levels of general management and two levels of technical management had been removed and the roles of Chief Engineer and Chief Surveyor had been dispensed with. Managers carried out their own co-ordination by communicating with each other on common issues and problems. In terms of Bank-wide nomenclature one manager was the equivalent of a Zone 2 Official and the others either Zone 1B or Zone 1A.

Mr Everett said that four years ago he had launched a cost reduction exercise which was due to be completed in the current budget year. A further review had been initiated a year ago for implementation in 1995/96. This had anticipated the Deputy Governor's call for options for expenditure reductions in overhead areas and the Premises Division contribution had been significant in reaching the target reduction required.

For the future he was taking a number of initiatives on target setting and on reviewing the performance of assets with the objective of achieving a further reduction in maintenance costs. Other preoccupations would be to consider further outsourcing of services, and energy management, where a target reduction of 5% had been set. Outsourcing had not been an easy route for the Bank to take for security reasons, but experience with contract cleaning in Bank Buildings, and its extension to Head Office, had resulted in considerable savings.

In thanking Mr Everett for his report, the Governor said that most of the Bank took the provision of the services for granted, which, in itself, was a compliment to Mr Everett and the work of his Division.

In response to Sir Christopher Hogg's enquiry about how the potential for a reduction in staff had been identified, Mr Everett said that he came to the job with considerable background having been the Premises Division's budget analyst, and from that viewpoint had seen changes that could be made.

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Sir Chips Keswick enquired whether the Bank had a disaster plan which provided facilities outside the City? In response, Mr Everett said that there was a Bank-wide Contingency Planning Committee and an overall Contingency Planning Co-ordinator, but each Department was responsible for its own contingency plans. Mr Plenderleith said that alternative facilities had been identified within the Bank's own buildings, and we also had access to other institutions' facilities, eg for dealing etc, but these were all in the City. Sir Chips thought this was a potentially dangerous situation.

In response to Sir Roland Smith's enquiry about safety in, and evacuation from, the Bank, Mr Everett explained that such safety was a joint responsibility of the Premises Division and the Banking Department. Currently they were reviewing the evacuation procedures, particularly those for the disabled. Sir Colin Southgate was interested to know if the Bank had targets for environmental issues and Mr Harris replied that the Bank's response to these issues was currently being developed and we were drawing on the experience of other City institutions. Sir David Scholey enquired whether there was any co-operation between the Bank and the City Corporation so far as our listed buildings were concerned. Mr Everett said that there was a close working relationship between the Bank and the Corporation, particularly his relationship with the City Engineer. There was a considerable sharing of information between the two organisations, but no sharing of staff.

In response to Sir Colin Corness's enquiry about the proportion of space in Bank buildings which was unoccupied, Mr Harris said that this was relatively small. Some space was available in Bank Buildings which was used as a shunt area while office replanning was taking place, and, in addition, there was a small area vacant on the ground floor at New Change.

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

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

At the Governor's invitation and with the agreement of Members of Court, Mr Smith, Head of the Industrial Finance Division, and [redacted] the author of the paper "The London Approach: recent developments including debt trading", attended Court for the following discussion.

[redacted] introduced the paper by drawing attention to the 'main tenets' of the London Approach namely that: - banks are initially supportive and don't rush to appoint receivers; decisions about a company's future are made on the basis of reliable information which is shared among all the parties to a workout; banks, and where appropriate other creditors, work together to reach a collective view on whether and how a company should be given financial support; and pain is shared on a equitable basis. The Approach has a good track record - with the Bank being involved as "honest broker" in some 150 cases which were the tip of an iceberg, most of which was managed by the banks without reference to the Bank of England. He mentioned the issues which had been looked at recently. He cited the secondary market in distressed debt as the most significant of these issues but explained that the conclusion of widespread discussion was that it would be inappropriate to impose restrictions on the development of this market, whilst fostering the spirit of the London Approach within it.

Mr Smith stressed the need to explain the difference in culture between the UK and, in particular, the USA where most players in this market came from. There was some discussion as to whether 'different' implied better or worse. Mr King wondered if the London Approach existed to compensate for deficiencies in the UK insolvency procedures. It was accepted that there was room for improvement and that the current DTI proposals for reform might go some way to achieving this. On the other hand, Mr Kent argued that Chapter 11 in the US was far from perfect. In agreeing, [redacted] suggested that the London

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Approach could reasonably be seen as an integral part of the UK solvency system.

Sir David Scholey asked about the handling of the Metallgesellschaft case by the German banks. Mr Kent explained that the Bank of Japan and a number of mainland European institutions were actively considering what lessons they might learn for the London Approach and indeed one had sought a London banker's experience in dealing with the Metallgesellschaft case. He thought it had strained relations between the exposed banks. Sir Chips Keswick was convinced that a flexible and informal system was far more appropriate than a codified or legalistic one. The Governor agreed with this but recognised that informal systems also required a shared 'ethos': this was what the London Approach sought to capture and build upon.

Sir Chips Keswick asked if debt trading was in part driven by tax arbitrage opportunities, making the product more attractive to some nationalities than others. Mr Smith explained that we had not been conscious of this but would look out for evidence.

Sir David Lees noted that we had investigated the possible causes of so many corporate difficulties seen in the early 1990's. He suggested that these might be drawn together in published form. Mr Kent explained that we had publicised our findings through speeches, drawing particular attention to the shift from relationship to transactions banking.

Sir David Scholey asked if there was a 'Bank view' on the desirability of majority voting. Mr Kent explained that this was inevitably something the banking community would have to resolve for themselves. It entailed a trade-off between preserving an independent right of action and recognising the collective benefit of limiting the scope for a minority player to disrupt a restructuring process. We were supporting the proposed changes to the insolvency procedures which effectively introduce majority voting; the banking community was moving this way at least for less critical decisions other than

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advancing new money, extending a loan term, or changing the rate of interest.

Ms Masters asked if the trend to transactions banking would make the London Approach less tenable in future. Mr Kent acknowledged this risk but went on to say that the Bank's role as intermediary had taken different forms over the years. The current form of the London Approach had served the community well during the past recession but would need to change and adapt with the changing market environment. The Governor agreed that the nature of our role might change in parallel with reform of the insolvency legislation but that our fundamental role as a catalyst would survive.

Under the weekly executive report:-

1

2 The Governor mentioned that the Chancellor of the Exchequer would be lunching at the Bank after Court on Thursday 1 December.

Rupert Pennant-Rea

A. Coughton - Secretary. 14 April 1994.

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 14 APRIL 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
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 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.

The Governor reminded Members that earlier that year Court had agreed that the Committee to Consider the Securities of Certain Funds be stood down, and that responsibility for the investment

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management of the Staff Pension Fund be transferred to the Trustees of that Fund, who would agree with Court the investment strategy to be followed, and report regularly to Court on the performance of the Fund.

Accordingly, to put this into effect, it was RESOLVED that in exercise of their powers under Clause 4 of the Bank of England Pension Fund Trust Deed, the Trustees are directed to apply or invest the Fund until further notice in accordance with strategy to be decided from time to time in consultation with Court, and to report to Court on the implementation of that strategy at intervals of not more than six months.

At the Governor's invitation, and with the agreement of Members of Court:-

1 Mr Rumins, the Head of Finance and Resource Planning Division, attended Court for the discussion of the two Reports of the Audit Committee which covered meetings of the Committee held on 14 October 1993, and 10 February, this year.

Sir David Scholey, as Chairman of the Audit Committee, at the time of the meetings, introduced these Reports which were laid before Court. In opening the ensuing discussion, Sir Jeremy Morse said he was reassured to hear of the proposals for dealing with the Bank's support operations in the published accounts. He enquired whether, in some years, this would mean that the accounting policies would be deemed to 'present fairly' the state of affairs, as opposed to other years, being 'true and fair'. In reply, the Governor said no, as this would defeat the objective. We would adopt the term 'present fairly' as standard practice. Sir Colin Corness asked if the Bank is ready to disclose details of the support operation in respect of the National Mortgage Bank in this year's accounts. The Governor said that the scale of our provision had been disclosed the previous year, but the question of disclosing the bulk had not yet been decided.

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We had taken over the funding of NMB, and were thinking of taking over the Company itself. We would now be more relaxed about the disclosure of the NMB name.

Mrs Heaton commented that she was concerned the Bank might attract criticism if secrecy over support operations was preserved in the accounts. We should explain why we were doing so. The Governor said he agreed. He had gone into this question, purposely, in a lecture he had given last year, at the London School of Economics. There had been no public reaction, and parliamentary reaction had been positive. Therefore, we had adopted the position we had, but, it would need to be presented carefully.

The Governor concluded by thanking the Audit Committee for its Reports and, in particular, Sir David Scholey, who had recently stood down as Chairman.

2 Mr Saville, the Controller of the CREST Project and author of the paper 'CREST - Getting rid of paper in equity settlement', attended for the ensuing discussion.

With reference to the Minutes of 24 February, which included a progress report on the CREST Project, Mr Kent introduced the paper which covered the detailed design phase of the Project, and highlighted certain issues still to be resolved. He reminded Court that it was just over one year ago that the Bank was invited to pick up the Project, yet we were now within four weeks of the specifications being published. This reflected the extraordinary dedication of the design team. Ownership of CREST would be widespread across the securities industry, although, in this regard, there was still an issue to resolve with the Stock Exchange.

Mr Saville said that CREST essentially was just a boring piece of infrastructure. Any emotions that arose were generated, mainly, over the question of ownership between the Bank and the Stock Exchange and the role of the latter.

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One of the main objectives of CREST was to improve the efficiency of the wholesale market, and to make London attractive for international capital. It was necessary to ensure that retail investors, who hold certificates, have a genuine choice as to whether to use CREST or not. In this we had succeeded. The small investor would have a new opportunity to participate in CREST as a sponsored member. Investors would be able to become legal members of CREST, with their names appearing on the register - all, at a relatively low annual tariff. Mr Saville felt they could not do any more. He just hoped there would not be a revolt from retail investors. He concluded by saying that the City was sceptical as to whether or not the Bank would be able to have CREST in a working state by the end of 1995. He believed we could; we had built three systems before.

In opening the discussion, the Governor commented that whilst it might be a boring piece of infrastructure, it was very important for the market. Sir Jeremy Morse, in taking up the point that the retail investor would be able to use the system forever, asked if use might nevertheless die out. Mr Saville thought not, although the number of investors using the system would decline steadily. The corollary to this question was whether or not CREST could cope with 7 to 8 million investors. The answer to this was yes, and if necessary in 1997. In response to Sir Jeremy Morse's second question, as to what the systems were that had been built previously, Mr Saville mentioned those for the settlement of Gilts, Money Markets and ECU securities. CREST was more complicated, and larger, but there were no ingredients that had not been used in the other systems. Sir Christopher Hogg said he could not see why the Stock Exchange wanted a substantial shareholding in CREST. Mr Kent agreed. This was absolutely right, and we were awaiting the reaction of the rest of the market place to this. If the Stock Exchange wanted to provide the management, it could not at the same time dominate ownership. The question over management was one for the

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future owners to examine. However, the Bank was not yet in confrontation with the Stock Exchange over this point.

Ms Masters said she hoped to see CREST linked to other settlements systems in Europe. Mr Saville confirmed that this was an important strategic issue left open in the design.

Declaring his interest as a Director of the Stock Exchange, Mr Plenderleith said that the Exchange had no wish for confrontation or, indeed, any desire to dominate CREST, especially after its experiences with TAURUS. It was more that, in view of the Exchange's responsibilities for the trading market, it had a logical interest in settlement arrangements. He added that one advantage of CREST was that it was capable of being linked to other such systems in other countries. The international dimension, said Mr Saville, was an interesting and complicated one. When CREST comes in, other systems will be able to become members. The question of how to bridge the gap between CREST and other systems, such as RTGS, would be dealt with in phase 2, after the end of phase 1 in 1996. However, CREST would need to make strategic decisions in this area in 1995.

Sir Colin Southgate said he was delighted to hear Mr Plenderleith's comments about the Stock Exchange, as he had concerns about the approach of the new Chief Executive. He went on to say that it was very important, with the introduction of any such system, that the users must be walked through the design to see what was in it for them; they must sign off on the design from the beginning. In response, Mr Saville said that the seven people in his team had had widespread consultations with all interested parties. For instance, they sent out newsletters to 3,000 people, and made themselves available on the end of a telephone. In this context he mentioned two one-day conferences that were due to be held in London in May, so that people could hear what was proposed. The Governor

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endorsed the point that there had been extensive discussions with institutional users. Mr Saville added that, whilst it was evident that some firms had come to terms better than others with CREST, he did not see it as his duty to bring the worst up to the best.

Sir David Scholey said he had two questions. First: he wondered if there was a gap between delivery and payment. Second: the arrangements for the ending of the account. In answer, Mr Saville said that regarding delivery versus payment, full legal delivery involved getting on the register. The time it took to do this was being reduced from days to hours. The payment leg was instantaneous, but involved a possible exposure to the buyer's bank. The seller should thus negotiate his position with his bank, if he wished to avoid intra day exposure to the buyer's bank, whose identity he generally would not know. The risks were not large in relation to corresponding risks in the gilts market, and there was the prospect of their being resolved by RTGS, which was an option within CREST. In response to Sir David Scholey's second question, Mr Saville said that the account system allowed investors a sort of unmargined over-the-counter stock future; they could, for example, buy stock early in the account in the hope of selling before the end, without putting up any cash. The broker in essence provided free credit.

Under short-dated rolling settlement this would still be possible, since market makers would need to make markets for non-standard settlement to facilitate the transaction of paper-based investors. The last could not hope to meet the two or three day rolling settlement, which would probably become the norm in CREST. But the period generally available for such trading would be shorter. Some brokers would provide formal margin account arrangements, to allow investors to speculate for longer periods; and some investors might make more use of trade options, to fill the gap.

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For her part, Mrs Heaton thought there were a lot of risks in building a system and then handing it over to another party to operate. She felt the operator should be appointed at an early stage so there was a seamless web handover. Sir Roland Smith saw, as a major policy issue, the fact that there did not appear to be any arrangements for the Bank to divest itself of its holding in CREST. Mr Kent agreed that this was indeed a major issue, but it did not cause difficulty. The major owners were coming together in the near future to form a shadow board. We would help them decide this, and other such questions. It was important that the integration between ourselves and the operators went smoothly. We would not withdraw until the owners and operators were running CREST. This posed the question of whether or not we should have a share after we had withdrawn from our operating role. Mr Kent said his view was a pragmatic one. We might need to do so for the sake of the City, in the context of strategic thinking. It was, perhaps, a question to be played by ear, nearer the time. Sir Jeremy Morse commented that he was against the Bank having any shareholding, drawing on the analogy of 3i. We should find another way. The Governor added that our being involved did not necessarily mean we should have a shareholding.

3 The Governor mentioned that a paper entitled 'A Report on Salary and Benefits 1993-1994' had been sent to Members recently for information and suggested that they speak to Mr Harris, directly, if they had any questions about the paper.

Mr Rumins, the Head of Finance and Resource Planning Division, and [redacted] [redacted], attended Court for the ensuing discussion.

Moving on to consideration of the Bank's budgets for 1994/95 to 1997/98, the Deputy Governor said that the budget round had been conducted in an air of unreality this year, in view of the re-organisation of the Bank arising

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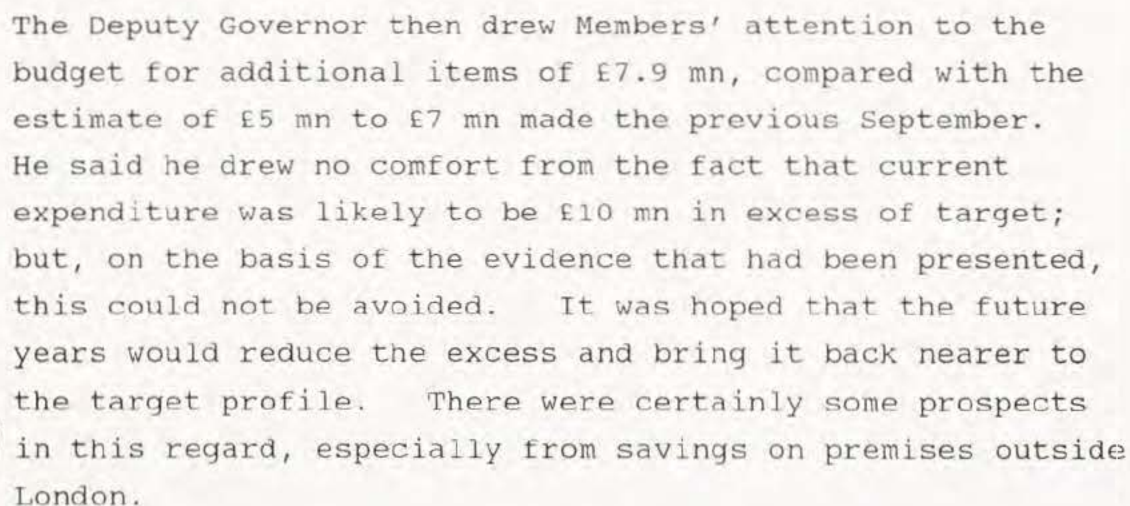
from Ashridge and the implications this had for budgets. The figures that emerged represented a best estimate on the basis of the Bank continuing as it is. The Deputy Governor added that a look had been taken as well at the question of the financial framework and its criteria. However, this had not been concluded yet and it was possible it could result in different objectives being identified. Also, the current estimates represented the last that would be made under the stewardship of Mr Rumins, and the opportunity would be taken to review how we present and draw up budgets. The Deputy Governor went on to say that there were a number of points he wished to draw to the attention of Court. The total targeted expenditure for 1994/95 as presented to Court in September 1993 was £221.6 mn, to which should be added a number of ring-fenced items it had been decided to bring back into the total. These amounted to £2.1 mn, giving an overall total of £223.7 mn, which, when an allowance was made for inflation, increased to £225.8 mn. The results of the budget round had produced a figure some £12 mn in excess. This was subsequently reduced by £2 mn, giving a final figure in excess of target of £10 mn. The main reasons for this were the cost involved in the RTGS project, additional costs relating to the EMI, and possible legal fees arising out of BCCI litigation. These had been foreseen when Court had discussed what the budget might look like last September.

The Deputy Governor then drew Members' attention to the budget for additional items of £7.9 mn, compared with the estimate of £5 mn to £7 mn made the previous September. He said he drew no comfort from the fact that current expenditure was likely to be £10 mn in excess of target; but, on the basis of the evidence that had been presented, this could not be avoided. It was hoped that the future years would reduce the excess and bring it back nearer to the target profile. There were certainly some prospects in this regard, especially from savings on premises outside London.



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In commenting on the figures, Sir Christopher Hogg said he was left with the overwhelming impression that the Bank attaches a huge amount of importance to the continuity of employment and, as a result, was not able to make savings, as in the private sector. He felt that, in the future, improved control of expenditure should arise from having a more flexible workforce. The Deputy Governor responded by saying that manpower had been reduced in the Bank and this would continue, with savings arising from technology. Some of the extra charges, such as those for EMI and BCCI, however, could not be avoided.

Sir Colin Southgate found it disappointing that we could not find what was the equivalent of savings of 5%. He suggested that the Bank should prepare its budgets from a zero base. He asked how accurate the estimates were of expenditure in the outline years. Mr Rumins responded by saying they were a well calculated set of numbers representing the actual budgets of departments. Budget centres were asked subsequently to account for how well they met their figures. He added that there had been a 14% reduction in expenditure in real terms between 1991 and 1994. Sir Chips Keswick suggested that profit and loss accounts were an element of a predatory culture. He did not subscribe to the philosophy that the only good budget was one that was less than the previous year's. Good management, on occasions, needed more money. The Governor commented that one of the problems lay with the fact that it was not possible to value output. Sensible objectives were identified through the budgetary framework. The Deputy Governor said that the Bank's profit and loss was driven to an extraordinary degree by the level of interest rates. We could not adjust spending according to every vagary of interest rates. Sir David Scholey saw the Bank as having two responsibilities, to keep the costs to its banking customers down, and, to provide an acceptable return for its shareholder. He did not see what the penalty would be for higher expenditure. What options had the Bank considered but rejected because of expenditure

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levels? The Deputy Governor replied that we had not looked at taking out a whole activity. Fifty percent of our expenditure was recovered from HMT, so if we discontinued an activity we could cut both costs and income. We were trying to smooth our income better so that we were less vulnerable to the effects of the changes in interest rates. We were looking, as well, at how to reduce our burden on the banking system. Taking up the latter point, the Governor said this was one of three elements in our financial framework. We had reduced cash ratio deposits in 1991 and 1992. Pressure on our expenditure had not allowed us to go any further, and we were unlikely to be able to do so in the future.

From his viewpoint, Mr Quinn said he felt an increasing sense of restriction, but with increased risks. The Bank had been asked to take on additional tasks such as CREST, RTGS and BITS. All this was putting an undue strain on the staff. This could result in accidents happening and staff leaving. It raised the question of whether or not we should stop doing things or refuse to take additional tasks on. Ms Masters said that others parts of the public sector faced just such questions. The answer was to build in bench marking or to take the opportunity of the restructuring to undertake zero based budgeting. A fundamental review of the budgetary processes needed to take place.

Sir Jeremy Morse reminded Members of Court that the Bank had not been unwilling to make cuts in staff, and he cited the demise of Exchange Control as an example. He felt it was important that the Bank made enough profit to cover costs and then have some over for independence. He did not think we should look for swingeing cuts, but use the reorganisation to have a review of housekeeping.
Sir Roland Smith did not see the Bank as a private sector company. It was more like a corporate Head Office - a centrepiece of excellence and quality. The Bank could

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always reduce costs, but it was necessary to balance this against the quality of the people.

Mr Plenderleith said he agreed with Mr Quinn's comments. In the Markets area they had had a hard look at their budget, and cut out some activities. It was not the quantity of resources that was critical, but the quality of staff. The pressures on the staff were different from elsewhere, because of the work, and its volume, as well as the pressures of expertise, and the speed of response that was necessary. He echoed the value of zero based budgeting. The only problem was that this led to cutting out activities, such as technical assistance to Eastern Europe.

The Deputy Governor commented that there was a dangerous combination of factors at work in the Bank. First, the emphasis on reducing expenditure to achieve productivity growth. Second, a growing mismatch between skills and tasks. The fundamental reason behind this mismatch was, third, the traditional policy of no redundancies. The combination of the three resulted in more and more pressure on a smaller number of people. Something would have to give.

Taking up the point on redundancies, Mr Kent quoted the example of the Printing Works. The workforce has been reduced by 50% in a decade, and at the same time there had been an increase in productivity. There were more savings to come, but all these benefits were taken away because the cost of the operation was met by HMT.

Sir David Lees said he was not clear where our shareholder saw us in the terms of our financial framework. What did HMT see as the financial objectives of the Bank? Had they set down financial objectives for us? The Governor responded by saying that HMT impose cash limits on our expenditure with very specific objectives. HMT were prepared to leave us to do our own thing, providing we

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showed we were responsible. The Bank continued to approach matters rationally, but we had to compromise between conflicting issues. We can introduce backbone into subjective judgements. An indicator was the number of hours worked by senior people and their health. When the Ashridge structure was in place, we would look again at our financial framework. Sir David Lees added that we should look laterally at whether or not a conventional profit and loss account was the right management tool. Could the figures be brought together in a more meaningful way? Sir Christopher Hogg suggested that much of the problem lay with the policy of no redundancies. Mr Harris commented that there was a provision for redundancy, but that it had not been used on a compulsory basis. We had only 20 surplus staff. The Governor added that that number had been reduced over the last two to three years, but the question was: had the right people gone? It was not so much a question of the quality of staff but, more, greater demands for high quality people.

Court then considered the review of capital expenditure and the forecast of the Banking Department's Profit and Loss.

4 [redacted], the Secretary of the Working Parties set up to consider the Ashridge proposals, remained for the discussion on the proposed new structure for the Bank.

In introducing the latest proposals for the re-organisation of the Bank, the Deputy Governor reminded Court that the objectives of the Ashridge exercise were to bring the organisation of the Bank into line with its main objectives; to bring operational and analytical work closer together; and to ensure that the Bank had the right number of staff in the right places. Discussions within the two structural Working Parties were sufficiently far advanced to put out some draft organisation charts to seek views from staff and, on this occasion, from Members of Court. Referring back to the earlier discussion on the Bank's budget, the Deputy Governor said that this had been

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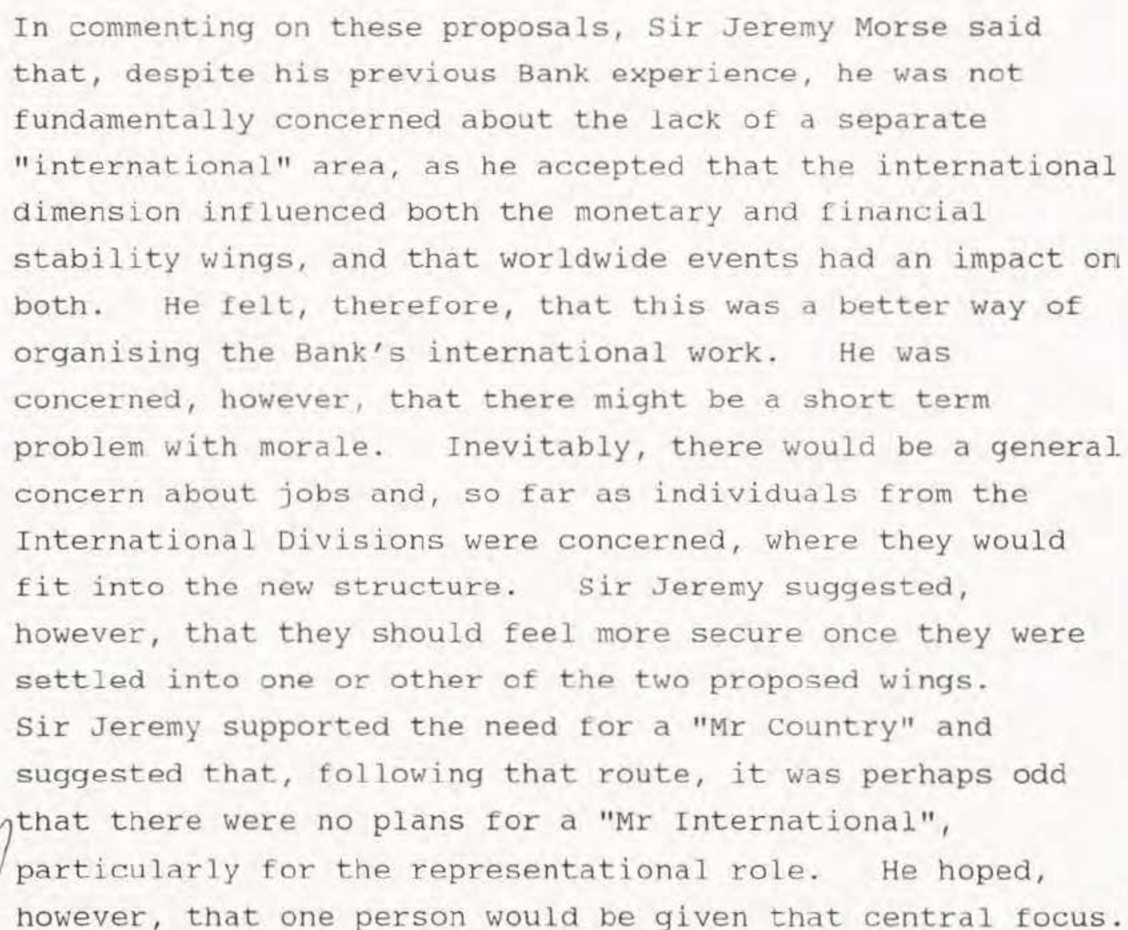
a zero-based exercise to see how the Bank should be organised to achieve its two main goals, of monetary stability and financial stability. The Working Parties had set out to define the tasks necessary to achieve stability; and then to consider how those tasks should be grouped together. The final part would be establishing how many people would be required to carry out those tasks.

In referring to the chart setting out the proposals for Financial Stability, the Deputy Governor said that the right-hand side of this chart, which covered the area described as Financial Infrastructure, included the issues relating to the Bank's third core purpose. This had been the most difficult territory to chart, and it was an area on which he would welcome the views of the Non-Executive Members of Court.

In commenting on these proposals, Sir Jeremy Morse said that, despite his previous Bank experience, he was not fundamentally concerned about the lack of a separate "international" area, as he accepted that the international dimension influenced both the monetary and financial stability wings, and that worldwide events had an impact on both. He felt, therefore, that this was a better way of organising the Bank's international work. He was concerned, however, that there might be a short term problem with morale. Inevitably, there would be a general concern about jobs and, so far as individuals from the International Divisions were concerned, where they would fit into the new structure. Sir Jeremy suggested, however, that they should feel more secure once they were settled into one or other of the two proposed wings. Sir Jeremy supported the need for a "Mr Country" and suggested that, following that route, it was perhaps odd that there were no plans for a "Mr International", particularly for the representational role. He hoped, however, that one person would be given that central focus.



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Reverting to the first of the Ashridge objectives - to bring the organisation of the Bank into line with its main objectives - Sir Jeremy asked whether the concept was standing up well as the new structure developed. One test was the ease, or otherwise, with which the minor issues fitted in to the wider structure. One other issue was also important: equality of esteem between the two wings. He had the impression that the general perception was that the Monetary Stability wing was the more highly regarded of the two. In connection with this, he suggested the proposed nomenclature may be looked at again.

The Deputy Governor said that he felt encouraged that the structure was right: within the Working Parties, they had tested the structure by working through a number of case studies to see how they would be dealt with in the new organisation. In practice, the only difficulty that they had encountered was in the area of financial infrastructure. In commenting on Sir Jeremy's point, about equality of esteem, the Governor said that there had been a problem of this nature in the past, in that Banking Supervision had been considered less glamorous than the Markets area. Mr Quinn confirmed this, but felt that there would now be a greater sense of equality in the proposed arrangement with the two wings. Mr Plenderleith agreed and said that the balance and perception were better in the proposed structure; it was good that financial stability was not just Banking Supervision. Equally important was the impact of the international aspect on the markets area. This would provide a far broader range of interest, a point the Governor endorsed.

Sir David Scholey said that he thought the proposed structure for the Monetary Stability wing was interesting and integrated well. So far as the proposals for the Financial Stability wing were concerned, he suggested that it was only a modification of the present structure. He suggested that under the area entitled "Financial Infrastructure" the sub-division "Markets and Systems"

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would fit more logically under "Regulation, Supervision and Surveillance" where it would relate more closely with "Prudential Advice."

Sir Colin Southgate said that the issues identified under Financial Infrastructure should not be integrated within the rest of the wing: to do so, he suggested, was to fudge the solution. Mr Kent said that the Financial Stability wing incorporated a number of functions, some of which were statutory and others non-statutory: there was a school of thought that suggested that the discretionary functions falling under Financial Infrastructure were ones that the Bank should cease to do. Apart from being non-statutory, the Governor suggested that some of these issues were also distinct tasks. Sir Christopher Hogg said that although he had reservations about the third core purpose, given its existence, he was content with the proposed structure. He would not favour a third wing.

In response to Ms Masters's enquiry about how communications with the staff were being managed, and in particular the detail about how individuals would fit into the new structure, the Deputy Governor said that a lot of thought had been given to this. It has been, from the beginning, an open and consultative process. Members of the Working Parties were trying hard to keep everyone up-to-date with what was happening, but he accepted that, until individuals knew exactly where they fitted in to the new structure, there would be unrest. He hoped to make considerable progress in identifying individuals for jobs within the next four to six weeks.

In responding to the points made earlier by Sir Jeremy Morse, Mr King said that there was a need to integrate the work of the Bank as a whole and to focus on the topical issues. A recent exercise involving the Economics and International Divisions, and the Markets area, in producing a Report for the G.10 Deputies, had been particularly successful. There had been a clearly defined purpose, and

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a sharing of skills and ideas. So far as morale was concerned, he accepted that it was a serious problem in the International Divisions. On the whole, the junior staff were enthusiastic about the new proposals, but senior staff were less so. They were, not unnaturally, concerned about the jobs they might be doing. Reverting to the point about "Mr International", Mr King accepted that the Bank may lose something by not having someone to fill that role, but he felt that within the new structure, the relevant Director would be involved with the relevant issue. So far as regulatory or supervisory issues were concerned, Mr Quinn was the obvious "Mr International"; and he himself had established many contacts internationally with economists, many of whom he had known during his earlier academic career.

In looking at the overall structure, Sir David Lees noted that this was an early draft and that no names had been pencilled in. He suggested that when the Executive came to consider names for particular jobs, this might influence the detail of the structure. It may be necessary to modify the framework to accommodate the qualities of the individuals concerned. In response, the Governor said that the Executive had tentative ideas about names for jobs and would be discussing the matter further later that day.

Under the weekly executive report the Governor mentioned that it had been announced the previous day that the minutes of his meetings with the Chancellor would, in future, be published.

Rupert Pennant-Rea

G. A. Croughton
Secretary 28 April 1994.

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 21 APRIL 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Pendarell Hugh Kent, Esq
Mervyn Allister King, Esq
Ian Plenderleith, Esq
Brian Quinn, Esq

Hugh Christopher Emlyn Harris, 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 noted.

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

Rupert Pennant-Rea

E. A. George
Secretary 28.4.94.

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 28 APRIL 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
Brian Quinn, Esq
Sir David Gerald Scholey, CBE

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 14 April and the Meeting of 21 April, 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.

At the Governor's invitation, and with the agreement of Members of Court, Mr Footman, the Head of Information Division, and Mrs Bishop, attended for the following item.

The Deputy Governor introduced the draft text of the Governor's Foreword and Directors' Report which had been prepared for

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inclusion in the Bank's Annual Report for the year ended 28 February 1994, and invited comments from Members of Court.

In the discussion that followed, a number of points were made and noted, relating particularly to the nomenclature "monetary stability and financial stability", and the value of placing greater emphasis on the Bank's core purposes. The Governor said that these points would be looked at again. In particular, he suggested that the following year's Report should emphasise the Bank's core purposes, relating them to the new structure that would be fully in place by then.

With the agreement of Members of Court, , attended Court for the discussion on benefit improvements to the Staff Pension Fund which had been suggested by the Standing Committee on Pensions, and considered subsequently by ExCo.

In introducing the recommendations, Mr Harris explained that SCOP had been set up in 1978 and submitted reports, with suggestions on benefit improvements, to the Bank and BIFU every three years, to coincide with the revaluation of the Pension Fund.

Of the five recommendations for benefit improvements submitted by the Standing Committee on Pensions, Court endorsed ExCo's proposals in agreeing to:-

increase widow(er)s' allowances to 55% of base pension on reaching age 80;

replace the current commutation factors in the Staff Fund with new factors in line with those in the Court Scheme for men, and comparable new factors for women;

amend the rules to ease the restriction on the recovery of debts from pension.

It was agreed that these changes should be effective from 1 March 1994.

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Court also agreed to reject the remaining proposals to abolish abatement; and to improve the formula for increasing some deferred pensions.

, attended Court for the discussion of the draft Inflation Report, which was due to be published on 10 May.

In introducing the draft Report, Mr King said that rather than attempt to summarise the Report he proposed to focus on the medium term projection for inflation, which was our guide for monetary policy. There had been a small revision to our projection of inflation since February of this year, and there were two main themes to the story behind this. These were that inflation had been lower in the first quarter than we had expected, as a result of another squeeze in retail margins. RPIX and RPIY inflation had fallen by about 0.4 percentage points from December to March with RPIY inflation below 2% for the first time. However, headline inflation was up by 0.4 percentage points, as past interest rate cuts had dropped out of the twelve month comparison. The reduction in margins was expected to persist but not to be repeated next year. Hence the twelve month measure of inflation was expected to rise in the first quarter of next year as this year's fall dropped out of the index. At that point, inflation would be back to the level that we had expected in the last Report. The good news now entailed some bad news in twelve months' time, even though the price level will be lower for the whole period.

The second theme concerned developments in the labour market. Over the past three months the Department of Employment's estimate of the underlying growth rate of average earnings had risen from 3% in December to 3 1/2% in February, with 3 3/4% likely for the next month. Mr King said that he would welcome Court's views on this.

The Bank had expected some increase in wage settlements generally, but this had been faster than we had anticipated.

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The increases in actual earnings, as opposed to underlying earnings, had been even higher, mostly because of very large bonuses in industries such as banking and finance. Accordingly we had revised upwards slightly the projection for earnings in 1995, and slightly higher inflation in 1995 would roughly offset the lower estimate of inflation in 1994. He said that he would be very interested to learn the views of Members of Court on what was happening in the labour market.

Sir Chips Keswick noted that firms with which he was familiar were waiting for an opportunity to increase wages, in proportion to the increases in pre-tax profits which they had received in recent months. It was the increase in profits, and the need to give incentives to managers, which drove payments, not so much the state of the external labour market. Sir Martin Jacomb also noted that profitability had increased, as firms were able to win slightly better margins and slightly increased sale volumes. This had led to a climate where employers tended to be a little more generous when considering what wages to pay. There was a feeling that, for the sake of the morale of the workforce, they should be allowed to participate in the increased profits. He also noted that trade unions seemed to be a little more vociferous this year than they had been for a long time. The Governor noted that the impending tax increases might also contribute to this climate as employees attempted to maintain their real wages. But, so long as companies could not get away with raising prices, the outcome for wages would be uncertain and would depend upon future behaviour in the labour market. Sir David Scholey then argued that profitability did, in fact, affect incentives in the labour market as a whole. The level of profitability was relevant to what had to be paid to attract new people to a firm and retain the right staff. Sir David Lees noted that demand in the economy was stronger, and, as a result, confidence about job security had increased. This was probably the biggest single pressure on the pay round. Settling pay this year was definitely more difficult than it had been last year. Next year would be more difficult still, especially if the economies of continental Europe recovered, thus increasing demand

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further. He was pessimistic about the labour market outcome as a result. Sir Jeremy Morse raised the question of whether one should be more concerned about average earnings per head or firms' total pay bill. Mr King said that, in general, it was the growth of nominal earnings per head that mattered, compared with the growth of labour productivity. If productivity in the economy as a whole grew faster, then, indeed, nominal earnings could grow faster. But the picture was complicated by the cyclical behaviour of productivity.

Sir David Lees drew attention to the change in skills required in the employed labour force. He noted the higher skill base required and thought that this would contribute to higher wage pressure. Sir David Cooksey noted that smaller firms were in a different position from big firms, being subject to greater pressure on their liquidity, but they were still finding pressure from the external labour market, because of the difficulty of attracting good quality workers. Sir Chips Keswick noted that many people thought dividend payouts would be in the region of 4 to 5% this year. It would be very difficult for management to avoid paying a similar increase in earnings to their labour forces.

The Governor thought that the more rapid increase in nominal earnings at the beginning of this year was a little worrying. The bounce back was not as big as it might have been, however. For instance, when past pay freezes had come to an end in recent months, the new settlements had not attempted to claw back what had been lost during the freeze. The outcome in the labour market was not pre-determined and we would have to monitor developments very carefully to assess precisely what was happening. This was probably the most difficult phase of the recovery in which to exercise monetary policy. At some stage policy-makers would have to decide when to "take away the punch bowl".

Sir Martin Jacomb noted that there was some good news. The differences between nominal and real earnings increases were much smaller than when we last tackled this problem.

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Nevertheless, it was important to arrest the self-fulfilling nature of even small excess increases in nominal earnings. Negative equity would continue to hold back consumer spending, and indirect taxes would do the same. Exporters no longer expected to be able to rely on a depreciation of the exchange rate to win profits. Firms were likely to try to maintain margins by cutting costs.

Mr King argued that people's expectations about future inflation were crucial. Policy-makers must demonstrate that inflation will not be allowed to rise. This would change the bargaining environment compared with the last recovery. In the long run, monetary policy cannot affect real pay, but it can affect the level of nominal earnings. There was nothing at the moment in the data to suggest that nominal earnings were taking off, but earnings behaviour in the future would be very important. Indeed, it was more important for the whole economy than individual firms might realise, as earnings accounted for a larger proportion of the economy's total sales. It was inconceivable that unemployment was anywhere near its natural long-run rate, but the downward pressure that unemployment exerts does not appear to be enough to counteract the upward pressure by insiders, that is, those currently employed, on pay. Unemployed outsiders were not exerting effective competition in the labour market. Nevertheless, it was too early to be pessimistic about the overall outcome. The demand for hours worked in the economy and levels of employment were more or less stable. To a certain extent, it was developments on the supply side of the labour market, not the demand side, which would be relevant to the degree of labour market tightness.

Sir David Cooksey noted that the public sector pay policy's second stage had not been mentioned. He had understood this to mean that pay rises in the public sector had to be paid for by productivity gains. Did the Bank feel this was happening so far? Mr King thought that it was too early to say. The movement of public sector and private sector wages varied over the cycle, but there was no evidence yet that settlements in

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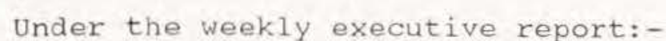
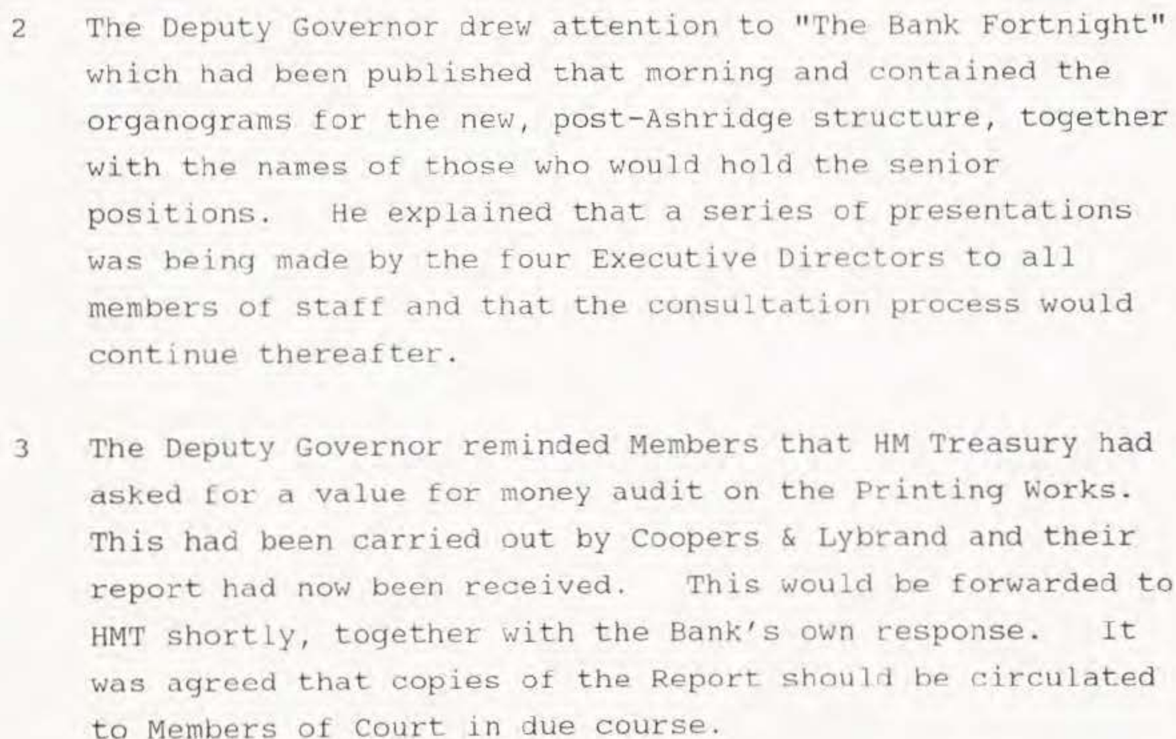


the public sector were exerting any additional upward pressure on private sector earnings.

Under the weekly executive report:-



2 The Deputy Governor drew attention to "The Bank Fortnight" which had been published that morning and contained the organograms for the new, post-Ashridge structure, together with the names of those who would hold the senior positions. He explained that a series of presentations was being made by the four Executive Directors to all members of staff and that the consultation process would continue thereafter.

3 The Deputy Governor reminded Members that HM Treasury had asked for a value for money audit on the Printing Works. This had been carried out by Coopers & Lybrand and their report had now been received. This would be forwarded to HMT shortly, together with the Bank's own response. It was agreed that copies of the Report should be circulated to Members of Court in due course.

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The Governor mentioned that he had chaired the Annual General Meeting of the Sports Club on 19 April 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.

R.A. Hoffmann
Assistant Secretary
5th May 1994

Rupert Pennant-Rea

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 5 MAY 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Ms Sheila Valerie Masters
Ian Plenderleith, Esq
Brian Quinn, Esq
Sir David Gerald Scholey, CBE

Hugh Christopher Emlyn Harris, Esq

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

At the Governor's invitation, Mr Bridger, the Chief Registrar, attended Court to speak about the work of his Department. He said that to put the operations of the Registrar's Department into context, it should be mentioned that while the Bank is the main registrar for British Government stocks, the Department of National Savings and the Bank of Ireland also have registers.

Mr Bridger went on to say that the decline in the size of the register, and therefore of work volumes, had become less sharp in the last two years as a result of the high Public Sector Borrowing Requirement, and the greater interest of the retail

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market in gilts. It is individual investors who provide the bulk of the Department's work. There were 375 staff working at Gloucester and they had a budget of some £13mn. He added that they provided, or procured, most of their own services.

During the past two years they had undertaken a number of one off jobs outside their core function. A considerable amount of work had been done on data capturing card indices for other areas of the Bank, and they had acted, also, as paying agent for the Deposit Protection Board.

So far as effectiveness and service quality were concerned, the Department had introduced a number of measures to enable them to judge their performance. They had a strict timetable for transaction work, targets for the speed of answering correspondence, and they aimed to contain errors within certain margins. The latter were also analysed, along with complaints, to ensure there were no systemic or training faults. Individual productivity was measured against targets and this had improved during the past three to four years as staff had gained in experience. Productivity was also measured by work done against all staff resources, which put the spotlight on overhead areas. Again, there was evidence of improvements in this area since relocation.

There were, said Mr Bridger, two main subjects under current consideration. Continuing the improvement in the the quality of service, with particular regard to letter writing. Also, managing their excess capacity, as contraction of their work continued. Their spare accommodation had been placed on the market, but the commercial property market in Gloucester remained weak. They were reviewing their computer systems, with the likelihood that they would move to distributed systems which should result in staff savings as well as gaining greater flexibility. And they were assessing the extent of staff surpluses, which were beginning to emerge at the more senior levels. They were endeavouring to expand their core business by trying to persuade HMT to transfer the National Savings Stock Register, with its 365,000 accounts, to the Bank. And they

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were continuing to seek further permanent work from the Bank in London.

The Governor, in thanking Mr Bridger for his report, confirmed with him that since moving to Gloucester both staff numbers and their budget had been virtually halved from the levels obtaining prior to their move.

Sir David Scholey enquired where the NSSR was housed. Mr Bridger said in Blackpool, where he understood they employed 65 staff. This was an operation which the Registrar's Department had estimated they could undertake with only 40 staff, although this would mean recruiting additional staff. Nevertheless, he considered they had a good case on cost grounds for undertaking such an operation, although HMT felt that primary legislation would be required before such a transfer of responsibility could take place. Mr Plenderleith commented that the Bank's position would be given added impetus by the Fundamental Expenditure Review that HMT were carrying out.

Responding to a question from Sir David Scholey, on the career pattern of staff in Gloucester, Mr Bridger said that at the present time prospects were not good because of their contraction in work. This, inevitably, had some effect on morale.

Mrs Heaton asked if there had been any proposals for the DNS to acquire the Bank's register. Mr Bridger said that this had not been considered seriously, although it had at one time been suggested as a possibility by HMT. Mrs Heaton concluded by saying how impressed she was by the quick and courteous response she received whenever she telephoned the Department.

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.

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Court gave their approval to Sir Martin Jacomb joining the Board of The Oxford Playhouse.

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

At the Governor's invitation, and in introducing the accounts, the Deputy Governor said that since 1971, the Bank had presented its accounts in accordance with the Companies Act. However, two events had caused the Bank to review the basis on which it presented its accounts:- (a) new Companies' Act accounting requirements which come into effect this year; (b) the problems which the Bank had experienced in recent years in accounting for its support operations.

The matter had been discussed at some length by the Executive, the Audit Committee, HM Treasury and Coopers and Lybrand. It had been concluded that the Bank should follow the requirements of the Companies Act as far as possible, without necessarily revealing the existence of support operations until their purpose had been achieved. To do otherwise could lead to market confidence being undermined. Having taken this decision, the accounts would change. In particular, it would no longer be appropriate to use the term "true and fair view"; instead, "present fairly" would be used both in the audit report and accounts, in the note to the accounts setting out the basis of their preparation, and the statement of Directors' responsibilities in the Directors' Report.

The Deputy Governor then took Members of Court through the significant points in the accounts.

In the Auditor's Report, the term "present fairly" had been used in their opinion, rather than "true and fair", as in previous years.

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The published profit and loss account disclosed much less information than last year, in order that it would be possible not to disclose support operations. Two new statements were shown under the profit and loss account, both being requirements of FRS3. The first, a statement of total recognised gains and losses, brings together, in one note, the profit for the year and the property revaluation deficit. The second one, a statement that all activities were continuing (since FRS3 requires a company to distinguish between continuing and discontinued activities).

The internal profit and loss account (not published) contains a more detailed analysis. The published profit on ordinary activities before tax of £120.2mn had been affected by a number of factors. Fixed income had declined by £4.3mn, principally as a a result of a decrease in Banking Commission and fees, partly offset by an increase in income from miscellaneous securities. The largest factor affecting profits had been the £43.9mn fall in variable income as a result of lower interest rates. Current expenditure had risen by £1.1mn, in line with budget, although personnel costs had decreased, and premises and equipment costs were higher. The SSAP 24 adjustment brought about an increase in pension costs caused by a revaluation of the Pension Fund. £10mn had been written back to profit in respect of provisions for Support Operations. Last year's balance sheet included a provision for NMB of £113mn. The provision was set at the level of NMB's forecast deficit at September 1996, the date when the existing arrangements were due to expire. On the same basis, the deficit this year would be £98mn. However, the Audit Committee proposed a more conservative approach by looking at the deficit at 28 February 1994, which was £105mn. This indicated a release provision of £8mn which had been rounded to £10mn, to avoid any spurious impression of precision.

Moving on to Tax and Dividend, the dividend of £48.4mn reflected the discussions that had taken place with HMT over the continuance of the 50:50 apportionment of post-tax profits. At the request of HMT, the Bank had agreed to exclude the cost

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of CREST from the dividend calculation. At this point Sir David Scholey enquired if the treatment of the cost of CREST was consistent with the treatment of profit obtained from operations without HMT's full support. Was this established or were HMT cherry picking? The Governor responded by saying he thought HMT were cherry picking, but as Members would see from his proposed response to the Chancellor of the Exchequer, which was in their folders, he was trying to establish a general principle - but with particular cases, such as 3i, considered in light of circumstances at the time.

Sir Chips Keswick said he was at odds with the basis of presentation of the accounts, and the judgemental view of what should be included and left out of the accounts. It was agreed that this was a matter that would be pursued outside Court, and the outcome reported to Court the following week.

The Deputy Governor then returned to the published accounts and the balance sheet. He said that the balance sheet was in a new format but close to that required by the Companies Act. As compared with the "statutory" balance sheet, loans and advances to banks had been combined with those to other customers, and provisions combined with other liabilities and accruals into a single item called "other liabilities". Overall, the balance sheet totals had increased by some £1.8bn. The increase was due to a £3.5bn deposit by the Issue Department with the Banking Department, offset by a fall of £0.75bn on the National Loans Fund deposit, and a fall of £0.9bn on foreign currency deposits from central banks. The fall was matched by a fall in corresponding foreign currency placements on the asset side. The main change on the assets was the increase in the loan to the BIS to £5bn from £2.5bn.

The notes to the accounts set out in detail why changes had been made to the basis of presentation of the accounts. The statement in 1a explained why the Bank did not publish detailed information on constituent elements of the profit and loss account and consequent restriction on detailed disclosures in the Balance Sheet, essential if we were to conduct support

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operations effectively. The remainder of the policies were the same as the previous year with the exception of policy (d), tangible fixed assets. This referred to the Directors' valuation of the Bank's properties made during the year, and necessary in order to incorporate the deficit on Southgate House, now owned by the Bank. The opportunity had been taken to revalue all the Bank's properties. Policy (e) had also changed to give a fuller explanation of the policy regarding bad and doubtful debts.

Note 2, on profit on ordinary activities before tax, gave less information than in previous years. If we continued to publish the same level of information as given previously, it would be possible to identify from the note the scale of changes to our support provisions. (In practice this year we are disclosing the change in provision in the Directors' Report, because the need for secrecy has passed.)

Note 3, Directors' emoluments, had been redrafted to show separately the emoluments of the present and previous Governor, and to emphasise that the present Governor receives the same salary as his predecessor. The various appointments made during the year amongst the Directors had meant that 20 had served during the previous year rather than the usual 18.

The note on Pension costs was in the same form as the previous year but referred to the actuarial valuation at February 1993, as this was the most recent. The increase in cost over 1993 was due, principally, to the reduction in the surplus of the Fund from £209mn to £64mn.

The note on loans and advances, and several other notes, includes a maturity analysis of major assets and liabilities. Note 11 includes in particular Directors' valuations in respect of 3i and BIS. The Deputy Governor mentioned, in this context, that the Audit Committee had recommended the adoption of a dividend yield method of valuation using 5% in respect of 3i, instead of 6% used the previous year. This had raised the valuation from £63mn to £89mn. The eventual proceeds of a

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flotation (if this were to come about) were likely to exceed, significantly, this sum. The method and basis of valuation of the remaining investments were the same as in previous years. The Members of Court agreed to the valuations.

The note on shares in subsidiary undertakings was broadly the same as previously, except that balances due from subsidiaries were now included with debtors. Subsidiaries were not consolidated as they are not regarded as material. Minories Finance Ltd continued to realise its assets, but it was not intended to reduce the capital of the company until all remaining legal actions against the company were resolved. EBS Investments had now been liquidated.

The format of note 13, on tangible fixed assets, remained unchanged. The principal movements were the transfer of Southgate House from BE Property Holdings, and the deficit arising from the revaluation of the Bank's properties.

Again, note 21, on the cash flow statement, was the same as last year. Under Section (iii), the word "certain" had been added to account for the fact that the advance to NMB had not been treated as a cash equivalent.

The definition of officers, in the note on transactions with Directors and Officers, had been agreed with Coopers and Lybrand and covered anyone who reports directly to a Governor or Executive Director. The Deputy Governor then asked for confirmation from Court that no Directors had a material interest, directly or indirectly, at any time during the year in any other significant transaction or arrangement, other than the details given, with the Bank or any of its subsidiaries. Such a confirmation was forthcoming.

The disclosure given under contingent liabilities was less than required under the Companies Act. The wording with regard to the BCCI writ was the strongest that Freshfields advised the Bank they were able to use. The claim by Lord Spens was not material and did not, therefore, require mention.

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The change to the Issue Department accounts over previous years was basically to expand the notes to give more information, and to move REPOS of British government securities and Treasury Bills into the "other securities" category.

The Deputy Governor concluded by mentioning the various points in the accounts where Directors were required to give a specific opinion. He said he would be asking Court the following week for confirmation that they were content to be associated with the statements.

Opening the ensuing discussion, Sir Chips Keswick queried the statement in paragraph 1a of accounting policies, namely that the Banking Department constituted a single business all conducted in the United Kingdom. It was felt this was an accurate statement, but it would be given further consideration.

The Governor said the accounts would come back to Court for approval the following week, subject to the outcome of the discussion on the matters Sir Chips Keswick had raised.

The Deputy Governor then asked Court if they were content with the letter of representation. [redacted] mentioned that it followed the format of the previous year with the exception of the wording in connection with the writ concerning BCCI, and the ultimate paragraph in note 1a, dealing with the basis of preparation of the accounts. Sir David Scholey added that the Audit Committee had been advised by Coopers and Lybrand that there were no additional matters to report. A formal letter would be sent to Freshfields seeking their approval to the form of the letter. Court would be asked formally to approve the accounts the following week.

The Governor then thanked Sir David Scholey, and the Audit Committee, for their work.

[redacted] said that Coopers and Lybrand's audit was virtually complete, and that they were due to sign the Report the next

Thursday. He added that the Deputy Governor had taken Members of Court through the changes in the format of the accounts, especially the reasons for the use of the words "present fairly", instead of, "true and fair". But this did not mean that there was any question of the accounts being qualified. This was not the case. He concluded by saying that his company had received the full co-operation of the internal auditor, and the finance staff, during the audit. The Governor thanked [redacted] for his help, adding that it was intended to publish the Report and Accounts on 25 May.

The Governor mentioned that a draft of the Banking Act Report for 1993/94 had been sent to Members the previous week. If anyone had any comments to make on this Report, he suggested they contact Mr Quinn outside the meeting. The Report, in final, would be discussed at Court the following week, when Mr Quinn will also report on the names of those parties to whom powers under the Banking Act and the Financial Services Act have been delegated, and provide details of the exercise of those powers.

Under the weekly executive report:-

1 [redacted]

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2 The Deputy Governor mentioned:-

(i) that a photographer would be present at the early stages of Court next week. He would be photographing the meeting for the artists who were producing the painting of Court, which was being presented by Members to the Bank to mark its Tercentenary.

(ii) that after considerable consultation of Members' diaries, it appeared that the 3rd Wednesday in each month would be the most convenient day to hold Long Courts. However, for various reasons, it would not be possible to hold Long Courts in June, July or August on this day. The new arrangement would start, therefore, in September. We would, however, be confirming this date, and the dates of the interim Long Courts, with Directors' secretaries.

Rupert Pennant-Rea

G. A. Croughton.
Secretary 12 May 1994

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 12 MAY 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Martin Wakefield Jacomb
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Sir Colin Grieve Southgate

Hugh Christopher Emlyn Harris, Esq

The Governor informed Members of Court that it had just been announced that Mr John Smith, the Leader of the Opposition, had died in hospital that morning following a heart attack.

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.

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With the agreement of Members of Court, [redacted] of Coopers and Lybrand, the Bank's Auditors, and Mr Rumins, the Head of the Finance and Resource Planning Division, attended Court for the presentation of the Bank's Report and Accounts.

At the Governor's invitation, the Deputy Governor reminded Members that the Annual Report and Accounts for the year ended 28 February 1994 had been laid before Court the previous week, and drew attention to certain changes which had been incorporated following the discussion at Court on that occasion.

Members being content with these changes, 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 1994 to be printed and issued; and having noted the receipt of a letter from Coopers and 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 were presented fairly and those of the Issue Department presented fairly the outcome of transactions.

The Deputy Governor reported that a further payment in lieu of dividend of £26,001,000 would fall due to HM Treasury on 5 October next, bringing the total payment in lieu of dividend for the year to 28 February 1994 to £48,351,000. Court approved thereto.

Court gave their approval to Mrs Heaton joining the Board of Harrisons and Crosfield PLC.

Under the weekly executive report, the Governor reminded Court that the Deputy Governor had mentioned the previous week that the mornings of the third Wednesday of each month appeared to be the best time to hold the monthly long Courts, starting at 10 am, and that it was proposed to introduce this new arrangement from Wednesday 21 September.

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In the meantime it was the intention to continue with the long Courts on 16 June, 14 July and 11 August, starting at 11 am, as already notified to Members, and in the intervening weeks it was proposed to hold short Courts. Members would be welcome to attend any of these meetings, which would be of a purely routine nature. The Governor said that he would write to Members shortly setting out the details of future Courts.

With the agreement of Members of Court, Messrs Foot, attended Court for the discussions on Banking Supervision matters.

At the Governor's invitation, and in introducing a paper prepared on the question of freeing-up the Building Societies, Mr Quinn said that it raised general issues relating to the present state of the building society movement and its future survival, given the current challenges from banks and other financial companies on both the asset and the liability side. HM Treasury had reviewed the issue in the context of the general pressures on the housing market a year or two ago, when it was recognised that there was now some possible decay in the safety net which the building societies have traditionally provided to weaker members. The Bank was also on notice that it will be required to give evidence to the TCSC, in its current enquiry into financial regulation, and the question of the regulation of building societies has arisen in the context of the previous TCSC enquiry. The paper was in response to a request for advice from HM Treasury on the subject in general, and also specifically in relation to the Cheltenham and Gloucester takeover, which was due to be heard in Court later this month; but it could also serve as a paper to the TCSC, if requested. The paper did not take a view on whether the Bank should or should not take on the supervision of building societies, and in fact the Bank was not seeking a mandate to do so.

Mr Foot noted that when the building societies' legislation was passed in 1986, the example of the Savings and Loans' problems in the United States had led to the fairly tight restrictions

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which were placed on the building societies. The market had since then become considerably more consolidated, with most of the business carried out by a few large societies. The gap had also narrowed between the supervisory approaches of the Bank and the building societies' regulator, in such areas as capital adequacy and liquidity. Arguments about the lack of a level playing field seemed to go in cycles - sometimes it was the building societies who were complaining, sometimes the banks. Mr Foot referred to a question raised previously by Sir Colin Corness on whether it was worth considering differing supervisory approaches to wholesale and retail banks: he pointed out that the paper on building societies did not address that issue, but stressed that the question had not been forgotten.

Sir Colin Corness said that he was not clear in any case about the concept of mutuality in building societies. There was no mutual interest between borrowers and savers, as savers wanted the highest rate for their savings, while borrowers wanted the lowest possible rate for their mortgages. They also tended to belong to distinct groups, with savers, for instance, tending to be older. The distinction between banks and building societies was thus a fairly artificial one, and the Cheltenham and Gloucester move and other recent developments emphasised the blurring of distinctions between the two. He noted also that no depositor had made a loss in a building society, not just in the past seventy years (as mentioned in the paper) but as far as he knew for the whole of this century. But people had lost money in banks. Market research had shown that people felt safer with their money in the building societies than in banks. Also, societies tended to work more in the interests of their depositors than their shareholders. All this meant that legislation to make it easier for building societies to transfer to bank status was unlikely to win votes in the run-up to a general election.

Two specific points to add were, first, that the 40% limit on wholesale borrowing was not in itself a problem; rather, the practical problem was that the regulator imposed a 30% ceiling.

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If societies were allowed to go up to the 40% limit, this would no longer represent a binding constraint on their activities. Secondly, it had proved of great benefit to depositors that there were constraints on building societies' commercial lending. In conclusion, he added that he felt the Building Societies Commission did a very good job.

Sir Jeremy Morse noted that during his term as President of the Institute of Bankers, the Institute had merged with the Building Societies Institute, and he had been surprised that there had been no debate about changing the name of the merged institution - it remained the Institute of Bankers. He felt that this demonstrated how much the building societies saw themselves as being in the business of banking, albeit in a narrower way. He used to feel 15 to 20 years ago that the building societies had a wonderful position on top of the hill; if he had been in charge of a building society, he would have been very happy to stay there. However, they have now been driven into more marshy ground, and mutuality was no longer a key to their business. He asked whether the Bank's approach to building societies' regulation was genuinely agnostic, or whether the Bank was in fact aiming to take it over, but adopting a softly, softly, approach.

In response, the Governor said that the Bank was genuinely disinterested. We had been asked what our attitude would be if constraints were relaxed, and our answer was that they should only be so as part of a package: extra freedom for the building societies meant they needed extra oversight, not only in terms of supervision but also from the market. Pressure was coming from the building societies to be freed up, and if this happened then they would need extra regulation: they would need to be regulated to at least the same standard and to the same criteria as banks, which pointed to at least a common framework, even if they were not supervised by the same body. But the Bank felt that it did supervision rather well; and given that the Bank had taken the view that it should retain responsibility for banking supervision, that did argue for its taking on the supervision of building societies.

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Mr Quinn added that the Bank's approach to the question was more agnostic than tactical. If it was decided to keep the two regimes separate, the first question was whether they had different supervisory approaches. The answer a few years ago was certainly yes - building societies were in effect regulated, while banks were supervised. The difference in approach had been underlined to the Bank when it took over the supervision of Abbey National a few years ago, but the differences had narrowed since then. The second question was whether it was wasteful to have two separate supervisors. The Bank had done a little work on this subject, and it appeared that there were not big savings to be had. However, there was the lesson of the US system, which demonstrated how different regulators can build up their own "patches". The Governor noted additionally that if building societies did move in the direction they were pushing for, the idea that a building society could possibly fail would arise. This would then raise questions of lender of last resort. If the Bank was to provide support this would be difficult if it did not also supervise societies, although there was nothing to say lender of last resort facilities for building societies could not be provided by HM Treasury.

Sir Chips Keswick commented that Sir Colin Corness had painted a very rosy picture of the position of building societies, but he wanted to point out that only 15% of their lending was with commercial counterparties, which gave them a very comfortable cushion for their operations. Sir Martin Jacomb noted that the building societies originally had very restricted powers, so the need for accountability had not arisen. However, by the early 1980s the building societies already had more than 50% of the deposit market, which led the banks to compete for mortgage business. The process of building societies becoming more like banks was inexorable, with de-regulation, and the Cheltenham and Gloucester takeover, as stages on the way. The only question was how quickly the distinctions would disappear. The question then would be what needed to be done about it; building societies could not be allowed to become more like banks without an economic interest in their accountability.

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Sir David Scholey wondered whether mutuality was really such an issue. He noted that it had not proved necessary in the insurance industry, where joint stock and mutual status insurance companies co-existed and were both regulated. Where was the inconsistency, in the banking or the insurance industry? In addition he asked whether, given the Bank's responsibility for financial stability, the Bank was content with its interface with the Building Societies Commission, and satisfied that the building societies were satisfactorily regulated. He also felt that the paper presented as an inevitable conclusion the assertion that greater market discipline and accountability were essential for building societies, when this was in fact a matter of judgment.

Mr Foot replied that the Bank's relationship with the Building Societies Commission was extremely good - we had worked very harmoniously with them for some months in advance of the Lloyds takeover of the Cheltenham & Gloucester. The BSC in any case only had some 50 people, and we knew the two leading people very well. Answering Sir David Scholey's first question, Mr Foot added that we had considered whether the insurance industry was a good model. However, it was an industry which was less transparent than some would like, and also less successful internationally than the UK banking industry. The problem with the mutual status of building societies was that unless the Board of a society was enthusiastic for it to be taken over, it was very difficult to get a change of ownership. Even agreed mergers between building societies had fallen through because of changes of mind on the Board. Mr Foot agreed with Sir David Scholey that he was indeed saying that the management of building societies is too protective.
Mr Quinn pointed out that co-habitation between mutual and joint stock status was a possibility: there were in effect already banks which had virtual mutual status, in the sense that they were consciously non-profit making. But he felt that the situation of building societies was bizarre in that the owners of the societies were precluded from the benefits that came from ownership and the discipline of the market place

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was absent; whereas banks, whether mutual or not, did have these features.

Sir Colin Corness noted that a striking feature was the apathy of the members of building societies. Even when they were sent forms to vote by proxy, the response was, at most, 3-4%. The only thing which excited building society members was the prospect of some cash - the main aspect of the Lloyds' bid for Cheltenham & Gloucester was a bribe to make people vote. He questioned whether it was desirable to encourage building society depositors to seek cash: it would cause money to flow speculatively from one building society to another. This was why the 1986 Act had stipulated that money had to be in a building society for at least two years, and he was not happy with the prospect of the Cheltenham & Gloucester takeover being waved through the Courts. It did not seem right that just one generation of depositors should take out all the benefits.

The Governor pointed out that the board of a building society could keep such an offer hidden from its members. Sir Colin Corness answered that a society could not just sit on a bid - the likelihood was that the bidder would make its intentions known through the press. The management of the building society would also have to consider their quasi-trustee role in relation to the depositors. Mr Quinn pointed out that this precise situation had arisen - a predator had decided not to pursue a takeover, because the board of the intended victim was not in favour and declined to inform its shareholders.
Mr Foot added that the predator had been afraid that it would end up owning a corpse, given the possible damage caused by a long public takeover battle.

Sir Martin Jacomb said he did not think that the mutual life assurance business was an analogue for building societies. The success of life assurance companies in selling policies depended very much on the companies' results, whereas members of building societies gained no discernible benefit from the societies' profitability.

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In conclusion, the Governor asked Court if they endorsed the approach being advocated, which was for the Bank simply to state that if the building societies wanted to go further down the route of becoming like banks, then the consequences were as set out in the paper. Members of Court agreed.

Turning to the next item on the agenda, Mr Quinn introduced the Annual Report and Accounts of the Deposit Protection Board, which were laid before Court.

In commenting on the accounts, Mr Swanney noted that the deficit of £6.8 mn for the start of the new financial year would continue to increase, and pointed out that payment to depositors of Wimbledon and South West had been triggered the previous day. The real reduction in the deficit would occur once dividends came in from the BCCI liquidators, although the timing of this was still uncertain. If the Abu Dhabi agreement went ahead there could be a first payout of around 20% to creditors of BCCI, which would bring about £20 mn into the Deposit Protection Board and put it back into surplus. The optimistic assumption would be that this may happen by the end of 1994 or early 1995.

Sir David Scholey asked, first, when institutions which would be liable for further levies would be notified. Secondly, he enquired if there was any information on the relationship between the total deposits eligible for compensation in failed institutions and the actual resulting claims. On the first point, Mr Swanney replied that institutions could be notified only once the Board had decided to make a levy. Arguably, the actual timing of making a levy did not matter, whether or not amounts were called before they were needed, as either the Fund earned interest (thus reducing future calls) or the contributing institutions earned the interest themselves. By way of illustrating the difficulties of knowing how much to levy, Mr Swanney noted that before the failure of BCCI and the "ethnic" banks, depositors' claims had generally been made for the full amount. However, claims from BCCI depositors amounted to only 36% of protected deposits so far, and such

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claims had nearly dried up. Claims in respect of the other three banks so far came to only around 30%, but those banks were rather less insolvent than BCCI. This meant that there was more money likely to be available to depositors from the liquidators, thus reducing the liabilities of the Fund. On the second question, it was difficult to know in advance how large claims in relation to a given institution would be, as one had to know what proportion of deposits was in sterling, and how much represented deposits of less than £20,000. These details are not monitored before an institution goes into liquidation, although obviously the details become available afterwards. Estimating the size of claims will become more complicated once the Deposit Protection Directive is in place, as the scope and coverage of the Fund will be widened.

Sir Jeremy Morse raised three questions on how the Board worked in practice. First, were the big banks still reluctant to pay their levies? Secondly, were wider issues discussed, or just the narrow functioning of deposit protection? And thirdly, how active a role did the outside members play? In response, the Governor said that the cost of the Scheme was not a current issue for the big banks, although it might become more so once protection extended EEA-wide. He noted that there was always a big bank member on the Board, which at the moment was HSBC. The discussion at Board meetings was generally technical, although the Board had had to consider difficult issues in connection with BCCI payouts: there were, for instance, conflicts of interest, with the Bank members of the Board having an interest in the liquidators' efforts to sue the Bank to obtain a bigger payout.

The Governor asked Mr Swanney to explain how the Deposit Protection Scheme would change once the EC Deposit Protection Directive had been implemented. Mr Swanney said that, as far as technical changes went, the percentage payout would increase from 75% to 90%, and the ceiling on payouts would also rise slightly. Cover would also extend to other EEA currencies and to the ECU, the minimum range of currencies required by the Directive. More fundamentally, deposit protection would now

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be aligned with the 2BCD supervisory arrangements, so that the UK scheme would have to cover deposits in all branches of UK banks throughout the EEA. This represented a bigger change for other EEA deposit protection schemes than for ours, given that there were more EEA banks with branches in London than UK banks with branches elsewhere.

One of the more complex issues that arises relates to arrangements for "top-up" cover. Other schemes in Europe are usually more generous than the UK scheme, and the Directive allows UK banks to purchase top-up cover for their branches in other EEA countries. The UK will also have to allow branches of EEA banks in London to purchase top-up, although there will probably be very few cases where this will happen, given that few schemes are less generous that the UK scheme. Nevertheless, there will be a question as to how much we will charge for top-up. The funding arrangements of the current scheme are relatively simple and the big banks are content with this at present, even though they have to contribute the lion's share of the funding. Some arrangement will have to be reached with the "topping-up" banks for provision of the top-up cover. Another issue is that the current scheme is very mechanical, with the only real area of discretion being set off. The scheme will have to be given more discretion in implementing the Directive, and discussions will have to be held with our EEA counterparts on administrative arrangements - for example, as regards top-up. The Governor noted that the Directive had been discussed with the banks, some of whom had pushed for a greater level of protection, but the matter had been resolved satisfactorily.

In introducing the Annual Report under the Banking Act 1993/94, Mr Quinn said that the format was essentially the same as in the past few years, covering market and policy developments, operational supervision and staff resources. It provided the context and background to the Bank's supervisory activities and aimed to tell a story, which for 1993 was one of a better year in the banking sector for both large and small banks. Pressures had eased significantly and banks' positions (at

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least in terms of capital) were fairly strong. However, there were longer term questions about future growth and sustainability of earnings. The Report also drew attention to complaints from customers and sought to emphasise the Bank's role of deposit protection, rather than consumer protection. So far as supervisory operations were concerned, it had still been a fairly busy year but not as difficult as the previous year. Banking Supervision Division had experienced reduced pressures, although it remained very busy. There was considerable activity on the policy front, where the volume and seriousness of the issues continued, driven partly by Brussels and also from Basle, which had given rise to some very intensive work. Mr Quinn drew attention to the "box items" on banking with low inflation, and on overcapacity, which appeared in the Annual Report and said that these were drawn from considerable amounts of work involving the Economic and International Divisions.

Sir Jeremy Morse enquired whether the Report was discussed in draft with other banks, which he felt might provide some protection for the Bank from inaccuracies that might appear regarding complaints from customers. Mr Quinn said that this was a formal report to Parliament and as such it was not the practice to discuss it in detail in a draft form with other parties. Nevertheless, some of the issues raised in the Report were discussed in the course of routine prudential meetings with banks. The Governor suggested that it was something that might be discussed with the Governor's Advisory Group ex post-facto.

Sir David Scholey said that he very much enjoyed reading the Banking Act Report and had noted that over the years it had changed from being very factual, and perhaps heavy going, to being factual but more interesting and lively, in that it now contained opinions on various topics. The original purpose of the Banking Act Report had been to enable the Bank to give an account of its stewardship of the banking sector. It had now broadened its approach in providing comment on various issues. He questioned whether this was a positive move on the part of

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the Bank and whether the Board of Banking Supervision were given the opportunity of discussing the Report in draft, in the same way as Court considered the Bank's Annual Report.

In response, Mr Foot said that the aim was to strike a happy balance and make the Report more readable. To this end some of the points made in the editorial of the Report were ones that we thought were worth airing. Responding to Sir David's enquiry about the Board of Banking Supervision, Mr Quinn confirmed that the Board did receive the Banking Act Report in draft but had not commented on the direction of the Bank's editorial. The Governor added that if we were going to use the Report to convey messages, we should be clear and concise in doing so.

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.

By way of introduction to the Report of the Board of Banking Supervision, the Governor said that Members of Court had suggested that it would be appropriate to discuss the Report with the members of the Board of Banking Supervision, who had agreed that this would be valuable. He had, therefore, discussed with Sir Alan Hardcastle whether it would be appropriate for the Bank's Executive, including those ex-officio members of the Board of Banking Supervision, to withdraw for this discussion. They had concluded that, as the independent members of the Board had the right and a duty to report any matter of disagreement between them and the ex-officio members of the Board to the Chancellor of the Exchequer, pursuant to Section 2(5) of the Banking Act, it would be appropriate for the ex-officio members and other members of the Executive to withdraw on this occasion.

Accordingly, the Governor, the Deputy Governor and Messrs Quinn, King, Plenderleith and Harris withdrew, and Sir David Scholey took the chair.

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In welcoming Sir Alan Hardcastle, Lord Swaythling, Sir Peter Leslie and Messrs Foulds, Gerrard and Taylor, the independent members of the Board of Banking Supervision, Sir David Scholey noted that, following the setting up of the Board in the wake of Johnson Matthey, responsibility for supervisory matters had effectively passed from Court to the Board, except to the extent that Court remained responsible for ensuring that the Board was properly serviced by the Banking Supervision Division. He enquired whether members of the Board ever stood back and examined the Board's current operations; whether they had the resources to achieve their objectives; and how their future format and functions might best evolve.

In response, Sir Alan Hardcastle said first that members of the Board welcomed the opportunity to meet with the Non-Executive Members of Court in this way. He felt that the Board had performed a useful function since it was established: the setting up of the Special Investigations Unit and the Legal Unit within the past two years had raised the level of intelligence available to Banking Supervision Division and to the Board, and had given Banking Supervision a sharper focus. The Board had taken a critical look at certain aspects of supervision following the Bingham Report. He felt that, generally, the Board was in a good position, having a well-developed working relationship with the Banking Supervision Division who provided them with first class information, the quality of the papers submitted to the Board being of a very high standard. But the suggestion that the Board might stand back and take a fresh look at their role, and the way in which they approach their task, was a good one that would commend itself to the independent members.

Sir Chips Keswick enquired whether members of the Board were comfortable with the criteria for assessing fitness and properness. Mr Gerrard said that, in practice, there were two issues which were a matter of concern. First, in the case of an appeal against the Bank's judgement, the burden of proof rested with the Bank and it had to justify its action: this was something that the Board would very much like to see

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changed. Secondly, there was a particular difficulty in considering the fitness and properness of individuals working in overseas banks with UK branches, where the Bank of England was not able to rely on the views of the home supervisor in establishing fitness and properness. The Governor had recently written to the Chancellor stating that the Board of Banking Supervision agreed with the Bank on the need for a revision to the legislation in this respect, but it seemed that a lack of parliamentary time would preclude any immediate action on this issue.

Sir Jeremy Morse said that he felt it was valuable for Members of Court and the Board to meet in this way to ensure that things did not slip between them. In particular, he was concerned about morale in the Banking Supervision Division and whether this was a matter of concern to be pursued by Court or the Board. He raised the question in the context of the proposed organisational changes in the Bank which, inter alia, he understood would improve morale in Banking Supervision. In response, Sir Alan Hardcastle said that he thought the question of morale was a matter for Court, rather than the Board of Banking Supervision. However, it was his view that despite the BCCI case and the Bingham Report, the quality and general attitude of staff seemed surprisingly good. Mr Taylor said that Members of the Board did not feel able to judge the level of morale in Banking Supervision Division, but they needed to ensure that adequate resources were available. He had not sensed any reluctance on the part of the Bank to provide either the numbers or quality of staff necessary. Sir Chips Keswick said that he felt that the ratio of supervisors to supervised was much higher than would be the equivalent in a commercial organisation (bankers to customers), but Mr Foulds felt that this was essential in order to ensure that the response time in dealing with cases could be quick. In this context, Sir Colin Corness enquired whether, post-BCCI, cases were brought by management to the Board soon enough. Members of the Board agreed that the experience of BCCI had sharpened the Bank's approach in this area and had led to an improvement in the information systems.

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Finally, Sir Alan Hardcastle confirmed that there was a very harmonious relationship between members of the Board, the Bank's Executive who were ex-officio members of the Board, and the staff of the Banking Supervision Division. In response to Sir David Scholey's question, there were no aspects of the Board's work or relationship with the Bank which the members wished to draw to the attention of the Non-Executive Directors.

B.A. Hoffmann
Assistant Secretary
26 May 1994

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 19 MAY 1994

Present

Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Pendarell Hugh Kent, Esq
Ian Plenderleith, Esq
Brian Quinn, 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 noted.

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

[illegible signature]
Assistant Secretary
26 May 1994

[illegible signature]

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 26 MAY 1994

Present

Edward Alan John George, Esq, Governor
Brian Quinn, Esq
Sir David James Scott Cooksey
Sir Christopher Anthony Hogg
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 12 May and the Meeting of 19 May, 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.

At the Governor's invitation, Mr King presented a draft of the Economic and Financial Report for May. He said that the remarkable feature of the economy in recent months had been the combination of surprisingly stable and steady economic recovery and instability in financial markets. Output continued to grow steadily at just over ½% a quarter, with a small increase in that growth rate in the latest quarter. All the incidental data indicated this was a true picture. Given that there are some reasons to suppose that activity has been underestimated, total output is probably growing at around 3% a year and non-

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oil activity at around 2½% a year. There had been no sign of any weakness in activity. To some extent these judgements reflected a view about the trade figures - although the CSO's audit had led to revisions in the figures, we were not all convinced that these figures were plausible. Although the balance of payments deficit may well have been underestimated, total manufacturing exports and output have also probably been underestimated.

Since the Inflation Report had been published, the new data reinforced the points made in that Report. First, the inflation outturn had been unexpectedly good. There was some real news in the April inflation numbers, with underlying inflation according to the Government's measure falling to a new all time low of 2.3% a year. And the Bank's underlying measure fell from 1.9% to 1.6%, also the lowest since the 1960s. For policy, the question was how these low inflation outturns affected our view about the likely inflation rate some two years or so hence. It was not an easy question to answer because there were conflicting affects. It was not clear that the extent of spare capacity was still exerting downward pressure on inflation, and part of the fall in inflation in April reflected substantially larger discounts in the prices of household goods, clothing and footwear. If these discounts were not maintained, then inflation would inevitably bounce back next year. Indeed, even if the discounts persist, but there is no further increase in discounts, then the measured twelve-month inflation rate would rise at this time next year. It was too soon to form a judgement on this. But the lower starting point is likely to make some small change to our inflation projection.

Mr King went on to say that in the Inflation Report we said that the inflation outlook remained good, but that there were three small clouds on the horizon. The first was the increase in the rates of monetary growth. The second was the rise in the inflation expectations seen in bond markets. There had been some confusion about the difference between the Bank's projection for inflation expectations and that inferred from

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bond markets. The Bank's projection was for inflation over the next two years or so. The inflation expectations, which it was possible to deduce from the yield curve, refer to expectations over a horizon from 5 to about 20 years. The sharp rise in expected inflation comes in the 5 to 10 year horizon. There was no obvious clash between the views that inflation over the next two years was expected to remain low and the concerns about inflation in the 5 to 10 year period, not least because of political uncertainty.

The third cloud was the impact on earnings. Data showed that the growth rate of average underlying earnings was higher than expected having risen from 3 to 4% since the end of last year. Although part of this was the result of bonuses and overtime payments, it would seem undeniable that earnings and wage settlements had started to pick up. And unemployment was continuing to fall quite rapidly. Whilst this need not threaten the inflation outlook, it did suggest that, as we said in the Inflation Report, wage developments would need to be monitored very closely.

The impact of the recent data had not led us to revise our view in the May Inflation Report. The bias to ease monetary policy reported in the January monthly minutes of the Governor-Chancellor meeting had now disappeared. But there was no need to decide or speculate now on when interest rates in due course should be raised. More important, was the fact that the monthly cycle of analysis and meetings seemed to be working well, and there was a broadly similar view between the Bank and the Treasury about our attitude to interest rate decisions given the data which had emerged. Some of the press comment on the publication of the minutes had been rather, to use the technical word, excitable. But from others we had seen evidence that the publication of the minutes had led to a more informed view about how we judged developments in the economy, and led them to a more stable and predictable view of how our views were likely to evolve.

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Mr Plenderleith, in introducing the discussion on monetary policy, said that the Inflation Report had indicated 3 areas which needed careful monitoring. The first, growth in earnings, had been covered. The second was the monetary data and in considering this he would look separately at narrow and broad money. It was difficult to see what the former was telling us. The growth in M0, at 6.2%, was above the monitoring range of 0% to 4%. M0, however, was not the most helpful way to monitor narrow money, containing as it did bankers balances with ourselves, which could be volatile for no particularly significant reason. It was better to look at the figures for notes and coin in circulation. These had been growing at around ½% a month until April when there had been a larger increase. The rate of growth was uncomfortably fast, but there were reasons which could explain it. One was that notes and coins in circulation are related to the level of retail sales. Moreover, holdings of notes and coins could be higher because interest rates were now lower. But we would in due course reach a point where we would expect to see the growth rate in notes and coin moderate. In this connection, it was interesting to see that since mid-April, the faster growth rate in Bank of England notes and coin had levelled out. At this stage, however, only limited comfort could be taken from this deceleration and we needed to continue to monitor the position closely.

Moving on to broad money, there had been quite strong growth in February and March but more subdued growth in April. The monthly pattern was distorted by Easter and also by the effect of the timing of the funding of the Public Sector Borrowing Requirement - which was rear-end loaded last year. In addition, the month-to-month pattern of M4 growth was affected by portfolio adjustments in the wake of the disturbance to the bond markets. In the last 3 months as a whole there had been an average ½% growth per month in M4 - the same as for the last 6 months of last year. In April the 3 month, 6 month and 12 month figures all showed an annulised rate of 5.7%. This represented steady growth in the middle of the monitoring ranges. The lending figures remained subdued but mortgage

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lending continued at a reasonable level, though the April figures were somewhat more subdued on a seasonally adjusted basis. The April figures also showed the first indications of a possible pick-up in consumer lending, although it was not possible to tell whether this was as a result of the tax increases or consumer confidence. It was possible, therefore, to say that broad money was on course, though narrow money might be a cause of concern if its growth did not moderate.

The third area that the Inflation Report had indicated needed watching was inflationary expectations. The Bank had examined the recent rise in bond yields very carefully and it seemed likely that there were five factors at work:-

1 Some rise in yields in correction to the strong rally last year.

2 Technical factors pushing up yields in some areas, eg as building societies hedged their lending for fixed rate mortgages.

3 Some rise in real rates, as evidenced by the rise in index-linked gilt yields.

4 Some deterioration in inflation expectations.

5 An increase in the uncertainty premium because of the high level of volatility.

Thus, though a deterioration in inflationary expectations was part of the picture, and as such a significant concern, it was not the only factor, and it was important to understand all the factors. This was germane both to considering the monetary stance as a whole, but, more particularly, to planning of the Bank's approach to gilt-edged funding. There the Bank was faced with two choices: to defer funding, or to find a variety of ways to avoid locking into high long-dated yields. To defer funding could be misinterpreted as an act of weakness and could lead to problems later in the year; and we did not really have

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such an option as HMT had stated in their published remit to us that our fundraising should be spread throughout the year.

Mr Plenderleith went on to say that the Bank had therefore sought to create a variety of new instruments and these had been used for the last three auctions. They were:-

1 A floating rate gilt in March - which had been well received.

2 In April, a standard 5 year gilt stock but added as a further tranche to an existing issue in a way that ensured it was immediately fungible with existing supply, which helped its liquidity attraction. The technical arrangements for this procedure had been worked out in conjunction with the Registrar's Department in Gloucester.

3 At the end of May, a 3 year convertible stock with 4 options to convert in the future into an eighteen year stock. This essentially involved selling a volatility-related option and getting value for it.

Mr Plenderleith added that the Bank's tactics were in marked contrast to those displayed the previous day by the Deutsche Bundesbank. They had cancelled their bund auction, which had resulted in a sharp fall in their market. It had affected other European markets as well. If they had cancelled their auction an hour earlier it would have been disastrous for the Bank as we were undertaking our own auction at the time. Mr Plenderleith said he regarded the action of the Bundesbank as poor debt management and clumsy tactics in the present volatile market conditions.

Drawing all the data together, Mr Plenderleith said that the picture that emerged from the data was on the whole coherent and consistent. Recovery was proceeding on course and inflation was subdued. It was the reaction of the markets that was unstable. There was a general sense that an easing in the

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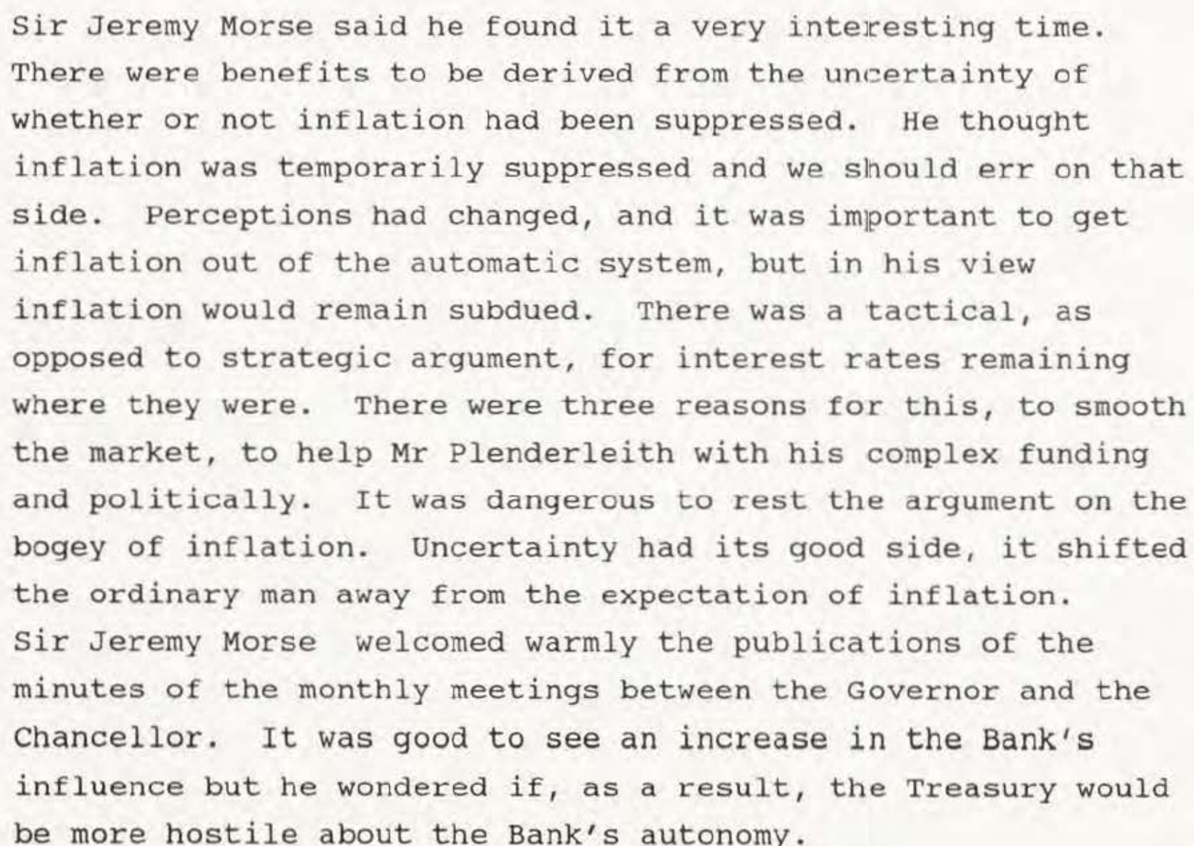
monetary stance was not called for and to do so would create an adverse reaction. There appeared to be a feeling that matters were on course.

In opening the ensuing discussion, Sir Chips Keswick said that he would like to hear a customer say that he had read the Bank's economic report and dropped the hurdle rate from 15% to 10%. He suggested that the Bank's Agents be asked to approach their local contacts on this point. Reiterating the Governor's comment that this had been done, Mr King said 200 firms had been approached and there was some evidence that hurdle rates of return had been reduced. We had learnt a little from the exercise but not a great deal. It was questionable whether or not their expectations should be influenced by what we write. Whereas we might be able to convince them of our analysis of the economic situation, we could not convince them of what the policy would be in 5 years time - which was the horizon for investment decisions. We cannot pretend to determine, only to influence.



Sir Jeremy Morse said he found it a very interesting time. There were benefits to be derived from the uncertainty of whether or not inflation had been suppressed. He thought inflation was temporarily suppressed and we should err on that side. Perceptions had changed, and it was important to get inflation out of the automatic system, but in his view inflation would remain subdued. There was a tactical, as opposed to strategic argument, for interest rates remaining where they were. There were three reasons for this, to smooth the market, to help Mr Plenderleith with his complex funding and politically. It was dangerous to rest the argument on the bogey of inflation. Uncertainty had its good side, it shifted the ordinary man away from the expectation of inflation. Sir Jeremy Morse welcomed warmly the publications of the minutes of the monthly meetings between the Governor and the Chancellor. It was good to see an increase in the Bank's influence but he wondered if, as a result, the Treasury would be more hostile about the Bank's autonomy.

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The Governor responded by saying there was no sensitivity on the part of the Chancellor of the Exchequer, he was robust about autonomy. It had been the media who had been attempting to play up differences. But it was a situation to which the Bank must be sensitive. The Governor continued by saying that in his evidence the previous day to the Treasury Select Committee he had emphasised that the Bank had agreed to the reduction in interest rates in February. It was very important we did not overstep the mark and embarrass the Government. At the moment they were not looking to rein back the position we had reached. Any aggressive push should come from them, not from us.

Returning to the question of inflation, Sir Christopher Hogg thought we were some months off the crunch point. We had been entering the danger zone for some time. The effect was that things were getting better; the slack in capacity was being taken up. Sir David Lees said that he found that an interesting observation. He went on to say that in a recent discussion of monetary policy with a group of 20 businessmen, he had found a unanimous view that any further easing of policy would not be a good idea. It was important to be consistent. The economy was getting into the position where the next move should be one of tightening, and not easing, although he hoped this was still some way off.

Answering the Governor's question concerning the expectations of the CBI, Sir David Lees said that the pressure for easing had receded. There were still concerns about the effect of the tax increases although these were diminishing. People felt business was improving. There was no clamour for a further easing of monetary policy. The Governor commented that at some point we would need to face this difficulty. We would need to persuade people that a tightening of policy was necessary to sustain growth. It was what the United States had been doing - raising rates to sustain recovery. Sir David Lees added that he was pleased to see that the Prime Minster, in his foreword to the White Paper on competitiveness , had made the point that

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it was necessary to have low inflation to encourage competitiveness.

Sir David Cooksey said that there was a desire across a range of small firms that the situation be kept stable. Speaking of these firms, Sir David Cooksey said that banks, who in the past had been loathe to offer term loans were now forcing such loans on them which was having the effect of forcing up interest rates. The Governor said the position was difficult. Both sides had agreed there should be more facilities. One went through these swings but he found it hard to believe loans were being forced on companies. If that was the case they should go elsewhere. Mr Quinn commented that he had just completed a round of prudential discussions with major banks. The demand for credit was hard to detect. The banks were claiming that for the first time they were beginning to price credits for the very long term. It was, Sir Jeremy Morse commented, a feature of this stage of the cycle.

Under the weekly executive report, Mr Quinn reminded Members of Court that following last year's Returned Note Incident, the Audit Committee and Court had asked for consideration to be given to 100% sorting of paid in notes as an alternative to the continuation of the current arrangements where only some 40% of returned notes are sorted. A Working Party was set up and they had carried out extensive research and detailed consideration of the various options. In doing so they were governed by two principles. The first, to improve the integrity of the notes in circulation. The second related to the commercial case - to see whether 100% sorting yielded net financial benefits in terms of recoveries for counterfeits and notes fit for subsequent resale to the banks.

The question that arose was whether or not one needed to sort 100% of used notes to achieve both objectives. Coopers and Lybrand, who had recently carried out a value for money audit of the Printing Works, thought not. But it was not a question that needed to be decided immediately. In the meantime, four obsolete sorting machines had been replaced with machines that

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should provide a significantly higher throughput and, therefore, increase the proportion of notes sorted from some 40% to over 50%. We should then know whether or not we needed to go for 100% sorting, taking account of both security and financial considerations. The steps that had been taken did not close off any of our broader options - particularly those relating to the Branches.

In response to a question from Ms Masters, who thought it odd to increase the capacity of note sorting, Mr Quinn said that Coopers and Lybrand had recommended that the level of note sorting could be much lower than at the moment for sampling purposes; however we needed to install new machinery in any case to maintain our ability to meet the requirements for our note sorting contracts. Sir David Cooksey commented that he felt it was very unsatisfactory that Coopers and Lybrand's report had not given the Governor any indication of the factors that could be used to identify where progress could be made.

[illegible] Rupert Pennant-Rea
[illegible]stant Secretary
2nd June 1994

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 2 JUNE 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Mrs Frances Anne Heaton
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Ms Sheila Valerie Masters
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq

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 Plenderleith spoke about the foreign exchanges, including the Official Reserves figures for May, and the state of the domestic markets.

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

Rupert Pennant-Rea

G. A. Coughlan
Secretary. 16. June '94

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A MEETING OF DIRECTORS AT THE BANK
WEDNESDAY 8 JUNE 1994

Present
Rupert Lascelles Pennant-Rea Esq, Deputy Governor
Pendarell Hugh Kent, Esq
Mervyn Allister King, Esq
Ian Plenderleith, Esq

Hugh Christopher Emlyn Harris, Esq

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

Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

Rupert Pennant-Rea

G. A. Gaylor
Secretary 16 June 94

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A COURT OF DIRECTORS AT THE BANK

THURSDAY 16 JUNE 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey
Sir Colin Ross Corness
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Ms Sheila Valerie Masters
Ian Plenderleith, Esq
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

Hugh Christopher Emlyn Harris, Esq

The Minutes of the Court of 2 June and those of the Meeting of 8 June, 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.

Sir Martin Jacomb, in his capacity as Chairman of the Trustees, introduced two Reports relating to the Staff Pension Fund.

The first related to a Report from the Chief Investment Manager, outlining his management of the Pension Fund

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Investment Portfolio during the latest period. Sir Martin said that the Trustees had asked the Bank to provide a letter stating that the Bank recognised and accepted the continuing risks associated with the investment strategy of the portfolio of assets continuing to be invested primarily in equities. This with the objective of maximising returns, notwithstanding the maturity of the Fund's liabilities. Such a letter had been received from the Deputy Governor.

Moving on to the second Report, this contained recommendations concerning the increases in pensions and allowances paid from the Staff Pension Fund with effect from 1 July 1994, together with a recommendation that future annual pension increases should be approved by the Governors.

Both recommendations were approved by Court.

The Governor, having declared his potential interest in the Court Pension Scheme, together with those of the Deputy Governor and Messrs Quinn, King, Kent and Plenderleith, invited Sir Colin Corness, the Chairman of the Trustees of the Court Pension Scheme, to introduce certain recommendations from the Trustees. Sir Colin Corness said that, having approved the recommendations in the Report of the Trustees of the Staff Pension Fund, it was now also appropriate for Court to consider the question of increasing the pensions and allowances payable to former Governors and Executive Directors, and to the widows of former Governors and Executive Directors, with effect from 1 July. The Report contained, also, two further recommendations concerning widows' allowances.

Court approved the three recommendations contained in the Report.

In thanking the Chairman of the Trustees of the Staff Pension Fund and the Court Pension Scheme, the Governor asked that the thanks of Court be conveyed to the Chief Investment Manager in acknowledgement of the performance of the Staff Pension Fund,

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which was in the top one per cent of a survey that had been undertaken of the performance of such Funds.

With reference to a Minute of 1 July 1993, the Governor introduced a Resolution appointing Mr Kentfield to act as the Bank's representative, and exercise powers on behalf of the Bank, at meetings of the Board of Financial Law Panel Ltd. Accordingly, to put this into effect, it was RESOLVED that consequent upon the appointment of Mr G E A Kentfield to the Board of Financial Law Panel Ltd and pursuant to Section 375 of the Company's Act 1985, as amended and extended by the Company's Act 1989, and until otherwise resolved by the Court of Directors, Mr G E A Kentfield be appointed under Article 17 of the Articles of Association of Financial Law Panel Ltd, to represent the Bank, and exercise powers on behalf of the Bank, at meetings of Financial Law Panel Ltd and at meetings of the company.

With reference to a Minute of 10 March 1994, the Governor introduced a Resolution concerning changes to the Board of BE Museum Ltd. It was RESOLVED that consequent upon the appointment of Mr D F Hills to the Board of BE Museum Ltd, and pursuant to Section 375 of the Company's Act 1985, as amended and extended by the Company's Act 1989, Mr H C E Harris, or failing him, Mr J R E Footman, or failing him, Mr G A Croughton, or failing him, Mr D F Hills be authorised to act as a representative of the Governor and Company of the Bank of England at any meeting of BE Museum Ltd.

At the Governor's invitation, and with the agreement of Members of Court, Sir Peter Petrie, an Adviser to the Governor on Parliamentary matters, and author of the paper "The Bank's relations with Parliament: recent experience", and Mr Footman, the Head of Information Division, and author of the paper on "Opinion Polls", attended Court for the discussion of these two papers, which came under the general heading of Public Affairs.

In introducing the discussion on the Bank's relations with Parliament, the Deputy Governor said that the briefing meetings

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for MPs were started some two years ago. It was necessarily a slow process, as it was only possible to accommodate 10/12 visitors at a time. Nevertheless, it was an essential process that would bear fruit in the long term. There were important messages to get across to MPs, for example BCCI where MPs' constituents had an interest. The briefings took place in a relaxed atmosphere and considerable time was left for questions. Although these events were time consuming, they were very worthwhile. Sir Peter Petrie added that these briefings were one instrument among many which the Bank could use to help get our message across. We now needed to consider whether we should focus on other groups such as MPs' personal assistants and researchers etc. It would be interesting, therefore, to know what other people did in this field as well.

Sir Christopher Hogg said that these briefings were admirable; but so far as extending them to other groups, he suggested that the House of Lords was a rather lower priority. He suggested that it was important for the Bank to adopt an even-handed approach irrespective of the views of the recipients, and enquired whether MEPs were included in the invitations, whether we did something similar for journalists, and whether there was any advantage in inviting in the City Editors for such briefings. In response, Mr Footman said that we did not target the City Editors or senior journalists in this formal way because they had their own contacts within the Bank. However, we did approach journalists at a lower level. In response to Sir Christopher Hogg's comment about even-handedness, Sir Peter Petrie said that to date the number of Labour MPs who had been to the Bank had increased to some 55 or 60, compared with the figure of 34 quoted in the paper.

Following on Sir Christopher Hogg's comment about briefing young journalists, Mrs Heaton enquired whether, in the context of the Bank's relations with Whitehall, we had considered inviting junior civil servants, not only from HM Treasury but from other Departments too. Sir David Cooksey suggested, as well, that there might be some value in keeping in touch with

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the Librarians at the House of Commons as, from his experience, MPs frequently sought advice from that source.

In response, Mr Footman said that the Bank had frequent contact with the House of Commons Librarian and that many MPs wanting information did make enquiries of the Information Division. Sir Peter Petrie said that in addition to the areas already mentioned, the Bank kept in close contact with the clerks of the TCSC - one in fact was to be seconded to the Bank shortly for a period of two years.

In response to Ms Masters's question about the numbers of MPs that the Bank was targeting, Sir Peter Petrie said that at the present time we had been in contact with about 100 out of the 600 Members of Parliament. He thought that it was appropriate for us to aim at around 300 in the first instance. However, there was the question of providing follow-up or refresher courses which would enable us to update MPs on current issues but these courses took a considerable amount of the Governor's time.

Ms Masters questioned whether it was necessary for the Governor to be involved in all of these briefings. In response, the Deputy Governor said that it made a considerable difference if the Governor was involved. The MPs attached much significance to the Governor's commitment to these briefing sessions.

Looking at the broader issue, Sir David Scholey said that, whilst he would not wish to increase the burden on the Bank, he was aware that many people in the City had never been in the Bank. He suggested that with the recent debate on independence, and the publication of the minutes of the Governor's meetings with the Chancellor, it was an important time for the Bank to continue the de-mystifying process. He suggested, therefore, that invitations might be extended to the whole business community. In response, the Deputy Governor said that we were stepping up the numbers of people being invited to lunch in the Bank and this enabled us to make and

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maintain the contact with wider groups of people in the City and elsewhere.

The Governor said that although it required a big effort on the part of the Bank to maintain these briefing sessions for MPs, he felt it was right that we should do it, and enquired whether any of the Non-Executive Directors had any feedback. In response, Sir Christopher Hogg said that, generally speaking, the feedback he had about the Bank, though not necessarily from MPs, was very constructive and re-assuring. Mr Kent said that a City contact of his, had, the previous day, said how good the Bank Briefing was and had suggested that we should spread it freely around the City "like confetti". Mr Quinn added that from his point of view he was convinced that personal contact, though requiring time, was much better than relying on TV and media coverage generally. Finally, Sir Chips Keswick said that he appreciated that this was a very demanding avenue to pursue and that a disproportionate amount of time should not be spent in its pursuit.

Moving on to the second paper, and whether or not the Bank should use opinion polls to establish what people in the City and elsewhere thought about us, Sir Colin Corness said that he was very sceptical about employing opinion pollsters. They usually had several clients paying for the same work, the results were often too general to be valuable and were not necessarily specific to one's own organisation.
Sir David Scholey agreed, and suggested that if the Bank wished to gather this sort of information we might be more systematic in receiving and recording what others were saying about us. Sir David Cooksey said that when Howard Davies was working in the Audit Commission he carried out a poll for HMT about the public's attitudes towards them. The poll targeted a number of outside contacts whom HMT respected and suggested be questioned. When asked for their views on the Treasury, however, the same high opinion was not always reciprocated by these contacts. A survey of this type could be very effective. Sir Roland Smith said that from his experience MORI had been particularly helpful when carrying out an

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internal poll. In response the Governor said that he was interested in the exercise that Howard Davies had carried out and would raise it with him when they met shortly. He thought, as well, that it might be helpful for the Bank to consider an internal poll once the changes being brought about at the present time had settled down.

Sir Roland Smith asked what the Bank had learned from these meetings with MPs and whether anyone outside the Bank, and particularly in Government, had challenged our reasons for doing them. In response, the Governor said that both Whitehall and Government were aware of what we were doing and were perfectly content. They accepted what we were doing and he felt that this said much for them and their attitude towards us.

At the Governor's invitation and with the agreement of Members of Court, Miss Place, the Deputy Governor's Private Secretary, who had been closely involved in the reorganisation following the meeting at Ashridge, attended Court for the discussion of the two papers on Ashridge-related issues.

In introducing the first paper entitled "Ashridge - structure and numbers", the Deputy Governor said that, on structures, we were just past the time of maximum uncertainty. Such a situation was inevitable when changes of the magnitude of those under way took place. There was bound to be a lot of resistance and scepticism. Staff wanted to know the effect that it would have on them individually. Therefore, we had been removing these uncertainties and making people more positive. This was true, also, with the change to the International Divisions. Staff were starting to appreciate that the folding in of work on the international dimension into the Bank's structure was a natural progression. Much of the initial hostility had now been dissipated, as staff were becoming excited at the prospect of becoming plugged in to the Bank's main activities. Doubts were diminishing, as well, over the perceived gap between the two wings and, there was a

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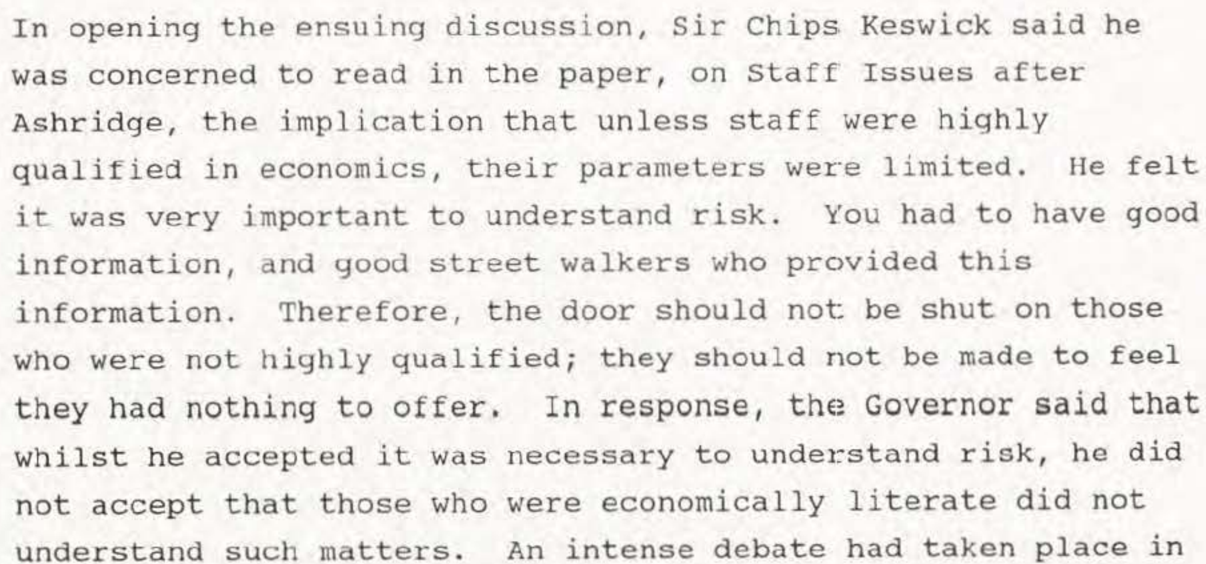
feeling developing that the joining together of the operational and the analytical work will succeed.

The same progress had not been made, however, on staff issues. Some of the changes were alien to the traditional Bank approach and, because of this, they were being magnified. There had been a move away from the traditional approach, but not to an extreme, and anxieties will be shown to have been exaggerated. We had asked Directors, and their Deputies, whom they would need to do the jobs at different levels in the two wings. Those who had not been bid for, had been told that there was not a job for them in the new Bank. There had been no question of compulsory redundancy. We were working closely with those who wanted to find another job outside the Bank, and all those concerned had been offered a favourable severance package. This had helped to soften the blow, but it had been a blow nevertheless, and represented a change in the Bank's approach. It is likely that severance on this scale will be a one-off exercise. If our staffing policies in the future are right, and the Bank works well, it will not be necessary subsequently for people to leave the Bank in this manner. The situation, not unnaturally, had provoked an atmosphere of some fear and unease, but it was necessary to get through the processes as soon as possible. Most staff were keen to see the Bank value management, and not just technical ability. If we can motivate staff, then there will be enthusiasm for what is proposed.

In opening the ensuing discussion, Sir Chips Keswick said he was concerned to read in the paper, on Staff Issues after Ashridge, the implication that unless staff were highly qualified in economics, their parameters were limited. He felt it was very important to understand risk. You had to have good information, and good street walkers who provided this information. Therefore, the door should not be shut on those who were not highly qualified; they should not be made to feel they had nothing to offer. In response, the Governor said that whilst he accepted it was necessary to understand risk, he did not accept that those who were economically literate did not understand such matters. An intense debate had taken place in



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the Bank about the merits, or otherwise, of economic literacy. It was felt that staff must have this ability if they were to hold their own in senior positions in the Bank. It was very necessary in their dealings with those outside the Bank. Those who were deficient in this regard we would help understand and train.

Sir Christopher Hogg drew attention to the question of immediate redundancies. It was, he said, a very painful one; more so at senior level. But it was not an issue to fudge. If there was not a place for someone, then they should go. His second point, in the context of longer term policy, was that he was confused over the difference between someone whose career had peaked, and someone no longer making a contribution. Many people reached a peak early, but that did not mean, necessarily, they had no further contribution to make. He had a feeling this point had not been put across sufficiently clearly. The Deputy Governor said that an article had appeared in the Bank's fortnightly staff paper covering this point, with the result that there was now a better understanding. But what Sir Christopher Hogg had said was absolutely right; there were a number of people whose careers had peaked, but were making a full contribution through their experience.

Ms Masters said she had a small point to make on terminology. She found the term "second jobber" an insulting term for those joining the Bank from outside who might, as a result, feel they were not part of the Bank. As a second jobber himself, the Deputy Governor said he accepted the point; the term was essentially one of shorthand.

Focusing on those who were leaving, Sir David Cooksey suggested they should be moved out in a more systematic way, with account being taken of the possibilities afforded by secondments. The Deputy Governor agreed that such matters, if at all possible, should be handled in a sympathetic manner.

Having visited one of the Branches recently, Sir David Scholey said that the note on staff issues had come as something of an

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exocet. It was seen as the manifestation of a change of culture that was taking place within the Bank. There would be a long tail of reaction. As Court, in recent years, had had more contact with senior people in the Bank, he suggested they should be made aware of the names of people who had not succeeded. He went on to ask where the pockets and levels of resistance were. Were any of them identifiable?

In reply, the Deputy Governor said yes, amongst ages and generations. He had met some recent graduates the previous evening, who, not having the attachment to the past, were all enthusiastic about the changes. Those who had been in the Bank for some time, naturally, felt cynical. There had been previous reclassifications which they felt had not worked. So far as areas were concerned, it was hard to be precise. There had been, as already mentioned, initial unease in the International Divisions, but this was now diminishing.

For his part, Mr King said that although there was unease among economists, there was no bad feeling. On the international level people felt they could identify now with how the operation was being conducted, as opposed to undertaking tasks which appeared largely irrelevant. The benefit of the exercise lay with the fact that we had asked what we wanted people to do and who we wanted for these tasks. For some there was not a job but, in most cases, they had been relieved and, indeed, grateful to have been told, despite it coming as a shock.

Mr Plenderleith said he agreed with the sense of general reaction, but he had some reservations. The integration of international work was welcomed, as was the prospect of greater line involvement and back up, although there was some scepticism as to how this might work. Also, it was good to involve younger people earlier in their careers. His reservations centred, first, on whether the proposals could be made to work - this would be a challenge. Second, if there was a greater tendency for people to move out of the Bank before their 40 year career was complete, it would help those who moved up to take their places, but not if they were

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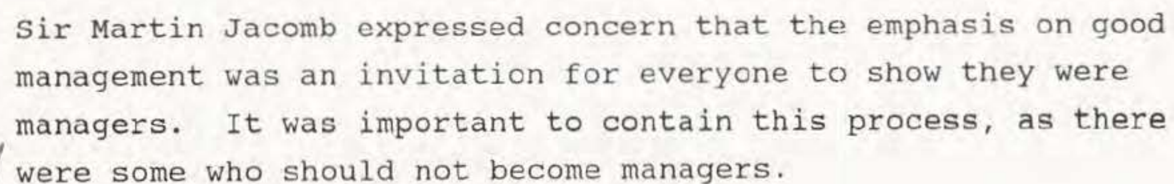
ineffective. It would become a source for concern for people in their forties that they could become redundant at a time when their personal overheads were at a maximum. It was important that the Bank was not seen as a hirer and firer, but continued to be seen as a responsible employer.

Sir David Scholey commented that attention should be given to the development of management skills; not necessarily one of the strengths of those in the Bank. Mr Harris felt this aspect was one to be emphasised; it was important that we assessed staff on these abilities. Moving on to the question of pay, he said we lost a lot of analysts and officials into the City as a result of the higher salaries that were on offer. In view of the greater career uncertainties that staff would feel they faced, they would be looking to be paid more by way of compensation. There was likely to be a need to increase salaries for those in their late twenties.

Mr Quinn thought the turmoil in the minds of staff stemmed largely from the fact they were being asked to take on quite a number of significant changes at the same time. Also, the downside of the changes, the release of 20 staff, was seen to be happening, but none of the upside. He was surprised, also, by a number of good middle managers who had expressed concerns that they saw no future for themselves in the organisation, as they had reached the limits of their potential. However, he saw the atmosphere improving after 4 July, when the new structure actually became operational. He drew a parallel with the Reserve Bank of New Zealand, which had gone through a similar restructuring quite recently, losing half of its staff in the process. Subsequently, the exercise had been regarded as successful.



Sir Martin Jacomb expressed concern that the emphasis on good management was an invitation for everyone to show they were managers. It was important to contain this process, as there were some who should not become managers.

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Returning to the question of delegation, the Deputy Governor said it was easy to talk in general terms, what mattered was specific. Senior management would be looking at this question over the coming months and at the end of that period he would welcome enquiries from Court on what progress had been made. There was a lot of appetite for further delegation, but we were not yet in a position to go into the detail. He went on to say that management started at a particular level. Many did not have such a responsibility, although those who were more senior did. We had not encouraged in the past the worth that the management side of a job should be given.

Sir Roland Smith saw risks in delegating. He viewed managers as akin to university tutors, with a role in developing subordinates. Mr Plenderleith said the text in the paper that had been issued had been discussed by the Executive Directors. The extent of delegation varied according to the work involved. In the Regulation, Supervision and Surveillance area, there was certainly scope; but in the Markets area, delegation was more difficult. Work could be delegated, but responsibility could not. The team must produce the right result. You could involve management and staff much more in the process, seeking their advice and views on what should be done.

Sir Christopher Hogg said he had two particular thoughts. The first was that the biggest long term stimulus to a change in culture was education - which could be achieved in many ways. The second related to the Bank's public relations and third core purpose. If the educational process was to be taken seriously, why not involve people from outside the Bank? Set up an arena where people from the Bank and outsiders, such as those from the financial markets, could mix. Such an arrangement could exert influence in the future in the financial sector.

Sir Colin Corness expressed unease with the comment in the paper that the overriding reason for remaining on the staff would be that an individual had more to contribute. There were many who did a good job but who could not contribute more. The

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Bank needed good solid regular performers. He felt the paper over-emphasised the need to advance and improve; there were some who did not want to move. He appreciated the paper was directed at officials and potential officials, and that the same criteria would not apply to officers. The Governor agreed it was important to get this point across to officers. Sir Colin Corness added that it would be necessary to look closely at staff benefits. Whilst cheap mortgages and pension rights were attractive, and important to long servers, the same was not true for those serving a shorter time. It was important they did not become hooked in by their mortgages.

Mr Plenderleith saw as one of the fundamental problems people staying in the same job for too long, which stemmed from the fact they reached senior positions in their careers too soon. People performed well for 15 years but in so doing blocked off younger staff. It was necessary that the elders moved out of the Bank so that we did not lose the youngsters. But we must achieve a balance.

The Governor concluded by thanking Members of Court for a very useful discussion. He added that the changes that would be necessary to the Bank's Purposes, Responsibilities and Philosophy statement would be considered later in the year.

At the Governor's invitation, Mr Quinn introduced two Resolutions, the first concerning an extension of the delegation to prosecute on behalf of the Bank under the Banking Acts 1979 and 1987. Accordingly, it was RESOLVED that further to the Resolution of Court passed on 13 July 1989 (whereby Court authorised the Governors and certain categories of official to exercise severally on behalf of the Bank all of the powers, duties and functions of the Bank under the Banking Acts 1979 and 1987), and with immediate effect, each of 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) be severally authorised to prosecute on behalf of the Bank any

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proceedings for criminal offences, where such offences arise under any statute other than the Banking Acts 1979 and 1987 (as amended) or under the common law, with power to delegate at his sole discretion and on such terms as he thinks fit such authority.

The authority hereby conferred shall with immediate effect supersede and replace any and all previous authorisations in relation to the same matters, without prejudice to anything done pursuant to any such previous authorisation prior to the passing of the resolution.

The second Resolution corrected an inconsistency in the current Resolutions delegating authority under the Banking Act, the Banking Co-ordination Regulations and the Financial Services Act. It brought into line the wording of the delegation of authority under the Financial Services Act with that of the Banking Act. Accordingly it was RESOLVED that with immediate effect each of the persons for the time being holding the positions of Governor (as defined in the Regulations) or Head of Wholesale Markets Supervision Division (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.

The Governor went on to mention that in these Resolutions reference was made specifically to the Executive Director responsible for Monetary Policy and Operations and the

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Supervision of the Wholesale Markets as well as reference to a previous Resolution naming the Head and Deputy Head of Banking Supervision. Provision was made in these resolutions that they apply to the successor positions to such positions.

Therefore, from 4 July, and as a result of the restructuring, the positions previously mentioned would be taken over, in so far as they applied to these Acts and Regulations, by the Executive Director responsible for Regulation, Supervision and Surveillance.

In this context Court, on 11 December 1986, had Resolved that the Chief of the Banking Department, for the time being, be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of a number of companies connected with cheque and credit clearing. Again, as a result of the changes taking place on 4 July, this authority would in future be vested in the Chief Cashier.

Under the Weekly Executive Report:-

(i) The Governor said that a number of gifts had been received from overseas Central Banks to mark the Bank's Tercentenary and these were on display in Mr Crockett's former room. Sir Martin Jacomb said that, in the context of the Tercentenary, he thought that the Symposium at the Barbican had been an outstanding occasion and appreciated greatly by those attending. The Governor thanked him for his comments and in agreeing the occasion had been successful, said great credit was to due to the Secretary and his team.

(ii) In updating Court on the progress of the pay negotiations with the main bargaining unit, Mr Harris said they had reached a mid-stage. The bargaining unit, which covered the pay of the Officers and other allied groups, was the last in the cycle of Bank settlements for 1994 and was due to be effective from 1 July. BIFU had submitted a claim for a 5% increase in salary

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(minimum £500), together with improvements to the arrangements for personal loans. The first meeting of the negotiating council had taken place at which a 2% across the board offer had been made, but no improvements to the terms for personal loans. The offer had been rejected. Mr Harris said, in accordance with the guidelines agreed by Court, he would settle at 2½% and no more.

(iii) With reference to a Minute of 14 April, Mr Kent updated Court on the flotation of 3i. He said preparations for the flotation of some 40% of 3i were proceeding satisfactorily, with the offer due to open on 22 June and close on 6 July. Final size and pricing discussions were underway and a decision was expected soon. Current indications suggested that the Bank will contribute pro rata to the flotation, thereby reducing its stake to just below 10%. A flotation at the level indicated will produce gross proceeds for the Bank of some £80mn in mid-July.

Rupert Pennant-Rea

G. A. Croughton.
Secretary. 7 July 1994

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A MEETING OF DIRECTORS AT THE BANK

THURSDAY 30 JUNE 1994

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Ian Plenderleith, Esq
Brian Quinn, 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 Meeting, having been circulated, were noted.

Mr Quinn spoke about the weekly figures and Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets.

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

Rupert Pennant-Rea

G. A. Croughton.
Secretary 7 July 1994.

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