12A110/10

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 12 JULY 1995

Present:

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

A question having been raised on the draft Minutes of Court of 5 July, approval was deferred until the following week.

There being no comments on the markets, Court proceeded to consider the final draft of the Board of Banking Supervision's Report on Barings. At the Governor's invitation, Mr Foot was in attendance.

Mr Quinn said that Court Members had now had an opportunity to read Chapters 12, 13 and 14 of the draft Report, together with a summary of the entire Report, and the Bank's draft response to the main recommendations. A question and answer briefing was being prepared. Comments on the final draft were being collected from members of the Board with a view to sending a final, agreed version to the Chancellor on the following day. The Chancellor was proposing to make a statement in the House, after which there would be a short debate, on Tuesday, 18 July. Parliament was to rise on 20 July, but its last business day was likely to be 19 July, and the Governor and Mr Quinn had been called to give evidence to the Treasury and Civil Service Committee on that day.

The Report would contain the Board's conclusions and its recommendations. The Governor and Mr Quinn had been excluded from the Board's discussions on the role of the Bank and of the SFA. Mr Quinn believed that the Board had tried to judge the Bank fairly and objectively, but we could not entirely agree with all of its judgements. If anything, the Board had endeavoured to avoid any accusation of favouring the Bank, and had judged us by the highest standards. While we did not seek any other measure, this had led to some harshness in their assessment of the Bank.

The Board's main conclusion was that the collapse was caused by a comprehensive breakdown in the internal controls of the integrated banking and securities entity. The breakdown had been so comprehensive that it was difficult to understand how it could have occurred. It was important not to forget that the origin of the problem was Leeson's activities, and these activities extended back over a period of time.

Barings had been trying to put a securities company and a bank together as a single operating entity, and to do so in a number of geographical locations which were competing hard for business. There were different cultures, and different attitudes to controls. There were internal strains and rivalries, and the combined entity had not paid sufficient attention to the need for a controls environment that matched the nature and speed of the risks that they were taking on. There had been confusion about responsibilities, reporting lines and accounting procedures. As a result Barings had been vulnerable to abuse and deceit. Leeson had exploited this. The Report could not say why, but it was clear that his activities had gone undetected or ignored for a long period. Information provided to management and regulators here and abroad had been false and misleading. In early 1995 matters had escalated very rapidly, particularly following the Kobe earthquake. Even then, signs were ignored.

Mr Quinn said that Court Members would want to assess the culpability of the Bank itself. The Report criticised us for the implementation of our policies rather than for the policies themselves or our approach to supervision. These criticisms were focused on one individual, Thompson, who had in fact resigned the previous day. The Report did not conclude that we had contributed, by omission or commission, to the collapse - but neither did it exonerate us. It was conceivable that we might have detected something earlier had we been more vigilant, but Mr Quinn believed this doubtful given the state of Barings' controls in the banking/securities area: and we had no hint of the problems there. Other businesses in the Barings Group seemed to have been conducted properly. We had in fact planned to do a controls inspection on the combined securities/banking entity in March 1995. It was debatable whether Coopers & Lybrand would have discovered the weaknesses.

The present Parliament were unlikely to give us the benefit of the doubt. The Barings management story was well enough known already: the spotlight would undoubtedly be on the Bank. A good deal of attention was likely to fall on Thompson: Mr Quinn said that he stood ready to provide details of his terms of departure, if Court required.

Finally, Mr Quinn said that the production of the Report had been a monumental effort by the Board and the supporting team, with 20 man-years work since March and with the Report completed in less than five months compared with a year for BCCI, 15 months for House of Fraser, 24 months for Blue Arrow, 6 years for Barlow Clowes - and Guinness still incomplete.

Sir David Scholey said that the Report showed that management systems had been inadequate over a long period. It was not clear whether the Bank had been seeing internal audit reports relating to this, and to what extent the Bank had asked questions of management about controls. Mr Quinn said that the problems had begun in 1992 when the securities trading activities of Barings became unprofitable. Questions had been thrown up about management controls at that stage, and had been discussed between the Bank and the SFA. Barings had considered disposing of the securities arm, but had eventually decided to merge it with the bank. We had subsequently had regular contact and stayed close while Barings put the two operations together. We had had contact with the external auditors on control questions, and they had told us that the controls in Barings were "informal but effective". We had taken comfort from that. We had chosen to wait until the merger was complete before instituting a review of high level controls - this had been planned for March 1995.

Sir Colin Southgate said that his concern was the time taken by the Bank to react to events. There was the case of the request of January 1993, which was not dealt with until May 1994. Then there had been the solo consolidation: the first example of its kind, and one that should have required much management attention. Mr Quinn said that it was hard to give satisfactory answers to these questions. It was clear that we were vulnerable: we had not been as rigorous in dealing with outstanding issues as we should have been. In defence of the supervisors, there had been nothing either in the background or in the foreground that might have led them to feel nervous. The large exposure guidelines were about credit risk, and the risks involved seemed very low. Sir Colin Southgate said that the Bank had granted a concession on an existing policy, and should have reviewed that regularly for so long as it was in place.

Sir Christopher Hogg asked whether the Bank talked regularly to overseas regulators about the overseas subsidiaries of UK banks. Mr Quinn confirmed that we did, including to Singapore, who were members of the offshore supervisors group and a country where many UK firms were established. There were in fact good contacts with the Monetary Authority of Singapore, who were a tough, competent and helpful supervisor. But in late 1994 and early 1995 there had been two visits explicitly to check on the operations of UK banks in Singapore: the Monetary Authority had raised no points about Barings - even though they had raised concerns about other institutions. There were recommendations in the Report about liaison with overseas supervisors. Sir Christopher Hogg asked why Singapore had been uncooperative with the Inquiry. Was it because they were defensive about their own role? Mr Quinn said that Singapore was a fast developing financial centre, and the authorities there were indeed sensitive to their image; but they did have genuine legal difficulties as well. The Governor added that we had ourselves found it difficult to pass some information <u>to</u> Singapore through the gateways.

Mrs Heaton asked whether there were a large number of concessions. Mr Quinn confirmed that there were. The large exposures rule had been introduced, by the Bank, in the 1980s, and then redefined by an EC Directive. When banks and securities companies had merged we had had to adapt the large exposures rules, but there had been quite a lot of respecification. One outcome was the granting of treasury concessions. There were probably too many of these. Mrs Heaton noted that the informal concession in this case had run on as policy was still being developed. Mr Foot said that the handling of this had nevertheless been unusual: it would be normal for a concession to be limited both in time and amount, and known to other people.

The Governor said that the apparently leisurely progress of Barings' Osaka exposure reflected the fact that there was a debate on the appropriate treatment of an exposure to a futures exchange: whether it was a single exposure, or whether it was a series of exposures reflecting the support of all the members of the exchange. It was a perfectly reasonable question for debate, and a question on which Barings was entitled to seek legal opinion of its own. It was certainly not a question that needed to be decided immediately. The Governor added that, as presented to the Bank, Barings had been operating on misleading data. There was no ambiguity at all about the connected lending limit. Barings understood, and we knew they understood, that the limit was 25%. The fact was that Barings thought the top-up represented lending to clients, and consequently they did not report it as connected lending.

Sir Colin Southgate said that he found the performance of the auditors highly questionable. Sir David Cooksey agreed: the Report said that Leeson squared off his books at the year end, but nevertheless there had been massive funding, which should have been spotted. Mr Quinn said that the auditors had chosen to test sample transactions, rather than all transactions. This was legitimate, but the testing had been inadequate. He believed that the section of the Report dealing with auditors would prove extremely awkward for Coopers.

Mr Quinn noted that the large exposures section of the Report was the only area where the Board had been unable to come to a view on whether or not the Bank had contributed in some way to the failure. But he found it surprising that the question had been left open. Up until the end of January 1995, the large exposures concession could have made no difference: Leeson was not relying on margin payments. The suggestion that by pressing Barings to comply with the 25% rule after the end of January 1995 would have made any difference seemed fanciful: Barings, as the Report made clear, were not in a position to know whether they were meeting it or not.

Sir David Scholey referred to the speech given by the Chairman of the SIB that day. The Bank seemed vulnerable to the criticism that it was not sufficiently familiar with securities markets. We needed to anticipate that line of argument. Mr Quinn said that the Bank was certainly less well equipped to understand securities markets than it should be, but the question could not be fully addressed without going into the respective roles of supervisors.

Mr Simms noted that Leeson had shown considerable IT skills, and wondered whether the regulatory authorities were competent enough themselves in the IT field. Ms Masters felt that this raised the question of the controls monitored by internal and external auditors: Sir Colin Southgate remarked on Leeson's ability to have reporting instructions changed without any control consequences. Mr Quinn said that Leeson had in practice had a free rein in Singapore, being responsible both in dealing and settlement. On IT, the Bank had eight years ago issued guidance to banks on IT risks, and that was still in use. Mr Foot added that the Bank's traded markets team was competent both in the use of models and in computer systems. The Governor felt that it was inconceivable that the Bank could have detected a change in a computer programme in an offshore location. The Bank was only one in a series of barriers, which included management, internal auditors and external auditors. We could not ever hope to have complete knowledge, worldwide, of the workings of a banking group. In response to a question from Ms Masters, Mr Quinn said that the auditors had specifically targeted the controls on margining - and had said that they found the internal control regime in that area to have been satisfactory.

Sir Roland Smith asked whether we would have supervised the institution differently if its name had not been Barings. Mr Quinn said that we would not - but we did take track record into account. Ten years ago it might have been said that the Accepting Houses had a relatively soft ride, but the present supervisory team, under Carol Sergeant, was tough and inquisitive. Mrs Heaton noted that the Report itself had referred to the management of Barings being well known to the Bank. Mr Quinn said that management might be trusted, but they were still asked many penetrating questions.

Sir Roland Smith asked how much the Bank relied on the Securities and Futures Authority, which emerged from the Report looking a bit feeble, with frequent staff changes. Mr Quinn said that there was close cooperation with the SFA, whose Chief Executive was a former Bank supervisor. Mr Foot said that the organisation was relatively new, and did have rapid staff turnover, but we had to rely on them because they had the UK site responsibility for Barings Securities. Sir Roland Smith asked whether we were ourselves worried about continuity of staffing. Mr Foot said that Thompson had been in place since 1991, although there had been a more rapid turnover of the analysts involved.

Sir David Scholey asked how the proposed quality assessment reviews would be conducted. Mr Foot said that the reviews would not be conducted by line management but would probably not be external to the Bank. The Governor said that we had yet to take the decisions in this area, and that he himself had an open mind on whether there should be some kind of external input. We already had a capability via the SIU for cold reviews, but that tended to concentrate on fraud rather than on a review of the supervision of the bank itself.

Mr Plenderleith wondered whether the standard of supervision displayed in this case was typical. Mr Quinn said that there had been a substantial culture change since BCCI, and this had led to a toughening up of supervision. We were now more penetrating than ever before. Thompson, the senior manager responsible for Barings, had found this culture change harder than most. We had already had doubts about him in this respect even before this episode. Mr Foot said that several other supervisors needed to be moved out, but we couldn't rush at this because there was a need to preserve continuity and knowledge.

Ms Masters asked whether supervision was a continuing process or something that happened intermittently. Mr Quinn said that it was continuous, although there was obviously a prudential timetable: but that we needed to avoid a rule-book based supervision, which went for appearance rather than substance. The Governor added that each supervisory interview, in a sense, was an audit. A question which we would be looking at was whether the points raised at a supervisory interview should be written down in letters, analogous to signing-off an audit. We also needed to look at the handover mechanisms between individual analysts in supervision.

Sir David Lees wondered whether there were lessons for BOBS itself in the Report. Were there areas in which they themselves should have taken a closer interest - for example large exposures, or internal audit reports? There was a question as to whether the Board was the ultimate authority for supervision - the position seemed obscure. The Governor noted that in their recommendations, the Board asked for regular reports on large exposures. Sir David wondered whether there were other areas in which the Board's relationship with the Bank might change. The Governor said this had not yet been discussed. The Board's relationship to Banking Supervision was rather similar to that of Court with the rest of the Bank: they were able to form judgements about management, and review management decisions, but without checking excessively everything. Sir David noted that Court itself had an Audit Committee - the Board did not. The Governor thought that the proposed quality assessment reviews might have a role to play here. Sir David Scholey felt that it was up to Court itself to make sure that the Bank was capable of delivering the requirements set by the Board. He felt that there should be another discussion with the Board now that the conclusions on Barings had been received.

Sir David Scholey asked what was the most justifiable criticism of the Bank in the Report. The Governor said that in general terms, the criticism was that the Bank had been a long-stop and had failed to stop a difficult and bouncy ball. Specifically, we had been less than rigorous on large exposures and on solo consolidation. Sir David Scholey asked whether this failure reflected specifically on Thompson. The Governor confirmed that it did: more rigour on his part would have avoided criticism of the Bank, although perhaps not stopped the failure. Mr Quinn said that his main worry was the recurrence of a failure of internal communication. Sir Roland Smith asked about litigation. The Governor said that the Act protected us, although the bond holders, who were actively campaigning for compensation, might attempt to sue. The auditors were more vulnerable.

The Governor said that he would wish to look again at the response document which had been placed before Court: he wanted it to be clear that the Bank had failed to detect the problems, and that we accepted all the recommendations. Court members welcomed this, and Ms Masters said that she would expect to see more in terms of an action plan with timings in the specific responses.

Sir Christopher Hogg said that he was generally uneasy about the Bank's position in supervision. We could not be sure that this would not happen again. The Bank was now fighting for its supervisory life, and it fell to Court to consider what constituted adequate supervision, and how it was to be delivered by the Bank. Sir David Scholey felt that it would be right for the Bank's Executive, the Court and the Board of Banking Supervision itself to meet to discuss what future role the Bank should have in supervision. The debate was widening internationally in this area, and it was time now for Court and the Board either to confirm the present position or to debate it. The Bank's standing was vulnerable to more episodes of this kind. He would welcome a debate on this topic once the new Deputy Governor was in place. Court agreed to this.

Finally, Sir David Scholey said that the supervisors themselves should not be unduly downhearted. They did a good job in extremely difficult circumstances. Whatever criticisms there might be in the Report, the Bank should not forget that it had taken the right judgement about Barings in February, and been vindicated.

BCCI Litigation

Mr Quinn said that on the following Monday there was likely to be a hearing of the Bank's application for trial on preliminary issues in the BCCI litigation. This was, in effect, our application to strike out the liquidators' writ. The hearing would determine whether there was any substance to our claim.

John Footman
Secretary
19 July 1995

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 19 JULY 1995

Present:

Mr George, Governor
Mr Quinn, Acting Deputy Governor
Sir Christopher Hogg
Mr Kent
Sir Chips Keswick
Mr King
Sir David Lees
Ms Masters
Sir Jeremy Morse
Mr Plenderleith
Sir David Scholey
Mr Simms
Sir David Simon
Sir Roland Smith

The Minutes of the Courts of 5 and 12 July were approved.

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

Mr King recalled that in May, the Bank had recommended a 1/2% increase in short-term interest rates in order to improve the chance of meeting the Government's 2 1/2% inflation target by the spring of 1997. The minutes of the June meeting had been published that day, and showed that we had repeated the advice, while acknowledging that the case for a rise in interest rates had not been strengthened very greatly by the subsequent events. Since then activity had become weaker, but RPIY inflation had risen. Our dilemma had thus become more acute. It was clear that cost pressures were coming through into inflation, although domestically-generated pressures were weaker. On activity, the final figure for non-oil growth in the first quarter was 0.6%, around the trend rate. It was clear that the figure would have been lower but for the

National Lottery. Manufacturing output had been flat for some time, as had retail sales. The first estimate for growth in the second quarter would be available on Friday, and would be an important indicator, as would be the CBI's quarterly trends survey. The labour market statistics published that morning had showed continued growth in employment according to the Labour Force Survey (LFS), but unemployment falling more slowly, even rising on the LFS basis.

The questions that we had to address as we approached the next Governor/Chancellor meeting and the Inflation Report were whether the apparent pause in growth was temporary or a sign of further slowdown; what risks could be seen to the inflation outlook, arising for example from wage pressures (though there had been remarkable stability thus far); and whether the "tale of two cities" analysis still held - whether net trade remained such a positive contributor to growth.

Mr King added that a further element in the puzzle was money growth. Narrow money growth was well above the official monitoring range; it had been argued that this was a good indicator of future inflation, but it was nevertheless difficult to explain the trend. Broad money growth had been increasing very significantly, and was now above the top of the monitoring range according to short-run measures. Indeed the corporate sector had suddenly become a hearty borrower.

Commenting on the market charts, Mr Plenderleith said that sterling had made up the ground lost on the Conservative leadership election, but had not made up the ground lost since the beginning of the year. Interest rate expectations, meanwhile, were much lower in the near term, but further out there had been a significant rise in expectations. Taken together, these two developments pointed to a worsening in the credibility of monetary policy, and raised the question whether there would be an impact on behaviour.

Sir Christopher Hogg agreed that inflation had moved into a cost-push phase, but believed that industry and commerce were likely to be able to contain this over the next few months. He now saw less inflationary pressure than had been the case a few months ago. Sir Chips Keswick pointed to the rapid growth in agricultural prices and incomes: Mr King said that it was true that the CAP had an inflationary effect at present - we had pointed this out in the May Inflation Report, and would do so again in August.

Sir David Lees said that an important question was the likely strength of our export markets. If these were weakening, it would be bad for the export sector, and perhaps quite a material issue for future growth. He felt slightly less confident of the prospect than had been the case six months before; but he acknowledged that there were particular uncertainties at the moment, not least because of the new car registration year. Mr Simms said that housing remained an extremely depressed area, as did construction. Industrial construction contracts, which might be an indicator of investment, were falling very sharply.

Sir David Simon said that cost pressures arose not so much from wages as from inputs. On overall growth, it was hard to know whether we were facing a pause or a slowdown - to company management they tended to look the same. But it was clear that the oil price had come off, and was now at the low end of the expected range, and bulk chemical costs were off as well. There was evidence from the United States that inventories were being built up. Overall, he felt that companies would have a relatively good time at current exchange rates for a while longer.

Sir Jeremy Morse said that our difficulty was greater because we were facing neither a raging boom nor a slump. Consumers everywhere were enjoying less personal security, and we were therefore likely to see a continuing shallow recovery or a shallow dip. On the apparent worsening in monetary policy credibility, he felt that, if doubts existed, they had more to do with the prospect of an election than with the split between the Governor and the Chancellor. The Bank had been right in

May to advise against taking a risk: but the Chancellor had done so, and so it was important for him to be shown right.

Sir David Scholey wondered how far we were still affected by long-term trends: the initial benefit of our exit from the ERM, and the debt-related contraction of the consumer sector. If those effects were wearing off, then so too were some of the positive influences that had helped monetary policy thus far. He felt the monetary indicators were very worrying.

The Governor said that the dilemma was now quite acute. We clearly had cost pressures, including labour cost pressures, all in the short run. In the longer run, if one took the view that the slowdown was likely to persist, then it was possible to see how we could get to a 2 1/2% inflation rate. But you had to ask why consumer spending should not pick up next year. Incomes were likely to be higher, and taxes lower or at least not still increasing. Investment in industry, which might be expected eventually to raise capacity, was all in the future - so it was easy to see how inflation might rise. Publicly, we had to acknowledge that the economy had slowed more than we expected. But we could not take any view on how long that would go on for. There was a risk in trying to talk the economy down. Mr Quinn noted that tradable goods prices were rising more rapidly than non-tradables; At present tradables reflected net export strength. If domestic demand should pick up later this year, the indices for both tradables and non-tradables could pick up sharply.

The 1995 Pay Round Report (Mr Lecky-Thompson in attendance)

With reference to a Minute of 5 July and in presenting this year's report on the pay round, Mr Lecky-Thompson said that we had had a successful outcome in all our bargaining units, well below Union demands ; were prospectively within the public pay target for the year; and had started a strong trend towards merit pay rather than across-the-board settlements. Nevertheless he did see difficulties in the future. Thus far we had met pay policy by taking advantage of staff savings and resulting productivity. There would be fewer in the coming year such as the 40 or 50 job losses in the Branches. In addition the market, particularly for professional staff, was hardening against us. And there were genuine additional demands for such staff. Overall, in recent years we had cut the number of Officials by 10%, but the workload had been rising. We would soon be reaching a stage where we needed to do major recruiting in that area and were already recruiting some support staff at a junior level. This could put the public pay limit under pressure - conceivably, having looked at the numbers, we would need to go back to the Treasury.

Sir David Scholey asked what had caused the market to harden against us. Mr Lecky-Thompson said that there had been clear upward pressure on pay; we had seen this in our recent attempts to recruit staff in their late 20s and 30s. It was in the professional area, the Officials, where the pressures were most acute: in general, the Bank was relatively well paid at the lower end, and relatively poorly paid at the higher end.

Mr Plenderleith commented that looking through the cycle as a whole, we tended to attract two sorts of individual. On the one hand, there were those who were genuinely interested in the Bank's work, and the issues that arose: we were still attractive to that group, who were less driven by pay. But increasingly we needed to hire staff from the financial sector, with tradeable knowledge, who would be more mobile and more concerned about salary differentials. We could and did lose people from that group, although we could occasionally accommodate them on short-term contracts. Mr Quinn said that in the 30-35 year age group, perceptions of prospects had been clouded by the Ashridge message: their traditional willingness to accept a poor pay package against the prospect of a long term career had diminished. We were clearly now suffering from that. (Sir Chips Keswick noted that after Barings we might need to pay danger money to supervisors!)

Sir David Lees warned that we would need to be very clear, before approaching HMT under the public pay policy rules, that there really was no scope for further economies: we might need to make a special case in the supervision area alone, rather than for the Bank as a whole.

Sir David Simon said that he was surprised to see the "across-the-board" language still in use at the Bank: the practice increasingly was to pay very small rises across-the-board, if any, and to concentrate entirely on personal merit pay. Nevertheless, he said, BP had lost more people over the past six months to higher paying jobs than over the whole of the past four years.

The Exchange Clearing House (Mr Clark in attendance)

At the Governor's invitation, Mr Clark presented a paper describing the Bank's proposed role in monitoring and supervising the ECHO netting system. Mr Clark said that ECHO was a London-based clearing house for the multilateral netting of spot and forward foreign exchange contracts. Such a netting system, if properly structured, could bring significant benefits to the foreign exchange market, reducing risk and increasing efficiency. The counterpart, however, was that it did concentrate within ECHO the counterparty risk that would otherwise exist between the participating members, and this in turn focused moral hazard on the host central bank. Measures to deal with this had been at the heart of our own consideration of the proposal, which had taken place against a background of the Lamfalussy standards agreed a few years ago. The key protections were that the arrangements should be legally robust, that participants should be substantial institutions with adequate financial resources, that there should be a pool of assets to provide immediate liquidity and adequate loss sharing agreements. A particular issue for any scheme of this kind was the UK Insolvency Act, and ECHO needed to derogate from that provided for under the 1989 Companies

Act. The Bank had to set up a regime under that Act, and regulations were shortly to be laid before Parliament.

Sir David Scholey asked whether any other centre was likely to set up an equivalent netting scheme; and whether the Bank was effectively the lead regulator or sole regulator. Mr Clark said that there was the Multinet scheme in the United States, which was running a little behind ECHO; and confirmed that the Bank would be the sole regulator of the ECHO scheme.
Sir Roland Smith asked where the Bank was at risk. Mr Clark said that we would have to demonstrate due diligence in approving the scheme, and when the scheme was going, ensure that the standards continued to be met. The Governor added that while the financial risk to the Bank was small, there was inevitably a reputational risk.

Sir Jeremy Morse asked what other organisations conducted this kind of supervision. Mr Clark said that there were no others, though a close parallel existed in the SIB in its oversight of clearing houses. Sir Christopher Hogg asked whether ECHO would deal with Herstatt risk: Mr Clark said that that was best addressed through the interlinking of national RTGS systems. The Governor agreed.

Court <u>noted</u> the Bank's involvement in the ECHO scheme.

Relations with HM Treasury (Mr Clark in attendance)

In presenting this paper, Mr Clark said that it had been prepared at the former Deputy Governor's suggestion, and provided a situation report on the Bank's relationship with its different counterparts at HM Treasury. Sir Jeremy Morse thought that the paper was extremely helpful. He noted that whatever the statutory arrangements between a central bank and a treasury, the practical working depended on the mutual respect of those involved. His general sense was that relations currently were not too bad. He had two areas of concern: firstly, whether we were able to cover adequately the international side of the Treasury; and secondly, the implications of the Chancellor's initiative in relation to the City. In this respect he knew from experience how difficult it was to corral City interests; and the City itself knew that Government was to be treated with caution. He assumed that the Bank's attitude was that such initiatives from the other end of town would have a relatively short life.

Mr King felt that the present arrangements for international affairs were working well: both the Bank and the Treasury had been overwhelmed by international issues, and he had been able to play a part with Sir Nigel Wicks. The precise division of work was reasonably clear, and once the Treasury reorganisation had been settled, and the international side of the Treasury found its position secure, their concern about the Bank's reorganisation had greatly diminished.

On the City initiative, the Governor said that he had encouraged the Chancellor to take it. It was clear that what the City would want in any discussion of this kind were changes in regulation, tax and infrastructure, and these were things that only the Government could provide: if anyone else were in the chair, they would be squeezed between conflicting interests. Sir Chips Keswick felt that it would be a great pity if the Bank gave up its role of intermediating between the City and Whitehall on issues such as the quality of legislation. The Governor said that we were not giving up our interest, but felt it better if the City became directly exposed to the Government and vice versa on issues which only the Government could address. He agreed with Sir Jeremy Morse that we should keep close to what the Government was doing. Mr Kent said that the objectives of the proposed City group had yet to be explored: its first preliminary meeting was that day. The group had to write its own objectives, and the thought was that it would act as a catalyst for addressing short term structural issues involving the City; outward promotion, and inward promotion. Sir David Simon thought the most interesting issue was how you promoted the competitiveness of the City as a whole in international markets. One could approach this either in a top down, macro way, or in detail, at the micro level. The former was quite difficult for the City, and it might be dangerous to set up a single institution. Sir Christopher Hogg said that the proposed group would give tangible expression to concerns in the City on issues of organisation. He had sensed for some time the Bank's reluctance to be pro-active in this area, or to set itself up as offering more than it could deliver.

More generally, Sir Christopher Hogg thought that the overall relationship between the Bank and the Treasury must have improved considerably over the past three years. Mr Quinn felt that generally the Bank and the Treasury operated well in tandem. In the regulatory field, though, he had occasionally recently found them "thinking their own thoughts"; and some officials were less easy to deal with. Mr Plenderleith said that an important development in his area had been the development of explicit remits, for example in debt management. The Bank had been closely involved in the Treasury's debt management review, which as a result had come out far better than might at one stage have been expected. One reason for that was our own new internal organisation, which had enabled us to address the issues raised by the Treasury in an extremely constructive and effective way.

On the Debt Management Review itself, Mr Plenderleith reported that the paper to be published that afternoon would review the entire framework of debt management, articulate the framework more clearly, announce some operational changes in the area of auctions and taps, and report the various changes in the market structure already announced. We were very happy with the outcome, and this was reflected in the fact that the Governor had now signed a foreword to the report.

The Risks from CREST (Mr Simpson, CREST Company Secretary, in attendance)

Mr Kent introduced the quarterly report on CREST. He said that the aim of these reports was to reassure Members of Court that

CREST was not posing a risk to the Bank. The main risk highlighted in the report was the continuing debate with the Stock Exchange, which now turned on the costs of de-commissioning the Talisman system. The Stock Exchange wanted to put these costs onto CREST. How large these costs were, of course, depended on how the transition was managed: if Talisman ran for a long time at below capacity, the fixed costs would dominate and the losses would be large. A quick changeover would reduce the problem. Some of the market owners of CRESTCO had now begun to discuss the issues directly with the Stock Exchange, and we were hopeful of a satisfactory outcome, which is why CREST now classified this as a low risk area. The risk in respect of SIB authorisation was also looking more likely to be resolved satisfactorily, and Mr Kent felt that the risk could now be categorised as "medium". Ms Masters asked what financial risk remained to the Bank if CREST failed to work: Mr Kent confirmed that there was no residual financial or contractual risk to the Bank of England if CREST failed.

The Printing Works Annual Report and the Report and Accounts of Debden Security Printing Ltd (Mr Jarvis in attendance)

Sir Christopher Hogg said that he remained keen that Debden should be exposed as far as possible to the commercial world in a real way. Mr Jarvis said that he saw DSP as a useful means of achieving this, and referred to the commercial contracts that had been successfully negotiated or were in contemplation.

Sir David Lees asked why Debden Security Printing was paying no dividend to the Bank: Mr Jarvis said that there were various contingencies which required DSP to have reasonable liquidity at present, but the Governor said that we would take advice on the question of a dividend and revert to Court. Ms Masters asked what would happen to the spare property at Debden when the refurbishment was finished: Mr Jarvis said that this would revert to the Bank, and would be available for Bank purposes or for sale if required.

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Sir Roland Smith asked whether Mr Jarvis regretted the passing of the Debden Committee: Mr Jarvis said that he did, as he had valued the opportunity to discuss the Printing Works with people with direct commercial experience.

A Report of the Trustees of the Court Pension Scheme together with the Annual Report and Accounts

The Governor, having declared his potential interest in the Court Pension Scheme, together with those of Messrs Quinn, King, Kent and Plenderleith, invited Sir Roland Smith, the Chairman of the Trustees of the Court Pension Scheme to introduce the Report. This commented on a recent Report of the Chief Investment Manager, the latest Report and Accounts of the Scheme and the actuarial valuation of the Scheme as at 28 February 1995. With regard to the latter item, the Report recommended acceptance of the Actuary's suggested contribution rate of 19% pa of pensionable remuneration for the current year together with a special contribution of 27% (of the £78,600 earnings cap) for the Deputy Governor-elect for the latter six months of the Scheme year (27% being the rate determined by the Actuary to fund future service benefits); these contributions, to be paid on 1 and 11 September respectively.

Court approved the recommendation.

The latest Report and Accounts of the Court Pension Scheme were laid before Court.

A Report of the Trustees of the Staff Pension Fund together with the Annual Report and Accounts.

Sir Christopher Hogg, in his capacity as Chairman of the Trustees of the Staff Pension Fund, introduced a Report of the Trustees relating to a Report of the Chief Investment Manager concerning the management of the Fund's investment portfolio during the six months from 1 October 1994 to 31 March 1995. The Report also drew attention to the Fund's holding of £2,250,000 9.25% Perpetual Subordinated Notes issued by Baring plc. In view of the potential conflict of interest, the investment managers had sought guidance from the Trustees on what action they should take to maximise recoveries. The Trustees had been advised by Mr Kent, as the only Executive trustee, that they should not join with the various action groups: but the Trustees felt that they needed a direction from Court to confirm this. Ms Masters expressed some concern about a failure by the Trustees to maximise returns, but it was noted that it was open to Court both to direct the Trustees and to make good any consequential losses. Sir David Lees wondered whether the Pension Fund could put pressure on ING by threatening to withdraw business from Baring Asset Management or to renegotiate the substantial fees charged; Sir David Scholey had earlier indicated support for this idea. The Governor said that he would find himself in some difficulty with ING if this course were pursued. Mr Kent said that his view had been based on the fact that the Fund had a surplus, that the prospective loss was small; that the Fund already had an unequivocal guarantee from the Bank to make up the necessary funds; and that in the public perception it would be difficult to disentangle high profile actions by the Pension Fund and those of the Bank. The Governor said that he agreed with this analysis. Sir Jeremy Morse said that it would in the circumstances be right for the Bank to undertake specifically to make good any losses occasioned by a failure to pursue the rights of note holders alongside any action group; and Court agreed that the direction should be given on that basis.

The latest Report and Accounts of the Staff Pension Fund were laid before Court.

The Executive Report

With reference to a Minute of 12 July, Mr Quinn reported that the Bank's application in the BCCI case for a trial of the preliminary issues had been successful. A hearing was likely to take place later this year. In the meantime the Liquidator was said to be amending his claim, yet again. This seemed on balance to be not such good news.

CP

[redacted]

The Governor said that he was proposing to arrange a joint meeting of Court and the Board of Banking Supervision on Thursday 21 September. This would be a special meeting of Court, and we would be contacting Members' offices directly to see if it were possible.

David Lees
16 August 1995

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 26 JULY 1995

Present
Mr Quinn, Acting Deputy Governor
Mr King
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.

David Lees
16th August 1995

CWB

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 2 AUGUST 1995

Present:
Mr George, The Governor
Mr Quinn, Acting Deputy Governor
Mr King
Sir David Lees
Mrs Heaton
Mr Plenderleith
Sir David 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.

Mr Plenderleith spoke about the markets. Sterling had begun to rise on the OECD Report, and had taken the Inflation Report, published that morning, as repeating the view that rates would have to rise in order to achieve the Government's target.

Mrs Heaton asked about the implications of the Bank of Japan's rescue of the Cosmo Credit Union. Mr Quinn felt that this case had been handled better than earlier ones. But there remained a major question over the vulnerability of other institutions, and whether the Japanese would address that. The Governor believed that the situation remained potentially dangerous. We ourselves had been providing advice at the Bank of Japan's request.

David Lees
16th August 1995

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 9 AUGUST 1995

Present
Mr George, The Governor
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 Meeting, having been circulated, were noted.

Mr Plenderleith spoke briefly about the state of the markets.

16 August 1995

MINUTES OF A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 16 AUGUST 1995

Present:

Mr George, Governor
Sir David Lees
Professor Sir Roland Smith
Sir Colin Southgate
Sir Christopher Hogg
Mrs Heaton
Sir Chips Keswick
Mr Kent
Sir David Cooksey
Ms Masters
Mr Simms
Sir David Simon

The Minutes of the Court of 19 July and the Meetings of 26 July, 2 and 9 August, having been circulated, were approved.

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

Commenting on the Bank's Inflation Report, which had been published on 2 August, Mr Bowen said that although the inflation forecast was slightly lower than in the May Report for most of the next two years, the central projection remained above the Government's 2.5% target in early 1997. The dual nature of the recovery remained evident with inflation in the traded goods sector now, unusually, higher than that for non-traded goods. The inflation outlook depended on the answers to three questions. Will output continue to grow at its recent pace? Will the inflationary pressures felt in the traded goods sector cause second-round effects via domestic inflation? Will the recent increases in the money supply lead to higher demand? On the latter question Mr Bowen noted that M4 had grown by as much as 6.7% in the year to June and there had been a significant increase in individuals' deposits in the second quarter. The causes of this growth were not clear, but if it continued it could result in increases in planned expenditure. There was a parallel increase in bank lending but the purposes were not clear. But similarly, if it continued it could herald an increase in investment demand.

Turning to the output question, Mr Bowen noted that although GDP growth had been slowing it remained close to the economy's potential and we did not think it would slow much further. But there had clearly been involuntary stock building in late 1994 and early 1995 and one uncertainty was whether any attempts to unwind these stocks would lead to a more general slow down in demand. Next week's GDP data would shed more light on this question. But today's retail sales data, including revisions to back figures, showed an encouraging picture of a pick-up in retail demand. One difficulty in interpreting the economy at present was the strong growth shown by the services sector, for example, the post and telecommunication industry had shown an increase in the value of its output of 90% since the trough of the recession. Although the latest labour market statistics showed some slowing in employment growth, this remained consistent with GDP growing at trend and an encouraging sign was that there remained little evidence of increasing wage pressures.

Taking all these uncertainties together the Bank's central projection was still for inflation to exceed the 2.5% target in 18 months' time and this was not out of line with other forecasters or with expectations implicit in the gilts market. Finally, Mr Bowen noted the lags between monetary policy actions and effects which required monetary policy actions to be taken even though the economic situation might remain unclear.

Mr Townend drew attention to the significant revival of the dollar since early August and in particular since the successful round of concerted intervention taken on the previous day. Sterling had been helped by the stronger dollar as well as by the favourable recent OECD report. Although market expectations of higher interest rates had eased in recent months, there had been a corresponding increase in their long-term expectations of higher inflation.

The Governor was concerned by the public reaction that as long as we did not miss the inflation target by much it would not matter and so we should not tighten monetary conditions for fear of slowing the economy. Public sentiment seemed to want the Chancellor to direct policy towards growth and employment rather than resisting inflation but history showed that this gave only short-term relief but had long-time pain. The Governor noted the uncertainties surrounding the economic outlook but felt that if the Bank were to back-off from its counter-inflationary advice at this stage it would encourage the pass through of second-round cost effects into wider inflationary pressures.

Sir David Lees felt the Bank should emphasise that 2.5% was the Government's target. The Governor took the point but did not want the Bank to hide behind the Government's target which we had, after all, endorsed. Sir Colin Southgate stressed that the aim was to get inflation below 2.5%, rather than around 2.5%, and was concerned that this formulation was becoming obscured. Sir Chips Keswick said that the markets did not believe that interest rates alone determined inflation but that exchange rate developments and developments abroad were becoming more important. The Governor agreed that the strengthening of sterling was a welcome factor in reducing inflationary pressures but it was difficult to quantify its effect. He would be delighted if the pound recovered to end-1994 levels but there was still some way for it to go. Mr Simms drew attention to the weak state of the construction industry and Mr Bowen acknowledged that if construction demand fell further it would give the forecasters pause for thought but there were, of course, offsetting gains in other sectors such as services. The Governor enquired about the weakness of public sector construction demand and noted that this might be balanced to some extent as the public sector finance initiative got more fully into its stride next year.

Mr Simms felt that the Bank was not getting its message across on the lags in monetary policy effectiveness and therefore the need to take early action. If we could get that point across it might help get us off the current counter inflation/low growth policy dilemma.

Sir Christopher Hogg wondered if greater emphasis could be put on fiscal rather than monetary policy as a counter-inflation tool at this stage of the cycle. The Governor noted that the tightening of fiscal policy in 1993 had been fundamental to the subsequent improvement in the economic situation, but it was not necessarily well suited to the present problem of coping with the effects of imported cost inflation. It was difficult to fine tune fiscal policy and in any case a tightening of fiscal policy at this stage would be at least as difficult politically as tightening monetary policy.

Professor Sir Roland Smith asked about the impact of the rise in the pound on the growth rate. Mr Bowen noted that the beneficial impact for exporters of the earlier fall in the value of the pound had not yet been fully felt so that the recent appreciation would merely shade down the earlier favourable effects. The Governor noted that the stronger pound meant an erosion of exporters' margins which might in fact increase pressures on them to pass on their higher raw material costs into domestic prices. Sir David Simon felt that the pressure of higher imported costs had peaked and there was reason to hope that manufacturers would not pass them on.

In conclusion, the Governor said he did not detect a view that the Bank should change its policy advice but was grateful for the helpful suggestions on presentation. We must get across the fact that the policy dilemma was not in fact acute and that the differences in view were relatively small. In addition the underlying economic performance of the economy remained encouraging. The question was, on what side do you take risks. Our advice was based on the need not to take risks on inflation; but the pressures on policy were more in favour of not taking risks on growth.

Update on preparatory work for Stage 3 of EMU (Mr Townend in attendance)

With reference to a Minute of 15 February when Court discussed the scenario for transition to a single currency, Mr Townend said that the paper before Court today focused on recent developments in relation to the preparatory work for Stage 3 of EMU. Mr Townend drew attention to the work in various European Union fora on alternate scenarios for introducing monetary union. Attention was being focused on the nature of "phase B" - the period after national currencies had been locked together in the monetary union but while they continued, to some extent, to circulate. The European Commission's Green Paper of 31 May considered four approaches. "Immediate Big Bang" - the immediate switch from national currencies to Ecu - but no-one regards that as a practical possibility. "Critical Mass" whereby wholesale market transactions would be compulsory switched into Ecu from the start of phase B, an approach favoured by the Commission and the French. "Demand-Led", the approach the Bank favoured, whereby the European System of Central Banks would provide Ecu facilities but it would be up to the markets and the public to determine how quickly to switch to Ecu. "Delayed Big Bang" in which use of the Ecu would be prohibited until the three years or so it took until Ecu notes and coins could become available at which time there would be a compulsory switch from national currencies to Ecu - an approach previously supported by the Germans in the interests of their numerous small banks, but now abandoned because of pressure from their big banks. Mr Townend reported that our discussions with banks found that those predominantly with wholesale operations saw little difficulty in coping with sterling and Ecu denominations co-existing for a time while retail banks saw greater problems.

Mr Townend noted the anxieties being expressed in some quarters in Europe about the effects of current exchange rate changes, in particular the competitiveness effects of the depreciation of the lira and the peseta. Similar concerns could, of course continue after Emu if non-participating currencies depreciated against the block, which was a concern being increasingly expressed by the French. Mr Townend also noted the continuing work being conducted on the operating techniques of monetary policy after monetary union, and on the design of the future single currency note.

The Governor felt that the most immediate issue was the choice of scenario. He had reservations about the Critical Mass approach: there was a practical problem in defining particular market transactions that would have to be conducted in Ecu and it was in any event economically inefficient to compel people to switch to the Ecu before they felt it was in their interest to do so. Much of the apparent problems of phase B were merely those of currency translation provided the European System of Central Banks was committed to switching national currencies into and out of Ecu without limit. Phase B would last at least three years because that was the necessary preparation time for issuing the new retail currency but it was an open question as to how long after that time national currencies should be permitted to continue circulating - some might argue that they need never be withdrawn. Sir Christopher Hogg feared that the circulation of two currencies would cause problems for retailers and be costly but the Governor felt that large retailers would cope readily while small and more remote retailers would simply choose which of the two currencies to use. Sir Colin Southgate agreed that with modern technology the double-running of the two currencies should not cause insuperable problems.

The Future Organisation of Economic Liaison (Mr Townend present)

With reference to a Minute of 17 May when Court reviewed the roles of the Bank's Branches and Agencies, the Governor introduced a paper which considered afresh the scale and organisation of economic liaison. The Governor welcomed the support that Court had previously given to the Bank's economic liaison work and said that he planned to publish the Agent's reports through the Quarterly Bulletin. However, our review of their function had highlighted a number of gaps which we propose to fill. Specifically we planned to open new agencies in Cardiff, Nottingham and Greater London and to increase the staffing in Glasgow. In addition we proposed to switch the

Winchester Agency to Southampton. The new appointments, together with suitable office accommodation, would increase the Bank's costs by up to £800,000 a year. A key issue was finding the right calibre of agent and this might take a little time.

Sir David Lees strongly supported the expansion of the Agents' coverage and hoped their reports could be published in a more widely-circulated publication than the Quarterly Bulletin. He suggested that Bank Briefing might be a more suitable medium and was supported by Ms Masters who felt that wider circulation of the Agents' findings could raise the quality of the national debate on economic policy. Further support was given by Sir David Cooksey who had found favourable feedback from industry about the Agents' contribution. He did, however, question the move of the Winchester Agency to Southampton as he felt that the latter was not the most dynamic part of the region.

The Nolan Report and Purdah (Mr Footman in attendance)

Following the publication of the 'Nolan Report' in May and recognition that the Bank's policy in relation to purdah was not in line with that of the Civil Service, which the Report found to be acceptable, Mr Footman introduced a paper outlining the differences in practices of purdah between the Bank and the Civil Service and considering options for change. The Bank's current policy was to adopt a three month notice period during which time staff would be taken off any sensitive work. If, in any particular case, a longer purdah period were required the Bank would pay compensation for the fact that employment could not be taken up. However, Civil Service regulations went further with a requirement that for a total period of two years the approval of an advisory committee must be obtained before senior officials can take further employment. It was not clear to Mr Footman how this requirement was, in practice, enforceable. It would be difficult for the Bank to go so far with its own employees as it could create real problems for recruitment. Accordingly, for staff he recommended that the present three month notice and purdah arrangements should be continued unchanged. But perhaps there might be a case for a two year monitoring period for former members of the Bank's Executive.

Mrs Heaton felt that in some circumstances a purdah period of longer than three months might be appropriate, particularly if supervisory information were at stake. But Ms Masters found it difficult to envisage a situation in which a period of as long as two years would be appropriate. Although it was generally agreed that a three month purdah-notice period for staff remained appropriate, the Governor said he would have no difficulty with a two year notification period for former members of the Executive. However, Ms Masters doubted that this would be useful as it begged the question of what the Bank could do if a difficult case arose. Sir Colin Southgate felt that it was harder to impose purdah when an official retired from an organisation rather than simply changed jobs. Sir Christopher Hogg argued that the present three month arrangements should be left unchanged and the Governor concluded that the majority view on Court was in favour of retaining the three month notice/purdah arrangements for both staff and the Executive. If problems arose then this could be considered, again.

Appointments: new Deputy Governor and a Resolution concerning Delegation of Powers

The Governor mentioned that Howard Davies would take up his post as Deputy Governor on 11 September and there were some internal matters stemming from this appointment which required Court's approval.

1 It was Resolved that in pursuance of Clause 3 of the Trust Deed of the Houblon-Norman Fund, Mr H J Davies, in his capacity as Deputy Governor, be appointed to succeed Mr R L Pennant-Rea who resigned on 22 March 1995, as a Trustee of the Fund with effect from 11 September 1995.

2 With effect from 11 September 1995 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, it was agreed that:

(i) MR H J DAVIES shall become a Director of Bank of England Nominees Ltd in place of MR GORDON MIDGLEY. The Board will then consist of Mr Davies (Chairman) and Mr Plenderleith.

MR H J DAVIES, or failing him MR IAN PLENDERLEITH, 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.

(ii) MR H J DAVIES shall become a Director of BE Property Holdings Ltd. The Board will then consist of Mr Davies (Chairman) and Mr Midgley.

MR H J DAVIES, 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 BE Property Holdings Ltd.

The Governor advised Members that the Bank had an interest in two companies which were involved in payment systems. These companies had recently changed their names and the Chief Casher wished to change the Bank's representation on the Board of one of the companies and he had requested an updated resolution reflecting the new names.

It was RESOLVED that the Chief Cashier, for the time being, or such other person as shall be nominated by him in writing, be authorised, until otherwise resolved by the Court of Directors, to act as the representative of the Governor and Company of the Bank of England at any meeting of the following companies:

CHAPS Clearing Company Limited
EftPos UK Limited

Executive Report

There were no items for discussion under the Executive Report.

Sealing Committee Minutes

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

A Report of the Remuneration Committee

In accordance with Section 10 of the Charter, the Governor and Mr Kent withdrew.

In the absence of Sir David Scholey, the Chairman of the Remuneration Committee, Sir David Lees said there were three recommendations of the Committee before Court for consideration and approval. They were as follows:

1 That the present limit of £50,000 on housing loans to Governors and Executive Directors who joined the Bank prior to 1980 be raised to £100,000, the limit now permitted by the Companies Act.

2 That housing subsidy for Governors and Executive Directors who joined the Bank in 1980 or after to be provided on the same terms as for staff joining at the same time, subject to any limitations in the Companies Act.

3 That the Bank provide to Governors and Executive Directors beneficial loans for non-housing purposes, on the same terms as for staff, up to a limit of £5,000.

<u>The Recommendations were approved</u>.

Sir David Lees noted that these benefits had implications for whatever disclosure the Bank made in conformity with the Greenbury recommendations. After a brief discussion it was agreed that although Greenbury is aimed at listed companies the Bank should do its best to comply with the Code and Court requested a mock-up of the way the Bank's Greenbury disclosure might appear.

Howard J. Davies

[illegible]
Secretary
20/9/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 23 AUGUST 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.

Howard J. Davies

J Footman
Secretary
20/9/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 30 AUGUST 1995

Present

Mr Quinn, Acting Deputy Governor
Mr King
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.

Chairman

Secretary

20/9/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK
WEDNESDAY 6 SEPTEMBER 1995

Present
Mr George, The Governor
Mr Quinn, Acting Deputy Governor
Sir Christopher Hogg
Ms Masters
Mr Plenderleith
Sir David 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.

Mr Plenderleith spoke briefly about developments in the markets. He noted that, domestically, a flattening of the yield curve indicated that the markets had no expectation of an increase in interest rates in the short term. There were no significant changes in the Official Reserves figures for August, which had been published earlier in the week.

Secretary
20/9/95

COURT OF DIRECTORS

For the period ended 29 February 1996

Declaration Made before	Date	
		Edward Alan John George, Esq, ~~Deputy~~ Governor
The Governor	13.9.95	*Howard John Davies, Esq, Deputy Governor
		Sir David Gerald Scholey, CBE
		Brian Quinn, Esq
		Mervyn Allister King, Esq
		Sir David Bryan Lees
		Professor Sir Roland Smith
		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
		Neville Ian Simms, Esq
		Sir David Alec Gwyn Simon, CBE

* Appointed 11 September 1995

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 13 SEPTEMBER 1995

Present
Mr George, The Governor
Mr Davies, The Deputy Governor
Mr Kent
Mr King
Mr Plenderleith
Sir Jeremy Morse

The Governor welcomed Mr Howard Davies, the Deputy Governor, to his first meeting of Directors.

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 exchange and the domestic markets, and characterised current developments as satisfactory and helpful.

In response to a question from Sir Jeremy Morse, the Governor clarified the position he had taken at his latest monthly meeting with the Chancellor. He confirmed that, because the date of the monthly meeting was in the public domain, and because of market exigencies, the likelihood was that, whenever the decision was taken to change interest rates, this would in practice be implemented immediately.

Howard J. Davies

[illegible]

Secretary 20/9/95

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 20 SEPTEMBER 1995

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Sir David Cooksey
Mr Kent
Sir Chips Keswick
Mr King
Sir David Lees
Ms Masters
Sir Jeremy Morse
Mr Plenderleith
Mr Quinn
Sir David Scholey
Mr Simms
Sir Roland Smith
Sir Colin Southgate

The Governor welcomed Mr Davies to his first long Court. He said that the absence of a Deputy Governor over the past six months had put additional burdens on the Executive Directors, and he was grateful to them for their support. In particular, he expressed appreciation for the work that Mr Quinn had done as Acting Deputy Governor: Court warmly endorsed this.

Minutes

The Minutes of the Court of 16 August and the Meetings of 23 and 30 August and 6 and 13 September, having been circulated, were approved.

Monthly Economic and Market Report, including market charts. Prospects for the Autumn Budget (Mr Jenkinson in attendance)

Mr King said that the monthly data for the third quarter were so far painting a flat picture for output, but it was possible

8

that the quarterly data would show more buoyancy, reflecting the contribution of services. There had been no surprises in the recent inflation data, although the RPI had been affected by seasonal foods. On the costs side, input prices were growing less fast, but the slowdown was not yet feeding through to output prices, and there were significant cost pressures in the supply chain still to feed through. The key question was whether these would be absorbed in margins, and his first question to Court Members was what had been and would be happening to margins.

Unit labour costs had started to rise, partly reflecting the cyclical pattern of output growth. There was a puzzle over the apparent absence of wage drift. It was normal for earnings to grow faster than settlements at this stage in the cycle - but this was not happening. We needed to understand why this was so: we had been fearful of second round effects, but at present they were apparently not happening. Mr King said that he had some doubts about the figures: it could be that the figures for earnings did not adequately capture changes in the composition of the workforce. Another possible explanation was the influence of profit-related pay. He would welcome Members' comments on these points.

Narrow and broad money continued to grow relatively fast. Narrow money could be explained; broad money was more of a problem. Analysts who normally paid close attention to broad money were surprisingly unruffled by the data: this was partly because lending to the personal sector was weak; and growth in private sector M4 deposits could reflect precautionary saving. Even so, we couldn't ignore the signals.

Overall, there was little case for changing our basic view of the inflation outlook: indeed there was much less of a change in the two-year prospect between May and now than many commentators had been suggesting. With weaker final demand, the case for a rise in interest rates had become less pressing. But we would be closely monitoring the stock cycle: if there was a bounce back from the present pattern of stock building, we would need to review our assessment.

Mr Plenderleith said that the financial markets had further lowered their expectations of short-term interest rates, as a result of the softer economic data and cuts in interest rates abroad. Short-term sterling rates had eased slightly, so sterling had not gained much on the foreign exchanges, and yields on gilts had fallen less than overseas bond markets. It seemed that the foreign exchange and bond markets continued to reflect concern about the UK's long run inflation performance.

Sir David Lees felt that the cost/price squeeze in manufacturing had been mitigated by volume effects. Without those, there would have been a squeeze on profits, as manufacturers' ability to pass through costs remained limited. There was evidence of contracts in some sectors being agreed on the basis that prices were held for the moment but would rise in the future. Like Mr King, he was suspicious of the published earning figures, which he would expect to be higher than the figures showed. He was unclear about the impact of profit-related pay. (The Deputy Governor commented that about 2 million workers, or 1/7 - 1/8 of the private sector workforce, were covered by PRP, and the number was increasing.) Sir David added that general views on the inflation outlook had become more pessimistic, but this reflected political rather economic factors. Echoing this point, Sir Chips Keswick said that the market might be happy for a higher PSBR to finance a fall in taxes, but not to finance a rise in spending. He thought there would be some market turbulence if the Budget was not credible. There was growing scepticism about the impact of politics on the economy.

Sir Colin Southgate said that the next CBI survey would again show a weaker picture, with exports softer and price expectations down. In general, industry was looking at a weaker demand picture, and there was evidence of continued stock building. If anything, he saw the prospect for inflation two years ahead as slightly better, mainly because of the slowdown in activity.

Sir Roland Smith saw continued pressure on retail margins reflecting the fierce competition between the major retailers, especially in food. This was impacting on manufacturers supplying branded goods. On the future course of inflation, he commented that people seemed unconvinced that low inflation was here to stay - it would take a long time to get the message across and change behaviour.

Mr Simms confirmed that the construction sector remained very weak: output was down 14% on the year and 11% over the latest quarter; private housing was down 17%; infrastructure spending down 23% and public investment down 25%. He had written to the Chancellor about delays in PFI projects. It seemed that Government departments were using the PFI as a device to slow orders: an illustration of this was that the spend on roads was 40% down. The Governor asked whether the delays were down to HMT or to spending departments: Mr Simms felt it was partly the latter, and partly the time it took for private sector to gear up to tender for often quite challenging projects. He felt that, once the initial log-jam had been processed, there could be a surge of contracts and orders. Ms Masters commented that the PFI needed to achieve some pathfinder deals, for example in the Health Service.

Sir Colin Southgate commented that a considerable amount of spare industrial property was currently available. Mr Simms said that much of it was unsuitable for modern processes: but investment in new capacity turned on confidence. Boards were currently delaying. The main reason, he thought, was political uncertainty, rather than any particular fear about inflation.

Sir David Cooksey said that the retail sector had been badly affected by the weather in August (Sir Colin Southgate confirmed this, but said that there had been an improvement in September). He saw little pressure on wages, with settlements running at 3%-4% in most sectors. Business was strong in the pharmaceutical/ healthcare sectors; new capacity coming on-stream had enabled productivity increases. On the general inflation prospect, he commented, like other Court members, on the impact of political concerns on expectations over the next few years.

Sir David Scholey was surprised at how many Court Members had felt that counter-inflation policy would not stick. The reason companies were slow to invest was partly because counter-inflation policy <u>was</u> expected to work, so that the cost of the debt that companies would need to take on in order to invest was prospectively the highest they had ever contemplated.

Commenting on the discussion, Mr King said that in looking at the weaker sectors it was important to distinguish between stocks and flows. One would not expect a huge boom in construction at the moment, given the excess capacity installed in the 1980s: the sector was still seeing the tail end of the bust. The retail sector, likewise, was still affected by the debt burdens built up in the 1980s.

The Governor said that he was impressed by the change of mood in Court since 3-4 months ago. This had been recognised in the change of policy announced in his speech that week. The crucial question was whether the economic slowdown was temporary or permanent. It was difficult to be sure; but, looking at the personal sector, it was clear that incomes were rising, that the tax burden was unlikely to increase further, and the debt burden was easing. Conditions in exporting and manufacturing sectors were likely to lead to further investment. The recent international slowdown was likely to be temporary. It was difficult to reconcile these factors with expectations of continued slowdown - unless political uncertainty became a stronger factor.

The Budget Letter

Mr King introduced the draft letter containing the Bank's Budget advice. The awkward question for the Government, in his view, was whether it made sense to relax policy at a time when the fiscal position was worse than had been expected a year ago - when further policy tightening had been deemed necessary. The Government was planning to contain real spending growth to 0.7% over the three years 1995/96 to 1997/98; this followed real growth in spending of over 7% in the previous three years. There were real doubts as to whether the targets were achievable, let alone whether significant further cuts could be found.

Our advice attempted to shift the focus to the longer term deficit/borrowing strategy. Current plans, if achieved, would wipe out the general Government deficit by the end of the century. This would make possible a further decline in the ratio of debt to GDP; and this was important, because a high debt to GDP ratio gave the Government an incentive to spring inflation surprises as a way of reducing the real burden of debt. Looking at the immediate Budget numbers, our concern would be with the sustainability of any adjustment on spending or revenue. The sale of assets to finance tax cuts, for example, was not an example of sustainable adjustment. The Government's move to resource accounting would make the process clearer and more transparent.

Sir Chips Keswick was concerned that resource accounting would tempt the Government to borrow against supposed resources or assets: Mr King argued that resource accounting would make the trade-offs more explicit. Sir Colin Southgate hoped that resource accounting would expose some of the "nonsenses" of the Private Finance Initiative, which could result in services being obtained more expensively in the long run as the price of a short-term PSBR gain.

Sir Roland Smith was concerned that the OECD figures, which showed the UK's long-run fiscal position in a favourable light,

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might be used to justify more current spending. The Governor agreed that this was a real difficulty. The projections made it easy for people to claim that the UK was well placed to increase spending. Mr King said that the comparisons were potentially misleading. The UK's position looked relatively favourable because our pension provision was indexed to prices rather than earnings: other countries had indexed their pensions to earnings. Whether in the long run it was feasible for the UK to reduce the relative value of pensions so dramatically was debatable.

Sir Jeremy Morse said that the political pressure to cut taxes in the Budget was extremely strong: the Bank's advice might reasonably start from an acceptance of this, and suggest ways in which revenue losses might be balanced. The Governor said that the Government was indeed making a huge effort to cut spending, though it was not clear how successful this would be. Already existing plans were not being met. But it was not the Bank's task to identify specific areas for spending cuts: our interest lay more in the aggregate numbers.

Sir David Cooksey wondered whether the Bank's advice should look at ways in which investment might be encouraged; whether there were desirable incentives that could be proposed. The Governor said that this, too, was not part of the Bank's locus.

Mr Quinn thought that the Bank's analysis provided further evidence that fiscal policy could not be used for short term demand management. That being the case, there was likely to be still greater dependence on monetary policy as the main economic weapon: he wondered whether this put the Bank in an uncomfortable position. The Governor said that on both fiscal and monetary policy, the need was for a general environment of stability. It was undesirable for taxes to rise and fall sharply, just as it was undesirable for interest rates to oscillate wildly between 15% and 5%. On the balance between fiscal and monetary policy, one could not be sure: the aim was to provide stability for the framework as a whole.

Mr Jenkinson commented that there was still a role for fiscal policy as a cyclical buffer, in terms of the automatic stabilisers; in our advice we were talking about the broad fiscal judgement. Mr King commented that over the years, the UK had found it easier than many countries to conduct a highly discretionary fiscal policy - the outcome had not been particularly encouraging. The Deputy Governor asked whether our advice, in short, was to stick with the plans announced in 1993/94. Mr King agreed: and the Governor said that he took the discussion as a general endorsement of the line in the Bank's draft advice. While recognising the present dichotomy in the economy, we did not want to encourage the Government to expand the fiscal deficit, and we wanted the Budget to remain as close to neutrality as possible.

Preview of the IMF Annual Meetings (Messrs Collins and Drage in attendance)

Mr Collins summarised the main issues for the forthcoming IMF meetings. There would be discussion of improved surveillance, including new requirements for publication of data. There would be discussion of the emergency financing mechanism, which was essentially accelerated procedures for dealing with countries in acute difficulties. And there could be a further proposal for a general distribution of SDRs, which would get no support from the major countries. On the other hand, there was likely to be widespread support for an increase in quotas under the eleventh review, although the prospect of ratification by the US Congress is very doubtful. Another issue on the agenda, post-Mexico, was devising a framework for orderly workouts for countries in difficulty: this would undoubtedly be addressed on a long timescale. The subject had been discussed at a seminar in the Bank on the previous day.

Sir Jeremy Morse asked whether reforms in Russia and Eastern Europe, and the financial system in Japan would be major issues. The Governor said that Russia would certainly be on the agenda: Japan would be more a matter for bilateral corridor discussions. The Governor commented that the position had improved a little since Court discussed the matter in May: the Japanese authorities had become better at handling its problems and the fear that they would be hampered in doing so by political constraints had become less acute. Their achievements so far had been partly at the expense of requiring bank creditors of institutions in difficulty to participate in support packages.

Sir Chips Keswick commented on the relationship between the IMF and credit rating agencies, which he saw as becoming over-powerful, and capable of creating the crises which the IMF would have to pick up. Sir David Scholey thought that the problem was not so much that they were becoming too powerful, but that people attached too much importance to what they said. Sir Jeremy Morse commented that the Mexican crisis had been as much a failure of the private as of the public sector, and asked whether work going forward in the IIF was being taken into account. Mr Drage said that the IMF were drawing up minimum standards for data, and in doing so had talked to a range of bodies including the IIF - they had also talked to rating agencies, including IBCA, as well as to the Bank and the CSO.

Sir David Scholey wondered whether Mexico would have welcomed intensified surveillance ahead of the emergence of their financial difficulties: any such dialogue would be bound to be extremely sensitive, and could become self-fulfilling.
Mr Collins said that Mexico had been a classic example of client-state syndrome: in this case Mexico had been a client of the United States, which had sought for a long time to keep its difficulties out of the IMF's purview.

Change in the Gilt Market (Messrs Townend and Tucker in attendance)

Introducing his paper, Mr Tucker said that the changes in train in the gilt market amounted to the biggest programme of reform for a decade. Underlying the reforms was a change of priorities: whereas 10-15 years ago management of the gilts market had been seen primarily as a part of monetary policy, the core objective now was to raise finance for the Government at least cost and risk. The measures introduced - repos, strips and tax changes - were all designed to make the gilts market more efficient, and thus to reduce the funding cost to the Government.

As the gilt market had developed and become more liquid, we had been able to become more predictable in our funding. Progressively we had switched to auctions, and that was now recognised in the latest remit.

The most difficult outstanding question was what the underlying shape of the Government's debt portfolio ought to be. We and the Treasury wanted to manage the portfolio strategically, and to have a clear goal for the debt maturity structure.

The index-linked market would play an important part in this, and last week there had been a conference on the index-linked market attended by a wide range of market participants, investors, academics and overseas investors. Currently some £40 bn of index-linked stock was outstanding, around 15% of the total. We needed to improve the liquidity of the market, and enable the Government to issue more without depressing prices too much.

Mr Plenderleith said that the programme of work was continuing. The major outstanding issues were to define the strategic portfolio, and to work through the implications of repo, in particular, for our management of the money market and our relationships with counterparties in that market.

Sir Jeremy Morse said that he was entirely in favour of the direction taken, but wondered whether the small investor was seen as playing a part. Mr Plenderleith said that it was difficult to define. If we could get inflation convincingly down, then fixed-rate conventional stock could again be attractive to the small investor. It was expensive and possibly counter-productive to force feed the market at present, though index-linked gilts did provide a natural investment medium which had not thus far been fully exploited.

Mr Tucker commented that issuance of index-linked stock offered the best way to protect the Government against the risk of an increasing real debt burden while the credibility of counter-inflation policy was being established. The Governor agreed, but said that one should not attempt to distort investment preferences - there were limits on how much one could issue index-linked stock. Mr Plenderleith said that the general approach was to increase index-linked. In the meantime we could try to promote understanding of the market: we were certainly a long way ahead of other countries in this area.

Sir David Scholey asked whether a consequence of the recent changes would be to shorten the likely maturity profile of Government debt; and wondered what type of debate the Bank conducted with final investors. Mr Plenderleith said that the move from taps to auctions would have no effect on maturity decisions: as to end investors, we had regular contact - Mr Tucker said that we aimed to see 20 or so of the largest institutions a year, including non-UK holders.

Labour Party proposals relating to the Bank of England, Supervision and Regulation (Sir Peter Petrie and [redacted] in attendance)

Introducing his paper, Sir Peter Petrie said that the questions for the Bank were how Labour policies were evolving, and how we could hope to influence them. He thought that for some time policies were likely to remain short on detail; and that the Party were not likely to commit themselves to Bank independence ahead of an election. However the location of Banking Supervision was becoming a national debate, and the Party would be influenced by that. Our own briefing programme for Labour MPs would continue, and we were placing increasing emphasis on selected Shadow Cabinet members and teams. From the start of the briefing programme we had had to counter two general beliefs about the Bank: first that it was part of a cosy City club; and second that it was obsessed with counter-inflation policy for its own sake. We had developed ways of explaining our approach, but there was much work still to do.

Sir Jeremy Morse said that he was pessimistic now about the prospect for independence: there had been a huge international wave of interest, but there was inevitably going to be a reaction to that. The Governor said that the EMU question would keep the independence debate alive, at least in one form. That aside, there was perhaps a cyclical lessening of interest, but the trend was still moving in the direction of independence. Inevitably at this stage in the cycle, with the damaging effects of inflation receding in memories, people became less sure that they wanted stability. The public debate with the Chancellor since May had also set the cause back. Nevertheless he thought the Labour leadership was more positive than they were prepared to admit in public. The Deputy Governor said that he would be surprised if the Labour Party committed themselves to independence in their manifesto. But the structure they had suggested for the Bank was oddly incomplete: it was clear that they had not yet said their last word. [redacted] said that they had explicitly signalled further consultation on the role of the Bank.

Sir Chips Keswick wondered whether the Bank, in its pursuit of independence, was accepting too readily a loss of its banking and supervisory functions. The Governor said that there could be no question of our losing our banking functions. We had a role in the payments system which was core to our function as a central bank. The question of supervision was rather different. We had discussed that with the Labour front bench. The conventional arguments against the Bank doing supervision were weak: it was suggested that we had a conflict - but if one existed, it would not be cured by separating supervision from the Bank; it was suggested we were incompetent, which was nonsense; and it was suggested that the Bank risked reputational damage from periodic supervision difficulties - which was tempting, but on examination unconvincing. The big question was what would happen to the financial sector as a whole, as it became increasingly homogenised. At some point, the question would arise as to what constituted a bank, and then it would be right to ask whether it was sensible to have institution-based regulation. At the moment it was clear that banks were distinct entities: only they were involved in the payments system, and only they conducted a maturity transformation service through their balance sheets. But it was possible to envisage circumstances in which securities companies undertook similar roles, so one could not say that a change in arrangements was inconceivable. We couldn't exclude a change forever. But we could exclude it for now.

In discussions with the Labour front bench we had found quite a lot of that accepted in a broad way, but they certainly wouldn't commit themselves.

Mr Quinn said that the definition of "a bank" was exercising supervisors around the world, and had been an issue at the meeting of the Basle Committee the previous week. He also commented that the Labour party was likely to take a close interest in the Bank's third core purpose; they were interested, for example, in the Bank's industrial role, and in the Bank's branches. The Governor said that this had been one of Gordon Brown's interests when John Smith had been leader, but more recently they seemed to have shifted their interest towards small firms and the PFI - areas that we were involved in anyway. Ms Masters asked whether we paid attention to the Liberal Democrats - the Governor confirmed that we did, and were well aware of their commitment to Bank independence; but, as the Deputy Governor pointed out, this was driven mainly by their interest in European Monetary Union.

A Resolution: ECHO

The Governor reminded Members that last July, they had been advised about the establishment of a clearing house in London for multilateral netting of foreign exchange contracts, and the Bank's role in monitoring and supervising the netting system.

Mr Quinn added that in this connection and under the Companies Act 1989, authority had been vested in the Bank to exercise certain powers, duties and functions and for practical reasons it was necessary to delegate these by means of a resolution.

[redacted]

It was RESOLVED that with immediate effect the Head of Payment, Settlement and Clearing Systems Division (or any successor Division) be authorised to exercise, on behalf of the Bank, the powers, duties and functions of the Bank under the Financial Markets and Insolvency (Money Market) Regulations 1995, and any subsequent related Regulations, and under the Bank's Conditions for Admission to the list maintained by the Bank in accordance with Section 171 of Part VII of the Companies Act 1989, as made in August 1995, and any subsequent conditions, with power to delegate such authority at his sole discretion and on such terms as he thinks fit and be required to make a Report to Court once a year on the exercise of these powers.

The authority conferred above ratified the decision taken on 15 August 1995, after due consultation, to place Exchange Clearing House Limited (ECHO) on the Section 171 list.

The Executive Report

Mr Plenderleith reported on the Foreign Exchange Survey which had been published the previous day. It showed that London was by and away the largest foreign exchange market in the world, and was growing faster than any of its main rivals. We had of course to be careful about the accusation that this was all speculative froth, but it was clear from the figures that the ratio of customer to interbank business was something like 1:3, which was very reasonable when one considered the number of offsetting transactions that each customer trade might require.

Howard J. Davies

C A Bennett
Assistant Secretary
4 October 1995

MINUTES OF A MEETING OF DIRECTORS AT THE BANK
WEDNESDAY 27 SEPTEMBER 1995

Present
Mr Davies, 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 Court, having been circulated, were noted.

Speaking about developments in the markets, Mr Plenderleith said that the most significant event had been the relatively weak response to the gilts auction held that morning. It had been fractionally undersubscribed, with bids received for £2.97 bn of the £3 bn stock on offer; at previous auctions, bids had always covered the stock offered by a margin of at least 10%. Yields had subsequently risen by 1/8% on medium-dated gilts and by a little more at the longer end; knock-on effects had produced a slight firming of money market rates and a small fall in sterling.

Mr Plenderleith characterised the outcome as a hiccough which did not contain any significant messages about either market fundamentals or funding methods, though he anticipated some further steepening in the yield curve reflecting the market's expectations of funding to come; and he noted the importance of taking other opportunities to sell gilts without undermining the role of auctions. The details of the auction programme for the next quarter, to be announced on the following Friday, would have to be carefully considered in the light of this result. He agreed with

Sir Jeremy Morse that the outcome could be helpful for future auctions in highlighting that the markets, and not always the Government, could be winners from the auction process. But it would also probably increase market concern at the size of the PSBR which was emerging in the current year.

Howard J. Paine

C A Jewell
Assistant Secretary
4 October 1995

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 4 OCTOBER 1995

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Sir David Cooksey
Sir Christopher Hogg
Sir Chips Keswick
Mr King
Sir David Lees
Ms Masters
Mr Plenderleith
Mr Quinn
Sir David Simon
Sir Roland Smith

The Minutes of the Court of 20 September and the Meeting of 27 September, having been circulated, were approved.

On the markets, Mr Plenderleith reported that trends in the foreign exchanges were hard to discern: the US dollar had crept higher but now seemed to be stuck while, for no obvious reason, Sterling had shown a firmer tone. Underlying uncertainties concerned the extent of recovery in the US economy and of softening of the Japanese economy. Domestic money market rates had weakened fractionally, reflecting the slight rise in Sterling rather than any change in interest rate expectations. Meanwhile, the markets were treating the outcome of the previous week's gilts auction as a hiccough rather than anything more serious: the Bank would be taking steps to avoid such hiccoughs at future auctions.

Under the Executive Report, the Governor spoke briefly about the ECOFIN meeting on EMU the previous weekend. He felt that good progress was being made on the transitional arrangements: the EMI's proposals would be finalised and delivered to finance ministers in time for the Madrid summit in December. But he was less sanguine about the resolution of the technical dilemma over the availability of convergence data and the timetable which the EMI saw as necessary for decisions if the start date of 1.1.99 specified in the Maastricht Treaty was to be achieved.

David Scholey

Chairman

Secretary

18/10/95

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

THURSDAY 12 OCTOBER 1995

Present
Mr George, The Governor
Mr Davies, The Deputy Governor

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.

Chairman

Secretary
18/10/95

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 18 OCTOBER 1995

Present:

Mr Davies, Deputy Governor
Sir David Scholey
Sir David Cooksey
Mrs Heaton
Sir Christopher Hogg
Sir Chips Keswick
Mr King
Sir David Lees
Ms Masters
Sir Jeremy Morse
Mr Quinn
Sir David Simon
Sir Roland Smith

The Minutes of the Court of 4 October and the Meeting of 12 October, having been circulated, were approved.

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

Mr King said that the "Tale of Two Cities" was still reasonably intact, but there was a little more evidence of weakness in manufacturing and strength in services. Events had thus far largely borne out the view of inflation that we had formed in the Spring: that the weaker exchange rate would lead to a temporary rise in the inflation level, which would be reversed next year. The latest data, for September, showed a rise in annual RPIX inflation from 2.9% to 3.1% - well above the target level, but influenced by the unusually seasonal weather and by some pick-up in food retail margins. Interestingly, retail sales of food were down in the data published that morning, while non-food sales were sharply higher. Also published that morning, unemployment in September had shown an unexpectedly large fall, with employment in services up sharply. This suggested that the third quarter GDP estimate could turn out relatively strong.

Nominal earnings, encouragingly, were still weak; there was little evidence, therefore, of the second-round effects that we had seen as a potential upside risk to the inflation forecast. But the real test of this would be in the peak wage bargaining periods of January and April 1996.

The downside risk to the forecast had been weaker activity. Here we had the continuing depression in construction, and possibly weaker exports associated with softer markets in Europe.

Sir Chips Keswick said that, while earnings as a whole were weak, that morning's figures had shown strong growth in manufacturing earnings. This was significant, and, taken against a background of strong manufacturing profitability, suggested a risk of wage pressures. Sir David Lees agreed. There had been good profit figures in manufacturing and there were more to come. Employment was picking up. He expected some significant pressures in the January bargaining round. A 4-5% range was being talked about. Sir David Cooksey asked if Profit-Related Pay had distorted the earnings data. Mr King thought that the effect was likely to be small - although there was a question why wage drift was so low. The Deputy Governor suggested that the growth of annual-hours deals could be having an effect. Mr King added that the Bank's central projection would be affected if earnings were rising at 5% rather than 4%.

Sir David Simon said that the "Tale of Two Cities" remained entirely plausible. Developments in the business cycle here were following a pattern familiar from earlier months in the US and elsewhere. The pattern of stocks and input prices were also largely predictable - when the exchange rate fell, stocks were built up in anticipation of price rises; now stocks were falling and input price rises slackening.

The Deputy Governor reported Mr Simms' comments on construction. The industry was in renewed recession. The private industrial sector had been weak, despite a few large projects; private commercial property was growing, but lower than forecast; public housing was likely to fall sharply with reduced support to Housing Associations; and private housing remained very weak.

Sir Roland Smith said that while food retailers had managed to increase margins and (just) to hold resources, non-food price increases could not be made to stick. But the mood in the retail sector was increasingly to risk losing share rather than margin.

Sir Christopher Hogg remained very suspicious of the potential for inflation to rise. Uncertainties were forcing people to be cautious, but there would be renewed pressures in 1996.

Sir David Lees commented on the apparent contradiction in the Governor's latest advice (7 September). On the one hand, the Bank expected inflation to be above target two years ahead, and had said that a rise in rates would take two years to take effect. On the other hand, the Governor was not pressing for an immediate rise. The Deputy Governor and Mr King explained that the argument turned on the balance of risks to the forecast. Given the weaker economy, the range of possible outcomes had shifted down, even though the central forecast had remained above 2 1/2%. Given uncertainties about the pattern of demand over the Summer, it had made sense to wait and see.

Financial Fragility in Japan and a Survey of Financial Stability in the US (Messrs Green, [redacted] in attendance)

With reference to a Minute of 21 June, [redacted] introduced a further paper on Japan. The major development since the earlier paper had been the emergence of a "Japan premium" in the inter-bank market. This reflects the three recent failures, the publication of low ratings by Moody's by rating agencies, and the fraud-related losses at Daiwa. But there had been positive developments. The Japanese were making it clearer that they were ready to take action to support all their internationally-active banks. They were actively monitoring global liquidity, and considering ways in which they could mobilise their foreign exchange reserves to provide non-yen liquidity support if necessary.

We ourselves had contingency plans for high-frequency liquidity monitoring on Japanese banks in London. We had not implemented these yet, for fear of precipitating a problem. We were also ready to respond if the Japanese asked for Sterling facilities. There had already been discussions with the Federal Reserve Bank about mobilisation of Japan's dollar reserves.

Sir David Scholey, who had just returned from Japan, was not so sure that the authorities were reconciled to supporting all their banks. And he had found opinion, including in industry, still unfriendly to banks and reluctant to accept bail-outs. Mr Green said that the contingency plans remained very private. There was likely to be a firm plan, and partly-covert budgetary support, in place by the end of the year.

Mr Quinn said that he would be visiting Japan early in November, and would be raising these issues with the Japanese authorities. They were concerned about the premium, which reflected a lack of credibility on the part of the authorities: the markets were not confident that they had fully accepted the scale of the problem, or that they had command of the mechanisms for addressing it.

Commenting on the United States, [redacted] said that the economic background had been favourable and that both banks and securities firms had reported good profits so far this year. But there were still risks: in the capital markets, it was not clear that all firms had the capacity to control and contain their market risks; in banking, competition could lead (again) to a lowering of credit standards; and in off-balance sheet business, there were concerns about the abilities of the supervisors to keep up with market developments. These risks needed to be monitored carefully given the growing importance in the UK and EU of institutions owned by US parents not subject to consolidated supervision at the Federal level.

Mr Quinn said that US banking was in turmoil. The long-awaited reforms to Glass-Steagall, and the advent of multi-state banking, were creating talk of massive bids - and there was a real risk that banks would over-reach themselves again.

Sir Jeremy Morse hoped that a future analysis could concentrate on European banking. Mr Green said that many of them were rapidly building up investment banking capacity, some of which was conducted in London under home-state supervision.

The Deputy Governor, summing up, said that Mr Quinn would report back to Court on his trip to Japan, and that a further (shorter) paper might examine the linkages between banking systems in the US, Japan and Europe.

A Report of the Audit Committee

Sir David Lees reported on the draft Minutes of the last meeting of the Audit Committee which covered the Coopers & Lybrand Report to Management for the year ended 28 February 1995, Coopers' fees for 1995, work in hand in the Bank on various corporate governance initiatives and relationships with NMB. The Deputy Governor said that he would be discussing the internal control question with Sir David Lees later that day.

Sir David Lees said that the Audit Committee had taken into consideration the potential criticism of Coopers arising from the Barings Inquiries. They had sought and received assurances that no staff involved with Barings had been involved in the Bank audit. It was in any case the intention to put the audit out to competitive tender in 1997.

The Risks from CREST

Court noted the Report from Mr Saville. Sir David Scholey said he would pursue with Mr Saville, outside the meeting, concerns he had about the relationship between CREST and CGO II.

Staff and other Issues
(i) An Overview
(ii) Report on the Staff Opinion Survey (Mr Roger Maitland of International Survey Research Ltd, Mr Lecky-Thompson and Mrs Betts in attendance)

The Deputy Governor explained that a series of papers on the management of the Bank would be brought to Court over the next five months - the details of how they would fit together and the sequence had been set out in his note of 13 October circulated to Members the previous week. Members were advised that the Governors and Executive Directors would be spending a weekend away in early December to review the Bank's strategy in the light of Court's comments in November, and to consider the way ahead following the staff opinion survey.

Introducing the results of the Opinion Survey, Roger Maitland, Managing Director of International Survey Research Ltd, said that the overall picture suggested that staff were happy with their involvement with the Bank, got satisfaction from their jobs, felt well-organised and fairly assessed. They were less happy on management effectiveness, training, career development and communications. Viewed against the expected response from a company in the Bank's position (a company "in transition") they were surprisingly content with pay and benefits; they were also relatively positive about their immediate management. But they were extremely critical of top management across a wide front. Morale was low - so low that it was difficult to believe the answer. Only 4% thought morale was high. Senior management was not seen to be providing leadership, or to be stating objectives clearly. There was a tension between perceptions of senior management and the general respect for divisional management. One explanation was that divisional management (and middle management) were identifying with staff

- playing to the gallery - and this was consistent with the extremely positive views of all staff on the closeness of working relationships. Such a pattern was characteristic of a company in the Bank's position: under external threat the staff formed huddles; and middle management was part of these huddles.

The Deputy Governor outlined the Bank's response, as set out in the note circulated to Members. There would be extensive presentations to staff the following week. There would be four working groups, each headed by a HOD, and each with a Deputy Director attached. They would look at the four specific areas of weakness: communication; intra-Bank interfaces; decision taking; and career development. They would attempt to clarify the issues and report back to the Executive ahead of the Off-Site Gathering.

Sir Jeremy Morse observed that the Bank was a unique institution, without obvious comparators - high or low morale tended to become polarised in such cases. And first surveys were different, as he had found at Lloyds Bank. Nevertheless, low morale in the Bank was a long term problem. The Bank had laid great stress on technical competence in recent years, becoming more professional in the process: this had been at the expense of traditional leadership qualities. He wondered where the split was in the Bank: he thought it was most significant between ExCo and HODs. He was surprised by the result on pay, which he had thought to be a problem.

Sir Christopher Hogg said that the results confirmed what many Members of Court had said before - that core purposes don't create a strategy. He supported the steps proposed on the emphasis on strategy.

Sir David Scholey said that the Bank was suffering from the double effects of restructuring and the loss of the Deputy Governor - but 50% of the answers would have been the same five years before. One concern - which was new - was the implication that the Bank said one thing and did another.

Ms Masters wondered whether HODs were the right people to lead the task forces. The survey implied that they were the problem. The Deputy Governor said that they were not themselves the problem, but were at the fulcrum of the problem. Staff at a lower level might not have the necessary authority. Sir David Scholey wondered whether staff would regard them as not empowered to deliver the necessary changes.

The Deputy Governor said that the Bank would be ready to respond positively to press enquiries when news of the exercise broke, but would not itself issue a press notice. If necessary he would talk to journalists.

Banking Supervision

The Deputy Governor introduced two papers which responded to issues raised at the Court/BoBS discussion on 21 September. The paper on the relationship between Court and BoBS spelt out how we thought the relationship ought to work, and made specific proposals. The most significant was that the Executive Director for Supervision should report regularly to Court on staffing and resources in S&S, this being the area for which Court was directly responsible, and then perhaps two Courts during the year should be dedicated largely to supervision questions. There were also some "nuts and bolts" proposals to improve the flow of information to Court. The second paper described how Arthur Andersen would be invited to conduct a management audit of Supervision, leading to a bench-marking exercise that would form the basis for a subsequent quality assurance review. Arthur Andersen would start the process quickly, and this would help us to identify where extra resources were needed in Supervision.

Ms Masters commented that the Arthur Andersen proposal did not completely address Court's concern, which had gone to the style, culture and relationships involved in Supervision as much as to the detailed operation. The Deputy Governor acknowledged the point and said it would be included in the exercise.

Sir David Lees, commenting on the paper on BoBS, said that it made it very clear that Court was responsible for Supervision. This was new and indicated that past assumptions had been mistaken. And yet few issues in Supervision had ever been brought to Court. He could not recall specific supervisory cases ever being brought to Court. Sir David Scholey commented that the latest paper nevertheless set out the accurate position. The Deputy Governor added that we had hoped that the framework suggested would allow Court to feel that they were able to discharge the responsibilities outlined. Sir David Scholey said that of the specific options at the end of the paper, he would favour Option D - that is, a six-monthly supervisory Court with BoBS present.

Sir Jeremy Morse said it would be important to distinguish detailed case work from broad oversight of the style and approach of supervision. It was right for BoBS to advise on the former; Court had to be concerned with the latter. He thought the proposals in the paper might drive Court too far towards the detail. Sir Roland Smith recalled that at the time of BCCI the question of the personal liability of Court Members had been raised. The change in perception of Court's role might make this relevant again. On a separate matter he wondered whether the members of the Board had the right attributes: were they "surveillance-type" people.

Summing up, the Deputy Governor said that his impression was that Members welcomed the greater clarity proposed for Court's role in Supervision, and were content for the Bank to proceed with the management review. But further thought was needed about the content of a "supervisory Court", where should the dividing line between general policy and operations be drawn? Sir Chips Keswick hoped that existing management would welcome the audit and not see it as yet another attack on them. Above all, it should not be seen as an external imposition.
Mr Quinn commented that it was difficult to judge how far supervision needed to change, and for that reason he was fully in support of the Arthur Andersen review. Anybody responsible for a major function should be happy to see an exercise of this

kind conducted. The quality assurance review was an exercise which he himself had first suggested. The Deputy Governor said that he and Mr Quinn would be talking to the Board of Banking Supervision on the following day, and might find it easier to find the dividing line between Court and BoBS after that session.

The Executive Report

The Deputy Governor said that Sir Roland Smith and Sir Christopher Hogg would be leaving Court in February, and that the Governors would like to agree at the next Court some recommendations for the Chancellor. He and the Governor had reviewed earlier lists of names that had found favour with Court, and had reflected again on the background required. The Governors thought that both candidates should be non-financial, and that at least one might usefully be from the retail sector. With this in mind he suggested [redacted] He would be grateful for reactions to that list over the next week or so and any further suggestions. Sir Jeremy Morse wondered whether a candidate who might be able to give particular attention to staff concerns might be acceptable. Sir David Lees thought the Court should take the opportunity of suggesting again that it would be helpful to have a Trade Unionist on the Court.

Mr Quinn spoke about the Report on Barings by the Singapore inspectors, which had been published the previous day. Compared with the BoBS Report there was no substantive difference in terms of conclusions, although there were differences in emphasis probably stemming from access to documents and individuals in Singapore. For example, the Singapore Inspectors had concluded that Norris had misled them and been untruthful, and suspected that he had been involved in covering up Leeson's activities, at least at a late stage. There was no significant criticisms of the Bank and on a highly significant point - whether the delay in reaching a conclusion on exchange exposures had lead directly to the Barings failure - the benefit of the doubt went to the Bank. Coopers & Lybrand were more heavily criticised.

Howard J. Davies

Bennett

Assistant Secretary

1 November 1995

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 25 OCTOBER 1995

Present
Mr Davies, The Deputy Governor
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.

Howard J. Davies

[illegible]
Assistant Secretary
1 November 1995

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 1 NOVEMBER 1995

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Mrs Heaton
Sir Chips Keswick
Mr King
Ms Masters
Mr Plenderleith
Mr Quinn
Mr Simms
Sir David Simon

The Minutes of the Court of 18 October and the Meeting of 25 October, having been circulated, were approved.

On the markets, Mr Plenderleith noted that the gilt-edged auction held the previous week had had a successful outcome; this served to confirm the view that the disappointing result of the September auction was a hiccough and not an indication of any fundamental problem with the mechanism. But the latest auction had nonetheless been less robust than appeared in the bare numbers and, thus, caution was needed not to put too much strain on the auction programme. He was however comfortable with the level of funding achieved in relation to the Government's currently announced (pre-Budget) borrowing requirements.

The Governor spoke briefly about his trip to the Far East - taking in Hong Kong, Malaysia, Tokyo and Shanghai - from which he had returned earlier in the week.

Howard J. Davies
[illegible]
15. November 1995

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 8 NOVEMBER 1995

Present:

Mr George, Governor

Mr Davies, Deputy Governor

Mr Kent

Mr King

Sir David Lees

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 briefly about the markets and the Official Reserves figures for October.

Howard J Davies

[illegible] 15 November 1995

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 15 NOVEMBER 1995

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Sir David Cooksey
Mrs Heaton
Sir Christopher Hogg
Mr Kent
Mr King
Sir David Lees
Ms Masters
Sir Jeremy Morse
Mr Plenderleith
Mr Quinn
Sir David Scholey
Professor Sir Roland Smith
Sir Colin Southgate

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

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

Commenting on the Bank's Inflation Report, which had been published on 8 November, Mr King said that inflation had been rising since the end of 1994, but the question was where was it going now. The rise in inflation since the August Report had been largely due to temporary factors such as seasonal foods and meat prices. The principal change in our view of inflation in recent months had been that, whereas earlier in the summer we had seen the risks to the inflation forecast as being principally on the upside, we now saw the risks more evenly distributed. But the degree of uncertainty about the forecast had increased due to three factors. Was the obvious slowdown in demand and output merely the temporary effect of destocking or did it reflect a more long-lasting trend? Second, would the re-emergence of wage drift cause higher inflation pressures or would wage settlements remain modest? Third, to what extent did the recent increase in broad money reflect a shift in the supply function reflecting banks' greater willingness to lend, for that too could increase inflationary pressures?

Mr Plenderleith drew attention to tremors in the exchange market. The dollar seemed to have stabilised at around 100 yen but had tended to ease against the deutschmark reflecting concerns about the budget crisis in the US while uncertainties about EMU sparked demand for the deutschmark. This latter factor had caused the French franc, the lira and the peseta all to suffer spells of weakness while the Canadian dollar had been unsettled by the run-up to their referendum. Sterling had drifted distinctly lower in the last two months, reflecting increasing market expectations that interest rates will be cut in the short-term. The market's expectations of inflation two years hence had also been scaled down but remained well above the Government's 2 1/2% target, while expectations of inflation ten years hence remained stubbornly high at around 5%. Thus the market seemed to believe that the monetary stance was not tight enough to meet the Government's inflation target but that nevertheless interest rates would soon be cut.

In commenting on the Report, Sir David Lees agreed that uncertainties were increasing, not least because of the approach of the election. But although he saw the prospects for output as a little flatter than three months' ago, he did not expect it to fall sharply. The softer tone to output could help moderate wage demands but there were signs that settlements in the motor industry would be significantly higher than last year. Sir Colin Southgate said that demand for consumer durables was flat in the UK but in Northern Europe, especially Scandinavia, demand remained strong. Demand was weak in the US, where it seemed that people had taken personal credit to the limit and this had taken the heat out of the rise in personal consumption. The Governor noted that central bankers in Basle had agreed that there was a widespread pause in economic expansion but there was considerable uncertainty on how long that would last. At an anecdotal level, Sir Jeremy Morse thought there was less grumbling by small businesses and this might reflect the easier stance of bank credit. Sir Roland Smith believed that the UK was at the end of the stock-building process given the prospect for more stable raw material prices. Although the motor industry faced problems with wage demands, this situation was not reflected elsewhere. Sir David Lees noted the fall in steel prices, which was bad news for producers but good news for those many industries which consumed steel. The Governor summed up that part of the discussion by noting that although uncertainties were enormous, it did not appear that the economy was about to fall over a cliff of falling demand.

Sir Colin Southgate noted that British businesses were better managed than ten years ago and thus better able to cope with economic uncertainties. Sir Roland Smith agreed up to a point but questioned the quality of management, particularly in the large utility companies.

Sir David Lees asked how accurate market forecasts of inflation had been in the past. Mr King said that there were technical problems with the two-year projection arising from the cashflow patterns of near-maturity indexed bonds. In addition, even if one looked back to the early 1980s, there were only two business cycles during which to collect data which meant that the number of observations was quite small, but the tentative conclusion was that the market predictions of inflation tended to exceed the outturn. Mr King also drew attention to chart 3.2 in the Report which indicated how unusually smooth the economic recovery had been so far. Accordingly, one should not worry if a fall in GDP was seen in a single quarter, for such a pattern would be typical of previous recoveries. Because of the considerable uncertainties around the forecast it was difficult to support extreme forecasts of either a sharp rise in GDP or a significant recession. There were very fine differences between our central projection of inflation and the Government's target, which made judgments on interest rates particularly difficult at present.

Sir Colin Southgate wondered if small changes in interest rates might be used to try to generate a feelgood factor but the Governor said that any change in interest rates would need to be justifiable in terms of the policy objective, otherwise there could be adverse confidence effects.

Sir Roland Smith pointed to the aggressive competition between food retailers and suggested that the Bank should monitor the trends in the food retailing sector closely. The Deputy Governor said that the Bank now received useful data from one supermarket chain, which helped illuminate what was happening. The Bank had also undertaken an examination of trends in retail margins.

Sir David Lees feared that the Financial Times did not seem to understand how counter-inflationary policy was applied and seemed to place too much emphasis on the precise position of our central forecast and overlook the wide-range of possibilities. Could we do more to inform them? After a brief discussion of press attitudes, the Governor concluded that the Inflation Report was the best vehicle clearly to explain our message to the press.

The Bank's Strategy (Messrs Lecky-Thompson and Midgley in attendance).

In introducing his paper concerning the Bank's strategy for the next 2-3 years, the Deputy Governor said that this was one of a series of papers on the Bank's strategy and management. Next month there would be a paper on the Bank's staffing policies and another on financial controls, in January a report from the Executive's off-site gathering and in February there would be the paper on the budget for next year. Therefore he hoped that today's discussion would concentrate on section 1 which dealt with the external environment, and section 2 which looked at the core purposes and suggested detailed objectives related to them. On the external environment he noted that the debate on independence had gone quiet while uncertainty over EMU seemed likely to remain for sometime. The members of the TCSC had compromised on a recommendation that the Treasury should review the Bank's role in supervision, though it was not clear how the Chancellor would react to that advice. The Labour Party were themselves reviewing their policy on this question but their review seemed to be endlessly delayed.

The Bank's core purposes seemed robust and the Staff Opinion Survey showed that they were well understood by the Bank. The priorities for the Monetary Stability Wing seemed to be on the right lines but there was clearly more work to do on improving the external perception of the Bank's counter-inflationary role. A larger task of influencing perceptions arose from the Financial Stability Wing, where there was a need to explain our approach to the world in general while raising morale inside the Bank. Our aim should be to set our sights high and create a centre of excellence in supervision within the Bank and the appointment of the Arthur Andersen team should help achieve that objective. Although there might be a need to expand and direct more expensive resources towards S&S, this should be achievable over the next three years if we could generate savings elsewhere in the Bank.

In inviting discussion, the Governor asked if the paper correctly judged the state of political opinion about independence. Sir David Scholey felt that, as far as the public were concerned, independence was yesterday's argument. He advocated a softly-softly approach of influencing decision-makers while not raising the subject publicly; our best case was made by the performance of our tasks. He regarded the Inflation Report as a remarkable document but feared that it might go over the heads of some of the Bank's business audience. He was concerned that the Bank should continue to give a simple, unambiguous message on keeping inflation below 2 1/2%. The Bank had to be the keeper of the Holy Grail. Mrs Heaton agreed that the Bank should speak loudly and firmly in its case for low inflation and Sir Christopher Hogg agreed that the Inflation Report was of outstanding quality. He suggested that the Bank could make its views more widely known by televising the Inflation Report press conference, a suggestion the Governor agreed to consider further. Ms Masters wondered if the Bank was clear at whom it was trying to target its counter-inflation message, and thought we should go wider than just the business community.

The Deputy Governor said that the Bank had been considering the circulation of the Inflation Report and had lowered its price, but there was probably more that could be done. Mervyn King noted that Bank Briefing was the main alternative medium to the Inflation Report, comprising an executive summary of the Report and being sent to a much larger audience. Sir David Scholey said the Bank should look for new ways of expressing its counter-inflationary messages and look for new audiences to target. The need to keep inflation down was not as well understood by the public as it should be.

Sir David Cooksey felt that the strategy document lacked sufficient benchmarks or targets and so risked looking complacent in places.

Sir Christopher Hogg feared that the Bank was fighting for its supervisory life but in doing so was constrained by being part of Government. It was increasingly unsatisfactory to look at supervision by institutions and the Bank should look increasingly at supervision by functions. The Bank was unique in its position in the City and its international role and both were real assets for UK plc. He felt that the Bank should be more pro-active in relation to the financial sector in general, whereas the tone of core purpose 3 was too reactive. If the Bank faced financial restraints it should solicit the help of outsiders by commissioning external studies. He regretted that the Bank had not been more pro-active towards Lloyd's and the Stock Exchange in the 1980s, as he felt the Bank had been in a real position to influence those markets. Sir Jeremy Morse endorsed Sir Christopher Hogg's comments which he saw in the spirit of Montagu Norman's Bank, but this was an approach which the Bank had increasingly moved away from during the 1980s. However, the Governor observed that the Government had consciously created a framework of regulation for the City in the 1980s and the law did not provide for the Bank to play a leading role. Thus the Bank found itself in quite a different legal position vis-a-vis the City than was the case in Montagu Norman's day.

Sir David Scholey called for greater collaboration between the Bank and other supervisory agencies. Perhaps the Chairman of the SIB should be a member of BoBs. Although Members of Court should be publicly supportive of the Bank's role in supervision, they would want to be fully involved in the Bank's internal discussions in evolving that role. He warned against the Bank taking on responsibilities under core purpose 3 that it lacked the power to carry out. There were increasing dangers for the Bank in exceeding its legal responsibilities in an increasingly litigious world. The Governor agreed and said that the Bank's role where it lacked authority should be to monitor the situation and act as a catalyst for solutions. Mr Quinn felt that the Bank should understand how the wider financial system worked without usurping the authority of other regulators. Sir David Scholey did not agree that the central bank was best placed to look at the financial system as a whole and commended the work of some other investigative bodies such as the Harvard Group.

Sir Jeremy Morse feared that the pendulum had swung too far towards a mechanistic, legalistic approach to banking supervision and this risked that the supervisors missed seeing the big picture. In pushing the pendulum back it might be necessary to bring in more externally experienced, street-wise people. Sir David Cooksey said that it was not simply a matter of better quality supervisors, they also needed better tools and, in particular, the right level of IT support. Mr Kent, referring to the discussion of core purpose 3, noted that the Bank was already looking closely at supervision of financial markets in general through the Regulatory Policy Division. He and Mervyn King were seeking to recruit more financial economists and these should help go some way towards the relationship with other supervisors that was being sought. The Governor felt that the question for core purpose 3 was how pro-active the Bank could be in a world of more legally-based supervision of financial markets. How could the Bank avoid getting responsibilities without power? For example, the Bank had been monitoring the problems of TAURUS and London Clear and offering its informal advice for some time before those projects reached crises, but it was only after the Bank had received invitations from those markets that it could act to resolve the problems.

Sir David Scholey felt the strategy paper lacked a section on management development. Looking ten years ahead he was anxious about the Bank's ability to develop breadth and the depth of management. The Governor responded that these were issues which would be considered by the Executives at the off-site gathering.

Sir David Lees felt that the paper did not fully address questions of prioritisation and affordability. The Deputy Governor said that there would be resources to begin strengthening supervision over the next 18 months or so because of planned resource savings in other areas, and in any case it would take some time to build the supervisory team in the way desired. In the medium-term the constraint could well be the Bank's overall pay bill, which was frozen by the Government's public sector pay policy, rather than a shortage of financial resources as in fact the Bank's income position was buoyant.

Sir Roland Smith foresaw the possibility of a Labour Government which would attach a high priority to reducing unemployment. Our strategy did not seem to take that possibility into account. The Governor said that this question had been discussed with the Opposition and they accepted that they would not be able to use demand management to bring about a lasting fall in unemployment but would need to look at structural measures instead. The Bank accepted its own need to expand its resources on analysing structural developments in the real economy.

In concluding the discussion, the Deputy Governor said that the question of how changing financial markets should affect the way we manage supervision and the view we should take on the appropriate institutional framework would shortly be discussed in EXCO, with a report to Court in due course. The worst criticism that the Bank faced was when it was said the Bank did not understand what was going on. Such criticisms were unfair but we needed to do more to turn round that false perception. Similarly, on the monetary side we did not always get our message across on the need to curb inflation. He welcomed the Directors' comments on benchmarks and said there was a good appetite in the Bank to adopt such measures. All the comments made in discussion would be taken into account and a revised paper put back to Court early next year.

Appointments to Bank Subsidiaries

The Governor advised Members that Derek Bridger, the Chief Registrar at Gloucester, would be retiring from the Bank at the end

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of the month and he would be succeeded by Peter Ironmonger, currently the Deputy Chief Registrar. Mr Bridger sat on the Board of the two of the Bank's subsidiaries - The Securities Management Trust Ltd and BE Services Ltd - and it had been agreed that Mr Ironmonger would also take over these responsibilities.

With effect from 29 November 1995, 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, it was agreed that:-

1 Mr P W F IRONMONGER shall become a Director of The Securities Management Trust Ltd in place of MR D A BRIDGER. The Board will then consist of Mr Quinn (Chairman), Mr Midgley, Mr Kentfield and Mr Ironmonger.

2 MR BRIAN QUINN, or failing him MR GORDON MIDGLEY, or failing him MR G E A KENTFIELD, or failing him MR P W F IRONMONGER, be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of The Securities Management Trust Ltd.

3 MR P W F IRONMONGER shall become a Director of BE Services Ltd in place of MR D A BRIDGER. The Board will then consist of Lord Laing of Dunphail (Chairman), Mr Midgley, Mr Jarvis, Mr Watts, Mr Bartlett, Mr Lecky-Thompson and Mr Ironmonger.

4 LORD LAING OF DUNPHAIL, or failing him MR GORDON MIDGLEY, or failing him, MR A W JARVIS, or failing him MR J BARTLETT, or failing him MR ROY LECKY-THOMPSON, or failing him MR P W F IRONMONGER, be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of BE Services Ltd.

The Staff Pension Fund and the Court Pension Scheme - Rule amendments

The Deputy Governor introduced a paper from the Secretary of the Pension Fund outlining the rule amendments to the Staff Pension Fund; namely -

(a) change of the Trust Deed be revised to reflect more truly the manner in which the Bank's contributions to the Fund are agreed;

(b) segregation of members' contributions; and

(c) updating references to outdated legislation.

Court were advised that the Trustees of the Fund were content with the changes and gave its approval to the amendments proposed.

The Governor, having declared his potential interest in the Court Pension Scheme, together with those of the Deputy Governor, Messrs Quinn, King, Kent and Plenderleith, invited Sir Roland Smith, in his capacity as Chairman of the Trustees of the Court Scheme, to present his Report on Rule amendments. These were as follows:

(a) bring the Trust Deed and Rules into line with the overriding provisions of the Finance Act 1989, and to update references to old legislation where new provisions have been enacted;

(b) in order to allow for the possibility of female members joining the Scheme, to extend the current benefits for widows and children of male members to any such female members, and to allow Maternity Leave to count as pensionable service;

(c) where a spouse is more than 15 years younger than the member, to reduce the widow(er)'s allowance by only 2% for each year in excess of 15 (instead of 2 1/2%), subject in all cases to a maximum reduction of 50%;

(d) allow a member's voluntary contributions to the Scheme to provide extra widow(er)'s benefit where this would not breach Revenue limits; and

(e) segregate a member's voluntary contributions in line with "best practice" so that, in the event of the Scheme being wound up, they could not be used to meet the Scheme's other liabilities.

Court approved the amendments proposed.

The Executive Report

The Governor referred to the EMI's paper on the changeover to the single currency but given the hour suggested that the item be postponed until the December long Court.

Further to a Minute of Court of 18 October, the Governor circulated a draft letter to the Chancellor of the Exchequer recommending appointments to Court to fill the vacancies which will arise following 29 February 1996.

Mr Quinn reported that on Monday 20 November an important stage would be reached in the litigation against the Bank by the liquidators of BCCI. The Courts would consider an amended statement of claim by the liquidators and, at a hearing which could last for up to 16 days, the preliminary legal issues will be tried. These centre on matters of law rather than substance and rested on three questions. Was the Bank capable of being liable to depositors for the tort of misfeasance in public office? Were the depositors' alleged losses caused in law by the acts or omissions of the Bank? Are the plaintiffs entitled to recover for the tort of misfeasance in public office as existing depositors or potential depositors? [redacted] Judgment would not be given until the new year.

The Deputy Governor noted that the Bank would be hosting a Christmas drinks party on 18 December. It was hoped that as many

Directors as possible would attend. Finally, the Governor advised Members that Lord Richardson would be celebrating his 80th birthday on Saturday

Howard J. Davies

J R Footman

Secretary 20 December 1995

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 22 NOVEMBER 1995

Present

Mr George, Governor
Mr Davies, Deputy Governor
Mr King
Mr Quinn
Sir David Scholey

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 developments during the week in the foreign exchange markets.

The Governor mentioned his discussion the previous day with the Chancellor about Court succession. He noted that the Chancellor was minded to put four names forward to the Prime Minister for consideration: Sir John Hall, Ronnie Hampel, John Neill and Sir Iain Vallance.

Howard J. Davies

John Footman Secretary 20 December 1995

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 29 NOVEMBER 1995

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Mr Kent
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 said that the markets were digesting the Budget and the reaction to it. The relatively restrained fiscal stance was generally being interpreted as enhancing the prospects of an interest rate cut, but there was some disappointment at the scale of next year's PSBR. The net result was that both sterling and the gilt market had initially weakened after the Budget, though they now seemed to be steadying.

Mr King noted that the Treasury's growth forecast for 1996 on 1995 - 2 3/4% for non-oil GDP and 3% overall - seemed optimistic; if growth proved to be lower, the PSBR would increase.

Howard J. Davies

Initialled Secretary 20 December 1995

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 6 DECEMBER 1995

Present
Mr George, Governor
Mr King
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.

Howard J. Davies

[illegible] Secretary 20 December 1995

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 13 DECEMBER 1995

Present
Mr George, Governor
Mr Davies, Deputy Governor
Mr Kent
Mr King
Sir Jeremy Morse
Mr Plenderleith
Mr Quinn

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 said that the markets had responded positively to the 1/4% cut in interest rates announced that morning following the monthly Chancellor/Governor meeting; the cut had been in line with market expectations. The decision taken was what the Bank had recommended in the light of clear evidence in recent months that inflationary pressures were softening; and there had been a genuine meeting of minds, both within the Bank and between the Chancellor and Governor, that a 1/4% reduction in rates was now justified on economic grounds. There was value also in being able to move to a pattern of smaller adjustments in rates; past moves, in less stable conditions, had tended to be 1/2% or more.

The Governor reported that the Queen had approved the appointment to Court of John Neill and Sir John Hall. He had spoken to the former, who was willing to accept the appointment and had made a positive impression, but had yet to sound out the latter. If he also agrees, it should be possible to announce the appointments before Christmas.

Howard J. Davies Chairman Secretary 20 December 1995

[redacted]

[redacted]

[redacted]

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

The Minutes of the Court of 15 November and the Meetings of 22 and 29 November and 6 and 13 December, having been circulated, were approved.

Court expressed its sadness at learning of the death of Lord O'Brien of Lothbury, who had served the Bank continuously from 1927 until his retirement in 1973. The Governor said that he had attended Lord O'Brien's funeral on 1 December, and that there were plans for a Memorial Service on 9 February - which would have been Lord O'Brien's birthday - either at St Margaret's, Lothbury, or at St Paul's.

Monthly Economic and Market Report (Messrs Bowen and Jenkinson in attendance)

Mr King said that the recent Budget could be viewed, depending on the indicator chosen, as either neutral, expansionary or contractionary. In the sense of the tax and spending decisions against an indexed base, the Budget was neutral. In the sense that the PSBR levels both for this year and subsequent years were higher than projected a year before, the Budget was expansionary; in the sense that the Budget continued the process of fiscal consolidation started in 1993, the Budget was contractionary. On balance, the Budget was as good as we could have expected. There was some optimism in the profile of tax receipts, but the Treasury had taken a cautious view on the likely continuation of slippage from VAT receipts, and the Budget judgement was more cautious than some had feared. One worrying feature, displayed in the charts made available to Court, was the steady growth in the ratio of debt to GDP during the 1990s so far. It would be important to reverse this.

On the monetary front, recent news on activity had shown that growth was slower than we had thought at the time of the November Inflation Report. There had been a sharp slowdown on the continent. However there did seem to be some pickup of consumer spending, which might continue. The caveats remained the monetary aggregates and the exchange rate. M4 was growing rapidly. But there had been generally good news on current inflation: there had been falls in manufacturers' input prices, slower increases in output prices, and the recent RPI figures had been very favourable. We now expected inflation to be less than 2 1/2% two years ahead, a better profile than at the time of the November Inflation Report and, in the circumstances, the cautious 1/4% cut in interest rates had seemed sensible.

Mr Plenderleith said that the interest rate cut had been expected in the markets, and had resulted in no big shifts in sentiment; however Sterling had remained soft and fragile throughout the period, despite the evidence of fiscal and monetary caution, and despite the interest rate cuts in other major markets. The profile of three-month forward rates suggested that, the markets saw a further fall, followed by rises next year. Sir Chips Keswick said that in the three-to-five-year area, the market was speculating against the pound.

Sir David Lees commented that the Chancellor's growth forecast had been greeted with some scepticism and he wondered what the Bank's view of this was; he also noted the increasing proportion of employment based on short-term contracts, and wondered whether this would lead to weaker consumer confidence.

Mr King felt that the growth forecast was getting too much attention. The number in question was simply the percentage change between one year's average and the previous year's, and was consequently highly sensitive to the fourth quarter and first quarter outcomes. If GDP growth in the fourth quarter of 1995 and the first quarter of 1996 turned out at around 0.2%, then certainly the year-on-year forecasts would prove optimistic. But this could still be consistent with sharp growth in the last three quarters of 1996. Mr Jenkinson added that as a rough and ready rule of thumb 1% off growth would result in an additional £4-5 bn on the PSBR.

Mr Bowen said that there had been a rise in the number of workers on fixed-term contracts. The Deputy Governor added that it was often asserted that unemployment, though lower, had affected more people. But this did not appear to be the case. It was also not true that average tenures in employment were falling significantly - although it was more the case for men than for women. However it was clear that the proportion of the workforce covered by employment protection legislation had fallen dramatically, from 55% to a little under 40% over the past decade. And it was possible that this was associated with higher savings, and the lack of a "feel-good" factor.

Sir David Scholey drew attention to the rapid growth in money and credit, and asked how far we felt this outweighed the other data. Mr King said that M4 and credit growth had been strong for some time. It was one of the reasons why we expected growth to pick up in the latter quarters of 1996. In assessing the long-term implications for inflation, the question was whether it would persist: the recent spike in M4 growth was related to underfunding, and to the behaviour of the financial institutions - the growth of credit itself was not so strong, and mortgage credit was not growing very fast.

Sir David Scholey also asked whether the implied forward inflation rates in other countries, derived from yield curves, were likely to be as inconsistent with their inflation targets and projections as were ours. Mr King said that there was a gap in Germany, but generally the differences were not as large as ours: Mr Plenderleith said that there were difficulties in interpreting other countries' figures, as they did not have the index-linked bond market from which our estimates were partially derived. Nevertheless, independent forecasters in other countries were more in line with official forecasts and targets.

Sir Jeremy Morse noted that one of the great successes of the past year had been the tactic of moving early on interest rates so as to pre-empt inflation. He wondered whether the same would be true on the downward side of the curve - the problem being that the pressures, politically, were not symmetrical. Were we going to be able to cut off the bottom of the growth cycle? The Governor commented that this was not easy. The implication of the question was that we were managing interest rates in order to manage activity, which was not the case. The process involved taking account of the impact of activity on inflation, and steering by reference to that. The shift between November and December had happened because we saw activity placing less upward pressure on future inflation. Our aim was to set policy consistently so as to achieve an inflation rate of 2 1/2% or less. Sir Jeremy Morse commented that this did not give a very clear guide to future downward movements. The Governor agreed that this was one of the perceived difficulties of policy. It remained the case that we did not take a view on activity alone. We had to remember that we started with a burden of history - our credibility was nothing like that of other central banks, and we could not afford to take risks.

Sir Roland Smith commented that the general mood in industry was to expect activity to weaken. It was not clear whether we were aiming to move back to a 3% growth path. Sir David Simon said that the anecdotal indicators from the energy sector, which had all been consistent this year with the outcome, now had input costs poised to rise. The market believed that de-stocking had finished: forward prices were moving up, and real markets were becoming tight. Everything suggested that the market was turning. Sir Roland Smith commented that the question was whether attempts to impose price rises would be successful, or whether they would result in pressure on margins. Sir David Scholey noted that retailers' margins in the UK had been extremely wide by international comparisons, and that the reductions this year could well prove irreversible.

The Governor, summing up, said that his sense was that some Members of Court felt that the economy was weaker than did others. He hoped that Court agreed on balance with the decision to recommend a cautious 1/4% cut, and that they would take encouragement from the fact that we were now beginning to share the stability of European countries.

Progress Towards Monetary Union (Sir Peter Petrie and Mr Collins in attendance)

With reference to a Minute of 16 August, Mr Collins said that the recent Madrid Summit had endorsed the EMI's changeover scenario. The decision on who would participate in EMU would be taken in early 1998, based on 1997 data. The first period of changeover would last for about nine months. No statement had been made on the legal basis of the currency, but the name had been decided. Tradeable public debt issued by participating member states after EMU had started would be denominated in the new currency. Two studies had been commissioned: one on fiscal discipline - the Waigel Plan - and one on the relationship between the "Ins" and the "Outs" (the Prime Minister's initiative).

Sir David Scholey asked about the "ERM" convergence criteria. The Governor said that this had been discussed at the EMI, and the EMI had given an opinion, which essentially recognised that, while the Treaty had talked about "normal margins", the world had now changed. One could have a country which had fluctuated wildly within the 15% bands, but had nevertheless been "within normal ERM margins" - and one could equally have a country that had not been in the ERM, but whose currency had been rock-steady. Clearly this would require interpretation by the European Council, but the need was to look at substance rather than form.

Sir Colin Southgate asked whether there was any tendency to weaken the criteria. The Governor said that this was generally resisted, but at a political level it was always hard to tell what the outcome would be. Mr Collins added that little was being said publicly, but in practice there were countries like Belgium and the Netherlands which would not meet the criteria but which were unlikely to be excluded. No-one, publicly, was prepared to face up to that.

Sir David Scholey asked about France. Mr King said that they needed two things in order to meet the criteria. First, they needed to go through with their welfare reforms; and second, they needed a bit of luck on the cyclical front - a pick-up in Europe would obviously help them. Sir David Scholey felt that convergence achieved on this basis was unlikely to be sustainable. Sir Peter Petrie said that our Paris Ambassador's view was that France would have difficulty in reaching the 3% fiscal criterion, but that the possibility was not excluded.

Sir David Scholey asked whether we were still participating fully in all the technical aspects. The Governor said that we were, and in fact pulling more than our weight in the discussions - this being particularly the case in the debate on the transition scenario. In the UK, now that the changeover scenario had been published, we were in active discussion with various representative groups to see how we could assist in a changeover, if it were ever to happen. For London this was very important, particularly for the wholesale markets, and we would need to ensure that the mechanisms were in place and understood. John Townend and Stephen Collins were having extensive discussions with banking, industrial and retail bodies.

Sir David Lees asked about the Waigel Plan. Mr King said that the objective of the Waigel Plan was to prevent pressure on inflation from a build-up of public debt in the EMU countries. The proposal therefore was to fine countries whose fiscal deficits exceeded 3%. This was a principle which could produce difficult outcomes, for example in the case of a country which suffers an asymmetric shock, sees a rise in PSBR, and then has to pay money into the Community.

Real Time Gross Settlement

There was insufficient time for a discussion, but the Governor said that this project was on course and that the Bank team had done extremely well: Merlyn Lowther had played a very large part in this. Sir David Scholey asked about the remaining risks, which were not covered in the paper. Mr Plenderleith said that there were still a few risks, but already the system was trialling, and the basic CHAPS system was now operating on the RTGS software. Sir Colin Southgate asked about security, which Mr Plenderleith said was to a high market standard. Sir Jeremy Morse noted that initially there had been much resistance from the banks because of the loss of profit from the float. The Governor said that the main cost to the banks was holding liquidity against intra-day payments: that would only impose a cost to the extent that they were holding more liquidity than they would otherwise need.

Matters Reserved to Court

The Secretary introduced the paper, saying that while codifying Court's procedures was a novelty, it had in fact proved possible to come fairly close to the Cadbury Code without involving any significant change in Court practices. He invited Members to look particularly carefully at the choice of the words "consult", "inform" and "approve".

Mr Simms said that he felt that the paper was satisfactory, and encapsulated the Court procedures well. Sir Jeremy Morse felt that it would be right for Court to approve the appointment (or dismissal) of the Secretary.

Sir David Scholey felt that Court ought to be involved in approving the following matters: the nomination of Directors; the appointment of Deputy Directors; significant changes in management structure; significant changes in the business; Directors' contracts; risk management policies; and the minutes of Audit Committee. Sir David Lees agreed.

Ms Masters felt that the Court arrangements should be subject to annual review, and that it would also be helpful for Court to see a revised presentation, showing separately the lists of things which Court had to approve, on which it was consulted and about which it was merely informed. The Governor commented that "approve" and "consult" were often not clear-cut distinctions: comments made by Court on issues for consultation would clearly influence the decision.

Sir David Simon said that the introduction of a £10 mn approval for capital expenditure items jarred with the rest of the document, and should be removed.

Sir David Lees commented that the section on banking supervision would need to be rewritten in the light of subsequent discussion of the Court/BoBS relationship.

The Governor said that we would revise the paper along the lines Court had suggested.

Banking Supervision and Court

With reference to a Minute of 18 October, the Deputy Governor said that the Executive had undertaken to find a distinction between "policy" and "operations" with a view to determining the matters which Court would discuss in the proposed regular meetings on Banking Supervision. In practice we had found the distinction unhelpful, and had instead produced a stylised agenda, suggesting a quarterly and six-monthly cycle for discussion.

Sir Chips Keswick said that he felt that the Executive should find some way of reporting to Court what the practitioners themselves thought. BBA/LIBA views could be interesting in this context. Otherwise Court was subjected simply to one-way traffic. The Governor agreed that this would be a very helpful approach, although the Deputy Governor did not see the BBA and LIBA as necessarily the right bodies to provide input. He added that the Arthur Andersen brief did cover how institutions viewed the Bank. The Deputy Governor said that if any Member of Court wished to meet the Arthur Andersen team, he would be very happy to arrange it.

Sir David Scholey said that the paper did not cover the interaction between Court and BoBS, and he hoped that there would continue to be a regular discussion involving BoBS. The Governor confirmed that this was planned; the annual meeting was held in the context of the Banking Act Annual Report. Sir David Scholey thought that it would be helpful if all of Court and BoBS met for part of the time, and that the informal session could follow that. This was agreed. It was also agreed that discussion of staffing and resources could be done annually, perhaps jointly with BoBS.

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New Appointments

The Governor said that we had now heard from No 10 that The Queen had approved the appointment of Directors to Court from 1 March 1996. They were Sir John Hall, John Neill, CBE, Michael Foot and Mervyn King.

He added that a formal announcement from the Prime Minister's office was to be made later in the day. It was intended that Mervyn King should continue as an Executive Director and that Michael Foot will become one; and it was now for Court, in accordance with paragraph 11(2) of the Charter of 1946, to appoint them as Executive Directors with effect from 1 March 1996 and note, for the record, that Michael Foot will be the Executive Director responsible for Banking Supervision from that date. <u>Court approved the appointments</u>.

Sir David Scholey said that Directors would welcome an informal discussion with Michael Foot about how he planned to develop supervision.

Down Hall and After

The Deputy Governor introduced the Down Hall paper. He said that a strategy paper had been discussed with Deputy Directors and Heads of Division, who were now starting work on the implications for their areas. Meanwhile, at the Down Hall gathering the Executive had considered the reports from the Task Forces, which had been extremely helpful in identifying the areas where change was needed. The aim was to use the process to change gear, to stop whingeing about the past, and to focus on the future. The Down Hall communique, which had been circulated to staff two weeks earlier, had given basic messages about communication, culture and style.

Now we were ready, in the light of Michael Foot's appointment, to announce changes to the FS Wing that had been proposed at Down Hall, and also to announce a new management structure. The FS Wing had not been a success thus far. While in the MS

Wing the distinction between analysis and operations had been clear and widely understood, it had not been followed through in the FS Wing, where operational matters were scattered on both sides. In addition, the absence of Deputy Director coverage all of the FS Wing had made things more difficult. The proposed new structure put Alastair Clark as Deputy Director for all Financial Infrastructure side of the Wing, brought all the analytical areas together under him, and put supervision in S&S, including WMSD and ECHO. Oliver Page would be the Deputy Director for S&S.

On the management structure, the Task Forces had made it clear that while ExCo had set a strategy its implementation had ill-focused. There was a range of Committees - Personnel Committee, the Information Technology Steering Group - which took decisions, and the Deputy Governor himself had considerable personal discretion. ExCo played a co-ordinating role, but was expected to do too much. The new Committee, involving the Deputy Directors, would be a valuable way of ensuring that strategy was implemented in a coherent way.

Sir David Lees said that he had been concerned about ManCo. The Bank of England was a small organisation, and a well-ordered ExCo ought to be able to manage it, through the Executive Directors. The formation of ManCo effectively lifted the Executive Directors on to a plane above management. He was also concerned about the proliferation of one-on-one reporting relationships implied by the Executive/Deputy Director arrangements. Sir Colin Southgate agreed. He had been hoping to see management decisions pushed down from ExCo, but not the creation of a new Committee.

The Governor said that these concerns went to the heart of the question of whether we were going to run the Bank as one Bank or two separate wings. He did not believe that we could allow parts of the Bank to manage themselves.

Sir Jeremy Morse said that he had shared the concerns of Sir David Lees and Sir Colin Southgate. However he had accepted it more easily because he recalled the previous role of Executive Directors before 1980, when they were effectively advisers to the Governor and the management of the Bank was in the hands of the Heads of Department. Provided there was a good relationship between the Directors and the Deputy Directors, this structure could be made to work. He accepted that there were natural divisions between the wings, but that these should be moderated elsewhere: the divisions between officials and officers, economists and non-economists, permanent and contract staff were unhelpful. We had to minimise the sense that some bits of the Bank were more "core" than others.

He also felt that ManCo might not be a permanent structure, although it was the right solution for now.

The Governor said that one of the telling things from the Task Forces was their statement that, while ExCo might think that things were happening, they were not. The Directors on ExCo all had technical responsibilities, and did not have the time or the capacity to manage in detail the change programmes that they had initiated.

Sir Colin Southgate said that everyone agreed that we should have a single Bank - but this had more to do with culture than with organisation.

Sir David Simon said that he shared all the views expressed about the problems of one-on-one reporting relationships, but also saw that the biggest challenge to the Bank was the management of change. He was surprised that ManCo was put in charge of implementation of change management programmes, while there was nothing about ExCo developing a strategy for change. He would like to spend a lot more time thinking about ExCo's role in the management of change. Under the proposed arrangements, ManCo would be the driver of change, and ExCo would become more distant.

The Governor said that ExCo had set strategy, and had done so reasonably well. The problem was that the staff were telling us that what we thought was happening and had mandated to happen actually wasn't.

Mr Simms said that he was sure that the staff survey had made the Directors feel uncomfortable, but that was absolutely typical of such exercises, and there was no need to go beyond the reasonable in satisfying the demands put by staff. It was good to strengthen communication, but the creation of a new permanent committee was a mistake. It might be more understandable if it was just a temporary standing committee. He did not think the Bank should have a committee which took management away from ExCo.

Ms Masters said that she was uncomfortable about the link between the Deputy Governor and the Deputy Directors. It didn't feel right.

The Governor said that he was very disinclined to set ManCo up as a temporary body. He preferred simply to set it up and review it after the next survey, which would test whether the changes had worked.

Sir David Lees agreed that it would be wrong to set ManCo up as a temporary body. But he wondered whether having set ManCo up, it was time to reconsider the role and name of ExCo. What was needed was not an executive committee but a strategy committee. The Governor said that, in effect, ExCo was that. It set strategy, though it also had policy work, for example in monetary ExCo. The Deputy added that ExCo was in practice a very policy-driven body.

Sir David Scholey said that it was important to clarify the differences between the two Committees. What seemed to be proposed was that the chairmen of the different bits of the Bank would sit on a policy committee, while the managing directors would sit on a management committee. This was a matrix structure which might work, though it did seem to elevate the chairmen of the Divisions above the management structure. It was confusing to have a body called executive committee. The choices were to have an executive committee and then a simple co-ordinating committee below, or a policy committee, with a management committee below.

The Governor said that he felt the Bank's intention was very clear. ExCo was involved in policy and strategy. It would be concerned with where the Bank was going, and the policies that the Bank set. It could be called Policy Committee. But on top of that Committee, the Bank needed a management committee to make sure that what the Governors and Directors wanted was actually implemented in a consistent and efficient way. Sir David Lees said that it was worth considering whether ExCo should survive. Sir Jeremy Morse said that he would support the creation of PolCo.

Mr Kent, commenting on the discussion, said that the Non-Executives needed to understand that the present burdens on the Executive Directors were immense. They were deeply involved in policy work, at a very high technical level, and the output of the policy divisions tended to be through the top of the organisation, rather than (as in an industrial company or even the Printing Works) through the bottom. Added to that there was a management burden; and it was very difficult to cope with both effectively. He, alone of the Executive Directors, had tried to operate since Ashridge without a Deputy Director. He had found it impossible. The Governor added that these problems were not just focused on the Executive Director level. We could not avoid the fact that senior people in the Bank were closely involved in policy, as well as management, and they needed to allocate their time in a sensible way.

Concluding the discussion, the Governor said that he would take note of Court's comments, which were helpful. The Bank would proceed with the formation of the management committee, but would give further thought to the relationship between the management committee and ExCo, and to the role and title of ExCo.

Court approved the appointment of Oliver Page to succeed Michael Foot as Deputy Director responsible for Supervision and Surveillance.

Court noted the following appointments:

1 Alastair Clark, a Deputy Director responsible for regulatory policy, is to extend his responsibilities to cover all of the Financial Infrastructure Divisions, reporting to Mr Kent.

2 Clifford Smout, at present Head of the Banking Supervisory Policy Division, is to become head of a new division combining Regulatory and Supervisory Policy; he will be working both to Mr Page and to Mr Clark.

3 John Trundle, at present the Private Secretary to the Governor, is to become Head of the Payment Settlement and Clearing Systems Division, succeeding Peter Allsopp, who becomes a Special Adviser responsible for international payment systems issues.

4 Angela Wright, a Senior Manager in the Financial Sectors and Institutions Division, is to succeed John Beverly as Head of that Division.

A Report of the Remuneration Committee

In accordance with Section 10 of the Charter, Messrs Quinn, 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 special remuneration of Mr Brian Quinn it was **recommended** that, with effect from 1 January 1996, there should be no change in his remuneration of £145,000 pa but, on his retirement on 29 February 1996, he should receive a special, non-pensionable payment of

£15,000 in recognition of his contributions during the year as Acting Deputy Governor.

2 Having reviewed the special remuneration of the remaining members of the Executive it was **recommended** that, with effect from 1 January 1996, the following enhancements to remuneration should be made:-

Mr M A King from £135,000 pa to £145,000 pa
Mr P H Kent from £130,000 pa to £136,000 pa
Mr Ian Plenderleith from £125,000 pa to £132,000 pa.

3 Having reviewed the remuneration of the Governor's Advisers, it was **recommended** that, with effect from 1 January 1996, the remuneration of [redacted]

4 It was **recommended** that, on appointment to the position of Executive Director with effect from 1 March 1996, Mr M D K W Foot's special remuneration be £125,000 pa.

The recommendations were approved.

Howard J. [illegible]

Jm Footman
Secretary 17 Jany 1996

MINUTES OF A MEETING OF DIRECTORS

WEDNESDAY 27 DECEMBER 1995

Present

Mr Davies, The Deputy Governor
Mr King

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

The Minutes of the last Court were noted.

The Deputy Governor spoke briefly about the foreign exchanges and the state of the domestic markets.

Howard J. Davies

J M Footman

17 January 1996