[redacted]

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 4 JANUARY 1995

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Mervyn Allister King, Esq
Ms Sheila Valerie Masters
Ian Plenderleith, Esq
Brian Quinn, Esq
Professor Sir Roland Smith

The Minutes of the Court of 21 December and the Meeting of 29 December, having been circulated, were approved.

Mr Plenderleith spoke about the foreign exchanges, including the Official Reserves figures for December, and the state of the domestic markets. In the United States, there was an expectation that the Fed would raise interest rates again in response to strong domestic indicators; and in Germany, too, there was now a developing belief that rates might rise soon, to the embarrassment of the French. In the UK, bond yields still implied quite significant rises in rates over the next year or two, but the market could improve as gilt sales abated. Mrs Heaton noted that acceptance of high real interest rates seemed quite widespread - more so than in earlier business cycles. Mr King felt that real interest rates were returning to more normal levels for a healthy economy.

Under the executive report, the Governor advised Members of the support arrangements being put in place for Mexico. Problems had been feared ahead of the Mexican elections in the summer, but the high value of the peso had made the international community reluctant to provide support at the time. The new Government had now had to face that problem by allowing the peso to float; this had not been cleanly handled, and had prompted some financial market turbulence. When this showed signs of spreading to other Latin American countries, the international community, led by the US, had shown itself ready to support the Government's economic programme. The Americans had increased their swap line, to $9 bn, and this was the <u>first</u> line of defence. A BIS facility - consisting of two tranches each of $2 1/2 bn - had also been agreed. One tranche was to bridge to an IMF standby, should one be applied for and agreed; in practice only half was likely to be used. The other half was collateralised against cash - in effect window-dressing.

[redacted]

The Governor added that we had been monitoring market and bank exposure to Mexico, but were aware of no serious problem.

Rupert Pennant-Rea

[illegible]

[illegible]

18/1/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 11 JANUARY 1995

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Mervyn Allister King, Esq
Sir Christopher Jeremy Morse, KCMG
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.

Mr Plenderleith spoke about the apparent reasons for the current instability in the foreign exchanges; there followed a brief discussion, mainly on the financial situation in Mexico. The Governor noted that the BIS support facility to Mexico had now been varied: the tranche bridging the IMF standby had been reduced to \$1.25 bn, while the cash-collateralised tranche had been increased to \$3.75 bn. The Governor would, next week, update Court on these developments.

Under the Executive Report, the Governor advised that the Bank would be paying its capital contribution to the EMI on 17 January. The amount would be some ECU 93 mn, 15.3% of the total contributions due. The total capital had been calculated to generate sufficient income to meet budgeted expenditure of the EMI over its assumed three-year life.

Rupert Pennant-Rea

The within Secretary 18/1/95

[redacted]

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 18 JANUARY 1995

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
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

Minutes

The Governor drew Members' attention to two items covered in the Minutes before Court for approval. These were:

(1) Mexico: The bridging portion of the $5 bn facility was now only $1 1/4 bn; the remainder would be cash-collateralised. [redacted] The situation remained fluid. The Americans had increased their support for Mexico, and there were suggestions that the BIS Group should put in more. The Governor was reluctant to see the BIS bridge to any facility that depended on Mexico's performance, or to provide

excessive collateralised lending, given that its underlying purpose was window-dressing.

(2) The EMI: our capital contribution of ECU93 mn had now been paid over.

The Minutes of the Court of 4 January and of the Meeting of 11 January, having been circulated, were approved.

Monthly Economic and Market Report, including market charts (Mr Bowen in attendance)

Mr King said that inflation appeared to have passed a turning point, and all measures of retail price inflation were now moving upwards. Some of this was temporary, and associated with the changed timing of indirect tax increases. But RPIY inflation, which excluded these effects, was rising too. This could have an impact on wage and price-setting, and thus influence future inflation.

Output growth, meanwhile, seemed to be slowing down. Domestic demand was already weak, and external trade was responsible for the entire rise in output in the second half of last year. Now manufacturing production was slowing. Even so, export growth was still rapid and the labour market was tighter. The question was whether the apparent slowdown in output was real, and whether it would forestall a rise in inflation.

Mr Plenderleith, commenting on the market charts, drew attention to increased expectation of rate rises in Germany; UK rates were expected to rise too, but by less than before December's rate rise. The exchange markets had been turbulent since the turn of the year, but sterling had been steady.

On the prospects for output, Sir David Lees said that there was no sense of weakening in manufacturing: capacity constraints were increasingly talked about and the sector was affected by the upturn in Europe. Other Members commented on the renewed weakness of the housing market, reflected in lending, mortgage commitments, house prices, house-building and land prices.

The retail sector was seen as mixed, with intense price competition. Costs were rising, but with the impact moderated by intense competition in all markets, and (thus far) by falling unit wage costs. Margins were not rising with volumes.

But on the prosect for wages, Members felt that some upward pressure was likely. Sir David Lees thought that those employers who settled early would do best: he expected a 3-4% range this year. Sir Colin Southgate agreed that pressure was increasing; redundancies in the retail sector might work against that, but in general it made sense to settle early.

The Governor said that in the circumstances it was hard to see how our two rate rises last year could be criticised; the question rather ought to be whether we had done enough. But he was aware that the December's rise had attracted more criticism than September's; people had talked of overkill. Sir David Scholey thought these criticisms came from people who were out of sympathy with the objectives of policy and hankered after the "normal" inflationary drift. Sir Jeremy Morse thought timing thus far had been spot on; pre-emptive rises would lower rates across the cycle. But political pressures could change as the election approached.

Handling of the Inflation Report (Mr Bowen in attendance)

With reference to a Minute of 16 November 1994, the Secretary introduced his paper, outlining the changes already decided on to make the message clearer and the four options for briefing the press: off-the-record as hitherto; not at all, on the grounds that the Report could speak for itself; through a high profile live press conference; or through a technical briefing which would be placed on-the-record. Most Members favoured the last, though Sir Christopher Hogg commented that a higher profile televised briefing might in time be helpful to the Bank as its role developed. The Governor said that he was sensitive about raising his profile further; we could always move towards that option later, but if we started with it we would find it hard to draw back. Sir Chips Keswick said that a briefing was plainly important to the press. Sir Colin Southgate felt that the Report was clear enough to speak for itself. The Deputy Governor said he shared this view and felt that it would be reasonable to leave briefing to the Press Office to handle. Mrs Heaton also favoured this approach.

The Governor thanked Members for their comments and said that he would reflect further before reaching a view. He would need to inform the Chairman of the TCSC of the decision once it was reached.

Real Time Gross Settlement (RTGS) in the UK Payment Systems (Mr Kentfield and Ms Lowther in attendance)

Ms Lowther said that the project was on course to go live next year. It had been a co-operative project with the settlement banks, and was extremely significant - immediately as a means of reducing the risks in the payments system, and later as a means of enabling DVP in securities settlement and of avoiding risk in foreign exchange transactions.

Sir Christopher Hogg asked whether those who were to participate in RTGS were regarded as too big to fail. The Governor said that it was unlikely, though not inconceivable, that we could allow such institutions to fail. We were assumed to stand behind the settlement banks in the clearing; but we had never accepted that we would underwrite anyone. In any event we could not carry such risks on our balance sheet. Ms Lowther said that at present the Bank faced extreme options - either to settle all of the banks' obligations in the clearing at the end of the day, which could involve accepting huge exposures to one or more banks, or to refuse to settle the clearing at all. With RTGS the choice might still be faced, but only in relation to individual transactions. Through RTGS the Bank would control and reduce the implied risk. That was why the Bank had been ready to bear some of the initial cost of the project: the banks had less interest in our assuming less risk.

Sir Chips Keswick said that there was some unease on the part of the CHAPS banks about our views on forex settlement; they were happy just to net positions. Ms Lowther said that netting did not eliminate settlement risk. RTGS offered the chance to ensure that the $ and £ legs of a deal settled at the same time.

[redacted]

[redacted]

[redacted]

Counterfeit Notes (Messrs Kentfield and Sullivan in attendance)

In introducing this paper, which described the extent of counterfeiting and the Bank's recent campaign to increase public awareness, Mr Kentfield said that the problem tended to be exaggerated by the press - but it was nevertheless a real one. It was disappointing, given that the present series of notes had been designed to reduce the risk of counterfeiting (even at the expense of aesthetics), that counterfeiting had increased so rapidly. But Series E was essentially a product of the mid-1980s, and copier technology in particular had moved very fast since then. Sir Christopher Hogg, who had visited Debden the previous day, said that this was plainly a very serious subject. He had been struck by the influence that security considerations had on the design of banknotes; and he felt that it was possible for the public to tell counterfeits from real notes - it was a question of getting people to know the difference. He wondered whether the Bank had put enough effort into this. Ms Masters, who had also visited Debden, noted that the Bank could never be more than one step ahead of the counterfeiters. She wondered whether it was possible to press the clearers to do more.

The Governor asked where we now stood on 100% note sorting. The Deputy Governor said that there had been a discussion at ExCo last year, at which it was felt that the case for 100% sorting had not yet been made. We had resolved to review the question again in the middle of 1995, when we had had more experience. [redacted] Sir David Lees asked whether the problem was worse here than in other countries; Mr Kentfield said that it was very much worse in the United States and slightly worse in the Netherlands and Germany. Otherwise, our experience was not untypical.

The Risks from CREST (Mr Saville in attendance)

Following a recommendation of the Audit Committee that Court be regularly updated on the risks in the CREST project, Mr Saville presented the first of a series of quarterly reports to Court. He said that the two main risks at present were the reduction in the number of potential network providers to one, given that SWIFT was having difficulty in meeting its commitment to the CREST programme; and the question of whether customers would be ready when CREST was ready. Sir Chips Keswick said that there was a widespread perception in the City that the CREST project was at risk from another round of backbiting involving the Stock Exchange. He also encouraged Mr Saville not to dismiss SWIFT lightly; it was a major payment organisation. Sir David Scholey said that the City was generally confident that the CREST project would be delivered, mainly because the Bank was involved. But there was anxiety about the stance being taken by the Stock Exchange. People assumed that the Bank would in some way deal with the Stock Exchange problem; but nobody quite knew how. The Governor confirmed that there was still tension between the Bank and the Stock Exchange; the latter had aspirations to provide a lot of post-trade services, right up to the point of settlement, and wanted special facilities for trades confirmed in the Stock Exchange to be routed to CREST. We had refused to accommodate the Exchange's demands, as we did not wish to introduce any delay or complication into the CREST project. The Stock Exchange seemed now to be reconciled to that, and there was another, more realistic, approach which might be pursued, involving trade confirmation within CREST.

Rule Amendments - Staff Pension Fund/Compensation Scheme and Court Pension Scheme

The Governor, having declared his potential interest in the Court Pension Scheme, together with those of the Deputy Governor and Messrs King, Kent and Plenderleith, invited the Deputy Governor to introduce a paper which outlined a number of technical amendments to the rules of the Staff Pension Fund/Compensation Scheme and Court Pension Scheme. Having already confirmed that the Trustees of both funds were content with the proposed amendments which formalised what was already current practice, Court gave its approval to the amendments proposed.

1994/5 Banking Act Report: Initial Outline

Following a request made at Court last May, an outline of this year's Banking Act Report had been circulated to Members to give them an early opportunity to consider the kinds of issues it should cover and other points to be made. As Mr Quinn was not present at Court and time was pressing, the Governor invited Members to write to Mr Quinn with any comments they would like to make on the outline of the Report.

Executive Report

1 Mr Plenderleith updated Court on the announcement of two committees to take forward work on the Gilt Repo Market proposals.

2 The Deputy Governor advised Members that there would shortly be an opportunity for Court to review the outcome of Ashridge.

3 Mr Kent said that the Bank had been closely involved in discussions involving the London Clearing House, where it was proposed that the shareholding interest should be transferred from the banks to the members of the exchanges. A solution was close, and Court would be advised of the outcome.

4 Mr Kent said that he would be giving a speech on 24 January to the Parliamentary Group for Engineering Development, and simultaneously the Report which we had compiled on Small Firms would be published. This followed on from the Seminar held in the Bank on 10 January, which had revealed considerable improvements in the relationship between banks and their small firm customers.

5 Mr Kent said that as part of the Bank's contribution to small firms finance, we had sponsored a directory of banks for the Prince's Youth Business Trust. The cost was £5,000 and the product, which had been developed with co-operation from the banks, was a very good one.

6 Mr Kent said that he had now told De la Rue that the Bank was minded to re-open the paper supply contract with Portals. We would be looking, inter alia, for further reductions in paper costs, and for the right to negotiate direct with other suppliers.

[redacted]

8 The Governor said that he very much hoped that those Directors who wished to undertake visits to the Bank's offices and branches would feel free to do so, and to approach the Secretary who will make the necessary arrangements. Unlike in previous years, there would be no programme covering all the Directors, and certainly no sense of compulsion to undertake such visits; but he knew that they were very much welcomed by offices and that Directors found them useful.

Report of the Remuneration Committee

In accordance with Section 10 of the Charter, the Deputy Governor and Messrs King, Kent and Plenderleith withdrew.

Sir David Scholey, in his capacity as Chairman of the Remuneration Committee, said that there were four recommendations of the Committee before Court for consideration and approval. They were as follows:-

1 Having reviewed the salary bands established by the previous Committee for Executive Directors and the Deputy Governor, it was recommended that they be discontinued.

2 Having reviewed with the Governor the salaries of the Deputy Governor, the Executive Directors and the Advisers to the Governors, it was recommended that there be no change in pensionable remuneration for the year beginning 1 January 1995, but that the per diem allowances paid to Mr Watt and Mr Peddie be increased from £550 to £575 with effect from 1 January 1995.

3 It was recommended, in the light of the developing tendency in the Bank's pay structure to incorporate discretionary non-pensionable bonuses as part of compensation, that the Deputy Governor and the four Executive Directors should each receive with their February salaries a non-pensionable bonus payment of

£5,000; this would be in recognition of their having each successfully taken on significant additional burdens in the course of the year to December 1994, including the structural and management changes following on from the Ashridge review.

4 It was recommended that the question whether or not such bonuses might be payable in future years to any one or more individual Directors should depend on factors to be considered on a year-by-year basis.

The recommendations were approved.

Assistant Secretary
25 January 1995

[redacted]

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 25 JANUARY 1995

Present

Edward Alan John George, Esq, Governor
Brian Quinn, Esq
Sir David James Scott Cooksey
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
Professor Sir Roland Smith
Sir Colin Grieve Southgate

The Minutes of the Court of 18 January, having been circulated, were approved.

Mr Plenderleith spoke about the foreign exchanges, where there was some nervousness ahead of the impending FOMC meeting. The strength of the US recovery pointed to a possible increase in interest rates. However, the dilemma for the US authorities was in balancing the domestic need to check inflationary pressures against the difficulties a rate rise could cause for those countries which sought to maintain their currencies in a close or fixed relationship with the dollar. Sterling had been largely insulated from the current market uncertainties because of the perception that the fiscal position was under control and that the initial steps to tighten monetary policy had been taken early enough. The latest strong UK economic data were stimulating increasing market expectation that a further rise in UK interest rates might be in prospect, without, as yet, any hardening of views as to timing.

There were no items for discussion under the executive report but the Governor took the opportunity to advise Court of the death of Lord Nelson of Stafford, a Non-Executive Director from 1961 to 1987.

Assistant Secretary
1 February 1995

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 1 FEBRUARY 1995

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Mrs Frances Anne Heaton
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Mervyn Allister King, Esq
Ian Plenderleith, Esq
Brian Quinn, Esq
Professor Sir Roland Smith

The Minutes of the Court of 25 January, having been circulated, were approved.

Mr Plenderleith spoke about the foreign exchange markets, which were waiting on the outcome of the FOMC meeting later in the day, and the Governor/Chancellor and Bundesbank Council meetings the next day. There was general expectation that the FOMC would raise rates by at least 1/2%; a further tightening of UK rates was also anticipated within the next three months but there was, as yet, no predominant view on when this would occur. The initial reception to the revised support package for Mexico had been positive, but it remained to be seen if this would be sustained.

Under the executive report the Governor:

i) advised Members that the appointments, with effect from 1 March, of Neville Simms and David Simon as Non-Executive Directors in place of Sir Martin Jacomb and Sir Colin Corness had been agreed by the Prime Minister and the Chancellor. He expected that the formal announcement would be made within the next week or so.

ii) reported that his visit to Paris on the previous two days, accompanied by the Deputy Governor and Messrs Quinn, King and Plenderleith, had gone well. The bilateral discussions at the Banque de France were cordial and useful. He also invited any comments from members on the speech he had given at the Association Francaise des Banques on economic integration in Europe, a theme he would be returning to in another speech later in the month.

iii) noted that the situation with regard to the support package for Mexico was far from satisfactory. The handling of the initiative by the US authorities had been extraordinary, and the non-US elements in the latest package had not been agreed. There were still various important issues to be resolved and he anticipated lively discussions at the forthcoming G7 meetings in Toronto.

Rupert Pennant-Rea

ty Secretary
2.95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 8 FEBRUARY 1995

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

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.

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

The Governor spoke about the EMI Council Meeting in Frankfurt the previous day, and about his subsequent visit to Berlin.

Rupert Pennant-Rea

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Deputy Secretary
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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 15 FEBRUARY 1995

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
Professor Sir Roland Smith
Sir Colin Grieve Southgate

The Minutes of the Court of 1 February and the Meeting of 8 February, having been circulated, were approved.

Inflation Report Discussion and Market Charts (Mr Bowen in attendance)

Before commenting on the Inflation Report, Mr King said that the 'on the record' launch of the Report last Wednesday had been very successful. The press reports had been suitably low key, although one could not be sure that this would always be the case. In answer to a question from Sir Roland Smith, Mr King said that future Inflation Reports had been scheduled to be published one week after the meetings between the Governor and the Chancellor. As the dates of those meetings might be subject to change, this arrangement could not always be guaranteed.

Turning to the content of the Report, Mr King said that the central projection for inflation two years ahead was broadly unchanged from the previous report, reflecting two offsetting effects. The first was news about more rapid growth, together with a tightening labour market and cost pressures from producer prices moving down the production chain. In addition, retail price discounting in December 1994 had not repeated the aggressive pattern seen a year earlier. But an offsetting influence was the two increases in official interest rates, without which the central projection for RPIX inflation would have been nearer to 3%.

Mr King referred to that day's economic data and drew attention to the more rapid increase in inflation over the latest three months. The CSO had announced that they will publish RPIY data from next month, which was a helpful development and one the Bank had been pressing for. However, the CSO would cease to publish the TPI index, which might be presentationally unfortunate as this index was rising particularly rapidly at present. The data on retail sales, showing only a 0.2% rise in the year to January, might be distorted by changed seasonal patterns. The 5% increase in earnings in manufacturing contrasted with the 3% rise in services, illustrating the dual nature of the economy.

Mr Plenderleith noted that markets had responded calmly to the interest rate rise, but that sterling had since declined on political uncertainties. Overseas investors were becoming aware that this Parliament might not last its full term and so were beginning to sell sterling in pre-election hedging strategies. Market indications of interest rate expectations had fallen further after the recent interest rate rise but had backed up in the last few days as a result of the exchange rate tensions. Similarly the differential of UK bond yields over other Government Bonds had recently increased.

Sir Chips Keswick feared that the foreign exchange markets might test the authorities' resolve over the next few months. Sir Roland Smith thought that December retail sales may have held up in volume terms as shops brought forward sales promotion schemes before Christmas. He noted that February is usually a poor month for retailing. Sir Colin Southgate agreed that competitive pressures in retailing had been very intense before Christmas and that it was necessary for that sector to go through some retrenchment to sort out its problems. In answer to a question from Sir David Cooksey, Mr King noted that one should expect to see some cyclical recovery in retailers' margins up to the summer, but that a major uncertainty remained as to how large the recovery would be. Sir Roland Smith was not concerned about the dual economy scenario. In many ways it was healthy that the manufacturing and exporting sectors faced demand while other parts of the economy were more sluggish. Mr King agreed that this reflected a welcome shift of resources but warned that problems could arise if the process was too rapid, as was currently the case in Sweden. Sir Martin Jacomb found the continuing trade gap to be worrying. Mr King said that the answer lay in the need to raise the domestic savings rate, which would have consequential balance of payments effect.

Mr King asked Court if they believed that export prospects remained good. There was general assent, with Sir Martin Jacomb pointing to his own experience of strong performance by engineering companies contrasting with weakness in the construction and property sectors. He felt the Bank's strategy of shifting investment out of housing into manufacturing had been very successful. In answer to the Governor, Sir Colin Corness confirmed that price pressures in construction had eased in line with the sector's weak performance last year.

Mr Quinn noted that sterling's recent fall had occurred despite the fact that exports had not become uncompetitive and wondered if the weaker pound could therefore lead to further increases in input prices. Was sterling's weakness a worry or simply a correction? Mr King noted that partly the weakness reflected cyclical factors and in particular the upturn in overseas economies. However, if sterling's weakness continued, it would add to the dual economy effect and might eventually lead to monetary policy adjustment. Mr Plenderleith noted that so far the pressures on sterling had only lasted a few days and he hoped that no policy adjustment would be needed, particularly as the UK's underlying fiscal position was strengthening.

Ms Masters asked to what extent one should worry about the lack of an upturn in investment. Mr King noted that if the North Sea and housing sectors were excluded, investment in the third quarter was up 5% on a year earlier. He would expect that trend to go further this year as profitability was high, corporate liquidity strong and survey indications showed that investment intentions were buoyant.

The Bank's Budget for 1995/96 (Mr Midgley in attendance)

With reference to a Minute of 19 October 1994, Mr Midgley presented his paper which set out the Bank's current and capital expenditure plans for the years through to 1998/99. He explained that he was changing the presentation of the budget to highlight the distinction between running costs and investment. The 1995/6 budget was within its overall target, partly reflecting economies made in the banking area in previous years. He expected that trend to continue, as not all the benefits of BITS had yet been felt. The Ashridge process had led to a reallocation of staff, including the departure of some senior people and the recruitment of high-powered contractors. Income had benefited from the rental of floor space to the CREST team. Turning to investment, he noted that, leaving aside the Printing Works, most went on the building and security rather than taking forward the Bank's business. This was something he wanted to look at further.

The Deputy Governor referred to the streamlining of the budget process. From next year he planned a sequence which would begin with discussions with Directors to identify growth and contraction areas. This would be followed by a strategy document for Court. He noted that at last October's meeting the Court had discussed why the Bank needed capital and he hoped to bring a paper on this subject to Court in April or May.

Ms Masters noted that the present budget process was very input-based and wondered what progress had been made to switching to an output-based approach. Mr Midgley said that budget centres were being asked for more output measures. Although these were relatively easy to identify for quasi commercial functions such as the Printing Works and banking, it was more difficult in analytical areas where it raised questions such as how to measure the quality of advice. Sir Christopher Hogg welcomed these comments and said that the Court needed to take a view on the value of the Bank's human resources. He hoped that this might be included in next month's discussion of the Ashridge outcome. In answer to Sir Colin Southgate, the Deputy Governor confirmed that the budget was produced on the assumption of no changes in the Branches' operations but that investment spending at the Branches was on hold until the Branches' review was completed. He also confirmed that the Printing Works' refurbishment was now in its final phase. Mr Kent added that the next questions were how to use the freed land and buildings at the Printing Works.

Mr Midgley noted that the contracting areas were those with clerical, computer or premises staff, while the expanding areas were demanding analysts and other professionals. Clearly this imbalance created tensions in staffing, a point Sir Christopher Hogg considered a crucial issue for Court to consider.

The City of London: International Competitiveness and Leadership (Sir Peter Petrie, Mr Beverly and Miss Seal in attendance)

In presenting this paper, which outlined current competitive issues, the different views on the issue of leadership in the City, threats to London's international position and the role the Bank has been playing, Mr Kent noted that there were two schools of thought on how London should be promoted: those who favoured a grand plan, and those who felt that co-ordination between the various bodies would be more productive. The Bank favoured the latter approach.

Sir Christopher Hogg did not favour the "grand plan" approach, although he feared that the Government would be attracted to that route. He felt that the Bank had a role towards the City analogous to that of a non-executive director towards a company, being responsible for the welfare of that company but without the executive responsibility for day-to-day management. Sir Martin Jacomb felt that the Bank's traditional role in promoting change in the City had been very beneficial. However, he doubted that overseas promotions by British Invisibles was an effective way of generating much business for the City. Indeed, it could be counter-productive, by prompting Paris and Frankfurt to initiate their own strategies. The right way to help the City was for companies to go abroad and get their own business. The Bank's contribution should be to remind politicians of the value of the City as an exporter and an employer, and to publicise the need to reduce the costs to the City of regulation and taxes. Lloyd's post-war role had been built on tax privileges. Although these had, perhaps, gone too far, their removal had enabled continental centres to advance at London's expense. Mrs Heaton agreed with the need to educate Whitehall and Westminster, and perhaps Brussels too, about the value and the needs of the City.

The Governor also doubted the value of the "grand plan" approach. He felt that the Bank's role should be to provide a favourable environment in which the City could do business. Although the Bank could act as a representative of the City to the Government, one must recognise the limitations of that role. City interests could often have a bigger impact on Government when the Bank facilitates contacts between the two, rather than acting itself as the channel of communication. The Bank's role should be to act as a catalyst in getting City bodies to work together. Sir David Cooksey agreed with the Governor's view and stressed that it was important to get the

City's message across to Civil Servants - otherwise it was harder to persuade Ministers.

Structural Imbalances and EMU (Sir Peter Petrie and Messrs Collins and Jenkinson in attendance)

In introducing this paper, which addressed the importance of structural imbalances in the context of EMU, defined the convergence criteria and assessed the likelihood of countries satisfying them in the near future, Mr Jenkinson pointed out that economies in the European Union were inflexible in wage and price setting and therefore external shocks tended to lead to higher unemployment. In this situation there were risks in locking exchange rates, as it removed a tool which could facilitate economic adjustment. If inadequate wage and price adjustment led to stagnation in some regions, it could give rise to increased labour migration, although that would be limited by language and cultural barriers. The consequent need for fiscal transfers could cause problems for the European Union budget, which was still relatively small. Finally, judging monetary policy for the Union could be difficult if the economic needs for regions varied.

Mrs Heaton was not surprised by the analysis. She noted that the larger the Union the greater would be the strains, but that this would be something that had to be coped with in order to get the benefits of a common currency. Sir Colin Corness noted the remarkable transformation in East Germany since its union with the west, and observed that this required large cash inflows. In EMU would countries like Spain expect similarly large inflows? The Governor felt that Spain, Ireland, Greece and Portugal looked for inflows as a result of Union.
Sir Christopher Hogg was concerned by the dangers of putting the monetary cart before the political horse, a point echoed by Sir Martin Jacomb who noted that in the last century monetary union in Germany came at the end of a long political process.

Mr King said that monetary union required sustainable convergence which amounted to the economies responding similarly to external shocks. A few European Union countries were already in that position and could form a monetary union tomorrow; but, for most, that would be impossible. Monetary union did not imply price stability throughout the area. Rather, there are changes in the real exchange rates between the regions brought about by different regional inflation rates. Thus those countries which hoped to achieve price stability by joining a monetary union might not, in fact, achieve their wish.

EMI: transition to a single currency (Sir Peter Petrie, Messrs Collins and Jenkinson in attendance)

With reference to a Minute of 21 December 1994, Mr Collins said that the paper before Court today addressed the speed of transition to a single currency. It followed on from a previous discussion, when developments in Stage 2 of EMU were considered. In introducing this paper, Mr Collins noted that even the Maas Group, who were amongst the most enthusiastic advocates of an early change to a single currency, recognised the need for a six month period of double-running (phase 3a), with the ECU and national currencies circulating before the ECU could become the single currency. Therefore, certain fixed costs would have to be faced in any event. It was not clear that major accounting problems would arise, as the exchange rates would be completely fixed. All that would be involved would be an arithmetical translation between units of account. The principal problem that could arise in phase 3a might be if markets were to test the credibility of the system by exerting pressure on one or more of the currencies. This would lead to flows of the threatened currency into the European Central Bank, which would find it had mounting assets in that currency, and liabilities in ECU. This would not be a problem provided that the exchange rates remained unchanged. But in the event of a country leaving the Union, the costs of this exchange rate mismatch would have to be passed on to it.

Sir Christopher Hogg remained unconvinced. He felt that national currencies should not last a minute longer than was necessary. He did not see any need for a phase 3a. The Governor felt that the benefits from EMU came from locking the parities and introducing a single monetary policy. The transaction costs of moving between fixed rate currencies would be very small; and indeed, the national currencies could continue for ever. In phase 3a, those who wanted to switch to ECU quickly would have the freedom to do so, but the Governor did not see the need to impose the ECU on those people who might prefer to use national currencies. Sir Martin Jacomb was concerned that in phase 3a a country with a weak fiscal position might be able to abuse its power to finance its deficit by, in effect, printing ECUs. He expressed concern that the Maastricht commitments might not be achievable by some Governments. The Governor observed that the creation of money within the Union would be a concern for the monetary policy of the European Central Bank. National Governments would retain control over their fiscal deficits within the constraints laid down by the Treaty. But he took note of Sir Martin Jacomb's comments, which could be another reason for being cautious over monetary union. Sir Chips Keswick asked how a country might go bankrupt within the Monetary Union. The Governor explained that it was analogous to a local authority within a national state. Markets would respond to an excessive supply of debt by a government and indeed the market could close completely if default loomed. Mr Quinn thought there could be a need for more empirical work on the costs of switching national currencies into ECU at the start of phase 3b. Mr Collins said that the European Banking Federation and the EMI were examining this question. The banks were concerned that it would be expensive and that it would require a long lead-time; naturally they would not make the necessary investments until they were sure that phase 3b would come about.

Sir Chips Keswick: Directorships

Court gave their approval to Sir Chips Keswick joining the Boards of Anglo American Corporation of South Africa Ltd and Central Holdings International Ltd.

The Executive Report

1 With reference to a Minute of 19 October, the Deputy Governor said that he had met the Chancellor and the Permanent Secretary earlier in the month to discuss the areas of the Bank targeted by the Treasury team in HMT's Fundamental Expenditure Review. He added that the discussion centred on the Printing Works, the Registrar's Department and Note Issue. The Chancellor did not seem minded to pursue radical changes on Note Printing, but was more attracted by the possibility that the private sector could take on the registration function. The Bank had pointed to the possible loss of quality of service that this route might entail; if the Treasury chose to go to tender, the Bank would want to bid for the work. The Deputy Governor said that there were further economies planned for that Department. The question of the Note Issue was tied up with the Branches' Review, but we might have further savings to offer the Treasury. Overall, however, these items were relatively minor matters in the Treasury's review of total public spending.

2 The Governor advised Court of the latest developments with regard to the support package for Mexico. He reminded Directors of the origins of the support proposals which had emerged shortly before the New Year. When the US authorities had to withdraw their attempt to obtain Congressional support for guarantees to Mexico, the arrangements had to be reconstructed. They now rested heavily on the use of the US official reserves and a very large standby credit from the IMF. This would be supported by a $10 bn facility from the BIS and a similar

[redacted]

facility from non-G.10 central banks. [redacted] the BIS facility for Mexico would itself be cash collateralised. This arrangement was designed to build market confidence in Mexico rather than provide real resources, which would create risks for the BIS and its members.

Standing Committees

The Governor thanked Directors for their help in changing the membership of the Standing Committees and promised that details of the revised Committee structure would be circulated shortly.

The Governor paid tribute to Sir Martin Jacomb and Sir Colin Corness on the occasion of their last appearance at Court. He asked that his gratitude be recorded, together with that of their colleagues on Court, both past and present.

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

Rupert Pennant-Rea

Assistant Secretary
1.3.95

[redacted]

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 22 FEBRUARY 1995

Present
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Brian Quinn, Esq
Pendarell Hugh Kent, Esq
Mervyn Allister King, Esq
Sir Christopher Jeremy Morse, KCMG

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.

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

Rupert Pennant-Rea

Bennett
istant Secretary 1.3.95

A COURT OF DIRECTORS AT THE BANK

SUNDAY 26 FEBRUARY 1995 (6.30 pm)

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Sir David James Scott Cooksey (from 7.00 pm)
Mrs Frances Anne Heaton (from 7.00 pm)
Sir Christopher Anthony Hogg
Sir Martin Wakefield Jacomb (from 7.05 pm)
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Ms Sheila Valerie Masters (from 6.50 pm)
Ian Plenderleith, Esq
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith

The Governor thanked Members for attending at the Bank at short notice on a Sunday evening.

The Governor said that a situation had arisen over the weekend at Barings. A trader in Singapore, employed by Barings Futures Ltd, had built up large unauthorised positions in the Nikkei Future, the Japanese Government Bonds Future and the Euro-Yen Future. As of Friday night, the mark-to-market losses on these contracts were £385 mn, and over the weekend losses of a further £240 mn had been identified. All of these positions were still open. The Nikkei was likely to open in the morning substantially down, so that the losses were likely to rise further. We had over the weekend obtained an indicative price for closing out the contracts of £175 mn. This meant that the total loss facing Barings was of the order of £800 mn, and Barings therefore had a net deficiency.

Discussions had been taking place over the weekend with a consortium of leading banks, and they had come up with contingent commitments to recapitalise Barings amounting to £640 mn. Subsequent to that, it had emerged that the Brunei Investment Authority would be prepared not only to provide a cap to the open positions on the Nikkei Index, which was of course a pre-condition of any capital injection, but would also be prepared to put in £300 mn of equity in return for 50.1% of the company. If they did so, the call on the consortium would be proportionately less. Barings already had £100 mn of spare capital, and we could accept a risk asset ratio of 8%, down from the former 10%. There were also ways in which Barings could free-up capital by cutting their balance sheet.

This deal did not necessarily require Bank of England involvement. Our contribution would be to sort out the liquidity if the cap were put in place and an equity injection provided. Barings had an adequate bond book, and we would be able to provide if necessary up to £500 mn of liquidity against good collateral.

There was one way in which we had been asked to support the capital injection: the Brunei Investment Authority, who would be taking the Nikkei open positions out, were concerned about their technical capacity to complete the transaction, and the proposal was that they would assign their positions to Bankers Trust and CSFB via the Bank of England. We would therefore take the positions ourselves, with Brunei indemnifying us against all costs and losses. The indemnity from Brunei would be in effect unsecured. The Governor asked if Court, subject to legal advice, would be prepared to accept this risk.

Sir Chips Keswick said that he would be very uncomfortable with such a risk unless a large part of Brunei's cash were available as collateral; the Governor said that it would be possible to try, and an alternative might be to give Brunei comfort that the deal was a reasonable transaction. Sir Chips remained concerned both about Brunei's motives and about the technicalities of the transaction. In response to further questions and comments from Members of Court, the Governor said that if the proposed rescue package could not be agreed, then Barings would certainly have to stop that evening.

Sir David Scholey asked whether the Bank felt that Barings' failure would trigger a systemic crisis. The Governor said that the perception that we were prepared to let Barings stop would have a major effect on all British banks, but we would present this as not a generic problem but one relating to Barings only. We would try to make it clear that potential liquidity problems would be addressed by the Bank of England. Sir David Scholey said that in the meeting of bankers that had taken place earlier in the day, a representative of Deutsche Bank had stressed the potential damage to London as a financial centre if Barings were to stop.

Members of Court agreed that should the need arise, the Bank could enter into the proposed transaction with Brunei. The Governor then reported that the proposals had changed, and that Brunei were now looking more for comfort than for the Bank's intermediation; Members of Court agreed that this should be given as necessary.

Sir Roland Smith asked what the Bank's loss would be if Barings were to stop. Mr Plenderleith said that we had £70 mn of Barings' bills in hand, though there was of course recourse to the drawer.

The Governor said that the syndicate of bankers had reached broad agreement on a contribution, and there was no need for the Bank to put any money in. However it had been represented to him that a token contribution from the Bank would be welcome, and he would like Court's authority to put £5 mn in to the capital injection. The Treasury had earlier been prepared to contemplate our participating on a much larger scale. Court agreed to this proposal.

Rupert Pennant-Rea

Gunnell

Assistant Secretary 1.3.95

COURT OF DIRECTORS

For the year ended 29 February 1996

Declaration Made before	Date	
		Edward Alan John George, Esq, ~~Deputy~~ Governor
		Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
		Sir David Gerald Scholey, CBE
		Brian Quinn, Esq
		Mervyn Allister King, Esq
The Governor	15.3.95	#Sir David Bryan Lees
		Professor Sir Roland Smith
The Governor	15.3.95	#Sir Colin Grieve Southgate
		Sir Christopher Anthony Hogg
		Mrs Frances Anne Heaton
		Sir John Chippendale Lindley Keswick
		Sir Christopher Jeremy Morse, KCMG
		Pendarell Hugh Kent, Esq
		Ian Plenderleith, Esq
		Sir David James Scott Cooksey
		Ms Sheila Valerie Masters
The Governor	15.3.95	*Neville Ian Simms, Esq
The Governor	9.3.95	*David Alec Gwyn Simon, Esq CBE

Reappointed 1 March 1995
* Appointed 1 March 1995

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 1 MARCH 1995

Present
Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Mrs Frances Anne Heaton
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Ms Sheila Valerie Masters
Ian Plenderleith, Esq
Brian Quinn, Esq

The Minutes of the Court of 15 February, the Meeting of 22 February and the Court of 26 February, having been circulated, were approved.

Mr Plenderleith spoke about the foreign exchanges and the state of the domestic markets. Although sterling had been marked down sharply when the foreign exchange markets re-opened following the revelations about Barings, it had recovered somewhat during Monday and had not been under any particular pressure since. The domestic financial markets were steady, as was the equity market, which had recouped some of the decline recorded at the beginning of the week. The Bank was monitoring liquidity levels and had noted evidence of lines of credit being withdrawn from classes of banks, but not at present on a scale to cause undue concern.

Under the executive report, the Governor said that it might be necessary for the Bank to quote a price for Barings' CDs for institutions whose holdings of the latter were equivalent to a substantial part of their capital. Given the current uncertainty, it was difficult for a holder to value this one-name paper. To date, we were aware of only one institution, holding £25mn of Barings' CDs, which might be a case in point and the Governor thought that we should have heard already were the problem a large scale one. Quoting a price would, the Governor acknowledged, involve the Bank in some risk, but this was unlikely to be material in relation to the Bank's balance sheet. Any deal would be a private one with the holder of the CDs, and only at a price which met the minimum needs of the holders.

Court, noting that the matter would be revisited, should the risk to the Bank prove to be greater than currently envisaged, approved the provision of liquidity in the circumstances and manner which the Governor had outlined.

The Governor said that the Agenda for the Long Court on 15 March would be varied to include discussion of the Barings case and its implications.

Rupert Pennant-Rea

[illegible]

[illegible]

15/3/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 8 MARCH 1995

Present

Edward Alan John George, Esq, Governor
Rupert Lascelles Pennant-Rea, Esq, Deputy Governor
Mervyn Allister King, Esq
Sir Christopher Jeremy Morse, KCMG
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.

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

Rupert Pennant-Rea

Chairman

Secretary

15/3/95

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 15 MARCH 1995

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 John Chippendale Lindley Keswick
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq
Brian Quinn, Esq
Sir David Gerald Scholey, CBE
Neville Ian Simms, Esq
Professor Sir Roland Smith
Sir Colin Grieve Southgate

The Governor welcomed Mr Simms on the occasion of his first attendance at Court. He added that due to prior engagements, Mr Simon was not expecting to attend Court before April.

Minutes

The Minutes of the Court of 1 March and the Meeting of 8 March, having been circulated, were approved.

Monthly Economic and Market Report, including market charts (Messrs Allen and Bowen in attendance)

Introducing the Report, Mr Allen said that there had been clear signs of an upturn in retail price inflation, on all measures, beginning late in 1994. The January RPI figures were in line with the projection in the February Inflation Report, but the major development since its publication had been the fall in the exchange rate - nearly 3% on the effective index. This obviously raised questions about the impact on inflation. There were three possibilities:

(i) the exchange rate fall might prove temporary, and be reversed with no effect on inflation;

(ii) the lower rate might persist for a while with some temporary impact on inflation caused by higher import prices; or

(iii) the weakening might prove permanent, in which case higher import prices could be expected to spread into domestic costs and prices. At the extreme, this could add 1/4% - 1/2% to the inflation rate in two years' time.

On output, there were clear signs of a slowing, and the economy was now growing at a more sustainable rate. There was still evidence of a dual economy, with tradable products growing strongly but non-tradables doing less well, especially in those sectors close to the consumer. Recent exchange rate movements would do nothing to reduce this. Manufacturers were still being disappointed in their ambitions to raise prices further, with the extent to which they could pass costs on to consumers clearly restrained by weak consumer demand.

Over the past few months, industrial production appeared to have flattened out - according to the published statistics, it had barely increased since August of last year, after growing by 5 3/4% in the preceding 12 months. This was puzzling, because CBI surveys reported stronger economic output, particularly for export. Our own Agents' reports showed much the same story as the CBI.

Another puzzle related to manufacturing investment, which had not increased as much as might have been expected, given expectations about output. Part of the answer might be that manufacturers were responding to increased demand by adding new shifts and taking on more labour, thus using their existing capital plant more intensively. It was certainly true that employment in manufacturing had risen by 37,000 since September, the first substantial increase in manufacturing employment for many years. Meanwhile underlying annual earnings growth in manufacturing had gone up from 4 3/4% to 5%, while in services it had fallen from 3 1/2% to 2 3/4%. That left underlying earnings growth for the whole economy at 3 1/2% - about 1/2% less than we had expected a year ago.

Mr Plenderleith said that the past month had been a turbulent period in financial markets, and sterling, while generally on the sidelines, had recently been drawn in. However, this had not had much effect on the domestic markets. The main story was of dollar weakness. There were many possible explanations: a shift in forward-looking interest rate differentials; the failure of the balanced-budget amendment in Congress; and Mexico. The effect of the weak dollar had been felt mainly in the weaker European countries; the peseta and the escudo had been re-aligned in the ERM; and there had been rises in Italian and French interest rates. Sterling had initially risen against the dollar, but then ran into profit taking, and had fallen against the Deutschemark. The fall had been partly reversed, so that the ERI had weakened by only 2% over the period. The lack of impact on domestic markets was illustrated by the short-term interest rate future, which showed expectations of three-month interest rates in December lower now than a month ago; the bond market yield curve had also fallen. The market was plainly taking the view that sterling's decline would not feed through into inflation, either because it would prove temporary, or because, if permanent, there would be a monetary policy response. Confidence in our own monetary policy stance had given us some support relative to other European countries.

Sir Christopher Hogg commented that much of the analysis was based on volume and output measures, rather than profitability. Company management tended to be driven by margins, profitability and cash flow: if those elements were disappointing, then firms would undoubtedly remain cautious about investment. The Governor felt that profitability had been quite strong in manufacturing, and Mr Allen noted that profitability on exports was likely to be high. Commenting on activity, the Governor said that there had been a slow-down, and that the run of numbers had been relatively weak since the turn of the year. But the Agents and the CBI remained fairly positive. Sir David Lees said that there had been little falling away in the engineering sector, though building was weaker. Sir Roland Smith said that the pressure was undoubtedly on margins because of raw material costs. There was still a lack of confidence about the outlook, and employers were tending to use capacity more intensively, as Mr Allen had suggested. They were, for example, taking on more part-time workers, which gave them more flexibility. One particular complaint from managers related to electricity prices, which had risen very sharply in January and February. Sir Colin Southgate said that this applied only to pool electricity prices, and would not have affected those firms which had hedged.

Mr Plenderleith asked whether capacity was a less absolute concept than formerly. Sir Roland Smith said that there was certainly more flexibility in the way companies could use labour, and that it was therefore possible to use existing plant more intensively. This would not go on forever, of course. Eventually there would be a need for new investment; and during the recession a lot of product development had been abandoned. Sir Roland suggested that further work be undertaken to try to understand not just what was happening, but why. Sir Christopher Hogg remarked that the Agents' reports provided an excellent and consistent analysis, but Sir David Scholey commented that they tended to report current perceptions rather than explain them; it ought to be possible, looking at company analysts' reports on the major industrial companies, to provide more analysis of their investment behaviour.

Mr Simms said that construction output, after three years of decline, had been rising gently for the past 18 months. The make-up of the improvement was complex, with the Government chopping and changing on the road-building programme; but commercial building was looking up, and that was an important part of total demand. The recovery was far less strong than in previous recessions. Private sector housing remained extremely weak - with prices flat in 1994 as a whole, and dropping in the early part of 1995. The effects of this would undoubtedly be felt further down the chain. Sir Chips Keswick felt that housebuilding in the early part of the year had been less depressed.

The Governor commented that the overall picture was difficult to assess. There were encouraging figures from the labour markets, and a ray of hope on input prices. But there was plainly a good deal of cost pressure in between. On output, the general indications of weakness were greater in the first quarter of this year than previously. It was also clear that the exchange rate could become more of a problem.

The Barings Failure

With reference to Minutes of 26 February and 1 March, the Governor reported on the events at Barings. The focus now was on the Investigation, which had a lot of ground to cover. It would need to comment on the lines of responsibility within Barings; on the internal and external audit processes; and on regulatory arrangements, including contacts between the local regulators in Singapore and Japan, the Securities and Futures Authority and the Bank of England.

Concern had been expressed publicly about the make-up of the investigation, and in particular about the Bank apparently acting as judge and jury in its own case. It had been decided within the Board that the three Executive members would step out of the process for that part of the enquiry relating to the Bank, so that the six independent members would report independently, with Sir Alan Hardcastle as Convenor. The aim, initially, was simply to establish the facts, and we had set ourselves a target of six weeks to complete it. The conclusions would be in two parts: first, dealing with the failure itself, and the actions which Barings and possibly the regulators could or should have taken. Second, there would be regulatory lessons: whether the structures or format of regulation could be improved.

At first, public attention had focused on the "all to do with derivatives" argument. That view had modified a bit: it was clear that what had actually happened was an old-fashioned control failure. Moreover, the derivatives over which Barings had come to grief were relatively simple ones. There had been some debate, too, about whether we should have constructed a market rescue. The reasons why we had not been able to do so seemed to be generally understood. And there had been a debate about whether public money should have been used to rescue Barings. Generally, and leaving aside some rather excitable comment, it had been accepted that this was neither a case of simple liquidity difficulty nor a systemic problem.

The Administrator had been very fortunate to find ING Bank. If that proposal had failed, Barings would have been sold in bits, and the ordinary creditors would have lost money. It would have been a much messier and more highly-charged situation.

There were bound to be long-term effects, not so much for London as an international financial centre as for the British banks. Some pressures had been evident already; the Barings episode would not have made them any easier. In the inter-bank market, some banks were paying a little more for funds, but less that might have been the case. We had made it clear that we stood ready to provide liquidity if needed, but no one had taken us up on that.

Mr Quinn, commenting on the previous supervision of Barings, said that the house had been highly regarded in the Bank. It had seemed to be a well-run institution. Its main profit streams had been evenly spread, and year-in and year-out had produced good results. That was the general market view of Barings as well. We had seen them regularly, and although we did not do inspections, we did have reports from the auditors: there had been no sign in those reports of control deficiencies. The auditors had described Barings' control arrangements as relatively informal, but had seemed to regard that as a strength rather than a weakness.

Much had been made in the press of the internal audit report last year. We had not seen that report, and would not have expected to. The press had also commented on the possible breach of the large exposures rule. There had been an occasion last Spring when the exposure of Barings to its overseas securities operations temporarily breached the 25% limit, but it had been brought back at our request. There had been no subsequent sign of the limit being exceeded. A request from Barings for a concession was received late last year, but rejected. The speed with which the exposure to the Singapore operation raced away had not been visible from the returns, which we received quarterly.

Our own position was that we were the lead regulator in the UK. It was we who called the colleges of supervisors domestically, and we also conducted consolidated supervision worldwide. This was plainly not something we could do by ourselves. We had to co-operate with other authorities. In the UK, the authorities concerned were the SFA and IMRO; and in Singapore, SIMEX and the Monetary Authority. There had been no sign of concern among any of the other supervisors; Mr Quinn had seen the Singapore Supervisors in mid-January, specifically to discuss the UK banks, and no concerns had been raised.

One positive outcome of the Barings failure was that every single institution in the United Kingdom was now looking very hard at its own systems and controls. But there were also implications for the merchant banking sector as a whole. The impact might be limited to a price adjustment in the money market; it might go further.

Sir Colin Southgate asked whether money flows on the scale that had apparently taken place at Barings would have been spotted in another major bank. Sir David Scholey said that not knowing how the transfers had taken place, that question could not be answered. The Governor said that we simply did not know the facts: if it had gone from Barings Brothers Limited to Barings Futures, there would have been a large exposure breach. But it might not have gone that way. It might have involved drawing down banking lines in the Far East.

Sir Roland Smith said that the more he heard about the story, the more he wondered how we could ever supervise financial institutions. Mr Quinn had described Barings as well-run, but what had recently emerged clearly demonstrated that the business was not under proper control. Somehow we needed to have the inquisitorial mechanisms in the Bank to find out whether controls really were adequate. It was not clear that we had those. The Governor felt that this question lay at the heart of the debate. What realistically could a regulator be expected to do? He hoped very much that in the wake of the investigation that point could be debated properly. He had a feeling that expectations of regulators had been running far too high. We were expected to provide more protection than was actually possible.

Sir Chips Keswick said that the market had missed the Barings problem as much as the regulators. He also noted that the bonus structure of Barings could have created some of the tensions and control weaknesses. He was critical of the appearance by Mr Sharples of the Securities and Futures Authority on television the previous Monday.

Sir Jeremy Morse said that while it was fair to say that this kind of thing could always happen, it didn't have to happen on this scale. The checks - managerial and regulatory - were important. It was clear that a lot of traditional attitudes to control had lapsed in this case. He did not think that the Bank should make too much of the "don't exaggerate what regulation can do" point. He felt that the problem at Barings had been a rather characteristic one of a formerly conservative institution going into an unconservative line of business: the same had happened with Lloyds in Lugano, Credit Suisse in Chiasso and Continental Illinois in property in Florida. He was also not sure that the Governor was right to dismiss the derivatives element. Another point was the concern about merchant bank investment advisory arms re-depositing client funds with the parent institution. He felt that there would be pressure now for them to re-deposit with the major clearing banks, and this might erode the deposit base for merchant banks. The Governor said that he had heard this said, but equally had heard complaints that when people ran to larger institutions they got lower interest rates. He thought it possible that if the client money rules were changed, the result would be that client funds would be placed with more rather than less risky institutions, in order to increase returns.

Payment to HMT in Lieu of Dividend

The Governor advised Court that the interim payment, in lieu of dividend, was due to be made to HM Treasury on 5 April. The Deputy Governor went on to say that the agreement in effect preserved our asset base and earning capacity in almost every respect. On the contribution to the EMI, the effect of the settlement was that we and the Treasury would each contribute half.

Court agreed that, pursuant to Section 1(4) of the Bank of England Act 1946, an interim payment of £51.85 mn be paid to HM Treasury in lieu of dividend on 5 April.

Review of Workings of Court

Introducing the paper, the Deputy Governor said that there had been many changes, and Court might now want to take stock. There were two specific recommendations, designed to simplify the procedures whereby outside appointments were sanctioned. Specifically, it was proposed to withdraw the Court decisions of 1929 and 1918, and to substitute an arrangement whereby Directors simply notified the Secretary, in advance of accepting outside appointments. Sir David Scholey said that he had in practice no difficulty with the concept of seeking the Governor's approval for Directorships that he proposed to undertake; and he asked what the Bank's attitude would be if a Director were to become a director of a foreign bank. Sir Chips Keswick felt that it was important for the Governor still to have the ability to warn Directors against unsuitable outside appointments. The Governor said that the aim of the recommendation had been to try to avoid burdening Court with a series of routine appointments, but he accepted the points made by Sir David Scholey and Sir Chips Keswick, and would offer a revised recommendation at a future Court.

Turning to the substance of the paper, Sir Chips Keswick felt that the international aspects of the Bank's work were no longer getting sufficient prominence at Court. It was very evident that the Mexican situation had had an effect on the domestic economy; we did need a regular opportunity for Court to discuss international affairs.

Sir Jeremy Morse commented on the annual strategy Court. He felt that the sequence of presentations by Heads of Function was no substitute for a proper discussion of the Bank's strategy; and it was also no substitute for proper Heads of Function reports. He felt it was important for Court to see Heads of Function reasonably frequently. Other Members felt that, when Heads of Function came to Court, they should have a proper issue to discuss.

Sir David Scholey said that he had very greatly valued the opportunity for an informal discussion with the Governors over lunch, and felt that this should be repeated every nine months or so. Sir David Lees hoped that Court would have a discussion of senior succession planning. The Deputy Governor said that such a discussion was planned.

Sir Christopher Hogg said that he was conscious that the recent changes in Court had been very much driven by the Non-Executive Directors, but he would be interested to know how the Executives saw Court. He had no idea whether and in what areas Court's input was valued, or whether Court was regarded as an unnecessary encumbrance. The Governor said that he didn't view Court in that light.

Sir David Cooksey: a Chairmanship

Court gave their approval to Sir David Cooksey becoming Chairman of the Local Government Commission.

Appointments, a Resolution and a Recommendation

Court approved the membership of the Remuneration and Audit Committees and the Trustees of the two Pension Schemes, to 29 February 1996, namely:-

Remuneration Committee

Sir David Scholey, Chairman
Sir David Lees
Professor Sir Roland Smith
Sir Colin Southgate
Sir Christopher Hogg

Audit Committee

Sir David Lees, Chairman
Sir Jeremy Morse
Sir David Cooksey
Ms Masters
Mr Simms

Trustees, Court Pension Scheme

Professor Sir Roland Smith, Chairman
Sir Colin Southgate
Sir Chips Keswick

Trustees, Staff Pension Fund

Sir Christopher Hogg, Chairman
Mrs Heaton
Sir Chips Keswick
Mr Kent
Mr Simon
Mr Lecky-Thompson

The Governor advised Court that Lord Laing had agreed to serve as Chairman of BE Services Ltd, the Bank's catering subsidiary, for a further and final year.

The Governor mentioned that the Bank is one of a number of institutions entitled to appoint a director of Opportunities for People with Disabilities. The Company Secretary of that organisation had recently recommended that sponsoring institutions should formally appoint their representatives, and a Resolution to this effect was presented to Court.
It was RESOLVED that pursuant to Section 375 of the Companies Act 1985, as amended and extended by the Companies Act 1989, and until otherwise resolved by the Court of Directors, MR JOHN BARTLETT be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of Opportunities for People with Disabilities.

Following the retirement of Mr H C E Harris last Autumn, Mr Gordon Midgley, the Bank's Finance Director, had taken over some of his responsibilities and the Governor introduced a Recommendation delegating authority to Mr Midgley to approve certain items.
Court approved the Recommendation that with immediate effect, Mr Gordon Midgley be authorised to act as a Governor for the purposes of:-

(a) authorising expenditure in addition to agreed annual budgets; and

(b) authorising and monitoring projects,

within parameters specified, from time to time, by the Deputy Governor, and on the basis that Mr Midgley would provide him with quarterly reports of what he has authorised.

Personnel Strategy 1995-98 (Mr Lecky-Thompson in attendance)

Mr Lecky-Thompson introduced his paper. He said that the aim was to move first to good personnel practice, to support the Bank's aims and objectives, and then ultimately to move to best practice. The institution was in the midst of change, moving from an era of welfare paternalism towards an environment in which we had to support staff in managing their own careers, and to inculcate less expectation of automatic

advancement. There was plainly a morale problem, which could be addressed only if management was open and honest about individuals' prospects. The aim of the personnel function was to help line managers manage. With this in mind he was proposing to upgrade and upskill the personnel function, so that the professionals there would be better able to provide line management with practical help in their day-to-day operations. He told Court that the local TEC had agreed a £10,000 to £15,000 grant to assist in this process.
Mr Lecky-Thompson cautioned that culture change was inevitably a long drawn-out process: the pace could not be forced.

Sir Christopher Hogg said that it was plainly essential to be clear about what the Bank was trying to do. In particular, he felt that there should be more clarity about the third core purpose, which was distinctly ambiguous at present, and could mean that anything that went wrong in the financial sector was attributed to the Bank. Sir Jeremy Morse said that he supported much of what Mr Lecky-Thompson was proposing. It was true that if we could be clear about our purposes, then that would lift morale. There was plainly a big culture change in getting staff to take charge of their own futures. It would be helpful to encourage staff to be active in their own fields outside the Bank. Like Sir Christopher Hogg, he felt that there was a clearer focus in the monetary stability area than in the financial stability area.

Sir David Cooksey commented that in an organisation that was shrinking, it was very important to keep getting good people going through. He felt that the Bank should be more positive about acting, in effect, as a training ground for other organisations. This was a natural process, and we could recognise it by having more fixed-term contracts. Sir Chips Keswick took a different view. The Bank was a relatively small organisation, and in such circumstances a relatively "unfair, ad hoc and paternalistic" structure could work. He was not in favour of the changes proposed: he felt that they would not produce what they were aimed at.

Mr Simms said that there was a clear hint in the paper that a lack of overall strategy made it difficult to set personnel objectives. He noted that the paper proposed leaving a staff opinion survey to 1996. He thought that was a mistake, and could lead to management tilting at windmills. He felt that the survey should be done this year, and the strategy then built on the back of what the survey showed and what Court wished to do. Sir Colin Southgate felt the proposals were on the right lines and commented that the best organisations tended to bring people in at all levels. Recruitment from outside could stimulate the existing staff. We needed to find ways of attracting bright young people in, but we had to recognise that not all were going to go to the top. This argued for short-term contracts. He was concerned about the apparent morale problem in the Financial Stability wing. He saw merit in bringing people into the supervision side from outside. The disciplines were different, as were the roles. We should not expect to be able to transfer staff freely between Monetary and Financial Stability.

Sir David Scholey said that the paper was interesting and it was clear the Bank was going through a massive change of culture. He was concerned that if all of the proposals were implemented, even at the relatively slow pace Mr Lecky-Thompson had described, the Bank would risk losing control of the culture of the organisation. Change had to be engineered through line management. He felt it would be better for the principles set out in the paper to be regarded as a blueprint, to be implemented by a trickle-down process. If the various strands got out of kilter, the Bank would be in serious trouble.

Sir David Lees felt that what was missing from the paper was a clear cut statement of what the personnel function was responsible for, and where line management had responsibility. Sir Roland Smith broadly supported the proposals and agreed that Personnel were responsible for definitions: managers needed help with definitions, but implementation had to be their responsibility. He felt that it was helpful to bring

people in from outside; the best places were those where people were moving through. Mrs Heaton asked whether it was possible to quantify the ideal turnover rate.
Mr Lecky-Thompson said that it was hard to do this. The current rate of loss was 4%. For the City as a whole it was 20%. Plainly we could live with a slightly higher turnover so long as we kept the people we wanted. This was particularly true in an organisation where 4-5% of the total staff were effectively plateaued, and half of those were being counselled towards outplacement. We were using fixed-term contracts, but he was not sure that we were getting the distinctions right between contractors and permanent staff. The culture in the Bank was still against leavers - who were known, pejoratively, as "quitters". Sir Jeremy Morse suggested that it would be useful to compare notes with the FRBNY, which was well known in the United States as a training ground for Wall Street.

The Governor said it was clear that the Bank had shifted a little way along the spectrum towards using staff on a shorter term basis. He was not sure how much clearer Court could be about the strategy that provided the structure for Personnel matters. We had tried in our annual strategy review to look both at the purposes of the Bank and at changes of emphasis for the coming year. He was concerned about suggestions that the two wings required completely different people. It would be undesirable for the Bank to begin to break down into two separate units. There was already a sense that supervision could be hived off from the Bank, and in some circumstances we would not dissent from this - for example if regulation took on a more consumerist nature. But he did not want to pre-empt that. It would make the Bank increasingly difficult to manage. Sir David Scholey commented that this would probably happen unless we created more movement of staff at lower levels.

The Deputy Governor said he would want to consider the possibility of bringing forward the opinion survey.

The Executive Report

With reference to a Minute of 15 February, the Governor briefed Members of Court about the BIS facility for Mexico. He said that the facility was now offered, and could be drawn down. The amount offered so far was $5 bn, and it was pure window dressing: it would be paid into a blocked account at the BIS which could not be drawn on. All in effect that would be at risk was the interest on the facility. There was a possibility of a further $5 bn from the BIS, but the Governor said that he would be reluctant to participate in this. Because the facility was riskless, there was no Treasury guarantee. The facility could not be drawn until $9 bn of the US facility had been used. In addition Mexico had obtained $7.3 bn from the IMF, with the prospect of a further $10 bn on 1 July.

Governors' Engagements

The Governor mentioned to Members that they may have seen reported in the press last week the death of Lord Benson. He was an Adviser on industrial matters (between 1975 and 1983) to Lord Richardson when he was Governor of the Bank.

The Governor added that Members may also be aware that the Memorial Service for Lord Nelson of Stafford - a Non-Executive Director between 1961 and 1987, who died on 19 January - would be held at St James's Church, Piccadilly on Tuesday 21 March at 11.30 am.

David Scholey

22/3/95

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 22 MARCH 1995

Present

Edward Alan John George, Esq, Governor
Sir David James Scott Cooksey
Sir Christopher Anthony Hogg
Pendarell Hugh Kent, Esq
Sir John Chippendale Lindley Keswick
Mervyn Allister King, Esq
Sir David Bryan Lees
Sir Christopher Jeremy Morse, KCMG
Sir David Gerald Scholey, CBE
Professor Sir Roland Smith
Sir Colin Grieve Southgate

The Minutes of the Court of 15 March, having been circulated, were approved.

Mr King spoke about the markets. Sterling's weakness at the end of the previous week had been partly reversed following statements suggesting a decline in German rates. There was no likelihood of the Japanese easing their rates. The Governor added that the turbulence in foreign exchange markets was having little effect on domestic markets anywhere, which made the arguments that "something must be done" sound rather implausible.

A Letter of Resignation

The Governor laid before Court a letter from Mr Pennant-Rea dated 21 March 1995 giving notice of his resignation from Court, with immediate effect, in the office of Deputy Governor.

The Governor said that while the Deputy Governor had told him of the affair a year ago, until he saw the newspaper article the Governor had not known how far the Bank itself had been drawn in. He had therefore taken the view, as had the Deputy, that this made it difficult for the Deputy to continue.

It was RESOLVED that the Secretary be directed to communicate to the Chancellor of the Exchequer the notice of resignation of Mr Pennant-Rea from the office of Deputy Governor of the Bank pursuant to Clause 8(e) of the Charter of 1 March 1946.

Recommendations from the Chairman of the Remuneration Committee

[redacted]

The Recommendations were approved.

Assistant Secretary
5 April '95

NOT CIRCULATED TO EXECUTIVE DIRECTORS

A DISCUSSION FOLLOWING THE MEETING OF THE COURT OF DIRECTORS ON 22 MARCH 1995

Mr King and Mr Kent having withdrawn, the Governor said that he had had a first discussion with the Chancellor and the Permanent Secretary to the Treasury about the succession to Mr Pennant-Rea. He had told them that he would ask Mr Quinn to take on some of Mr Pennant-Rea's functions as Deputy Governor for an interim period. He would not however have the title Deputy Governor or Acting Deputy Governor.

So far as the permanent succession was concerned, the Chancellor's instinct was to look for an outsider, and to take some time in the search though he would hope to be able to make an appointment within, say, two months. He agreed nevertheless that internal candidates should also be considered. The Governor and the Chancellor had not got very far yet with names, but they had some thoughts about categories. The candidate would have an academic and/or financial background, combined with an ability to manage. The Governor mentioned a number of candidates who might suit. Sir David Scholey said that the emphasis should be on management qualities. Sir Chips Keswick said that he was concerned about the Chancellor's presumption that an outsider would be recruited: he felt that an insider would better understand the culture of the Bank. Sir Jeremy Morse agreed. Sir Colin Southgate and Sir David Lees both felt that it would be helpful for an outsider to continue the processes started by Mr Pennant-Rea, though Sir David Lees noted that it would depend on the list. Sir Christopher Hogg asked if there would be further opportunities to discuss the candidates, and the Governor agreed that there should be a meeting before his list was final, and possibly a further meeting once the Chancellor's own list had been seen. Members indicated that they would very much welcome such meetings.

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 29 MARCH 1995

Present

Edward Alan John George, Esq, Governor

Pendarell Hugh Kent, Esq

Sir John Chippendale Lindley Keswick

Mervyn Allister King, Esq

Sir Christopher Jeremy Morse, KCMG

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.

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

Assistant Secretary

5 April 1995

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 5 APRIL 1995

Present

Edward Alan John George, Esq, Governor
Brian Quinn, Esq
Sir David James Scott Cooksey
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
Sir David Gerald Scholey, CBE

The Minutes of the Court of 22 March and the Meeting of 29 March, having been circulated, were approved.

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

The Governor mentioned that Mr R L Pennant-Rea had been a Director of Bank of England Nominees Ltd and, following his resignation from the Bank, a new appointment needed to be made without delay as an interim arrangement.

It was RESOLVED that consequent upon the resignation of Mr R L Pennant-Rea on 22 March 1995, and pending the appointment of a new Deputy Governor, and pursuant to Section 375 of the Companies Act 1985, as amended and extended by the Companies Act 1989, and until otherwise resolved by the Court of Directors -

> MR GORDON MIDGLEY shall become a Director of Bank of England Nominees Ltd in place of MR R L PENNANT-REA. The Board will then consist of Mr Plenderleith and Mr Midgley.

MR IAN PLENDERLEITH, or failing him MR GORDON MIDGLEY, be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of Bank of England Nominees Ltd.

[illegible]

Secretary

19.4.95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 12 APRIL 1995

Present
Edward Alan John George, Esq, Governor
Brian Quinn, Esq
Pendarell Hugh Kent, Esq
Mervyn Allister King, Esq
Sir Christopher Jeremy Morse, KCMG
Ian Plenderleith, Esq

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

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

Mr Plenderleith spoke briefly about the foreign exchanges.

Brian Quinn.

Secretary
19/4/95

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 19 APRIL 1995

Present

Mr George, Governor
Mr Quinn
Sir David Cooksey
Sir Christopher Hogg
Mr Kent
Sir Chips Keswick
Mr King
Sir David Lees
Ms Masters
Sir Jeremy Morse
Sir David Scholey
Mr Simms
Mr Simon
Sir Roland Smith
Sir Colin Southgate

The Governor welcomed Mr Simon on the occasion of his first attendance at Court.

The Minutes of the Court of 5 April and the Meeting of 12 April, having been circulated, were approved.

Monthly Economic and Market Report, including market charts (Mr Bowen in attendance)

Mr King said that, on output and demand, the story was still of two economies. The inflation numbers had edged up very slightly in the past month, but there was no significant change in the position from the February Inflation Report. Data on costs had gone broadly in the right direction, and the labour market picture was relatively encouraging. There were two questions. First, the CSO figures showed manufacturing output flat; but anecdotal and survey evidence suggested that the manufacturing sector was far more buoyant. Second, the exchange rate had fallen sharply, that morning reaching record lows. The ERI was now 5 1/2% below its level at the time of the February report. This did raise questions for the inflation projection; at the very least there would be temporarily higher import prices, leading to an inflationary blip which monetary policy would not be able to arrest completely. There was a question as to whether that would feed through into the long run. It was possible to argue that the lower exchange rate had led to a loosening of our monetary policy, and on that basis, without countervailing action, it was possible to see the inflationary blip becoming permanent. But equally the lower exchange rate might be simply a function of the monetary policy cycle in other countries, or of the productivity cycle in other countries; in which case it was more plausible to see it as a short-term phenomenon.

Sir David Lees said that in his perception output was still strong, and he felt that the Bank should make efforts to reconcile the survey data from the CBI with the statistical data. Sir David Cooksey said that all the companies he was associated with had seen a sharp pick-up in the last month or so, following a slow-down towards the end of last year. The Governor said that we would be seeing the CBI quarterly survey this week, and that would help to set recent trends in context. Sir Roland Smith and Mr Simms both said that the construction and contracting sectors were relatively subdued. Sir David Scholey thought that it was disappointing that exports were performing less well here than in some other European countries: the Governor agreed, noting that conditions were currently excellent for exports.

Sir Jeremy Morse asked whether the patchy recovery was caused by the depth of the previous recession or by the new monetary framework. Mr King identified two main influences: first, the fiscal consolidation starting from 1993, and second, the high levels of household debt. Both had put pressure on the personal sector, and had enabled exports to grow rapidly without endangering inflation. The good news was that inflation expectations were down, and earnings growth had become more subdued. It was clear that there had been some gains in policy credibility. Sir David Lees commented that the trends in unit labour costs were worrying: compared to others, the UK performance was unsatisfactory. The Governor added that unit labour costs, on official statistics, had risen by 11% at an annual rate over the past three months: but he added that the figure did depend on the questionable output data, and the comparisons reflected the state of the business cycle elsewhere. Mr Simon commented that all statistics available in-house at BP confirmed Mr King's analysis. Industrial and road diesel fuel demand were growing faster than projected; gasoline for motor cars - personal consumption - less fast. BP was now supplying more energy into the manufacturing sector than at any time in the past four to five years.

Turning to the exchange rate, Sir Jeremy Morse commented that the ERI had held up well in the early stages of the dollar fall, but had since fallen sharply. This ought to be a matter of concern, and he wondered whether political risk factors lay behind it. Mr King said that if that were the case, then bond yields would reflect higher inflation expectations: but they did not. Sir David Scholey asked whether the devaluation of the green pound would have a serious effect on inflation: Mr Bowen said that it was likely to do so, and that recent work in the monetary analysis area had suggested that price-setting in the common agricultural policy had a much larger effect on inflation that we had recognised previously. The Governor commented that none of this made the policy dilemma any easier. On the face of it, it was difficult to see an overwhelming case for tightening on purely domestic grounds: but we couldn't ignore the exchange rate forever. Moreover if we were seen to be doing so, then that might exaggerate the movements against the pound. Sir David Scholey wondered whether it was right to risk export competitiveness, at a time when both the Americans and the Germans were (in different ways) improving their positions. The Governor felt that it was not possible just to lie back and enjoy the period of exchange rate weakness. Companies had seen big gains in export margins after 1992. He did not feel inhibited from raising interest rates by fear of a small appreciation in the pound. Sir Christopher Hogg added that the risk was of underestimating the strength of the economy, rather the reverse. Sir Chips Keswick commented that the markets were extremely uncertain at present; sterling was a pawn in the dollar/yen game. But the index was getting worryingly low, and there were concerns in the market that sterling was looking weak against Europe. A US rate rise might have an effect on the rate; a rise in sterling interest rates alone would have less chance of doing so. The Governor said that it was possible to get into a situation where the failure to take an opportunity to raise rates would reinforce worries about the currency.

Supervisory Relations with China (Mr Reid in attendance)

Mr Quinn commented on the Bank's relations with China and with the Peoples Bank in particular. We were keen to promote commercial banking and banking supervision in China, and it was clear that the Peoples Bank were anxious to cultivate relations with us. We had invested considerable resources in this exercise, which had by and large been fruitful. The only cloud on the horizon was the anxiety of the Chinese to see more of their banks established in London. We had been hesitant, but the Peoples Bank had been generally understanding of our stance.

The Governor commented that while this was a resource-intensive exercise, we felt that we were getting more for our money than was the case with parts of the former Soviet Union. Sir David Scholey wondered whether the Chinese were trying to establish competition between different financial centres, to "loosen a brick". Mr Reid said that the financial centres were by and large taking a common line, and were in any case bound together by the Basle Minimum Standards Agreement. The Chinese~~, in~~ any case, would rather be in London than anywhere. Indeed the Bank of China was seeking to establish a merchant bank subsidiary here. Sir Jeremy Morse asked about the implications for Hong Kong and Taiwan. Mr Reid said that the prospect of Hong Kong's reabsorption into China in 1997 was one of the reasons we wanted to have a close relationship with the Peoples Bank. It was clear that the PBC would have a growing influence in Hong Kong. Mr Quinn added that the PBC nevertheless wanted us to go on seconding staff to the Hong Kong Monetary Authority, and had not taken a stand on our recent refusal to allow [redacted] into London. As for Taiwan, our relations with the authorities were good, but we were putting less effort into that. Taiwan was further ahead on supervision. Directors generally endorsed the Bank's approach, though Sir Chips Keswick cautioned that we should treat the Chinese with a degree of mistrust.

A Report of the Audit Committee (Mr Midgley in attendance)

Sir David Lees, as Chairman of the Audit Committee, drew attention to the debate reported in the Audit Committee minutes on the Committee's Terms of Reference, and said that these would be brought to Court for approval after the Committee's next meeting. The other major issue was the need to have in place a system whereby Court could comment on the Bank's systems and controls, so as to be able to comply with the Cadbury Report: that work was in train. At the next meeting of the Audit Committee, Ian Hay-Davison would be present to discuss the position of National Mortgage Bank. There were no questions from Members, and the Governor expressed gratitude to the Committee for its continuing work.

The Bank's Annual Report: Governor's Foreword and Directors' Report in draft (Mr Midgley and [redacted] in attendance)

The Secretary and [redacted] introduced the draft of the Directors' Report, and Members made the following comments:

(1) that we should not, in the Governor's Foreword, claim sole proprietorship of counter-inflationary policy

(2) that the Governor's Foreword might also refer to the improved performance of the banking system during the year

(3) that there should be further reference in the Governor's Foreword to the extent of our involvement with the EMI, particularly on secondments

(4) that the reference to the "new administrative framework" in the Governor's Foreword should be played up a little more, and made consistent with the Directors' Report; the Tercentenary should also be mentioned in the Governor's Foreword

(5) that Mr Simon and Mr Simms should have their proper titles of Chief Executive

(6) that the position of the NMB Group should be described as "the position of NMB improved, but no release of provisions was possible" [the Audit Committee to finalise wording]

(7) the note on premises to be included in the Accounts rather than the Directors' Report if legally possible

(8) the reference to the Bank's contribution to the EMI being repayable to be deleted, if possible, or the phrase 'winding up' to be amended

(9) the reference to the anti-counterfeiting campaign to be enlarged, and the Bank's concern about the scale of counterfeiting to be stressed

(10) the introductory paragraph to financial stability to include up to four paragraphs on the state of the banking system, drawn from the Banking Act Annual Report

(11) the sentence about Registrar's Department management competencies to be deleted

(12) the last two charts on the Printing Works, and the forecast element of the first chart, to be removed

(13) the numbers on the staff tables to be corrected

(14) [redacted] to check whether the Governor was committed to say something about the payment of bills, and if so to revise the wording

(15) a reference in our Community Involvement paragraph to the Per Cent Club.

Community Affairs - 1994/95 Review and Future Development (Messrs Lecky-Thompson and Ireland were in attendance)

Mr Lecky-Thomson introduced the paper, saying that the aim was to match good practice elsewhere, and to involve staff more. He drew attention to the mission statement, with its reference to "enlightened self-interest". Court endorsed the paper.

The Risks from CREST

Mr Kent, introducing the quarterly report on CREST, reminded Members that two years ago CREST had been a blank sheet of paper: now we were eight months from completion of the build. The internal risks had decreased; but equally the external ones had increased. The main external risk related to the Stock Exchange. We had been seeking for many months an agreement on the boundary line between our system and those of the Stock Exchange. Each time we had come close to an agreement, we found the Stock Exchange shying away from what we thought they had been prepared to sign up to. Our aim is to combine the various elements of trading, confirmation and settlement as sensibly as possible. The longer the impasse with the Stock Exchange continued the more likely it was that potential members of CREST would delay putting systems in place and that the transition would be accordingly more complex.

The other risk to the project was of staff loss: we had now transferred the Bank team onto the CREST pay bill and were

Jw

tying the bonus structure to their continuing until the completion of the project.

The Governor said that there had been real progress on CREST, but that the Stock Exchange problem was serious. Sir David Scholey said that when the matter had last been discussed at Court he had raised this and been told that it was not at that stage a cause of anxiety. Clearly now it was. He wondered if we had the right fora for dealing with the Stock Exchange and its members. Mr Kent said that we had the Advisory Committee, though this was not a complete answer. Sir David Scholey said that he had heard that the relationship between the Directors and Executive of the Stock Exchange had become more detached on this issue. He felt that this was another accident waiting to happen. Sir Jeremy Morse agreed; he said that personalities were playing a role in the problem, and that somehow the Stock Exchange need to be pulled out of the impasse. He was sorry that the current Chairman was not making any progress. The Governor said that in this field the current Chairman was driven by his Chief Executive. The issue was one for the Stock Exchange vis-a-vis its members rather than the Stock Exchange vis-a-vis the Bank, which made it difficult for us to interpose ourselves. Sir David Scholey felt that there was a clear sense in the City that we should do so.

Directors' Outside Interests: Recommendations

Following a discussion at Court on 15 March, the Governor reported that he had reconsidered the Recommendations relating to Directors' outside interests put before Court that week and he hoped the revisions met with Court's approval.

Court approved the Recommendations that with immediate effect:-

(1) The Order of 17 January 1929 relating to Directors' outside engagements be rescinded;

(2) Directors shall notify the Secretary at least seven days before committing to become a member of the Board of any company or to undertake any duty or assume any post or engagement which may affect their position as a Member of Court. This would enable the Governors to raise any questions they may have and, if necessary, to consult Court.

(3) On appointment, and subsequently at the end of February each year, Directors shall provide to the Secretary details of all their relevant Directorships and appointments. The Secretary shall, as soon as practicable after the 1st of March each year, circulate to Court a full list of all the Directorships and Appointments so notified, together with a reminder of the provisions in the Charter of 1946 relating to the interests of the Members of the Court, and any relevant decisions of Court.

(4) The Order of Court of 21 February 1918 regarding connections with Discount Houses be rescinded.

The Executive Report

1 With reference to a Minute of 15 March, the Governor briefed Members of Court, about the latest developments on the Mexican facility. He said that the BIS had offered a facility of $5 bn to Mexico, which had been accepted. It would be paid into a blocked account, [redacted]

Turning to the position on Argentina, the Governor said that there was a proposal for a $1 bn bridging loan, to be advanced by the BIS against funds pre-committed by the IBRD and IADB. It would be secured on shares in a state-owned oil company. [redacted]

2 Mr Quinn briefed Members of Court on the Inquiry into Barings. A draft interim report had been delivered to the Board of Banking Supervision by the Inquiry team, who had already given two oral presentations. This Report, running to 200 pages, would be discussed with BOBS on 20 April. Subsequently the information in it would have to be verified and the report on Stage 1 of the Inquiry passed to the Chancellor of the Exchequer; this was likely to be towards the beginning of June. There were still some gaps in the information, but overall good progress had been made. This Report would be Stage I: the fact finding exercise designed to establish what actually happened; Stage II would look at the lessons emerging from the collapse and at the regulatory implications. The independent members of BOBS would report on the Bank.

Mr Quinn also reported on his and the Governor's appearance before the TCSC on 5 April. It had been a testing occasion, and although nominally enquiring into the derivatives market, they had branched liberally into the Barings story. They were plainly very suspicious of the derivatives market, particularly about the capacity of the banks to engage in proprietary trading; they seemed attracted by the idea of narrow banks which could not involve themselves in such activities. Other concerns, specifically on Barings, included the speed with which the Report was being completed, the independence of the Inquiry from the Bank, the system of banking supervision and its ability to pick up and respond to market rumour; and (from all parties) the scale of the bonuses awarded to former Barings staff on the takeover by Ing. The Committee would be calling the Governor and Mr Quinn back before the Report was available, and then twice thereafter.

The Governor said that it was clear from the findings so far that the Barings failure had turned on a single unauthorised trader who had gone to considerable lengths to put himself in a position to engage in transactions without the knowledge of his superiors. It looked as though what he had done had not been known to Barings management, but the question was whether it should have been. Similar questions could be asked about the external auditors and supervisors. Sir Jeremy Morse said that he was unhappy about the many stages now involved in the Inquiry, and had been surprised to see it reported in the press that the Governor felt the controls had failed at six different levels. He felt the Bank was being put into an impossible position, having to comment while a multi-stage Inquiry was proceeding. The Governor said that there was a strong objective reason to get the facts into the public domain: the market itself might have lessons to learn from the facts; and until the facts were known, it was impossible for supervisors and management to take action against individuals. He recognised that, as soon as the facts were published, there would be a barrage of comment. On the six levels of control, the Governor said that he had raised this in a speech as a question for the Inquiry to answer, not as a conclusion. Essentially, we had a choice of saying nothing until the Inquiry was complete, or trying to steer opinion as we went along.

Sir David Scholey asked whether it was appropriate for the joint meeting of the Board of Banking Supervision and Court to proceed while the Inquiry was still incomplete; the Governor said that the purpose of the meeting was to enable Court to satisfy itself about the relationship between BOBS and the Bank; there was no reason why the Inquiry should not be raised.

Sir Christopher Hogg asked whether there was adequate co-operation from Singapore. The Governor said that they seemed to want to co-operate, but had not been entirely forthcoming thus far. Sir Christopher Hogg also asked whether Mr Watt had been able to talk to Leeson. The Governor said that Leeson would not talk to the Inquiry without assurance of extradition to the UK, which we could not offer.

3 The Governor briefed Members of Court on the informal ECOFIN meeting earlier in the month. He said that, for the first time, Ministers had focused on the technicalities of EMU. It had been a very helpful debate, leading to a realisation that the time from a political decision to go for EMU to the fixing of parities among the participating currencies would be at least twelve months. Beyond that, the time likely to elapse before a new physical currency could emerge would be fairly long - perhaps four years for banknotes. There was still a debate about how the new currency would be introduced, but the whole discussion had moved on to a more realistic footing. There would now be a lot more consultation, including with banks, about the mechanics of transition. It was encouraging that nobody now thought that a decision could be taken until 1998; it was also encouraging that there was a deeper understanding about the need for convergence to be substantial rather than simply perfunctory.

[redacted]

Secretary
3/5/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 26 APRIL 1995

Present
Mr Quinn
Mr Kent
Sir Jeremy Morse
Mr Plenderleith

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.

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

3/5/95

MINUTES OF A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 3 MAY 1995

Present

Mr George, Governor
Mr Quinn
Sir David Cooksey
Mrs Heaton
Mr Kent
Sir Chips Keswick
Mr King
Sir David Lees
Ms Masters
Mr Plenderleith
Sir David Scholey
Mr Simms
Mr Simon
Sir Roland Smith
Sir Colin Southgate

Before turning to the formal business of Court, the Governor spoke briefly about the appointment of Howard Davies as Deputy Governor, and added that prior to his taking office on 11 September, Mr Quinn would continue to carry out the duties of Deputy Governor.

The Minutes of the Court of 19 April and the Meeting of 26 April, having been circulated, were approved.

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

The Report and Accounts of the Bank for the year ended 28 February 1995 - in draft (Mr Midgley and [redacted] of Coopers & Lybrand in attendance).

Mr Quinn presented the Accounts for the year to February 1995, highlighting three issues in particular: the provisions in respect of National Mortgage Bank; the treatment of post-retirement benefits; and the profit from the sale of part of the Bank's shareholding in the 3i Group.

Mr Quinn invited Members to consider, ahead of the Court on 17 May, the areas where the Directors needed to give a specific opinion: these were -

1 Note 1(a), which included a statement that the Directors' considered the Banking Department to constitute a single business

2 Note 1(d) and Note 13, which referred to the Directors' valuation of the Bank's properties

3 Note 11, including a Directors' valuation of unlisted securities

4 Note 12, stating that subsidiaries have not been consolidated because they are not considered material

5 Note 13, referring to the Directors' valuation of the properties as at 28 February 1994 - carried forward from last year

6 Note 24, referring to the Directors' opinion of the BCCI writ.

Sir David Lees confirmed that the Audit Committee supported these opinions. He added that the Audit Committee had met with the Chairman of NMB, and had discussed with him the presentation of NMB's accounts and the level of provisions. As a result of that discussion, the presentation of NMB's accounts would be improved; the level of provisions was regarded as adequate but not excessive. Sir David Lees also drew attention to the Directors' emoluments note, which provided a considerably fuller disclosure than in the past. This would need to be reviewed again after publication of the Greenbury Report. He said that the Letter of Representation, and the disclosures on the EMI [Note 11] and on CRESTCO [Note 12(d)] were satisfactory.

[redacted] of Coopers & Lybrand said that the Auditors had completed their work subject to a final check. They were satisfied with the provisions and the Accounts. They would be sending a management letter shortly, and would be giving an unqualified opinion in respect both of the Bank's Accounts and the Issue Department.

Sir Chips Keswick asked why the Bank's cash flow statement and balance sheet total had declined by nearly £2 bn over the year. Mr Plenderleith explained that this reflected the trends in our money market operations, there was no NLF deposit this year, and a smaller Issue Department deposit, both of which were matched by corresponding reductions in market assistance via the BIS deposit, and a lower level of bill holdings.

Sir David Cooksey asked for an explanation of the NMB table (page 45) to be included in the note.

Mrs Heaton asked what non-audit work Coopers & Lybrand had provided to the Bank. Mr Midgley said that there had been work for Printing Works, including value for money audits and work on cost accounting. Coopers had been involved with the BITS Project, and in training Banking Supervision staff, and there had been some routine tax advice. Ms Masters pointed out that the Audit Committee did scrutinise this spending.

Sir David Lees said that there was no reference in the Accounts to the Cadbury Code. This was a matter which would have to be addressed next year, and he had asked Mr Quinn to look at this, especially in relation to financial controls and to matters reserved to the Court. The Audit Committee would be addressing this in September. Mr Quinn confirmed that he had put work in train within the Bank.

Mr Simon drew attention to Note 22 (transactions with Directors) and suggested that this should more properly form part of or be adjacent to the Directors' remuneration note. Sir David Lees agreed that for future years this would be desirable.

Mrs Heaton asked how long St Quintin's had been property advisers for the Bank. Mr Midgley said that St Quintin's were only one of several firms used, but agreed to investigate and report back.

Mr Quinn asked if Court were content for him and Mr Midgley to sign the Letter of Representation. In response to a question from Sir David Scholey, he said that the main change from last year was in the reference to the EMI hedge. Court agreed that the Letter should be signed. **[Mr Midgley]**

Draft Banking Act Report for 1994/95 } (Mr Foot in attendance)
Post-Bingham Developments in Supervision}

In introducing the draft Banking Act Report for 1994/95, Mr Foot drew attention to the editorial section, which was intended to point up issues for debate. One outstanding question was whether Barings should be featured in this Section, rather than, as at present, included as a passing reference in the market development section. A number of Directors felt that it should certainly be given more prominence. Mr Foot also said that several of the minor facts contained in the Banking Act Report might draw comment as the implications sank in: particularly the changes on EC branches and banks doing business in the UK, and on the reporting of representative offices.

Sir Chips Keswick expressed doubts about the concept of providing for losses at the same time as loans were made: he hoped that the possibilities described on pages 6-7 of the Annual Report would not be pursued with vigour by the Bank. Mr Foot thought it was worthwhile taking the debate forward. He did not feel there had been much of a response yet from the accountancy profession, despite a speech from Mr Quinn. The Governor stressed that Part 1 of the Report was, as the introduction said, "intended to encourage debate".

Sir Roland Smith was concerned about aspects of the Report being taken out of context, and highlighted the boxes of derivatives and VAR models as possible problem areas relating to Barings. Mr Foot said that he had tried to make sure that there were no hostages there: the Report had certainly not been written with a view to putting tools into other people's hands.

Mrs Heaton said that she was not happy with the presentation of the Bank's restructuring: she thought more should be said about the Wings. She also felt that more should be said about Barings, in particular the decision not to support, which was referred to neither in the Banking Act Report nor in the Governor's Foreword. The Governor said that this was not a matter for the Banking Act Report, but could be included in his Foreword to the main Report.

Sir David Scholey welcomed the new style part 1, but felt that it struck a rather discouraging note: one didn't come to the more encouraging parts until well into the text. He wondered whether it would be better to start with the improved profitability of banks then stress the need for adequate capital; and then stress the risks on lending margins and covenants - "the flight to rubbish".

On post-Bingham developments, Mr Foot said the paper was no more than an update: the main focus was on the work on fraud and fraud awareness, and on training. Sir Colin Southgate asked whether Mr Foot felt that Government/Treasury support post-Bingham had been adequate. Mr Foot said that he would certainly like to be higher in the pecking order for new primary legislation, and that Treasury Solicitors were sometimes a problem. Line officials had improved.

Sir David Scholey wondered what attitudes now were to the SIU: did we now feel we should have had it before? The Governor said that it had been immensely useful, particularly in the recent case of Meridian Bank. Mr Quinn said that it had brought a different dimension to our work and was certainly fully employed. Sir David Scholey felt that supervision of banking was going to get increasingly into the securities area, and felt that there might be a parallel need to develop regulatory competence there. Sir Chips

Keswick was concerned at the implication in the SIU's work that the Bank didn't know its customers well: but Mr Foot said that most of the SIU's business had related to overseas-domiciled or registered banks. **[Mr Foot]**

The Executive Report: Sale of 3i shares

Mr Kent said that there was likely to be an announcement next Wednesday that a number of bank shareholders would be selling all or part of their remaining shareholding in 3i. The Bank was proposing to sell all of its remaining shareholding, realising, possibly, around £130 mn. He felt that Members of Court should be aware of this.

Lord Benson

The Governor took the opportunity to advise Court that a Service of Thanksgiving for the life of Lord Benson CBE would be held at the Guards Chapel, Wellington Barracks on Monday 26 June at noon.

Draft Report by the Board of Banking Supervision for 1994/95 (Sir Alan Hardcastle, Lord Swaythling, Sir Dennis Weatherstone and Messrs Gerrard, Foulds and Taylor - the independent members of the Board - were in attendance).

The Governor and Messrs Quinn, King, Kent and Plenderleith withdrew, and Sir David Scholey, the most senior Director remaining, took the Chair.

Sir David Scholey welcomed the independent members of the Board of Banking Supervision. The intention had been to invite the Board to reflect on the developments over the year, and particularly on the relationship of the independent members with the Bank. The meeting would give them an opportunity to bring points of interest and concern to Court.

Sir Alan Hardcastle said that the year had not until recently been unduly busy: but the pace accelerated towards the end with the Barings Inquiry. There were no particular concerns on relations with the Bank. The independent members had never had any sense of the Bank denying them information, and while they had not yet been able to form a view on Barings, they had not come across any instances where they had been driven to doubt the competence of the Bank's supervisors. They saw Mr Foot as a positive and forward-looking Head of Supervision. There was always a question about resources, but no sign at the moment of undue strain.

Sir David Scholey wondered how speculative the supervisors were prepared to be. He was not sure that they always had a sufficiently broad approach to supervision. Mr Taylor said that recent papers to the Board had been much better, more factual and better argued. Mr Gerrard said that he had specific worries about the culture of supervision. An illustration was the reference in the Banking Act Annual Report, to the peer group review. This was presented as an interesting exercise that might be repeated elsewhere, but had in reality thrown out concerns about the Bank's supervisors which they would need to address. He also questioned whether sufficient written confirmation was sent to banks about the conclusions of supervisory meetings.

Mr Foulds felt that it was worth saying that the Bank had been the first supervisor to agree to a peer group review. He also commented that the ex-officio members of BOBS tended to set the agenda for meetings. It was not always clear to the members that they were necessarily looking at the right things.

Sir Chips Keswick was concerned that the supervision area was underfunded. He felt that the Bank had become too proud of its ability to cut costs, and that its operations were creaking at the edges. He also felt that the quality of some of the younger people was not good, essentially because we were not paying enough in the market. Sir Alan Hardcastle said that all the members would like to see resources in Supervision increased, but in a controlled way. Sir David Lees said that he had been struck by references in the Board of Banking Supervision minutes to the supervisors operating 11 to 12 people under budget. It was clear that the supervision function had a high turnover, and that the Bank needed to make better forecasts of the likely loss of staff. Sir Dennis Weatherstone said that when he joined the Board he had gone round Supervision and talked to some of the Group Heads. He had reported their comments to the Board: there was no great crying out for resource, but the average tenure was low, and technology was not adequate. It sounded as though the problems were being addressed, and certainly the management in Supervision were open to suggestions and receptive of new ideas. Ms Masters said that she too had been to talk to the Supervisors. There was clearly a worry about resources and she wondered whether the right people were being recruited. Many supervisors seemed to be young and inexperienced; there were not enough senior staff, and there was a need to look at whether there were adequate resources put into training staff and keeping them. She also questioned the presumption in the Bank that the best kind of supervisor was a Bank generalist, and that accountancy, banking and legal expertise was always subservient - helpful but not central. The core problem was getting good people in. Sir Colin Southgate said it was his impression that within the Bank it was seen as a poor man's Division. He had always felt, in the wake of BCCI, that the Division was slow at grasping issues - there was a tendency to look for reasons for the other side to delay action. Lord Swaythling said that that was indeed one of the Supervisors' problems - the anxiety to find a way round a problem, rather than face it head-on. Sir Alan Hardcastle referred to the introduction of fact-sheets at an early stage in the Board's life, to make sure that Board members were aware of problems before they were brought to the Board, and could spot where issues were being allowed to drag.

Sir David Scholey wondered whether the independent members ever met informally with the Governor to discuss in general terms the remit and work of the Board of Banking Supervision, as the Non-Executive Members of Court did, once or twice a year. Some of the independent members expressed interest in this idea.

Sir David Scholey thanked members for a helpful discussion and said that he would look forward to repeating it in future years.

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 10 MAY 1995

Present
Mr George, The Governor
Mr Quinn
Mr Kent
Sir Jeremy Morse
Mr Plenderleith

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.

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

Responding to Sir Jeremy Morse about his latest monthly meeting with the Chancellor, the Governor confirmed that this was the first occasion that a formal announcement of unchanged interest rates had been made; the reason was the market expectation, prior to the meeting, of an increase. The Governor further confirmed that future interest rate changes were likely to be implemented as soon as the decision had been taken for the same reason unless there were powerful reasons not to move immediately. He added that the present arrangements were entering their most testing phase so far, and he anticipated a lively public debate about their appropriateness.

Chairman

Secretary 19/5/95

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 17 MAY 1995

Present:

Mr George, Governor
Mr Quinn, Acting Deputy Governor
Sir David Cooksey
Mrs Heaton
Sir Christopher Hogg
Mr Kent
Sir Chips Keswick
Ms Masters
Mr Plenderleith
Sir David Scholey
Sir Roland Smith
Sir Colin Southgate

The Minutes of the Court of 3 May and the Meeting of 10 May, having been circulated, were approved.

Inflation Report Discussion and Market Charts (Messrs Allen and Bowen in attendance)

Commenting on the Bank's Inflation Report, which had been published the previous Thursday, Mr Allen said that the rate of inflation had increased, on all measures, since the previous Report. There had been some pick-up in monetary growth. The exchange rate had fallen, with the ERI down 5% since the February Inflation Report. Preliminary figures for GDP growth in the first quarter suggested that the economy was continuing to expand at around 3% annually. However retail sales were subdued, and earnings growth weak. Manufacturers input prices could be easing up a little.

Turning to the prospects, there was still clear evidence of a dual economy, with manufacturing strong, and consumer demand weak. There were uncertainties: the data on manufacturing output were at variance with recent survey evidence. There was also uncertainty about the impact of the fall in the exchange rate. To assess the implications for the future, we needed to understand the reasons for the exchange rate fall: and in particular to understand why it had fallen when relative bond yields between the UK and other countries had not changed. The Inflation Report had explored possible reasons; and, drawing them together, saw the likelihood of an initial upward move in prices, which led to the Government's inflation target being exceeded, and then a question as to whether second round effects took place, and whether the authorities accommodated them. It was this question that gave rise to the upward risks in the forecast.

Commenting on the markets, Mr Plenderleith said that the absence of an increase in interest rates on 5 May, despite strong market expectations that there would be one, and subsequent events including the Bank's inflation forecast, had not had a sustained adverse effect on markets. The pound had initially fallen, but then risen quite strongly. Medium-term interest rate expectations were no higher than before, and the gilts market had shared in the recent world bond market rally. There were several reasons for this: one was a strong rise in the dollar; another an expectation that an increase in UK rates was now just a matter of timing. The Inflation Report had confirmed to the market that the Bank, at least, still had its eye on the ball. The Chancellor had publicly repeated his commitment to the inflation target. Nevertheless the markets were plainly volatile and jumpy, which was not necessarily a source of comfort.

The Governor asked Directors how they viewed output against the conflicting evidence, and what they saw as the prospects for prices. Sir Christopher Hogg said that he still felt the state of the economy to be less precarious than generally presented in the press: economic growth still seemed strong, and price pressures were much in evidence. Sir Colin Southgate thought that there was little pressure to put prices up in the consumer durables area, but that growth forecasts were reasonably healthy. Sir Roland Smith said that pressure to raise prices was constant. Where they couldn't raise prices directly, manufacturers were trying to change price levels by re-engineering or re-packaging products. In some manufacturing areas, capacity was being very intensively used. Many people were looking for ways to expand capacity in a hurry. On the conflict between the CSO figures and the survey evidence, he wondered if the CSO sample was up-to-date. Sir David Cooksey said that many companies were now regretting not having invested in capacity a year ago and were planning more now. The Governor reported comments from Mr Simms, who could not be present at Court, that prospects in the construction sector still seemed flat, with the likelihood of a significant fall in housing starts.

The Governor said that this was clearly a very difficult moment for policy. We were of course conscious that our forecast could be wrong. The issue for us was to give the best advice we could, to say what we thought was the most likely outcome. The bottom line was that we thought that the Government, on present policies, could not meet its inflation objective by the end of the present Parliament. Given that belief, we had no option but to advise accordingly. There were lots of data still to come, and some might well, at least in the short term, appear to contradict the Bank view.

There had been talk of confrontation, and of the Bank throwing its weight around. This was exaggerated: what we were doing was giving our best, disinterested advice, as we had been asked to do. The Chancellor understood that; the meeting on 5 May had not been an angry one. It was very helpful that the recent sequence of events had not led to a financial market crisis; and this enabled us to assess the arrangements in a reasonably mature way. The Governor was nevertheless worried that the exchange rate did remain volatile; there was the possibility that it might rise, which might of course cause people to ask what the Bank had been fussing about; but then it could go the other way. It was impossible to say. Either way, short-term movements would undoubtedly be over-interpreted.

Sir David Scholey asked whether the Treasury thought that the recent movements in the markets supported the Chancellor's view or the Bank's. In Sir David Scholey's view they supported the Bank; the sterling bond market was clearly expressing a view that the Government was not going to meet its implied target. The movement in the exchange rate at the short end was reflecting that. The Governor said that the Treasury was well aware of the position; all sides were anxious to avoid commenting on market movements. It had in fact been the case for some time that the market had not been wholly persuaded that we would meet the inflation objective, although progress was being made. There was a strong sense in Government that it should not be pushed around by the markets, and he could understand that. But what the authorities could not get away from was the fact of where they were relative to the inflation objective.

Sir Chips Keswick said that with yield curves world-wide beginning to slope downwards, spot currency relationships could easily change despite interest rate differentials, rather than because of them. We needed to get away from the perception that interest rates were in some way controlling exchange rates. The Governor said that we didn't believe that by tightening policy we could raise the exchange rate: and we were not aiming at that. We were aiming at the control of inflation, and at curbing the second round effects coming from the exchange rate fall. It was true that a lot of commentators took a more simplistic view. Sir Chips Keswick thought that we should do all that we could to counter it. Sir Roland Smith commented that the Government was under enormous political pressure to ease up on counter-inflation policy. He had heard it from senior members of the House of Commons recently. The Governor agreed that there was no question about where popular sentiment lay, but equally the Bank had to do its job, to say what the implications of growth and market movements were for inflation.

Sir Christopher Hogg said that he hoped that the Bank's forecasts would not lose credibility by being perpetually on the hawkish side: the Governor noted that the official Treasury's analysis was at present considerably more hawkish than our own. Nevertheless, the Governor said, pursuing the line that we had embarked upon would have significant implications for the Bank. People would say it was time to put the Bank back in its kennel. It was entirely possible that short term developments might appear to confound our fears of the long-term inflationary threat, in which case adverse comment on the Bank would only increase. He hoped that Members of Court would be able to help us not least by monitoring outside perceptions of the Bank's position.

Report and Accounts of the Bank for the year ended 28 February 1995 (Mr Midgley in attendance)

In response to a question raised by Mrs Heaton at Court on 3 May concerning the use of St Quintin for valuing the Bank's properties, Mr Midgley said that the relationship was a very long-standing one; but now that the question had been raised he proposed to review it in some depth, from the point of view of getting value for money.

Mr Quinn said that the Report and Accounts presently before Court incorporated the minor presentational amendments mentioned at Court on 3 May together with other changes, which had been placed in folders. He drew Court's attention in particular to the mention of the Bank's intention to sell more of its holding of 3i.

Mr Quinn drew to Court's attention the various points in the Accounts where the Directors give a specific opinion in addition to the overall "fair presentation of accounts". These were all as mentioned at Court on 3 May.

Mr Quinn said that Coopers & Lybrand had written to confirm that they knew of no reason why the Letter of Representation should not be given. The Letter of Representation was as approved by Court on 3 May.

Court gave approval for the Accounts to be signed, for the Annual Report and Accounts for the year ended 28 February 1995 to be printed and issued and for the Letter of Representation to be signed.

Mr Quinn reported that, pursuant to Section 1(4) of the Bank of England Act, 1946, a further payment in lieu of dividend of £50,381,000 would fall due to HM Treasury on 5 October 1995, bringing the total payment in lieu of dividend for the year to 28 February 1995 to £102,231,000. Court approved thereto.

Banking Act Report for 1994/95 and Deposit Protection Board - Annual Report and Accounts (Messrs Foot and Cobbold in attendance)

Mr Foot presented the Banking Act Annual Report, and outlined the changes made since the draft seen by Court on 3 May. Court noted the Report.

With reference to Minutes of 13 July 1989 and 4 February 1993, 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.

Introducing the Annual Report and Accounts of the Deposit Protection Board, Mr Foot said that it had been a relatively quiet year for the Board, and the Accounts were sound. There was a prospect of some recovery from BCCI at some stage later in the year. Sir David Scholey asked how long the Board was liable to BCCI depositors who had not yet made claims: Mr Cobbold said in theory the liability was perpetual, though there was a legal issue as to whether the Board could be compelled to pay after the company had been finally wound up and proof of debt could not be obtained. Court noted the Report.

Review of Branches and Agencies (Messrs Midgley and Kentfield in attendance)

Before inviting Mr Quinn to introduce the paper on the review of Branches and Agencies, the Governor mentioned that the Shadow Chancellor, Gordon Brown, was likely to make a speech that afternoon which would be generally supportive of the Bank and of its new monetary policy role, but which would stress the need for the Bank to have adequate "regional input". This provided a slightly sensitive background to any statement that the Bank might make about the Branches and Agencies. The Governor also drew the attention of Court to various letters received from MPs, copies of which had been placed in folders.

Mr Quinn introduced the paper. He said that the question of the role of the Branches had been before Court twice in the past ten years, in 1986 at the time of the Kentfield Review, and in 1991 when the Bank's banking work had been reviewed. At the end of the 1991 review we had undertaken to the staff of the Branches not to make any further changes for five years. That period was now more or less up.

The Bank had continued to lose clearing and banking business on account of intense competition. Cheque clearing was a declining industry, and we were getting a smaller share of it. It was clear that note issue work was the rationale for the Branch operations, so that had been the main focus of the review. As it happened, while the review was in progress, we had been approached by the Clearing Banks inviting us to consider radical changes. The paper reported a decision in principle to outsource cheque clearing and cease cheque clearing at the Branches, and to review with the Clearing Banks possible changes to the note issue, accepting that this could have serious implications for the Branches.

Sir Chips Keswick said that it was plain that the Bank had decided to close its Branches. The reasons given for closure were not convincing. He thought that the core problem lay in the Bank's reluctance to compete with the clearers, on the grounds that we took CRDs from them. Over the years we had therefore let the banking business of the Branches decline to a point where they had no viable future. He didn't believe that the decision to close the Branches was correct, or that the stated justification was persuasive. He thought that, in the absence of a substantial Branch doing real business, the credibility of an Agent would be impaired. He could not support the Bank's paper or the press notice.

The Governor said that it was wrong to say that CRDs were the sole reason for us choosing not to compete with the Clearers. If we were consciously to try to provide a full modern banking service, we would need to make many changes; we were at present not equipped to do so. It was also not true that the Agency function was eroded if there was no actual Branch presence. We had looked at that issue, and had found that it did work - for instance in Liverpool.

Sir Christopher Hogg expressed general approval of the paper. He had no sense at all that the Bank should be in banking: he was pleased that the economic representation role was to continue. He felt that the quality of the Agents' Reports was very good, and that the Agents themselves were far better than any analogues. He was wholly unmoved by the letters from MPs. He couldn't believe that the Bank's Branches themselves gave credibility to the Agents: what mattered was the quality of the people chosen to be Agents. Sir David Cooksey said that he, too, could not see the connection between doing banking business in the provinces and the Agents' representational role. He did find that people valued the Agents, though he wondered whether, looked at from a value for money point of view, the case for continuing and expanding the Agents' role had been made. Ms Masters agreed, and said that while the Agents were plainly valued, the paper didn't explore alternative ways of gathering economic information. The Governor said that he would be wholly opposed to having no Agents, or using outside agencies to gather information. But he would bring to Court proposals for continuing and expanding the Agents' role.

Sir Colin Southgate said that he was quite clear that the note distribution function should not be done through the Branches. We could in theory manage with a single note distribution site located close to a motorway. There was no logic in the Branches being involved. However there was great value in the Agents. It couldn't be measured in pounds, but it was plainly a great advantage for the Bank. He would strongly oppose any suggestion that the Agents should do their business from "a front parlour". It was important that they should have adequate premises of their own. The Governor said that this related back to Sir Chips Keswick's point. We did envisage the Agents continuing to have adequate premises. Mr Kent said that there had been some loss, in for example the Winchester area, from not having a more obvious physical presence. We needed to have something sufficient for people to notice that the Bank was in town. He hoped that in the press release we could stress that the Agents, and their physical presence, would be maintained in the main centres of the United Kingdom.

Mr Plenderleith said that he had initially approached the review with a view that we should remain as a bank. We had an efficient small-scale banking business, especially now that the computer changes had taken place. However the Branches were different. Most of their banking activity was simply cheque sorting: and cheque sorting was a bad business to be in. For the Bank as a whole, it meant that we were dependent on a few very large customers, and were tendering on a highly uneconomic basis for business.

Sir Roland Smith said that it was very important that adequate accommodation should be provided for the regional Agents. He also noted the enormous hostility in the country at large to the centralisation of economic decision-taking in London. This would have to be handled carefully.

Sir David Scholey said that he had no difficulty with the concept of closing the Branches. For a long time the issue had been fudged. The real question was how the Agents should be recruited. We should be clear that the Branches were not closing but re-emphasising: and we should make sure that the right people were chosen to be Agents. The Governor said that he didn't think anything we were doing would change the nature of the Agents: they had always been carefully selected. Sir David Scholey asked whether it was seen as a terminal appointment or as part of a Bank career. Mr Plenderleith said that several had gone out to be Agents and then returned with the prospect of a career in Head Office. Sir Christopher Hogg said that the ideal role for an Agent was that of ambassador, they should have the skills and resources to fulfil that.

Mr Kentfield noted that there had been little comment thus far on the question of dispersing other Bank operations to the provinces. The Governor felt that this could not be addressed now. We could only send false signals: our capacity to disperse was very small.

The Governor said that he felt that the sense of Court was in favour of preserving the Agents economic/business representational role; he would ensure that the press notice reflected the strong sense of Court that the Agents should maintain a clear physical base for this activity.

Court <u>approved</u> the proposals, set out in the paper, that

(1) Consequent upon the outsourcing of cheque clearing, the banking activities of the Branches be discontinued.

(2) Discussions take place with the clearing banks relating to all note activities except printing and authentication.

(3) The economic liaison role of the Agents be continued.

The Bank's Need for Capital and Reserves (Messrs Midgley and Foot in attendance)

With reference to a Minute of 19 October 1994, Mr Midgley introduced his paper which invited Court to consider what should be the appropriate level of capital and reserves for the Bank. He said that were many reasons for holding capital, but the core issue was the Bank's involvement, from time to time, in bank support operations. The question was who paid for such operations. In practice, the present system ensured that the banks did. Mr Foot said that the Bank seemed to meet the Basle minimum capital requirements for its normal activities.

Sir Chips Keswick said he had found the paper very clear. The only question was what capital we needed for potentially unlimited Lender of Last Resort Operations. The Governor said that there would always be a limit on what we could do from our own balance sheet. Mrs Heaton asked about international comparisons. The Governor thought these were unlikely to be helpful, as central banks abroad often had note issue and the reserves on their own balance sheets.

Sir David Scholey felt that we could argue either that we needed no capital, on the grounds that we were in the public sector, or that we needed a lot. He could see circumstances in which we might have found such a balance sheet useful had we chosen to support Barings. Mr Quinn added that it suited the Government for the Bank to have capital that could be discreetly deployed in such cases. He firmly believed the Bank should continue to hold capital for purposes of official support and felt we were correct in rebuilding it in relation to the growing riskiness of the banking sector.

Mr Kent took issue with the paper's view that CREST, Eurotunnel and ECHO all represented risks to the Bank In his view they did not.

The Governor said there was no suggestion from HM Treasury that the dividend formula, which allowed us to build up capital, ought to be changed. He took the sense of the discussion that Court agreed with that view.

A Report of the Trustees of the Court Pension Scheme

The Governor, having declared his potential interest in the Court Pension Scheme, together with those of Messrs Quinn, Kent and Plenderleith, invited Sir Roland Smith, the Chairman of the Trustees of the Court Pension Scheme to introduce his Report which contained the following recommendations:

(a) the annual pensions in payment to former Governors and Executive Directors and allowances to the widows of former Members of Court be increased, with effect from 1 July 1995, by the amount of the increase in the Retail Prices Index for the twelve months ended 31 May 1995.

[redacted]

(c) the annual allowance paid to Lord Richardson from the Court Pension Scheme under special arrangements which were approved by Court on 10 February 1983 be increased in accordance with those arrangements.

Court approved the recommendations, subject to ratification by those Non-Executive Directors who could not be present at the meeting. The Secretary reported that Mr Simon had already written to support the recommendation.

Houblon-Norman Fund (Mr Allen in attendance)

Sir Roland Smith, introducing the accounts of the Fund, said that arrangements had been made for the Fund to be managed by the Bank's Investment Unit. Objectives had been set, and benchmarks established. The new arrangements, which took effect on 1 March, were working well.

There being no comments on the Accounts of the Houblon-Norman Fund for the year ended 30 June 1994, the Governor invited Mr Allen, in the absence of Mr King, to comment on the Report of the Committee and the work of the Fellows. Mr Quinn wondered why the Fund was seen as available to support only research relevant to the Monetary Analysis work of the Bank. The Governor felt this to be a valid point, and Court <u>recommended</u> that the Fund should in principle be available to finance research across the whole field of the Bank's activities. Ms Masters suggested that the Advisory Committee, in seeking proposals for research, might suggest areas in which it would be interested in seeing work done. The Governor agreed that this would be sensible.

The Executive Report

BCCI Litigation

With reference to a Minute of 16 November 1994, Mr Quinn advised Members of the latest state of play concerning BCCI litigation. He said that when this litigation was last reported at Court, reference was made to two defects in the Statement of Claim:-

(a) failure to allege that Bank had a <u>discretion</u> as to whether or not to revoke BCCI's licence/authorisation, and that the Bank had knowingly exercised that discretion (against revocation) improperly;

(b) failure to allege that the Bank had the requisite degree of <u>knowledge of the consequences</u> of its alleged misfeasance sufficient to establish the tort.

At that time the intention had been to have the Court determine the two points by way of the Bank issuing an application <u>to strike out</u> the Statement of Claim, and dismiss the proceedings. Leave to make such an application was not required. [redacted]

Following the recent receipt of proposed amendments to the Statement of Claim from the liquidators, the Bank had now re-considered its strategy. [redacted] the Bank was <u>not</u> now pursuing the point in paragraph (a) above at this stage.

With regard to the point in paragraph (b) above, the proposed amendments were still considered to be inadequate. [redacted] the point should be determined not by way of a <u>strike-out</u> application, however, but by way of appropriate <u>preliminary issues</u>. Unlike a strike-out application, the leave of the Court <u>is required</u>, [redacted] If the preliminary issues are decided in the Bank's favour, the proceedings will be dismissed.

The liquidators' view had been, and remained, that the law deemed the Bank to have intended to cause loss to BCCI's depositors. This is because (a) some loss to some depositors at some time in the future was an inevitable consequence of the Bank's action in wrongfully licensing/authorisating BCCI and (b) the Bank is to be taken as intending the consequences of its actions.

The application <u>for leave</u> has been provisionally arranged for a date in the second half of July. If leave was granted, the substantive time hearing may take place before the end of the year.

Sir Alastair Pilkington

The Governor mentioned that the press had reported, the weekend before last, the death of Sir Alastair Pilkington who had been a Non-Executive Director of the Bank from 1974 to 1984. He had died on 5 May at the age of 75 after a short illness. A donation of £500 had been made to the Trinity Hospice in Clapham, in lieu of flowers, from the Governors' and Directors' of the Bank.

21/6/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 24 MAY 1995

Present
Mr George, The Governor
Mr Kent

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.

David Scholey

Chairman

Secretary 21/6/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 31 MAY 1995

Present

Mr Quinn, Acting Deputy Governor

Mr King

Sir Jeremy Morse

Mr Plenderleith

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

David Scholey

Chairman

[illegible] 21/6/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 7 JUNE 1995

Present

Mr George, The Governor

Mr Quinn, Acting Deputy Governor

Mrs Heaton

Ms Masters

Mr Simon

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.

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

21/6/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 14 JUNE 1995

Present

Mr Quinn, Acting Deputy Governor
Mr King

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.

Chairman

21/6/95

[redacted]

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 JUNE 1995

Present:

Mr Quinn, Acting Deputy Governor
Sir David Cooksey
Mrs Heaton
Mr Kent
Sir Chips Keswick
Sir David Lees
Ms Masters
Sir Jeremy Morse
Mr Plenderleith
Sir David Scholey
Mr Simms
Sir Roland Smith
Sir Colin Southgate

Mr Quinn reminded Court that on 17 May, Court had approved the recommendations contained in the Report of the Trustees of the Court Pension Scheme subject to ratification by those Non-Executive Directors not present at that meeting. Mr Quinn confirmed that the Non-Executive Directors in question had subsequently ratified the recommendations.

Accordingly the Minutes of the Court of 17 May, and of the Meetings of 24 and 31 May and 7 and 14 June, having been circulated, were approved.

Monthly Economic and Market Report, including market charts (Messrs Allen and Bowen in attendance)

Mr Quinn invited Mr Plenderleith to comment on the Minutes of the Monetary Meeting between the Governor and the Chancellor on 5 May, which had been released that morning. Mr Plenderleith reminded members that the Governor's advice on that occasion had been based on the forecast in our May Inflation Report, published a few days later. That saw inflation, assuming unchanged interest rates, rising to 3 1/2%-4% in the summer of 1996, falling away to slightly above the top of the lower target range in the first quarter of 1997. The Governor's advice had pointed to the risks of not raising interest rates, and had concluded with a clear recommendation to do so. The Chancellor, on the other hand, had taken the view that the economy was slowing, and that few signs of inflationary pressure were emerging. He therefore judged that the data did not justify a rise that month. Although the fact of the disagreement had been widely surmised, the Minutes were nevertheless bound to attract comment. Mr Plenderleith made three points:

1 We had, as we were bound to do, given the best candid advice we were able given our forecast and the Government's target. We had acknowledged that there was a balance of risks, but our duty as a central bank was not to take risks on the side of inflation.

2 Inevitably people had looked at recent indicators as a guide to whether the Governor or the Chancellor had been right; thus far those indicators had been judged to favour the Chancellor's view. But it was far too soon to judge who was right and who was wrong: we would not know that for many months.

3 There had been much comment at the time, owing to the proximity of the local council elections, that the decision had been reached on political grounds. Mr Plenderleith could say, having attended the meeting, that politics had not entered into the discussion at all: the decision had appeared genuinely to have been taken on economic grounds; certainly the discussion had been entirely in such terms.

Introducing the Monthly Economic and Monetary Report, Mr Allen said that the RPI had come out exactly as we had predicted in April, but had been a little higher than our expectation in May, perhaps reflecting the depreciation of the exchange rate coming through in retail prices. It was interesting that prices were rising despite the weakness of sales. It was possible that manufacturers and retailers now had less scope for squeezing margins. Nevertheless, our analysis of the likely effects of exchange rate changes was the same as it had been at the time of the Inflation Report: the ultimate effect would depend on the reasons for the decline in the exchange rate. Mr Allen also pointed to the development of bond yields: after the May meeting, and the decision not to raise interest rates, conventional gilt yields had generally fallen in relation to indexed gilt yields; but since the beginning of June they had risen again, suggesting that there had been an upturn in the market's expectations of inflation. It was also clear that broad money and credit were accelerating, driven in particular by borrowing by industrial companies. Survey evidence, the Agents' reports and the employment data all suggested some slowing of the economy; consumer spending was still subdued, as was the housing market. The first quarter GDP figures had suggested that the main contribution to growth was coming from net exports, and it was possible that the recent revisions to the trade figures, which had shown further improvements in the trade balance, could result in a further revision to GDP. We would know when the next set of data was published on Monday. Overall, however, demand and output were developing a little bit less buoyantly than we had expected, while inflation was rising a little faster.

Sir Colin Southgate said that the next monthly CBI survey was likely to show a lower net positive balance for order books, but an improved export order position. Output indicators were slightly down, as were average price increases. He felt that average earnings currently looked satisfactory and were holding steady. Looking at his own industry, margins on durable goods were weak, but on other products there was scope for increasing prices. Sir Roland Smith said that companies in the export sector were doing better and better. Anything involving the home market was becoming worse. There seemed to be a significant transfer of prosperity towards manufacturing. There was also an increasing divergence between trends in activity and trends in prices. This was likely to be relevant to the development of prices over the coming months. Sir David Lees agreed. In a lot of areas profit margins were buoyant, because activity was high. Manufacturers could make returns from higher activity without raising prices. The problem came when activity fell off: at that stage they would have to try harder to achieve price increases.

Mr Simms said that the construction sector was still flat, and prices on tenders very weak. Employment was falling. The housing market was extremely weak, and he felt that there could be an unpleasant shakeout in the industry yet to come. Sir Chips Keswick felt that there was an incipient threat to the world economy from the currency market. The flatter US yield curve had made bond and derivative markets less profitable: attention would now focus on Japan, which had chosen to repatriate assets; the question was whether, in order to protect their banks, they would choose to let the yield curve steepen in the way in which the Americans had four years earlier.

Sir Jeremy Morse, reverting to Mr Plenderleith's comments, wondered where the disagreement had left the new monetary policy process. The Chancellor had clearly been confident of his ground, and had taken the initiative in announcing his decision not to change rates. Sir Jeremy thought this took away the Bank's discretion over timing of interest rate changes, which he had seen as an important part of the new monetary framework. He was not sure about the "balance of risks": this language would have been more appropriate to the stage when we had been deliberately anticipating anti-inflationary pressures, and were in a better position to choose our timing. Sir Jeremy felt we were now past that stage: the question was starker and more immediate. Sir David Scholey said that the Minutes - and the Chancellor's subsequent Mansion House speech - had very strong political overtones, notwithstanding Mr Plenderleith's comments. But he was struck by the extent to which we had warned about the market implications of not moving rates.

Mr Plenderleith felt that we had been bound to give that warning. The market had in the event responded quite well to the perception of a disagreement; although there had been a sudden weakening in the exchange rate, the subsequent rise in the dollar had come to sterling's rescue. The Chancellor and the Governor had worked hard to stress the common ground between them. Mr Plenderleith hoped that the debate was moving towards the more grown-up phase, where people recognised that the Bank was tendering advice and the Chancellor was taking the decisions. In response to an earlier question, he confirmed that the Treasury officials had agreed with the Bank's advice; Mr Quinn commented that the entire Ministerial Team had, however, supported the Chancellor. On the apparent weakening of the Bank's "timing" discretion, Mr Plenderleith felt that that had never been likely to amount to much once the calendar of meetings had become firmly established in people's minds.

Survey of Financial Stability in Japan [redacted] in attendance)

Introducing his paper, [redacted] said that there was a general recognition that some action was likely to be needed to deal with the incipient financial problems in Japan: the Japanese needed both to get their banks out of immediate trouble, and to take steps to streamline the financial community. The environment for both was extremely difficult. There was great hostility in Japan to banks and politicians, and great resistance in giving any help to the banking system, as had been shown in December. The implications of the threat to the Japanese banking system were very considerable. The Japanese banks were important players in London, and the collapse of one or more Japanese banks would certainly have an effect here. It was important not to exaggerate. But even short of an apocalyptic outcome, it was possible that we could see funds withdrawn from the London market.

All Members of Court felt that the paper was an excellent one, and raised very important issues. Sir Jeremy Morse wondered whether we had discussed the general issue with the Bank of Japan, and what analysis we had undertaken of the likely problems in London that might ensue. Sir Roland Smith and Ms Masters both agreed that a strategy for dealing with the contingency was needed.

[redacted] said that he had regular discussions with the Bank of Japan and that our formal links with them were very good. The informal dialogue could be less productive: one could not always be sure how open the Japanese were being. Court Members suggested that there was a group of significant Japanese eg Gyohten, in both the private and the public sectors, who could be effective intermediaries in this kind: it might be worth opening a dialogue at that level.

Summing up the discussion Mr Quinn said that we would certainly need to consider the positions of Japanese subsidiaries and branches in London. The main risk was that the Japanese authorities would not react promptly to a failure of a financial institution with overseas operations and future market disruptions could follow. We should prepare ourselves for this possibility. Mr Plenderleith said that there was a direct implication for the Bank, and that we had many Japanese counter-parties both in our own account business and in dealing for HM Treasury.

Sir David Lees suggested, and it was agreed, that the subject should be revisited at a future Court later this year.

The Barings Investigation

Mr Quinn said that the Board had very largely completed collecting and analysing the evidence, though there was still the Maxwellisation stage to be completed.

The intention now was to produce a single report, but in two parts: the first would be an account of what had happened and of the roles and responsibilities of individuals and institutions, and how they discharged them. This part of the report would make judgments, draw conclusions and name names. The second part of the report would contain recommendations arising from consideration of the Barings affair. These recommendations would be tightly drawn, confining themselves to matters relating directly to Barings and not going wider. It would differentiate between recommendations relating to banks, the Bank of England, other supervisory authorities and so on.

The evidence available to the Inquiry was not complete. There had been little from Singapore, either in terms of papers or access to people. Coopers & Lybrand had given no access to their reports or

working papers. And of course there had been no access to Mr Leeson himself. Nevertheless, the team had felt able to draw conclusions. The Maxwellisation process was now going on. The Bank's own response to a Maxwellisation letter was going in the following day. Others criticised had made substantial representations, and this could have repercussions for the timetable.

The timetable was extremely tight. It was likely that Parliament would go into recess either on 14 or 20 July. The Chancellor and the Governor were very keen to put a report before Parliament before the recess, and were very sensitive to complaints about foot-dragging. It was possible that Singapore would publish a report soon - conceivably before our own. We were therefore aiming to produce a report against the deadline of 14 July. This was putting enormous pressure on the Board and the team, especially given Maxwellisation; but thorough Maxwellisation was essential because of the risk of judicial review. Complications involving legal and Parliamentary procedures meant that we would have to deliver the report by 7 or 8 July and this left minimal time for printing. The Board would be meeting on 29 June, 2 July, possibly 3 July and finally 7 July.

On the substance, Mr Quinn said he would give Court a full account but warned that this was based on the pre-Maxwellisation draft, and it was for this reason that the Inquiry had felt it inappropriate for Court to see the paper itself. Mr Quinn could nevertheless say that the Report concluded that the Barings failure was primarily a matter of comprehensive failure of management control. The integration of the bank and the securities company and its subsidiaries had simply not occurred at the level of management responsibility and reporting and control mechanisms. The Report made direct and severe criticisms of top management.

The Report also offered no evidence that Mr Leeson had been in collusion with anyone; indeed the inspectors had found it impossible to say why he had done what he had done. It was clear that he had begun in 1992, within a month or two of going to Singapore. It was not clear that any money was missing.

Mr Quinn told Members of Court that the Bank, in the pre-Maxwellisation draft, was criticised for insufficiently critical supervision of Barings following the formation of the combined investment bank. [redacted]

Mr Quinn said that the SFA was also likely to be criticised in respect of Barings activities under the Financial Services Act. He did not know what the investigation would say about Singapore and Japan, but it was likely that one conclusion would be the need for greater co-operation between the Bank supervisors, securities regulators and exchanges. It was unlikely that the Report would recommend any changes to the Banking Act.

Mr Quinn said that a revised, post-Maxwellisation version of the Report should be available around 2-3 July. It was likely to be published before the next long Court, and he suggested that Court members might like a further discussion in the light of the amended Report.

Sir David Scholey and other members confirmed that they would welcome a further discussion as suggested. Ms Masters asked what response the Bank would be making, and said that she felt that Court should have an opportunity to consider this as well.
Sir Jeremy Morse said that there was likely to be criticism of the Bank over and above the technical issues identified in the Report: if the Report found that the major problem had lain with the misfeasance of Leeson and a widespread failure of controls in Barings which should have checked that misfeasance, it was likely that such a major failure of controls would be seen to reflect on the system of supervision.

Sir Chips Keswick said that the most that one could expect was that supervision should have picked up the scale of the lending to subsidiary companies.

Sir David Cooksey had asked whether we had been helpful to Singapore despite their lack of co-operation with us. Mr Quinn said that Singapore had had significant access, including some transcripts undertaken by our Investigation Team. But our access to Singapore had been very limited. We had tried, through the Singapore courts, to obtain access to the Inspector's material, but had been turned down. Subsequently there had been some informal loosening up, but it was very limited. Sir Roland Smith asked if there was any criticism of the Board of Banking Supervision itself in the Report. Mr Quinn said that the Report was unlikely to be critical in this respect. He did not feel that the Report suggested a deficiency in our market understanding, or in numbers of people, or generally of the quality of people. It implied that the wool had been pulled over our eyes, and we hadn't taken proper steps.

Sir David Scholey asked if the positions of any individuals within the Bank were in jeopardy as a result of the Report. Mr Quinn said that this was true in the case of one individual, a senior manager in Supervision and Surveillance.

Court agreed that there would be a further discussion of the Board's Report, and the Bank's response to it, once the Maxwellisation process was over and prior to publication.

A Report of the Audit Committee

Sir David Lees reported on the draft Minutes of the last meeting of the Audit Committee. These included revised terms of reference of the Audit Committee which were presented to Court for approval. Court approved thereof.

Executive Report

1 Mr Quinn mentioned the latest state of play regarding the Officers' pay negotiations and advised Court that a post-event Report on 1995 Pay Awards will be produced for the long Court in July.

2 Mr Kent spoke about the sale of 3i shares.

3 Mr Quinn mentioned that a successor to Mr Peddie had been appointed: Mr Len Berkowitz, of Linklaters. He asked Members to keep this confidential for the moment. [redacted]

4 Mr Plenderleith spoke about the Gilt market reforms.

5 Mr Quinn sought Court's approval for Mr Kent's proposed directorship of Commonwealth Development Corporation. Court approved the directorship.

Finally, Mr Quinn mentioned Governor's Day at the Sports Club and encouraged Members to attend if they could.

A Report of the Remuneration Committee

In accordance with Section 10 of the Charter, Messrs Quinn, Kent and Plenderleith withdrew.

Sir David Scholey, in his capacity as Chairman of the Remuneration Committee, said that there were two recommendations of the Committee before Court for consideration and approval. They were as follows:-

(i) that the special remuneration for Mr Howard Davies, on his becoming Deputy Governor on 11 September 1995, should be set at £180,000 pa.

(ii) that Mr Davies be admitted to the benefits of the Court Pension Scheme subject to any earnings limitation in place from time to time, and that the Bank undertake to pay to Mr Davies, by way of pension and contributions to life assurance policies, such amounts as may be necessary to provide him with the entitlements of the Court Pension Scheme had the earnings limitation not been in place.

The recommendations were approved.

Secretary

5.7.95.

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 28 JUNE 1995

Present

Mr Quinn, Acting Deputy Governor
Mr Kent
Mr Plenderleith

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.

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

Mr Quinn mentioned that a conciliation meeting had been held that morning at ACAS following BIFU's rejection of the Bank's final pay offer in respect of the main bargaining unit.

[illegible]

[illegible]

Secretary

5.7.95

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 5 JULY 1995

Present:

Mr George, Governor
Mr Quinn, Acting Deputy Governor
Mrs Heaton
Sir Christopher Hogg
Sir Chips Keswick
Mr King
Sir David Lees
Mr Plenderleith
Mr Simms
Sir David Simon
Sir Roland Smith

The Minutes of the Court of 21 June and the Meeting of 28 June, having been circulated, were approved.

Court congratulated Sir David Simon on his knighthood in the Queen's Birthday Honours.

Mr Plenderleith spoke about the markets. Sir Chips Keswick said that there was great concern in the markets about the implications of the US/Japanese trade talks, which the Japanese had plainly won and which might have implications for the future course of the yen/dollar rate. Sir David Lees added that during his recent visit to Japan, he had heard increasing concerns being expressed about the position of Japanese banks.

Under the executive report:-

1 Mr Quinn mentioned that settlement had been reached in the Main Bargaining Unit on the basis of a 1 1/2% increase in pensionable salaries, and a non-pensionable bonus of £175 per person. He said that the firm intention was to move towards merit-based bonuses in future settlements.

2 With reference to a minute of 21 June 1995, the Governor said that the Bank had yet to see the final text of the Board of Banking Supervision's findings on the Bank itself, but he expected it to contain some criticism of the Bank and of Mr C J Thompson in particular. The Governor expected Thompson to offer his resignation the following day, and was minded to accept it. A question that arose, therefore, was the terms on which Thompson was to be allowed to leave: whether normal flexible retirement terms, or the enhanced severance terms. An important question in the Governor's mind was the effect on other staff in Supervision of the way in which Thompson's case was handled. The Governor said he was concerned about the difficulty of staffing the area in the future.

Sir Chips Keswick said that Thompson had been a good supervisor, showing integrity and a good understanding of his responsibilities. It was sad that he had to go, and he deserved the best treatment. The Governor said that the main concern arising from the investigation was that he had not been sufficiently inquisitive, and had granted a concession to Barings without reporting it up the line.

Sir David Lees and other Members felt that normal severance terms might not be appropriate in such a case, and that if we wanted to treat him well then an ex-gratia payment might be more suitable. Other Directors felt that the normal severance arrangements might be appropriate. Following discussion Court agreed that it would be right for Thompson to receive, one way or the other, more than the normal flexible retirement terms.

The Governor reminded Members that Court would be meeting on 12 July to discuss the Barings Report, which should by then have been finalised.

Sir David Lees drew attention to recent statements by Gordon Brown, the Shadow Chancellor, and asked what involvement the Bank had had. The Governor said that he was seeing Messrs Blair and Brown for dinner that evening, and had had several conversations with Brown about his ideas on the Bank of England. A Court discussion had been scheduled for September.

Confirmation

Wednesday

19 July 1995