MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 3 JANUARY 1996

Present
Mr George, Governor
Mr Davies, Deputy Governor
Mr Kent
Ms Masters
Sir Jeremy Morse
Mr Plenderleith

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

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

Mr Plenderleith spoke briefly about the foreign exchanges and the domestic markets: sterling was firm while expectations that the next interest rate cut would come sooner rather than later had lessened. He also noted that he was satisfied with the quiet start made the previous day in gilt repos and anticipated a gradual build-up in activity as familiarity with the new market increased.

The Governor reported on significant developments at the Stock Exchange, where the Board appointments committee had concluded that Michael Lawrence should no longer continue as Chief Executive. A meeting of the Stock Exchange Board had been called for the following day and an early announcement of Lawrence's departure was expected; his leaving was bound to be acrimonious. This turn of events marked the culmination of long-running difficulties between the Chief Executive and the non-executive members of the Board; but it reflected dissatisfaction with the Chief Executive's style and manner of operation rather than the substance of the debate about market structures.

The Governor went on to report that John Kemp-Welch, the Stock Exchange Chairman, had approached the Bank to release either Ian Plenderleith or Pen Kent to take over as Chief Executive. This would have been a major sacrifice on the Bank's part but, in the event, neither was willing to take on the role. However, a second proposition had emerged which the Bank's Executive were minded to agree: this was that Ian Plenderleith should take on temporarily, in a non-executive capacity, the role of one of the two Deputy Chairmen of the Stock Exchange, to provide support and advice to John Kemp-Welch who would be operating as executive Chairman until a new Chief Executive had been found and was in post. The other, existing, Deputy Chairman, Ian Salter, would continue in place. The Governor saw Mr Plenderleith as able to play a key role while the debate on the future of the Exchange and on market structures was concluded.

Sir Jeremy Morse accepted why the Bank would want to respond positively to the request but questioned the additional burden on Ian Plenderleith and the potential for conflict of interest.

The Governor acknowledged these difficulties but thought that they were manageable and was keen that the Bank should be seen to be supporting the Stock Exchange. Ian Plenderleith's precise role and involvement would, of course, need to be carefully defined. Based on his own experience as an existing member of the Stock Exchange Board, Mr Plenderleith did not forsee any conflict of interest arising in practice. He expected that the role might take up quite a bit of his time in the first few weeks but much less thereafter.

Mr Kent commented that he expected that the episode would lead to a fundamental review of the governance of the Stock Exchange and of its relationships both with the market and with other exchanges.

The Governor noted that, in all the circumstances, it would be difficult to turn down the request from the Chairman of the Stock Exchange. Depending on the outcome of the Board meeting, a public announcement could be made the next day.

The Governor advised that details of the Memorial Service for Lord O'Brien had been finalised: the service would be at 11.30am on Thursday, 14 March in St Paul's Cathedral; members of the family and Court would be invited to lunch at the Bank afterwards.

Howard J. Davies

Jn Footman

Secretary 17 January 1996

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 10 JANUARY 1996

Present
Mr George, Governor
Mr King
Sir Jeremy Morse
Mr Plenderleith
Mr Quinn
Professor Sir Roland Smith

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.

On the developments at the Stock Exchange, Mr Plenderleith reported that the focus of efforts over the last few days had been on damage limitation. There were three specific aims: to emphasise that the departure of Michael Lawrence did not signal a change of policy; to avoid giving undue prominence to the role of the Bank; and to demonstrate that the Exchange had a future. He was broadly satisfied with what had been achieved so far. In particular, there was clear consensus on the Board that the programme of reform must proceed as well as commitment from the senior executives, who remain in place, to carry the work forward. A consultative paper setting out various options for the new equity market trading structure would be issued later in the week and there was general acceptance on the Steering Committee overseeing this consultation of the need to move to an order-matching system for the bulk of trading. He was optimistic that this programme of reform and the implementation in August of a new computer system - which would represent a major technological advance - would leave the Exchange in a strong competitive position.

Responding to a question from Sir Jeremy Morse, Mr Plenderleith said that the Board recognised that Michael Lawrence's successor would ideally need strong business and diplomatic skills; if a candidate with the necessary qualities could not be found, one option would be to split responsibilities between an executive Deputy Chairman and a Chief Executive.

The Governor reported on a visit he had received from a group from the City Disputes Panel, headed by Lord Templeman, its Chairman. They are seeking to conciliate between Barings bondholders and ING and had hoped to win the Governor's support in bringing pressure on the latter. The Governor had responded that, while he would welcome a settlement achieved without recourse to litigation, he could not be seen to be taking sides in the dispute.

Howard J. Davies

J M Footman

Secretary 17 January 1996

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 17 JANUARY 1996

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Sir David Cooksey
Mrs Heaton
Sir Christopher Hogg
Mr Kent
Sir Chips Keswick
Mr King
Sir David Lees
Mr Plenderleith
Mr Quinn
Sir David Scholey
Sir David Simon
Sir Colin Southgate

The Minutes of the Court of 20 December and the Meetings of 27 December, 3 and 10 January, having been circulated, were approved.

A Report of the Audit Committee

Sir David Lees drew Court's attention to four matters.

(i) It had been agreed that Audit Committee should address the audit plan for NMB, and the Auditor's letter of engagement. A subcommittee of the Audit Committee had met that morning to sign this off.

(ii) No major issues were expected to arise in the 1995/96 Report and Accounts.

(iii) On Risk Management and Internal Controls, progress had been made, and agreement had been reached between the

Deputy Governor and Coopers that would provide a sound basis for work in 1996/97.

(iv) The Committee had reviewed its own terms of reference, and would be reviewing the scope and functions of the Bank's internal audit function over the coming year.

The Governor thanked Sir David Lees and the Committee for its continued hard work.

Financial Report (Mr Midgley in attendance)

There being no questions raised about the Bank's profit and loss statement, Mr Midgley proceeded to outline his proposals for regular financial reporting to Court. The aim was to provide this information on a functional basis, which the Ashridge reorganisation had made feasible.

Sir Chips Keswick commented that it was not always clear where risk in the Bank lay. For example, in what circumstances might the Bank be liable for losses on the EEA? The Governor said that market risk was for the Government - the Bank would only be liable for negligence.

Sir David Lees supported the general thrust of Mr Midgley's paper. In general, the Bank was a series of cost centres, though there were a few areas in which productivity could be quite easily measured. The question was not so much what Court required as what the Bank needed for its own management purposes. It would be important for costs to be broken down in line with budgetary responsibilities, with periodic statements of performance against budget.

Sir David Lees also cautioned against excessive cross-charging. "Informal shops" were valid if the customers could go elsewhere. If they could not, moving costs from one centre to another would not help much. The Deputy Governor agreed, but said that there were some areas - legal expenses for example - where you could get a better handle by putting the responsibility on the client rather than on the provider. We would not be going overboard on cross-charging.

Sir David Scholey suggested that the simple headcount, as much as staff costs, could be an important indicator. He also felt that, even in analytical areas, such performance measures as could be constructed and were managerially significant, should be included in the reports to Court. The Governor agreed.

Sir Colin Southgate said that he would like a system that picked up, for example, the £5mn costs in connection with Barings more swiftly. And he saw a need for a mechanism for telling Court which areas of the Bank were under stress. The Deputy Governor said that we monitored working hours and the caseload of the Staff Counsellor; Mr Quinn added absenteeism. The Arthur Andersen Review would monitor the pressure points in Supervision. Sir Colin Southgate also suggested that there should be an Executive Summary with the Financial Report. This would enable such issues to be aired. The Governor agreed; this would be provided by the Deputy Governor.

Mr Quinn said that the legal budget - including costs arising in connection with Barings - came to him for approval. The amounts were by their nature unpredictable. On stress, he said that people in Supervision were very busy, but no more so than in many other parts of the Bank. The pressure on resources was not budgetary but arose from the difficulty of recruiting the right people.

Sir David Cooksey commented that assets were often located in different places from the revenue they generated. An example was BE Services. It was important to find a structure that made Managers accountable for their use of assets.

Sir Christopher Hogg felt that the treatment of the Printing Works in the Report was more superficial than its importance merited.

The Governor thanked Members for the guidance on the form of the new Report.

Matters Reserved to Court

With reference to a Minute of 20 December, the Governor said that the schedule now before Court included the revisions suggested at Court the previous month. The revised paper was approved, subject to it being made clear that the appointment of directors to subsidiary companies was a matter for approval by Court. It was agreed that the text of the earlier resolutions referred to in the paper should be attached to the final version.

The Deputy Governor described the proposed changes to ExCo. In future it would be known as Policy Committee, and would meet to discuss policy papers with Officials of the Bank. If the Governors and Directors met as a group, without Officials, this would be known as Governors' Committee.

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

Mr King said that the period around Christmas and the New Year was often hard to interpret. But the overall picture seemed clear. There had been a slowdown in 1995. Output was now growing well below trend, at 1 - 1 1/2% pa. The rebalancing of fiscal and monetary policy had now come to an end, and with fiscal policy no longer tightening, we saw signs of strength in consumption, and of weakness in net exports. The major news since the last Court was the big downward shift of growth expectations in France and Germany. Output prices and the labour market were both reasonably encouraging, although there were some signs of wage settlements picking up. The particular questions on which he would welcome Court's views were retail sales, wages, exports and the reasons for the slowdown.

Mr Plenderleith added that there had been little movement in the main financial markets over the past month, though this partly reflected global uncertainties: the weakness in Germany; the budget negotiations in the United States; and uncertainty about the Japanese economy. Sterling had remained little changed, despite the political turmoil, but it was disappointing that it had recovered so little of the ground lost last year. The short Sterling market showed less expectation of further rate cuts than a month ago.

Sir Chips Keswick said that the proceeds of maturing TESSAs were likely to be spent, and that housing - both new and secondhand - was a little more buoyant. Sir Colin Southgate said that the UK retail trade was good, though continental markets were poor. The next CBI quarterly survey was likely to show a similar picture to December's, but suggesting that there had been destocking in December.

Sir David Lees said that the motor trade had slowed. There had been destocking and manufacturers had been deliberately thinning the pipeline of finished products. Nissan had taken an extra week out; Ford had cut schedules. This picture of slower activity might make the wage round easier - he was more optimistic on this than a couple of months ago.

Sir David Simon said that the indications from the energy sector also pointed to a slowing of activity. Activity in Germany and France was slower on all fronts. He felt that all French indicators and forecasts needed to be seen as part of their EMU negotiations with Germany.

The Governor commented that we seemed to have come to a clear patch in the prevailing fog. Cost pressures had clearly abated. This was a tremendous relief: for a year now the impact of tighter import costs had been a worry. There was a small victory there. The current position was soft. Consumption was better, external trade worse. The big question was posed by the monetary data, and what they implied for future activity.

Sir David Scholey asked whether the Bank thought that the current consumer picture was consistent with the monetary data three to four months ago. The Governor said that it did seem consistent with the rapid narrow money growth last year; but analysis of the relationship with broad money depended on the retail/wholesale breakdown.

Sir David Cooksey said that his experience in the small firms sector suggested that those involved in the retail sector were doing less well, those selling to manufacturing were doing better.

The Governor commented that at the Small Firms Seminar, held last week, small firms representatives had not been at all downbeat: and the message from all had been a shared determination that we should stick with stability-oriented policies.

Note Issue and Counterfeiting (Messrs Kentfield and Jarvis in attendance)

Mr Kentfield said that over the past year the counterfeiting position had got worse. The £20 note was the main target, but recently we had seen high-quality £10 counterfeits. It was therefore a serious problem, and had surfaced in the press as an issue of concern to the public. The "Know-your-banknote" leaflet had helped to raise public perceptions of what to look for in banknotes, and we were now considering help for banks and retailers, in terms of providing technical authentication methods. We were also co-operating with the police, and working with them on a combined computer system. The police had had some successes in tracking down counterfeits. But we recognised that all this might not be enough. We were therefore working on possible solutions, including a new £20 note to be introduced rapidly. [redacted] In the longer term we were looking at technical possibilities eg polymer substrate or foil.

Sir David Lees asked about the costs of introducing a new bank note. Mr Jarvis said that the design cost was small, and the stock-holding cost could be small, if the introduction was planned. Sir Colin Southgate asked how quickly a new note could be introduced. Mr Jarvis said that most of the procedures could be enacted fairly quickly - though there could be delays on taking decisions - and that the main technical obstacle was engraving, which involved about a six-month delay.

Sir Chips Keswick asked how we compared with other European countries. Mr Jarvis said that there was counterfeiting of the deutschemark and the French franc, and heavy counterfeiting of the guilder. But we were close to being in the worst position for counterfeiting.

Sir David Scholey said that he had never been clear what our costs/benefit trade-off was in this area. Printing Works were plainly subject to downward pressures on costs. But this had never been correlated with the need to offer protection against counterfeits. The Swiss franc notes were hard to counterfeit, but cost four times ours. How far would we be prepared to go? He suspected that the pressures tended to be on the side of cheapness. [redacted]. Their trade-off was plainly different. Sir David Scholey said that he had been concerned about the reduction in the quality of paper in bank notes. Mr Jarvis said that the quality had been reduced 20 years ago, but had recently been increased again. What we had been trying to do was to find technical improvements from savings in the production process. We had not, for example, gone to HMT for more money to pay for [redacted]

The Governor said that, in our recent internal discussion, we had concluded that we would need to go to the Treasury and flag the need to spend more money on anti-counterfeiting. It was clear that we had been very slow to respond in the 1990s. [redacted]

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[redacted] Nevertheless we had to step up our own efforts, and it was alarming that, in the context of the debate on the Euro-note, we were at the bottom of the security features league. We were putting into readiness an Elgar variation of the £20 note.

Mr Quinn said that he would give full support to work on anti-counterfeiting, and was concerned that confidence in the currency was now plainly being eroded. There had been a concern about the inactivity of the police, and about the small sentences handed down by the courts. Mr Kentfield said that that position had not changed materially. The Governor said that we would not get a sympathetic hearing on that score if we were not seen to be doing our bit.

Sir Colin Southgate said that we needed both a short-term and a long-term strategy. Mr Plenderleith said that the short term strategy was the stop-gap Elgar note. The longer-term strategy was to introduce higher levels of security features in a new series of notes - although this would plainly involve cost, and he was grateful for the expressions of support from Court. [redacted] The Deputy Governor said that plans were already made: the six-month clock was already ticking on the Elgar note. We would be approaching HMT on the long-term strategy, including a cost/benefit assessment.

[redacted]

With reference to a Minute of 17 May 1995, Mr Kentfield said that we had been in discussion with the banks about more cost effective arrangements for storage and distribution of banknotes. The discussions had been protracted. The banks could take over many of the things that we did. The

[redacted]

arrangements under contemplation would leave the Bank as issuer of new notes and taker-in of soiled notes, but with re-issue the function of the clearing banks. However the individual banks had different net positions, some were flush with notes, and others were structurally short. They would therefore need to co-operate. If we did go down the proposed route, it would mean scaling down our own outlets. We might finish up with one in London and one elsewhere. Of course savings made here could be put into the security equation.

At present, however, the banks were still arguing among themselves. He hoped there would be an agreement by the Spring. [redacted]

Banking Act:
(i) Initial outline of the Banking Act Report
(ii) Bank's Report to BoBS on Barings
(Mr Foot in attendance)

Mr Foot said that he proposed that the Banking Act Annual Report this year should follow broadly the same structure as last year, with the most important element being the editorial section, part 1. External interest would be mainly in what we said about the post-Barings situation. The Report would be timely in that sense, coming just at the end of the Arthur Andersen review.

Among the possibilities listed in his note, he was less inclined to talk about the consolidation of the banking sector (bank/building society mergers), and less inclined to talk about financial fragility in Japan. But we would plainly need to talk about derivatives, capital adequacy directive implementation, market risk, lending margins and covenants (which could be expanded to cover the personal lending market) and regulatory burden of smaller banks, which had been the subject of a study.

Treasury Select Committee our progress report. The Chairman of the TSC had acknowledged this, but had indicated that he would continue to focus on differences between the BoBS report and the Singapore report. We were likely to be asked to give evidence. The Deputy Governor spoke briefly about his visit to Singapore the previous week. It was clear that there were no big issues between us and the Singapore regulators, although they did still believe that there had been more collusion in Barings than our report had been able to indicate.

Staffing Policies (Mr Lecky-Thompson in attendance)

With reference to a Minute of 15 November Mr Lecky-Thompson introduced his paper. He said that it was an attempt to add the personnel dimension to the strategy paper, focusing in particular on issues in career development and training. The paper attempted to define "one Bank" for personnel purposes, to link personnel strategy to forward business plans, to give graduates wide exposure in their early years to the various parts of the Bank, and to provide mechanisms for career development, advice and guidance. The Bank would be increasing direct investment on training, and in particular introducing more effective management training. On rewards, the aim was to delegate more to local management within central guidelines, introducing a performance-driven culture. In the personnel function itself, there would be further work on benchmarking its activities against best practice elsewhere.

The Deputy Governor said that, looking back over the 2 1/2 years since Ashridge, the Bank had been moving rapidly away from central direction of personnel issues, and had probably gone too far too fast. In particular, the Bank had shown an inability to deliver on some of the promises made, and staff were understandably confused. The aim now was to correct the balance, though it would take time to get back onto an even keel - possibly as long as a full annual cycle of career interviews.

Sir Christopher Hogg said that he was uncertain whether the Bank felt that it had enough adequate people and simply needed to train them, or whether it felt that there was a real quality/experience gap which would have to be filled from outside. The paper did not answer that question. The Deputy Governor said that there were gaps in some areas. The Banking Supervision task was getting bigger and more complex. We were also suffering from an earlier period when the Bank had cut back on graduate recruitment, in the late 1980s. In the short run we were filling this gap by recruiting contract staff. This had worked in monetary analysis: but in supervision it was far more difficult. For the future, we would aim for a stable combination of good quality graduate recruits - our record in this area was not bad - and recruitment directly to specialist areas. He thought that this would give us what we needed.

The Governor noted, that over a longer period, there had been a huge shift in the Bank, away from banking operations requiring high quality clerking towards policy functions, requiring high levels of analytical skills. This had not been fully recognised when we were doing the graduate recruitment in the late 1980s. But if we continued to recruit on a regular scale, based on long-term requirements and not just on immediate locally-assessed needs, we should have an adequate supply. Sir Christopher Hogg said that the key to all of this was assessing manpower requirements in the light of the business strategy. The effectiveness of the policy would flow from the precision with which Court could assess the likely needs.

Sir Chips Keswick asked whether we would really be able to deliver all that was promised in the strategy in the absence of a readiness to spend a great deal more money on personnel. The Deputy Governor felt that, over the next three years at least, we would be able to deliver it from savings made in the routine functions of the Bank. But this would require some awkward decisions - it would require us to crack problems in the Branches and elsewhere, in order to give headroom in the salary bill. Thereafter, all bets were off, and it was highly unlikely that we be able to achieve the objectives against a constant salary bill.

Sir David Lees commented that the proposed personnel strategy booklet was praiseworthy but ambitious. He noted that succession planning was not covered in the document, though he was sure that it was implied. In his own experience the formal setting out of a succession plan was a good discipline for management. On rewards policy, he urged caution on the use of bonuses in situations where performance was not easily quantifiable. He cited the example of the Treasury, where the award of bonuses in year one had led to problems in subsequent years. The Deputy Governor said that we did have a process for succession planning, based on what was infelicitously known as drop-dead succession. On bonuses, there was a real conundrum. We had to make sure, in present circumstances, that we did not underspend on our pay bill: if we did, the limit would be reduced for next year. The only way to avoid an underspend at the end of a year, was to distribute any surplus in the form of bonuses. He also felt that the Bank was able to make quantified assessments for the purposes of bonus distribution: our staff evaluation system was not too bad.

Sir David Scholey welcomed the paper. However he noted that it concentrated on the wings, and warned that the support function should not be left out. He also felt that the objectives of any pay system needed to be more precisely defined. He strongly supported the case for increasing movement around the Bank in early years. If it was not happening, then it had to be forced by the Chief Executive: Managers were always reluctant let their best people move. The Personnel function should act as facilitators. On the booklet, he asked whether individual areas of the Bank had their own staff managers, or whether the whole function was being sub-contracted to the personnel specialists. He thought it necessary that areas should have their own staff managers. Mr Lecky-Thompson and the Governor said that in some large areas line managers worked with staff managers, and used the dedicated services of the Operating Personnel Managers. He also asked about the plans for management training: Mr Lecky-Thompson said that he was in discussion with a number of major providers.

The Risks from CREST

Mr Kent said that the Auditor, in reviewing the CREST Report, had identified no issues within CREST's control that posed a risk to the project. There were issues outside CREST's control, but the risk had become less in most areas: these were the risk of a shortage of City resources to implement; that the pricing policies of the two network providers could damage public and political acceptability of the system; and the need to get the commitment of listed companies to CREST.

Mr Kent noted that our relationship with the Stock Exchange had improved enormously over the past few months, and the Governor added that the relationship between the Bank and CREST in terms of CREST/CGO2 had also improved. The strategy of separate but parallel development was seen by both sides as providing the best way forward.

The Executive Report

<u>The Stock Exchange</u>
The Governor asked Mr Kent and Mr Plenderleith to talk about recent developments at the Stock Exchange, particularly in the light of questions raised by Sir David Lees about the Bank's role in Mr Lawrence's appointment and subsequent dismissal.

Mr Kent said that the Bank had two channels to the Stock Exchange: Mr Plenderleith was on the Board of the Stock Exchange, in his capacity as Government Broker; and Mr Kent kept in touch with the Stock Exchange as Director responsible for financial structure. At no time had the Bank been consulted about the appointment of Michael Lawrence. We did not know what due diligence they had undertaken - head hunters had been involved. It was true that criticism of Lawrence's style had reached epidemic proportions. Mr Kent felt that the Chairman had not been sufficiently active early enough - he had taken a very non-executive role right up to the end, when discontent in the City had reached a considerable pitch. There was no reason why the Bank, as a bank, should be involved in the appointment of the next Chief Executive. The Governor added that it would be a considerable extension of our role to be involved in such an appointment at the Stock Exchange, which was, after all, governed by its own member firms.

Mr Plenderleith said that the appointment of a new Chief Executive was the responsibility of the Stock Exchange Board on which he sat, and not one for the Bank. Lawrence's departure had not been a matter of style or personality but performance. In part, his performance had been good: he had put in place a good management team, and had set a strategy for the Stock Exchange. But in the management of the Stock Exchange's relationships with all of its constituencies, he had been a failure. There had been a series of incidents, leading to a process of alienation. We had experienced one instance of this in his handling of the Stock Exchange/CREST dispute last year.

The Chairman had taken soundings of all the Directors, and had found that to be the common view. He had judged that the only course open to him was to require Lawrence to resign: an attempt to rein him in would cause him to resign anyway. Now the shock of the departure had subsided, and the episode had been helped by Lawrence behaving well and largely refraining from public comment, so far. Mr Plenderleith said that staff morale at the Stock Exchange was not too bad - Lawrence had been unpopular, and his departure was not regretted. All of the executive directors were staying on board.
Mr Plenderleith's own role was to assist the Chairman in the interim, filling the vacancy that already existed for another Deputy Chairman. There was a substantial programme of work to be carried forward, including on the trading structure, which was now an agreed policy. Good progress was already being

made in this area: the consultation paper had been issued, the technological changes were being rolled out, and Sequence, provided the cost could be contained, looked a potential winner. The CREST system would be a further help. There would need to be focus on the governance of the Stock Exchange, and on the Stock Exchange's financial structure, which required substantial down-sizing. He believed the Stock Exchange had a role in the City, albeit a modest one, and it was reasonable for the Bank to help to steady it at a time of difficulty.

Sir David Lees said that, while one could not expect the Bank normally to be involved in the selection of the individual, Mr Lawrence's appointment had followed the TAURUS debacle, and he would have expected the Bank to have some views on the succession to Rawlins. He also doubted that the Chairman was justified in taking no action right up to the last minute, when Lawrence was dismissed. If a director was going off the rails, it was the job of the Chairman, however non-executive, to issue warnings. If the fear was that Lawrence would resign in the face of the warnings, then he could not see how that was a less happy outcome than that actually achieved. Sir Colin Southgate agreed that it was unacceptable that anyone should duck responsibility as chairman. Mr Plenderleith said that it was not that the Chairman had ducked responsibility, but rather that he had not, until now, felt the time had come to take action.

The Governor said that the general perception had been that Lawrence was doing a lot of good things, and the Chairman had felt that he had to back the executive. In the event, it had to be conceded that the Chairman was pushed.

Sir Christopher Hogg asked about rumours in the markets about a merger between LIFFE and the Stock Exchange. Mr Plenderleith said that that could always be a possibility, and the Governor remarked that some of the excitement arose from a misinterpretation by LIFFE of remarks made over a lunch at the Bank recently.

Sir Christopher Hogg

The Governor paid tribute to Sir Christopher Hogg, whose last long Court this was, and thanked him for his immense contribution to the Court over the past four years.

Lord O'Brien

The Governor also noted that Lord O'Brien's memorial service would be held at 11.30 am on Thursday, 14 March in the Chapel of the Order of the British Empire, in the Crypt of St Paul's Cathedral. Members would be invited to the lunch at the Bank afterwards, with the family.

Howard J. Davies

Assistant Secretary
7 February 1996

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 24 JANUARY 1996

Present

Mr Davies, Deputy Governor

Mr Kent

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.

Mr Plenderleith spoke briefly about the state of the domestic markets.

Assistant Secretary
7 February 1996

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 31 JANUARY 1996

Present

Mr George, Governor

Mr Davies, Deputy Governor

Mr Kent

Mr King

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 Meeting, having been circulated, were noted.

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

Assistant Secretary
7 February 1996

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 7 FEBRUARY 1996

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Mrs Heaton
Sir Christopher Hogg
Mr King
Ms Masters
Mr Plenderleith
Mr Quinn
Mr Simms

The Minutes of the Court of 17 January and the Meetings of 24 and 31 January, having been circulated, were approved.

Mr Plenderleith spoke about and the state of the markets, and the Official Reserves figures for January.

The Deputy Governor reported briefly on a meeting of the EMI Council which he had attended the previous day.

[illegible signature]

Chairman

Secretary

21 February 1996

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 14 FEBRUARY 1996

Present
Mr George, Governor
Mr Davies, Deputy Governor
Mr King
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 following the publication of the Inflation Report earlier in the day, there had been no reaction so far in the markets.

Secretary

21 February 1996.

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 FEBRUARY 1996

Present:

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

The Minutes of the Court of 7 February and the Meeting of 14 February, having been circulated, were approved.

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

Mr King said that the main conclusion from the Report was that, at current interest rates, it was a little more likely than not that inflation would be below 2 1/2% than above two years from now. The main news since the November Report was the slower growth of GDP over the past 15-18 months - growth rates of 1% or more per quarter, seen for most of 1994, were now seen to have fallen to rates of below 1/2% per quarter last year.

It was clear that the picture varied greatly from one sector to another: services had continued to grow, manufacturing had been flat, while construction had entered another downturn. The acceleration of output in 1994, and the slowdown in 1995, were almost entirely accounted for by changes in net exports.

However changes in short-term real interest rates had also played a role. Expectations of short-term interest rates had risen very sharply during 1994, and by more than had subsequently been validated by official interest rate increases. This rise had a dampening effect on demand in 1995. But in 1995, expectations of short-term interest rates had declined substantially.

Looking forward, the Inflation Report took the view that the output gap remained positive, and that the medium-term prospect was for rising demand and for output growth. In the short run, the risks to that central forecast were on the downside. Other major European economies were faltering, and it was quite possible that a further running down of stock would depress output growth for the first half of the year. Looking to the medium term - next year and into 1998 - the risks were more on the upside. The various substantial one-off payments to households could feed through to higher consumption, and the recent broad money figures might turn out to imply more rapid nominal demand growth. The Bank expected underlying inflation to drift down slowly during the coming year, but then to pick up slightly.

Mr King went on to explain the new presentation of the inflation forecast. This showed not only the band within which the central projection was to be found, but also the probabilities on both sides of the central band. Some people had described this new presentation as confusing, but policy was about an assessment of the balance of risks, and we had become increasingly concerned about the implications of publishing a single point forecast.

Mr Plenderleith commented on recent tensions in financial markets. Expectations of further monetary easing in Germany had diminished, following remarks by Tietmeyer, and Greenspan's latest testimony on the United States economy had had a similar effect on the dollar. With a growing view that the interest rate cycle had bottomed, bond markets and money markets had reacted negatively. Although the short sterling market still expected a small downward move in the near term, there was no expectation of anything beyond that and rises were forecast further out.

Sir Chips Keswick observed that the message from the market was that while the Bank might understand the path of GDP and inflation, no-one seemed able to articulate clearly the reasons for the errors in the PSBR forecast. If the markets did not believe that the Government was in control of the PSBR, then they would punish the Government through higher yields in the gilts market. Mr King agreed that it was hard to interpret the PSBR. A lot of the action tended to come in the last month of the financial year, so the figures still needed careful interpretation, but fundamentally people were afraid of a re-run of 1992, where the PSBR profiles had been good on paper, but pre-supposed better spending controls than the Government was actually capable of delivering. The other issue was that revenue was not running at the levels expected: this could not be attributed just to lower-than-expected levels of activity - it appeared that there had been a change in the relationship between activity and revenue, which neither the Customs nor the Treasury could explain. Mr King agreed that this was the most vulnerable area of policy at present.

Sir Jeremy Morse commented on the box in the Inflation Report, which compared our own forecasts with the outturn. He found the general tone rather defensive, but felt that the Bank had nothing to excuse. We had been a bit above or a bit below, but all in a narrow range. The Bank's duty, in any case, was to look at the possible dangers to inflation. We should not spend too much time fussing about the past. He felt that the new presentation, designed to take us away from the point forecast, was an over-complication. Mr King said that the Treasury Select Committee had asked us to provide the material on our forecasting record, and the box in the Inflation Report was a response to that. It was true that we had over-estimated where inflation would be over the years; and in the early years of the Inflation Report we had underestimated the extent of disinflationary pressure in the economy.

Sir David Scholey asked whether the divergence between manufacturing, services and construction had occurred in other developed economies; and what the Bundesbank's response would be to the present M4 growth here. Mr King promised a note on the sectoral breakdown. On the Bundesbank, he observed that they had missed their M3 target more often than they had hit it; and that their attitude to the money supply was very similar to ours, they would try to interpret it. They would try to identify temporary or special factors affecting the numbers, but if they saw that money growth indicated stronger growth in nominal demand, then they would react to it. In other words they behaved like us. Sir David Scholey asked whether we had been disappointed with the response to publishing Divisia money data. Mr King said that it was never likely to become a major element in the assessment, because it was a purely mechanical indicator and unlike other indicators it was difficult to tell a story about.

Sir David Lees thought that the new "probabilities" charts were better, but noted that the version given to Court had included a line showing where the 2 1/2% target lay. Mr King said that this would be included in future published versions.
Sir David Lees also asked for an explanation of why the Lottery had contributed to the slowdown in the economy. Mr King said that the CSO regarded net spending on the Lottery (purchases of tokens less prizes) as consumer spending. But the winnings tended to be spent slowly, and there had been delays in pushing the proceeds out to the good causes supposed to benefit from it. Sir David Cooksey said that the major problem was finding matching funding for the money, and that was going to hold back a lot of potential construction work that the Lottery was supposed to finance. It could thus be a depressing factor for longer than we expected.

Sir Jeremy Morse noted that the Bank had recently been recommending rate cuts, but doing so when we were prospectively only just below the 2 1/2% target. Should we not wait until we were "middle of band". Mr King said that the target did not take the form of a band, but was based on 2 1/2% or less.

Sir David Scholey said that we ought to ensure that references to the target made it clear that it was the Government's target; Mr King agreed, but it was noted that the Bank had supported the target in its present form.

Sir Colin Southgate said that the February 1996 Trends Survey was going to show an upward move in export orders, but domestic order books still down and stocks still down. He had an impression that manufacturers were tending to under-record their output. The retail sector had been strong in January and early February. Mr King said that the CSO had this morning reported a 0.6% fall in January retail sales. We were fairly sure that their seasonal adjustments were wrong; it was clear from all the anecdotal evidence that sales had been strong in January.

Mr Simms said that from the point of view of the construction sector he would be very concerned if we were giving advice on any basis other than that the inflation rate should be 2 1/2%. He said that there were a few positive signs in the construction sector, and hopes that the PFI would come more on-stream shortly and house prices were creeping up. On the other hand a 1 1/2% fall in construction output was forecast for this year; there was little movement in construction order prices; inevitably unemployment would continue to go up, with 50-100,000 more people moving out of the industry. The industry was relying on further interest rate cuts. Mr Simms thought that the new forecast presentation was unhelpful. It implied that we were highly uncertain about the inflation prospect.

The Bank's Budget for 1996/97 (Mr Midgley in attendance)

Mr Midgley introduced the Bank's budget for 1996/97. For the current year we were within our baseline; for the outline years we were less sure of that; we still had to see the outcome of the Arthur Andersen Review of Supervision; Personnel had yet to produce budgets consistent with the Personnel strategy agreed at Court recently, there were decisions awaited on the Branches; and there was an exercise in train on Registrar's to reduce costs. Mr Midgley went on to describe the Bank's financial framework. Income from Cash Ratio Deposits would increase as new contributors came in, but the Deputy Governor said that although there was scope for us to move down to 0.25%, consistent with the target we had set ourselves 10 years ago, we were being cautious in doing so, and so far had only indicated that we would not be moving back up to 0.4%.

On cash limits, we had agreed last August a reduction of 5% in cash-limited expenditure, and thought we could manage within that. The basic principle for cash limits was that we should not cross-subsidise cash-limited expenditure from other Bank income.

Sir David Lees wanted more detail of expenditure. He also found the presentation of the Bank's various classes of income and the way in which this "determined" the expenditure target, confusing; among other things, it would be helpful to have a clearer presentation of what was cash-limited and what was not. Sir David Scholey similarly found the breakdown of the Bank's planned investment expenditure confusing, as the very substantial contribution of property was not allocated across business areas, but treated as though it was a business area in its own right. Sir Chips Keswick could not understand why the Bank was taking so much trouble to squeeze itself inside artificial financial constraints when it should be finding the resources to pursue the strategy outlined by the Governor in his LSE Lecture. Sir David Simon could not see the relevance of the framework and he added that he found the presentation of the Bank's finances an exercise in sophistry at the highest level. Like other Directors he had a sense of immense frustration in trying to understand the Bank's financial framework, and felt that there should be some benchmarking of the way we conduct our affairs against other central banks. Court Members clearly did not understand the Bank's approach, he said, and did not think it relevant to what the Bank was doing and should be doing.

Mr Midgley explained that in determining spending capacity the Bank had to take heed of the burden that CRD's imposed on the banks and the needs of HMT in relation to public expenditure. To do otherwise, in the medium term, risked damaging the Bank's influence. It was in the nature of the Bank's finances that income was to a large degree not directly related to output and therefore expenditure.

The Deputy Governor said that three issues had emerged from the discussion.

1 Whether the financial framework presented to Court was comprehensible and appropriate. That plainly needed discussion.

2 Whether we should be imposing financial constraints on the areas where we have a choice.

3 This year's budget which required Court's approval.

The Deputy Governor noted that this year, we had been able to live within the constraints of the cash limits and the pay bill. Indeed the pay bill figures shown by Mr Midgley had suggested that we could live within the pay bill limit this year, and restructure Officials' pay and restructure S&S. He suggested that Court might wish to agree the budget, on the basis that he and Mr Midgley would bring further papers justifying any increase in S&S spending after the Arthur Andersen Review, and any reductions in Branches spending in the light of the Note Issue Review, during the budget year, and that he and Mr Midgley would provide a further presentation on the way in which the Bank's financial framework operates to address directly the concerns that had been raised by Court.

Court <u>approved</u> the Budget for 1996/97 on this basis.

Quarterly Supervision Report:

[redacted]

Introducing the first quarterly Supervision report, Mr Quinn said that he thought it would be helpful to take Court through some actual supervisory cases. [redacted]

[redacted]

The Deputy Governor said that there would be a progress report on the Arthur Andersen Review at the next long Court. They had talked to other supervisors in eight countries, and had discussions with banks and supervisors in the UK. There was some good news, and some bad news, both from the external and the internal inputs. The report to Court next month would still be in time for Court to influence the outcome.

The Executive Report

1 Cash Ratio Deposits. Mr Plenderleith reported that the banks had now been told, and it had been announced in the press, that CRDs would not increase from 0.35% to 0.40% this year.

2 Equitas. Mr Kent said that the Bank had been asked if it would approve the nomination of two or three of the six

trustees of Equitas. The trustees would be responsible for the trust which would own the share capital of Equitas; the beneficiaries of the trust would be the Names. There were no other obvious candidates to perform this role, the DTI being the regulator of Lloyd's. The Bank was inclined to accept it, provided sufficient legal protection could be built in which now seemed probable. The nature of the legal protection proposed was that the trust deed should refer to the two/three trustees being appointed by an "independent" body. The nomination of the Bank as that body would be a subsequent act; this would give us the opportunity to relinquish the role if circumstances changed. Lloyd's were anxious to announce this soon. Court took note.

3 <u>CRESTCO</u>. The Deputy Governor said that under the constitution of CRESTCO the Bank of England loses its control of CRESCTO when it goes live - now fixed at 15 July 1996. It does however appoint the Directors forming a Board proper on the first occasion. They are expected to be most of the present Advisory Committee. It had also been agreed, but not yet published, that Scott Dobbie, Joint Chairman of NatWest Securities, will succeed Mr Kent but CRESTCO has concluded that to change the Chairmanship at the same time as going live might not be the best timing. It had therefore been agreed that Mr Kent would stay on as Chairman until the end of this year at the latest, with the expectation that if all goes well with live operation, the change would be sooner rather than later.

4 <u>Pay</u>. The Deputy Governor reported that agreement had now been reached with the Officials Bargaining Unit on the basis on a 2% across-the-board settlement from 1 July, sweetened by an increase in the 1995/96 bonus pot which had now been agreed and paid. Heads of Division had received an across-the-board increase of 3%, together with bonuses amounting to 7% of salary. Sir Jeremy Morse said that he remained worried about the decline in pay in the Bank

relative to outside. The Deputy Governor acknowledged that there were people in the Bank who were less highly paid than they should be, but equally a number who were fairly fully paid. The restructuring in the summer would address some of these issues, and we had left ourselves, as Mr Midgley's presentation had made clear, some headroom to finance the restructuring.

5 Board of Banking Supervision. The Deputy Governor said that it had been agreed with the Board of Banking Supervision that in future the circulation of their minutes to Court Members would not include items that were directly relevant to individual Members of Court.

The Governors' engagements

The Deputy Governor paid tribute to Mr Quinn and Sir Roland Smith on the occasion of their last appearance at a long Court. He asked that his gratitude be recorded, together with that of his colleagues on Court, both past and present.

The Deputy Governor advised Members that Mr J C R Dow would be celebrating his 80th birthday on Sunday.

Sealing Committee Minutes for inspection

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

Assistant Secretary
6 March 1996

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 28 FEBRUARY 1996

Present

Mr George, Governor

Mr Davies, Deputy Governor

Mr Kent

Mr King

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 gilts auction earlier that morning had been reasonably satisfactory - one and a half times covered, but with a 5 basis point tail; the markets had since come off their earlier highs.

Assistant Secretary

6 March 1996

COURT OF DIRECTORS

For the period ended 28 February 1997

Declaration Made before	Date	
		Edward Alan John George, Esq, ~~Deputy~~ Governor
		Howard John Davies, Esq, Deputy Governor
		Sir David Gerald Scholey, CBE
The Governor	1.3.96	#Mervyn Allister King, Esq
		Sir David Bryan Lees
		Sir Colin Grieve Southgate
		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
The Governor	1. 3.96	*Michael David Kenneth Willoughby Foot, Esq
The Governor	6. 3.96	*Sir John Hall
The Governor	6. 3.96	*John Mitchell Neill, Esq CBE

Reappointed 1 March 1996
* Appointed 1 March 1996

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 6 MARCH 1996

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Sir David Cooksey
Sir John Hall
Mrs Heaton
Mr King
Ms Masters
Mr Neill
Mr Plenderleith
Mr Simms
Sir David Simon

The Governor welcomed Sir John Hall and Mr Neill on the occasion of their first attendance at Court.

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

Mr Plenderleith spoke briefly about the state of the markets, including the Official Reserves figures for February.

Domestic Appointments, etc
(i) Standing Committees
(ii) Pension Fund/Scheme Trustees
(iii) Directors of the Bank's Subsidiaries
(iv) Houblon-Norman Fund Trustee
(v) The Directorships etc of Members of Court

Court APPROVED the membership of the Remuneration and Audit Committees and the Trustees of the two Pension Schemes to 28 February 1997, namely:-

<u>Remuneration Committee</u>

Sir David Scholey, Chairman
Sir David Lees
Sir Colin Southgate
Mrs Heaton
Sir Chips Keswick

<u>Audit Committee</u>

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

Trustees, Court Pension Scheme

Sir Colin Southgate, Chairman
Sir Chips Keswick
Mr Neill

Trustees, Staff Pension Fund

Mrs Heaton, Chairman
Mr Kent
Sir David Simon
Ms Masters
Sir John Hall
Mr Lecky-Thompson

The Governor introduced three Recommendations relating to changes to the boards of certain Bank subsidiaries. It was recommended that, with immediate effect 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:-

1 (a) SIR DAVID COOKSEY shall become a Director of BE Services Ltd in place of LORD LAING OF DUNPHAIL. The Board will then consist of Sir David Cooksey (Chairman - to be elected), Mr Midgley, Mr Jarvis, Mr Watts, Mr Ironmonger, Mr Bartlett and Mr Lecky-Thompson;

(b) SIR DAVID COOKSEY, or failing him, MR GORDON MIDGLEY, or failing him, MR A W JARVIS, or failing him, MR B T WATTS, or failing him, MR P W F IRONMONGER, or failing him, MR JOHN BARTLETT, or failing him, MR R D T LECKY-THOMPSON be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of BE Services Ltd;

2 and, consequent upon the retirement from Court of Mr Brian Quinn and the appointment of Mr M D K W Foot:-

(a) MR M D K W FOOT shall become a Director of The Securities Management Trust Ltd in place of Mr Brian Quinn. The Board will then consist of Mr Foot (Chairman - to be elected), Mr Midgley, Mr Kentfield and Mr Ironmonger;

(b) MR M D K W FOOT, 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 and, consequent upon the appointment of new Directors to the Board of Debden Security Printing Ltd late last year:-

MR A W JARVIS, or failing him, MR D F HILLS, or failing him, MRS M A P SHEPHERD, or failing her, MR IAN WALKER, or failing him, MR M D JONES, or failing him, MR R F SORRELL be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of Debden Security Printing Ltd.

Court APPROVED the Recommendations.

The Governor said that following the retirement from Court of Professor Sir Roland Smith, Sir David Simon had agreed to take over his responsibilities as a trustee of the Houblon-Norman Fund. It was RESOLVED that with immediate effect and in pursuance of Clause 3 of the Trust Deed of the Houblon-Norman Fund, Sir David Simon be appointed to succeed Professor Sir Roland Smith as a trustee of the Fund.

The Governor reminded Members that on 19 April last year, revised arrangements for reporting Directors' new commitments to Court were approved, and, as agreed, there were copies in folders of all the directorships, appointments and business commitments of Members of Court. Also, as agreed last year, he reminded Members that they should notify the Secretary at least seven days before committing to become a member of the board of any company or undertake any duty or assume any post or engagement which may affect their position as a Member of Court.

Secretary 20/3/96

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 13 MARCH 1996

Mr George, the Governor
Mr Foot
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 Court of 6 March, having been circulated, were noted.

Speaking about the state of the markets, Mr Plenderleith commented on the volatility seen in securities markets, starting in the United States and spreading around the world, since the previous Friday. The instability had been concentrated on equities and bonds, but there had been no feed-through to the foreign exchange markets. In most equity markets, there had been a fairly substantial bounce back. However, bond yields had risen quite steeply, possibly reflecting the markets' view of governments' financing needs rather than concerns about any immediate emerging inflationary pressures.

Howard J. Davies

[illegible]
Secretary 20/3/96

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 20 MARCH 1996

Present:

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

The Governor welcomed Mr Foot on the occasion of his first attendance as a Director at a long Court.

The Minutes of the Court of 6 March and the Meeting of 13 March, having been circulated, were approved.

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

Mr King said that the pattern of recent months had continued: manufacturing output had clearly slowed down, partly reflecting a run-down in stocks, and construction activity appeared flat. On services, we were as much in the dark as ever until the CSO's quarterly estimates appeared in late April. But there was little to change our view that output was probably still growing below trend.

Recent inflation figures had been encouraging, and input prices had actually been falling. Domestically-generated inflation had been particularly low, and the cut in interest rates of three quarters of a percentage point since December had matched the fall in domestic inflation, leaving real short-term interest rates broadly unchanged. Looking ahead, the outlook for consumption in particular, and demand and output in general, appeared brighter. The retail sales figures published that morning supported this view, as did the continuing rapid growth of broad money. Unemployment had risen a little in February, and employment growth was clearly lower than in the first half of last year. Earnings growth had been unchanged since July at 3 1/4%; wage settlements had edged up a little in January, but by less than had been feared, and the softer employment picture might serve to moderate wage pressure. The market expected interest rates to rise later this year or during next year, but this view partly turned on the prospects for output and demand, on which Mr King would welcome Court's views.

Sir Colin Southgate said that the March CBI Report would not show a very promising picture on manufacturing: order books were down, and exports weaker after a positive move in February. Stocks had increased, but were now going down again; oddly, respondents were expecting the volume of output to increase. In his own business, Sir Colin had seen quite strong growth in the high street, even in consumer durables. It looked as though the strong December trend was holding. The biggest problems at the moment were related to the weakness of the economy in Europe.

Sir David Simon said that retail demand in the energy sector was very strong. Stocks were low, and his impression was that underlying industrial performance was likely to be stronger than anyone expected. Some continental markets were a little weaker; but prices were likely to continue to be firm.
Sir David Lees said that manufacturing was basically flat. Unit wage costs were worsening, affected by a fall in productivity (itself related to volume trends). The

continental European economy was gloomy, and this would have an effect on the UK.

Sir David Scholey commented that at a meeting of General Motors the previous week, a comparison had been made between unit labour costs in China, Eastern Europe and Continental Europe. This showed the continental countries' positions deteriorating against the low-cost economies, although the UK was holding its position. Sir Chips Keswick commented that estate agency and housebuilding business were both rising. Mr Simms said that house reservations were trending up, but still below the level of a year ago. For the construction industry overall, orders appeared to have dried up in the early months of the year and there had been job losses, with more to come. That would at least keep wage pressures low.

Sir Jeremy Morse commented that it looked as though we had reached the end of the uniquely favourable conjuncture, and we had to expect manufacturing to contribute less to growth. This had implications for policy. He asked how the Bank stood in the debate between Minford and Congdon. Mr King said that the only way to rationalise Patrick Minford's position was to accept that a massive output gap existed - 6% or more, and growing. If we were truly that far below potential output, then it was certainly right that we could and should cut rates and taxes as well. But almost no-one apart from Minford believed that we were at that level. Tim Congdon would say that the output gap was around 2% and that was an estimate in the mainstream. If that was accepted, then 10% growth in broad money was likely to lead to higher nominal demand and inflation pressures. We were looking very carefully at the trend in M4.

Commenting on the broader implications, the Governor agreed that the particularly favourable pattern of the "Tale of Two Cities" was bound to change. The impetus had come from the external position, especially from the European economies. This made it peculiarly hard to address, or to assess how it would feed through to the UK. It was not strictly an aggregate demand problem, and this made policy significantly more difficult. Sir Chips Keswick commented that although we were seeing distortions in Japanese markets, the authorities seemed to be pushing out liquidity and this could make for volatile exchange markets later. Mr Plenderleith agreed that the exchange markets had been remarkably stable, with most of the action in bond markets where yield curves had been steepening, here and abroad.

Note Issue and the Branches (Messrs Kentfield, Bartlett and Midgley in attendance)

With reference to Minutes of Court of 17 May and 16 August 1995, a paper was presented to Court which put forward recommendations for the future operations of the note issue and the branches, with a view to obtaining the endorsement of Court. Introducing the proposed strategy, the Deputy Governor noted that the branches had been under review for a long time. The announcement in May that banking business would cease had left the note issue work exposed. The buildings were big and empty - we had considered relocation of Head Office staff, but there was very little scope for that. Closure of branch operations was an international trend amongst central banks. The Canadians were closing their branches; some Europeans were doing the same, albeit from a much higher base. In our case the achievement of economies in this area would support our strategy of building up S&S and parts of MAD.

Mr Kentfield said that his starting point, in discussions with the banks, had been that present arrangements were sub-optimal. The proposal was that the banks should take on re-issue - we would restrict ourselves to issuing new notes and taking in, authenticating and destroying old ones. And we would do that from two sites - London (including Debden) and a northern cash centre.

Discussions with the banks were continuing. We had not exposed all of our thinking to them, and there were some details still to clear up. But they would not be surprised if we announced a single northern site. Mr Kentfield added that a change, once decided upon, would take some time to implement. It would be one to two years before the operations at the current branches ceased.

Sir Jeremy Morse thought that the case on note handling looked clear cut. The only question in his mind was whether we would lose any capacity to detect counterfeits. Mr Kentfield said that we would not. That apart, Sir Jeremy was concerned that the Bank should be as well-informed under the new arrangements as it now was - his impression had been that the Agents benefitted a lot from the input of their staff, and it was important that the new Agencies should provide them with good support. He noted the trend amongst central banks to drop branches, but he hoped that we would not carry it to extremes and that the northern branch would be in existence for a while. Finally, people might ask why we were making an announcement before settling matters with the banks - though he understood the need to give certainty to the staff as soon as possible.

Ms Masters asked what the announcement would say about timing. Mr Kentfield said that we would be aiming to close the branches during the second half of 1997: Mr Midgley added that it was unlikely that any branch would be closed until after a year, or that any would remain open after two years.

Sir Colin Southgate said that he did not accept the case for keeping a northern branch. Indeed he felt that London should not be involved in distribution: drawing on his own experience in industry, a single location would be best, determined by an analysis of journeys and needs. Sir David Scholey felt that the paper made a strong case for getting rid of everything except Debden: he had been surprised by the conclusions drawn from the facts presented. The arguments against concentrating on Debden were not convincing. Mr Kent said that there was a case for a strategic store in London, but the constant traffic to and from Head Office could not be justified. He also noted that the executive had yet to take a decision on the levels of sorting.

Mr Kentfield agreed that we needed to discuss the level of sorting undertaken, given the current level of counterfeiting. He also agreed that the role of the Head Office building itself was an issue. But he felt that if we moved the Issue Office function to Debden from Head Office, it actually made a stronger argument for a northern branch. There were risks in putting all our eggs in one basket. He said that the discussions with the clearers thus far had been on the basis of us having two cash centres, and we did want a solution that the clearers would support. We were fairly sure that they would support closing four branches and keeping one open; we were less sure that they would support a solution in which we closed all of our branches. We did not exclude eventually disengaging from the northern branch, but we didn't feel we could do so now; and to go for such a solution immediately would be making the best of the enemy of the good.

Sir Colin Southgate disagreed: he felt it was essential to settle on a final distribution centre, now. And he was also clear that a single centre was more desirable. Sir Jeremy Morse, however, could see the strategic and security risks of concentrating on a single site.

The Deputy Governor said that he personally would like to get Issue Office out of Head Office and into Debden. But for the moment, he was persuaded by the two centre solution. It was important to recognise the risks of keeping all one's eggs in the same basket: the Bank would be more vulnerable if its operations were in a single centre. We had considered a greenfield site, close to a motorway junction and surrounded by barbed wire: but in fact the advice from the police had been that town centres offered considerable advantages, because escape as well as access was more difficult and 24 hour police cover was more readily available. It was possible that in the long run there might be a better solution, but ideally this would be a collaborative solution, and it was not available now. For the moment, the two site solution was better. The Governor agreed. If you started from a clean sheet of paper you would get all the major note handlers to treat this as a collaborative project. But at the moment they wanted their own systems, and were competing. It was intrinsically sub-optimal, but given that, we needed two centres including the northern branch to service those banks who otherwise might depend on the strong note-handling banks. For the immediate future, the Governor feared that if we did not take the course proposed, we would end up doing nothing quickly. Mr King agreed.

Sir David Scholey asked whether the banks paid an economic charge for the note issue services provided by the Bank. The Deputy said that this depended on the note sorting contracts, which would need to be considered. Sir Jeremy Morse asked about the Notes-Held-To-Order Scheme. Mr Kentfield said that this had been abused by the banks, and our intention was to cap it. Sir David Lees said that he had some sympathy for the two centre solution, although he was less comfortable with three (treating Debden and London as separate): he noted that the Deputy Governor had implied that a move from Head Office to Debden was under consideration, and would support the proposal on that basis. He wondered, though, whether the Issue Office move would create any difficulty in making an announcement now to staff. The Deputy Governor said that it would not affect the announcement. Mr Plenderleith said it would be wrong to give any impression that the Bank was deliberately downsizing banking operations. On the basis of our strategy, we were in banking to stay.

Court APPROVED the proposals set out in the paper.

Payment to HMT in Lieu of Dividend (Mr Midgley in attendance)

The Governor advised Court that the interim payment, in lieu of dividend, was due to be made to HM Treasury on 4 April.

Court AGREED that, pursuant to Section 1(4) of the Bank of England Act 1946, an interim payment of £47.05 mn be paid to HM Treasury in lieu of dividend on 4 April.

Arthur Andersen Review of Banking Supervision (Mr Tiner, Ms Tan and Mr Page in attendance)

With reference to a Minute of 21 February, the Deputy Governor outlined progress in creating a quality assurance review. Arthur Andersen had been appointed both to design the review and to define what we meant by "quality". We had brought the matter to Court at this stage to give Court an opportunity to influence the outcome; the project would not be completed for another two months.

Mr Tiner (Arthur Andersen) outlined progress to date on the basis of a series of slides. The review team had consulted supervisors abroad, institutions at home and staff in the Bank. He said that the Bank had an outstanding reputation internationally, at all levels, though many of the international regulators could not understand how we could supervise effectively without on-site inspection. International supervisors had a similar view to us of the challenges ahead: the difficulty of supervising global multi-product banking groups, and the difficulty of recruiting and retaining specialists. All supervisors around the world were beginning to develop risk measures of one kind or another; but there was no consistency otherwise as to their use of supervisory tools. There was some move away from on-site supervision in the United States. Institutions at home had detected a hardening of the Bank's approach to supervision in recent years, but thought that it had not always been coherent or consistent. Some wanted more certainty - more rules - and felt that that was increasingly the trend, but there was still value placed on the Bank's traditional pragmatic approach to supervision. The Bank's staff were seen as bright and dedicated, but not always streetwise or commercially aware. Prudential returns were regarded as a bore: banks did not think that they told the supervisors what they needed to know. Prudential meetings were approached, by banks, with rather less trepidation than the equivalent sessions with rating agencies. The Section 39 process was seen as expensive and unfocused. Some banks would welcome a greater involvement in on-site supervision.

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Internally, there was some concern among the staff about the way in which they used their time: a prevalence of low-value tasks, like checking returns and writing briefings. There were significant differences in working practices across groups, and a shortage of training and experience at both management and technical level. Management skills were generally not recognised, and IT was badly applied in supervision: the technical platform was quite weak. A big investment was needed in this area.

Arthur Andersen's preliminary recommendations therefore related to the need get closer to individual institutions, and to improve management practices and supervisory methodologies. In particular, there should be a more systematic approach to the assessment of risk in an institution, and Mr Tiner demonstrated the preliminary risk assessment ("RATE") model. Work had been progressed on the Quality Assurance Review in defining the objectives and structure, and a preliminary paper put to the Board of Banking Supervision. The object of quality assurance was to assure the quality of supervision and, by a process of continuous assessment, foster the development of best practice. Quality assurance was seen as a management function, reporting to the Director of Supervision and Surveillance, with six-monthly summary reports to BOBS and Court. The Head should be externally recruited, in Mr Tiner's view, from a senior position in a major bank and have a number of staff seconded for two to three year periods both from within S&S and from outside the Bank. The work would look at substance, not just be second guessing supervisory judgements; it would extend both to vertical reviews, looking at individual cases, and to horizontal reviews, checking that policies were evenly applied across the supervisory function as a whole. The next steps were to test out the RATE model, complete the analysis of the supervisory tools, suggest alternative organisation structures for S&S, and to hold a conference of those banking supervisors who participated in the benchmarking questionnaire.

Sir Chips Keswick said that he found the whole presentation very disappointing. He felt that it was jargon-ridden and

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missed the key point, which was how do you assess whether your people, the supervisors, have adequate judgement. Barings and BCCI have nothing to do with systems: it turned on judgement.

Sir Jeremy Morse, by contrast, found the presentation very clear. He felt that it missed some of the things that the Bank did well, in particular the historical background to the Bank's non-inspection system. He agreed with Sir Chips Keswick that the key question was the quality of people - and he wondered if it was a question of raising quality generally, or of training the existing people more. He was also not clear what the purpose of the risk assessment model was.

Ms Masters agreed that quality assurance was a function of management. But she wondered whether it was not a bureaucratic solution to a management issue. The real question was how we got the best people, for they would be self-critical and be looking for ways to build in and sustain quality. That was more desirable than a new department to tell people what they were doing wrong. She felt that an external quality assurance head would be no more than a palliative.

Sir David Scholey said that he too was disappointed by the report, but for different reasons. His concern was that there was so little in the report that endorsed the Bank of England's current supervision. He feared that our reputation for excellence in supervision was historic, even nostalgic, and that radical changes were needed. There was a huge task ahead. He was however surprised that Arthur Andersen had not been more specific on the non-traditional banking areas and hoped that assessment of the risk model would take account of the great variety of banking business now. He also felt that Court should see the preliminary report to BOBS on quality assurance, to which Mr Tiner had referred.

Sir David Simon thought that the approach sounded good and practical, though he was not sure that it was best suited to the way that the banking world was developing. His main thought was that the quality of dialogue between the Bank and the supervised institutions was crucial, and he wondered how the meetings would take place, particularly in the context of the risk assessment model. Would the model simply provide an ex post rationalisation of what we were doing now?

Mr Kent said that while the presentation had been very clear, and he found much to agree with, he found it difficult to see whether we were saying that we needed the same people in supervision, but with different tools, or whether we needed different people.

Mrs Heaton agreed that judgement was very important, but people needed analytical backup: the process was important too. Sir David Cooksey said that he would welcome a quantitative as well as qualitative comparison between the Bank and other overseas supervisors. Mr Neill stressed the importance of developing IT skills as part of the standard tool kit of a supervisor.

Mr Foot agreed with other Directors that judgement was a critical issue. A pragmatic judgemental approach was very valuable, but it was also expensive and one had to have the right people. This focused attention inevitably on resources, the number, quality and mix of staff. There were big problems in IT in supervision. We needed high quality resources in that area. We also needed to be able to deal with complex banks. The factors identified for the risk model encompassed a wide variety of factors which should deal with the concerns there. He also felt that quality assurance was not a matter of management ducking responsibility - though it would be very difficult to get right. The office of the Comptroller of the Currency in the United States had introduced a quality assurance review which had almost brought the organisation to a standstill.

Sir Colin Southgate was struck by the complexity of the problem. He felt that some of the approaches suggested were too simple, and was not happy about the concept of "supervisory year". He also felt that IT should be dropped as an expression, and embedded into the process as a tool like any other.

Sir David Lees said that the key issue was the implications for the function as it stood. We had to get the right calibre of resources, and we had to put those in and worry about budgets later.

The Deputy Governor said that everyone had some hesitation about quality assurance. It must be a useful thing for management, and not just a series of hoops that people have to jump through. It had been a firm recommendation of the BOBS Report and Arthur Andersen were only doing what they had been asked in designing a process. We would send to Court the more detailed material that had been given to BOBS on this matter. He stressed that what had been presented that day was not the final report: there would have to be an imbalance between Arthur Andersen's and management's views, and we were certainly not going to allow the process to become too bureaucratic. He did not feel that any of the reforms proposed could substitute for supervisory judgment. But where the Bank had fallen down in the past was not on judgment, but on process.

Sir David Scholey said that it was very important that the whole shape of the personnel mix in supervision should be re-considered. He also noted that, on risk assessment, the Federal Reserve had told him that they did not like having a central model, because, if known, people would operate by it - "if that's how they check it, that's how we will run it".

Mr Tiner, responding to the discussion, said that the purpose of the risk assessment model was, first, to prioritise resource allocation; and second to help to tell supervisors more about the institution, to get them closer to the institution. He was not sure how radical these changes were: a lot was already happening in some parts of supervision. The final output of the whole process would be a management question about resources, the number of people and so on. He agreed that on the question of IT, a cultural change was required. The

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[redacted]

purpose of the risk assessment model, the RATE system, was not just to model risk, but to provide a framework within which supervisors could exercise judgment. It certainly was not intended to remove judgment from the system.

The Governor agreed. He said that if he were working in S&S, he would very much welcome this exercise. He did not see it as antagonistic or critical. It was clear that the world had changed, and some people had been in supervision a long time. They needed support to adapt. Certainly the structure proposed was not intended to replace the scope for judgment, but to make people feel more confident in exercising it. Sir Jeremy Morse returned to the question of whether the staff were adequate; Oliver Page said that in his judgment the average quality of staff was very high, and the issue was equipping them with adequate skills and experience. The Governor agreed.

Community Affairs - 1995/96 Review and Future Plans

Court read the paper without discussion. Sir David Scholey said those who had read the paper felt it reflected good work well carried out.

A Supervisory Issue

[redacted]

The Executive Report

The Governor advised Court that:-

(a) long Courts will continue to be held on the third Wednesday of each month;

(b) if Members would like to visit Departments/Divisions of the Bank, they should contact the Secretary who will assist with arrangements; and

(c) the Bank would be issuing to its staff new Personal Dealing Rules on 27 March - these replaced the current Insider Dealing Safeguards. The Governor added that this information was reported to Court as it involved a change of internal regulations, thus falling within the scope of 'Matters Reserved to Court'.

Governors' Engagements

Sir David Scholey recorded appreciation of the Governor's address at the Service of Thanksgiving for Lord O'Brien held the previous Thursday.

Sir David also said that he had been impressed by the Governor's recent speech on EMU, and suggested that Court should have an opportunity to debate EMU again once the House of Lords Report and the TSC Report had been published.

National Mortgage Bank (Mr Hay Davison in attendance)

Mr Hay Davison said that he had been asked to take on the Chairmanship on NMB in February 1992, following the support given by the Bank. Initially, NMB had been simply a vehicle for transactions by the NHL group. He had taken steps to separate NMB from its parent company, and then to start running down the book with the minimum of publicity and the least cost. A Board had been established and a £400mn facility negotiated with the Bank of England. In October 1994, the Bank had acquired NMB, and from then on financed it directly. The loan book had been a mix of business loans, consumer loans, leases and poor quality second and third mortgages. The total book had been run down from £620mn at the time of the acquisition, to £205mn in February 1996. Staff numbers had fallen from 164 to 39, and overheads from £5.6mn to £1.8mn. The Bank's exposure was now £92mn, and was predicted to fall to £62mn in 1999 as a result of the positive net margin that NMB was running. However, this margin reflected the fact that the first £100mn of the Bank's loan to NMB was free of interest. It would take a long time before the book was completely worked off; NMB were not actively discouraging borrowers to leave, and the option of a sale was not straightforward, unless the Bank were to recapitalise the institution. The accumulated P&L deficit was £167mn.

Sir Chips Keswick asked why the Bank currently provided finance of £240mn to finance a loan book of £205mn. Mr Hay Davison thought that this reflected the fact that there was a large accummulated P&L deficit, and the Bank's facility had not been written off correspondingly.

The Governor thanked Mr Hay Davison for his presentation, and for his work in realising the assets of NMB on behalf of the Bank.

Howard J. Davies

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Secretary

17.4.96

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 27 MARCH 1996

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.

Speaking about the markets, Mr Plenderleith said that the foreign exchanges were showing very little movement, with turnover light. There had been some recent turbulence in the domestic markets but the tone was now a little more settled. The gilt auction that morning had been covered 2 1/2 times, although the tail - four basis points - was long but not unduly so. The funding remit for the new financial year was due to be announced later in the day; although the indicated scale of funding would show little variation from the current year, a smaller anticipated borrowing requirement would be offset by a larger volume of maturities.

The Governor noted that the Monetary Analysis area were assessing possible economic implications of the beef scare. Unless there was a decision for a much more extensive slaughtering policy than currently seemed likely, indications were that the impact on Government finances would be no more than £0.5bn, and there was a possibility of some help from the Community budget. Mr King added that the effect of the scare on the RPI in the short term would be small, with a fall in the price of beef being offset by higher prices for other meats. In the medium term, the impact could be greater through price increases for beef-related and dairy products.

Howard J. Davies

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Secretary
17.4.96

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 3 APRIL 1996

Present

Mr George, Governor

Mr Davies, Deputy Governor

Mr Foot

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.

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

Howard J. Davies

[illegible]

Secretary

17.4.96

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 10 APRIL 1996

Present

Mr George, Governor

Mr Foot

Mr Kent

Mr King

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

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

Secretary

17.4.96

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 17 APRIL 1996

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Sir David Cooksey
Mr Foot
Sir John Hall
Mrs Heaton
Mr Kent
Mr King
Ms Masters
Sir Jeremy Morse
Mr Plenderleith
Mr Simms
Sir David Simon

The Minutes of the Court of 20 March and the Meetings of 27 March, 3 and 10 April, having been circulated, were approved.

Monthly Economic & Monetary Report, including market charts (Mr Bowen in attendance)

Mr King said that he would like to explore some of the themes for the May Inflation Report, to be published on 14 May. In the February Inflation Report, the Bank had said that the most likely prospect was for inflation to fall below 2 1/2% by the end of this year, remain there for much of 1997, and then pick up during 1998. We had said that it was more likely than not that inflation would be below 2 1/2% in the first quarter of 1998. The question was whether we should revise that view.

It was striking how little had changed since the February Report. Inflation itself had generated little news; RPIX inflation was unchanged in February, at 2.8%. Producer output price inflation had been extremely low in recent months, although surveys suggested that a moderate rise was in prospect. Input prices had been flat or falling. The one exception was the oil price, where the one-month Brent forward price had increased from just over $17 a barrel in February to almost $21 in April.

In the February Inflation Report, the Bank had pointed to two main downside risks in the short term. The first was a run-down in stocks, and the second weak export demand as growth fell on the continent. So far we had seen no significant run-down of stocks, and since involuntary stock-building had plainly taken place last year, stock-building was likely to be a drag on growth during 1996.

Further evidence of weakening on the continent had appeared over the past quarter. The prospect was for negligible output growth in Germany during the current year. This would have knock-on effects on other continental economies. Despite a more buoyant picture for the United States, such an outlook was very likely to imply weaker net trade for the UK this year than last.

Looking further ahead, into 1997 and beyond, there had been little change to the prospects for demand and output growth - both were expected to pick up with domestic consumption. Real disposable incomes were rising, tax increases were being replaced by tax reductions, and there were the windfalls to households from building societies and other sources. The housing market seemed now to be reflecting increased consumer confidence. All of this suggested strengthening consumption growth, and that picture was supported by broad money growth. Rising demand growth would close the output gap and then start to put pressure on resources, leading to higher inflation. But it was not clear <u>when</u> that would occur.

Mr Bowen added that the unemployment figures published that morning had changed our view of labour market activity. There appeared to be a resumption of the downward trend in unemployment that we had seen last year. Backward revisions to the data suggested that unemployment in the first quarter had been lower than earlier thought, and it was also clear that settlements were running a little bit higher. The quarterly Labour Force Survey, also published that morning, showed employment rises continuing and suggested that, perhaps, companies were converting some overtime working into employment of additional staff.

Mr Plenderleith said that the main recent features of the markets had been the stronger dollar, which had helped the pound, but which meant that the pound would be vulnerable if the dollar were to fall. He noted that forward expectations of short-term interest rates had risen further, not only here but also in Germany. Bond yields were rising most in the United Kingdom and the United States, both countries with relatively buoyant economic prospects, while they were levelling out in Germany and France, where the economies were significantly weaker. The rally in the equity markets had been sustained, to a point where the FTSE all-share yield had fallen below the yield on index-linked gilts: this was unusual, and suggested that some adjustment in equity values might be expected.

Mr Simms said that indications from the housing market were still ambiguous. Completions up to the end of February were still 5% down on the previous year and, while house prices were trending up, the recent Halifax figure, suggesting a strong upward movement in March, was disputed. The construction market still expected to lose more jobs than it gained this year. Nevertheless enquiries in the construction sector seemed to be better in quality, and, although people were not expecting a huge amount of extra work, forecasts of activity had moved from negative to positive. Overall there were some inflationary pressures building up all round in this area.

Sir John Hall said that the Millennium Commission, which was currently placing a number of major construction contracts, had been told by quantity surveyors to allow for 7%-11% annual inflation in their grants for such projects. In later discussion, Mr King said that some asset prices like land could rise sharply in a recovery. Sir John Hall felt that the answer was more likely to be that in sectors like construction, which had been cut to the bone during the recession, managers would take the first possible opportunity to raise prices and profit margins. Mr Simms said that many input prices were rising, despite weak demand, simply because companies had to make some level of profit. If they reached a point where they could invest, then it might be that prices would be more restrained.

Sir David Simon said that energy demand was still coming through at a stronger pace than had been expected - more than 50% faster. Inevitably this had had an effect on prices. Moreover stocks were low - in the US, lower than ever before. In the United Kingdom, demand had been growing spectacularly fast in early 1996. Gasoline sales were 2%-3% up, against 4% annual falls typically over the past few years. While forward crude prices were only $2 higher, this probably assumed that Iraq oil would be coming back on stream; if this didn't happen, prices could rise further.

Sir David Simon said that it was very hard at the moment to track service company growth. From the Deutsche Bank's Advisory Board, on which he sat, he had heard similar discussion among German industrialists, who found manufacturing and construction sectors extremely cautious, but services growing rapidly, particularly in the second half of last year.

Sir Jeremy Morse said that it was clear that we were moving away from the "Tale of Two Cities" analysis. The consumer, relative to manufacturing, was becoming stronger. The question was how quickly the reversal would take place, and whether it would swing too far. There was inevitably interplay with the election. And this meant that we might find it difficult to manage the interest rate cycle appropriately.

The Governor agreed that manufacturing activity had been extraordinarily flat. The standard explanations for this had been net trade and the expected stock adjustment. But manufacturing and consumers were in direct opposition. There ought to be a shift in demand on manufacturing from net trade to domestic buyers. We couldn't see that happening either. So we still saw a downside on manufacturing. On the consumer side, there were lots of things that could make growth stronger, but there were equally many reasons for consumers to be cautious. Even in terms of the money numbers, if one took out the OFI contribution, personal M4 was accelerating, but nothing like so fast as total M4. Questions of that kind would be critical to the policy timetable. The Governor felt that we could well get into a position where we wanted to raise rates at a politically sensitive time. The Chancellor had said that politics would not be an issue, but the Governor still felt that there could be a conflict. Of course we could run into the same situation with a Labour government, though for them it might be easier to address.

Mr King noted that one possible reason for optimism was that expectations of interest rates seem to be having an effect on business conditions more than in the past. At present, the short-term yield curve was pointing sharply upwards.

Sir David Cooksey said that in the small company sector there was some growth, but uncertainties about the immediate prospect. Companies supplying manufacturing seemed to be going ahead very rapidly. Manufacturing companies did seem to be seeing demand both from the UK and the US.

Sir David Simon felt that the cost-base in the economy as a whole was not yet moving in the way suggested by Sir John Hall. Competition was still intense between suppliers. Technology was still capable of bringing down costs. So, while he expected the economy to grow faster than many, it was not clear that prices would develop in the same way as in the past. The Governor agreed, but noted that the Retail Prices Index did now seem to be more sensitive to short-term demand fluctuations than in the past.

External Communication

Introducing his paper, the Secretary said that it contained little that was radical, and although written partly in the future tense, to a large extent described what we were already doing. It nevertheless identified some risks and some opportunities - a specific risk in the area of counterfeits, and specific opportunities in the area of payment and settlement systems, especially CREST and RTGS.

The broad messages that we wanted to get across were fairly clear. In the monetary area, inflation was still a potential problem; the Bank's technical competence was high; and that there was a substantial and broad input into monetary policy decision making, including a regional input. In the markets area we wanted to build support for the structural changes now in train. On Europe, we wanted to continue to press the Luxembourg theme, and to counter those who felt that the City's future depended on joining EMU. In supervision, we had to re-establish our reputation for technical ability at the level of detailed supervision of institutions. In policy and international areas we were strong, but we were seen as lacking in rigour in day-to-day supervision. We would also have to be ready to counter those who pressed for institutional change. In the note-printing area, we had a serious potential problem with counterfeits.

We had widened the array of techniques used to convey the Bank's message. The MPs' programme had been extremely successful, and the Secretary felt that some of the dividends had been seen in the reaction to the recent Branches announcement. Television and radio were used sparingly and the overall style of the Bank's Press Office was to try to be effective but not pushy. It did nevertheless represent quite a large cost to the Bank, and he was concerned that Court should feel that the right messages were being put across, and that they were being put across in the right way.

Sir Jeremy Morse said that he was concerned about the message on Europe. He thought that the Bank's public stance was too much concentrated on the politics of EMU, and that the tone was too negative. Whether or not we joined EMU had become a political question: the Bank's role should be, rather, to deal with the technical issues. He was also concerned about our arguing that the City could be relatively relaxed about our not joining EMU. The Governor said that these were issues of substance as much as presentation, and noted that a substantive debate on EMU questions was planned for July: Mr Kent said he hoped that the question of the impact on the City would be covered in that debate. The Governor also said that the economics of EMU was plainly for us the most important question, but that had been what his speeches had been about. Ms Masters and Mrs Heaton agreed: it was clear the Bank had been making a powerful analytical contribution to the EMU debate.

Sir David Simon said that, as a Non-Executive Director of the Bank, he was often asked about the institution, and the most common questions were:-

(1) whether the Bank had the capacity to maintain monetary stability, whether we could "make sure that the politicians don't mess it up". This led into the independence question;

(2) the Bank's views on EMU, where he was sure we should be involved in the debate and be seen to be technical masters of it. We had gained great strength in Europe and at home from the way in which the Governor had spoken;

(3) supervision, where he felt that the work Mr Quinn had done to publicise our performance in supervision, in particular relative to other countries, had been extremely useful.

What people were looking for from the Bank was judgement, professionalism and openness. It was in this last area that he felt we had work to do. The Bank needed to make sure that people understood how its judgements were formed. We had to be able to handle a more democratic release of data about the Bank.

On independence, the Governor said that our policy was that we campaigned for stability, not independence, while recognising that independence might contribute to stability.

Sir John Hall said that the Bank had two audiences: the financial world, which probably understood what we were saying, and the general populace, which didn't. We probably needed to do more public relations for the latter group. We would need it particularly if we got into a referendum on EMU. He wondered whether the Bank's present approach to public relations was professional enough, for example whether it was carrying the message into schools through videos. The Secretary confirmed that it was attempting to do so, and the Deputy Governor felt that the Bank's Press Office did have the technical capability to deliver what the Bank wanted. Where the Bank had greater difficulty, sometimes, was in agreeing the message that the Press Office should be delivering.

Sir David Cooksey mentioned that we should be cautious in trumpeting the success of CREST, as there were still many who regretted the inconvenience to private investors. (In the later discussion, Sir David Simon and Mrs Heaton both confirmed that at recent company AGMs there had been complaints from small shareholders about pressure to go into nominee names.)

Ms Masters asked about the plan for a new magazine on supervision. Mr Foot said that there were a number of things that we did which amounted to publishable material but for which we had no obvious outlet. The new publication would give us such an outlet. The Deputy Governor said that we would be producing a first dummy for purposes of market testing in June, and if that was thought to be worthwhile, we would be launching the publication in September. We thought there probably was a market for such a publication among those interested in risk management, compliance, and supervision generally.

The Governor asked whether we should be adopting different techniques - for example looking more towards television. Mr Simms said that we should not be trying too hard to become a "popular" institution, and Sir Jeremy Morse suggested that we should keep television for when we have something very specific to say. The Governor agreed: he felt that much of the material that he had to offer was best put out in lecture format.

The 1996 Annual Report - in draft (Mr Midgley and Mrs Bishop in attendance)

The Deputy Governor said that this year's Report was in a rather different format from previous years. We saw merit in more clarity and openness. The Bank wanted to be accountable, and it was consistent with our overall strategy that we should be so. We also saw merit in bringing the strategy and organisation of the Bank together, and giving some profile to the former. We had also been struck by a recent IMF study which had implied that our accounts were less informative than some other central banks. We had therefore looked to see what others were doing, and had tried to emulate the best.

The Deputy Governor said that one feature of the new presentation was to give some idea of the Bank's total costs, and how these were distributed among areas. However Sir David Lees had indicated that he was uneasy about doing so. Mr Midgley said that the figure given for operating costs could not be directly related to costs in our financial accounts, and did not in practice give away more than had been given away in previous accounts. In subsequent discussion, the following points were made:

(1) Disclosing costs by area could be risky - eg it drew attention to oddities like the high cost of the personnel function. The breakdown could perhaps be shown as a proportion of staff. But the Governors, and a number of Directors, saw merit in making as much

disclosure of costs as was consistent with the need to preserve our ability to disguise (for a period) support operations.

(2) That time series would be helpful. The Deputy Governor pointed out that both Personnel and Printing Works showed historic data, and Mrs Heaton suggested that, in the first year of a new format, we did not need to go too far.

(3) That more should be said about supervisory activities. The BoBS report, and the Banking Act Report, should not be the only places in which we discussed supervision.

(4) A number of suggestions were made on the tone and content of the Governor's Foreword.

(5) Directors generally welcomed the new format.

The Risks from CREST

Mr Kent said that CREST would now be on time, but not (quite) within budget. There would be an overrun of £2mn, taking the total cost to £25mn. About half of the overrun related to functions not in the original scheme - for example, the need to provide for stamp duty. But nevertheless, from a blank sheet of paper the CREST team had delivered, for a cost of £25mn, a working system costing far less than the failed predecessor. And it would be on time. About 2,500 listed companies, and 90% of Stock Exchange turnover, would be ready. It was likely that the market as a whole would be ready for CREST.

Mr Kent added that when the system went live, in July, the Bank would lose its controlling share. He would be stepping down as Chairman later in the year.

Sir David Simon and Mrs Heaton highlighted concerns among small shareholders about the move to nominal accounts. Mr Kent said that if often suited brokers to blame CREST for this, but the real reason was the move to 5-day settlement.

Houblon-Norman Fund

There being no comments on the accounts of the Houblon-Norman Fund for the year ended 30 June 1995, the Governor invited

Mr King to comment on the Report of the Committee and the work of the Fellows. Mr King said that we had been successful in attracting very powerful candidates, for example Robert Barro. For the coming year, the calibre was less exciting, but still good. Mr Kent said that it would be helpful to have more people of interest to the FS Wing.

Gilt Funding Remit (Messrs Townend and Tucker in attendance)

Mr Plenderleith said that this was the third year in which funding had been governed by a formal remit, and the second year the remit had been published. The aim of the remits had been to extend delegation, increase transparency and create accountability. The Government aimed to set out broad objectives for the amount and type of stock to be sold, and the sale method. Within that framework, the Bank was in principle free to conduct borrowing operations. The process had achieved useful results. But there were five areas of difficulty.

(1) The scale of funding required could increase sharply within the remit period - in the latest year, from £23bn to more than £30bn.

(2) The remit itself was quite elaborate, with as many as 12 separate objectives.

(3) The Treasury found it difficult to draw back from second-guessing the Bank.

(4) There was as yet no coherent framework for managing the portfolio of debt.

(5) The auction mechanism was not robust.

Mr Tucker said that the new remit for 1996/97 set the financing requirement at £35 1/2bn, of which £32 1/2bn was to be met by gilt sales. 15% of gilt sales were to be indexed, and the remainder split evenly between short, medium and long conventionals. There were 11 planned auctions, three of them dual auctions in which different stocks would be offered on a Tuesday or a Thursday. Indexed gilts would continue to be issued by tap. We had provoked a debate with the market on indexed auctions, but had not found sufficient practical support for Ministers to want to go ahead.

Sir Jeremy Morse asked whether the Treasury's tendency to interfere arose from particular individuals or was a more settled policy. Mr Plenderleith said that it was both: he saw it as inevitable, and in fact perfectly legitimate in that it was the Government's own debt that was being sold.

The Executive Report

(A) Branches and Agencies

The Deputy Governor said that press reaction to our announcement on 28 March had so far been muted, and in some cases surprisingly positive. We had succeeded in getting the positive aspects of our message across better than we had expected, in part because considerable effort was put into the communication of our motives, both here in London and by our Agents around the country. There had been an early day motion in the House signed by a number of MPs, just before the announcement. We had written or spoken to all of them; in some cases they were not aware of the nature of our plans, and there had been almost no following correspondence from them. There had been a few letters from local politicians, but some were understanding or supportive. BIFU were trying to stir up a political campaign but with very little success so far. They were not doing much to help the staff.

(B) Joint discussion with BoBS

The Governor advised Members that only two out of six of the independent members of BoBS could attend for a discussion at Court on 1 May, so the discussion has been deferred to the Long Court in July when four out of six would be present.

(C) The Bank's Financial Framework

The Deputy Governor said that he and Mr Midgley had recently had a very useful meeting with a small group of the Bank's Non-Executive Directors - Ms Masters, Sir Jeremy Morse and Sir David Simon - about the Bank's financial framework. They had agreed the structure for a presentation to Members of Court. This would start at 9.30am before the long Court meeting on 19 June, for those Court Members who would like to attend.

(D) <u>Real Time Gross Settlement</u>

The Deputy Governor said that RTGS was expected to be introduced on 22 April. Trialling of the system had proved successful and there was now a sufficient level of confidence within the user community which should mean that the target live date would be realised.

(E) <u>BCCI - Litigation update</u>

With reference to a Minute of 15 November 1995, the Deputy Governor updated Court on the litigation against the Bank by the liquidators of BCCI. A review by Freshfields of the provisional ruling on the Preliminary Issues had been sent to Members earlier in the month and, whilst the ruling was in the Bank's favour, he confirmed that it was only provisional and in the absence of relevant case law, the main issues were likely to go to appeal.

(F) <u>The City Arts Trust</u>

The Governor said that Brian Quinn had been a Director of the City Arts Trust which manages the City of London Festival. The Governor thought that Court should be aware that Pen Kent had now agreed to take over this responsibility.

(G) <u>President Chirac's visit</u>

The Governor advised Members that on 15 May, President Chirac would be visiting the Bank between 12.30pm and 1.15pm before going on to lunch at the Guildhall. Court, which would start as usual at 10.00am, would finish at 12.20pm. If Members wished, space could be found in the observer seats for the discussion with the President in

[redacted]

the Court Room. Members wishing to be present for this should advise the Secretary.

[redacted]

(I) <u>The Agencies</u>

The Deputy Governor said that he had commissioned a small exercise, led by a management consultant, to review the appropriate size and operating arrangements for the new agencies.

(J) <u>Informal ECOFIN</u>

The Governor briefed Court on the informal ECOFIN meeting the previous weekend. The outcome, as reported in the press, had been confusing. In reality, all countries accepted that there was no possibility of a mandatory ERM for the "outs".

Sir Jeremy Morse commented that the underlying fear of the "ins" of competitive devaluation by the "outs" was strong, and Sir David Simon considered that the French were unlikely to give up the fight. The Governor felt that, given the commitment of all countries to stability policies, the dangers were small.

Howard J. Davies

J M Footman
Secretary
1.5.96

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 24 APRIL 1996

Present

Mr George, Governor

Mr Davies, Deputy Governor

Mr Foot

Mr Kent

Mr Plenderleith

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

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

Mr Plenderleith noted that the gilt auction held that morning had gone well and that the market had responded positively to the outcome.

Secretary

1 May 1996

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 1 MAY 1996

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Mr Foot
Sir John Hall
Mrs Heaton
Mr Kent
Sir Chips Keswick
Mr King
Sir David Lees
Ms Masters
Mr Neill
Mr Plenderleith
Sir David Scholey
Sir David Simon

The Minutes of the Court of 17 April and the Meeting of 24 April, having been circulated, were approved.

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

The Report and Accounts of the Bank for the year ended 29 February 1996 - in draft (Messrs Midgley and Phillips and Mr Chapman of Coopers & Lybrand in attendance).

With reference to a Minute of 17 April, the Deputy Governor presented the draft Accounts for the year ended 29 February 1996. He said that the major items that had an impact on this year's figures were:

Release of provision in respect of NMB;
Provision for closure costs of Branches;
Valuation of Printing Works and New Change;
The Dividend to HMT.

There was also a change in the disclosure of Directors' pay, and the Accounts contained information on major related parties in accordance with the spirit of the new accounting standard FRS8. In addition, we had this year consolidated the accounts with the Printing Works.

Published operating profit before tax was £214mn compared to £226mn for the previous year. Both year's figures included profits on the sale of 3i shares. Almost 50% of the Bank's holding had been sold when the Company was floated in 1994/95; the remainder was sold in June 1995.

The £88mn payment to HMT in lieu of dividend was lower, by about £6mn, than the figure discussed at Court on 20 March. This was the result of higher provisions. The amount of the dividend, however, still represented an almost exact 50:50 split of post-tax profits including the profit on 3i. This had been accepted by HMT.

Profit before provisions had fallen by £1mn to £118mn. Although expenditure (excluding Printing Works) had increased by £21mn, there had been a similar increase in income. Provision movements however had reduced the operating profit to £96mn, down £10mn on 1994/95.

The increase in income was mainly due to the combined effect of higher average interest rates and higher levels of cash ratio deposits. Fixed income was slightly higher due to an increase in the gilts portfolio, and a £3.4mn dividend from Minories Finance. This had been partly offset by the loss of the dividend on the 3i holding.

Personnel costs had increased by £6mn due to payments made to agency staff working on special projects, [redacted] This increase in personnel costs had not affected the pay bill, which remained static.

The increases in premises and equipment costs were mainly due to depreciation being charged for the first time on the Printing Works refurbishment project. Some of the expenditure on this project had also been reclassified as revenue. A total of £9mn had been charged against profit this year, and the book value of the Printing Works was now £31mn. The Bank's valuers, St Quintin, had indicated that the open market value of the Works was about £18mn. The existence of this difference had prompted a fairly severe look at the project costs, as well as the £9mn charge of expenditure to the revenue account. We would carry the remaining variance and revisit the issue in the following year, when the regular quinquennial valuation of all the Bank's properties would take place.

The major reasons for the increase in other expenditure were the professional fees incurred in respect of the Barings Report and costs of the Arthur Andersen Review of Supervision.

Included in the draft accounts was a release of £10mn of the provision in respect of NMB. This was as a direct result of the improvement in NMB's position, which had arisen in part due to the sale of significant parts of their portfolio of loans.

A further £10mn had been provided for closing the Branches - of this, £7mn was for staff severance and £3mn for winding down expenses and as a marker against possible losses on the disposal of the buildings, whose total value was £12mn.

The published Profit & Loss statement showed a figure for total recognised gains and losses. The £12mn reduction reflected the movement on the market value of New Change as estimated by St Quintin. This building was treated as an investment property, and accordingly was revalued each year. St Quintin explained the fall as resulting from lower rental levels.

St Quintin had also estimated the market values of all the other remaining buildings. The total value of these was only 4% below book value. As this was not material, there was no need to mention the difference in the Directors' Report.

Sir David Lees confirmed that the Audit Committee, having had two discussions of the Accounts, were content with the presentation.

Mr Chapman said that in respect of all the items where judgement had been called for, Coopers were satisfied with the outcome.

Turning to the Notes to the Accounts, the Deputy Governor said that the Printing Works consolidation was referred to in Note 1 and reflected in Note 2. Note 3, Directors' remuneration, had been adapted to comply with the spirit of Greenbury (though without claiming compliance), and gave individual disclosures in respect of each Director. The explanatory section gave much of the detail that would have needed to be included in the Greenbury-style report of a Remuneration Committee. The Deputy Governor referred in particular to the disclosure in respect of the unfunded pension to Mr Pennant-Rea. [redacted]

The Deputy Governor said that the participating interest shown in Note 11 related to the Bank's investment in the European Monetary Institute. The value given for the EMI investment was based on the Bank's share of the EMI's net assets, rather than just the Bank's contribution as last year.

In Note 22, we were this year disclosing details of related party transactions, in line with the spirit of the new accounting standard FRS8. Although technically not required until the following year, the Bank was providing the information this year since the note was informative and did not reveal anything sensitive. We would review the presentation in the light of developments as more companies disclose.

The Bank had received a letter from Freshfields confirming their view that no further disclosure was required in respect of BCCI litigation, and a copy of that letter had been placed in Court folders. There were no other significant legal cases involving sums material to the Accounts.

The presentation of the statements for the Issue Department and Accounts had been amended to mirror those of the Banking Department.

Sir David Lees commented that the Audit Committee had been giving some thought to the valuation of the Bank's investment in the Bank for International Settlements. The recent dividend record of the BIS had been upward, and the present asset-based valuation put the investment onto a high-yield basis. There was a possible case for changing the valuation method to a yield basis in next year's accounts. Sir David Lees also commented that, in the following year, the Bank would have to consider disclosure in respect of Directors' pension rights. Sir Chips Keswick asked whether outsourcing costs appeared in other expenditure; Mr Midgley confirmed that they did. Sir David Scholey commented that the property situation appeared complicated, and that no reference to the Printing Works property was contained in Note 13. Mr Chapman commented that the recent view taken by St Quintin of the value of the Works was not a formal valuation, and no provision had therefore been made this year. The Deputy Governor added that the £9mn adjustment had not been a provision, but a deliberate decision to take refurbishment costs to revenue account rather than to capitalise them. This avoided any widening of the gap between book and market value. Sir David Lees commented that the gap in the Accounts was about £13mn on the informal valuation basis. That would close further during the year and we would sweep it up in the following year's Accounts.

The Deputy Governor drew Court's attention to several points in the Accounts where Directors gave specific opinions in addition to the "fair presentation" to the Accounts: these occurred in Note 1a, Note 1d, Note 11, Note 12, Note 13, and Note 24.

Sir David Lees confirmed that all of these points had been covered by the Audit Committee in its report.

The Deputy Governor went on to report the Audit Committee's discussion of the operational review and Directors' Report. A number of changes had been made in the light of this discussion, including the incorporation of the section formerly entitled "Financial background to the Bank's operations" into the Finance Section of the Operating Review, which had also been reordered. There had also been some redrafting to reflect Audit Committee's concerns over the presentation of the Bank's costs. A new pie chart had been introduced which explained how the costs of all areas added up to 100%.

There had also been some discussion of how far the Directors' Report should refer to movements in provisions. We had decided to mention the movement on the NMB provision, but not the provision for closing the Branches.

The Deputy Governor referred to the draft letter of representation that Coopers would like to receive in connection with their audit. Formal approval for this letter would be sought on 15 May. Mr Chapman said that he would write to say that he was not aware of any reason why it should not be signed. Sir David Lees said that the Audit Committee had asked Coopers to confirm that they were satisfied that they had identified no impropriety of the Bank's operations, and they had provided this confirmation.

Sir David Simon asked who was interested in the information on Directors' emoluments: the Governor said that the press always were, most intrusively, but the Treasury Select Committee could be as well. Sir Chips Keswick commented that financial journalists might ask why the Bank's expenses were up by 10% over the year; the Deputy Governor said that the main reason was the cost of the Board of Banking Supervision Barings' report. However, the numbers which might provoke the question are not part of the published accounts. Sir David Lees, commenting on the text of the Forward Strategy document in the

Annual Report, suggested that we should look again at the words "with the interest of our staff in Gloucester firmly in mind". If the need for sharp cost reductions was confirmed, then this text could be a hostage to fortune. The Deputy Governor said that the choices for Gloucester were between having a massive cut in their staff or having no staff at all. The text as drafted signalled our wish to safeguard at least some of the jobs at Gloucester. The Governor however said that the language would need to be looked at again. Mrs Heaton commented that the press might also be surprised to see that we had 451 staff involved in premises work: the Deputy Governor acknowledged that there was a problem there, though a large part of the staff were in fact involved in security.

The Governor thanked all of those who had been involved in the preparation of the accounts, and particularly the Audit Committee for their contribution.

The Deputy Governor drew Court's attention to the high level review recently undertaken by Coopers & Lybrand on risks and internal controls, and the resultant action being taken by the Bank. The mapping of the risk and control framework and the recommendations made by Coopers would provide a sound basis for future work by the Auditor. The Audit Committee had discussed the paper and expressed themselves satisfied with the management response to it. Sir David Lees confirmed that, and said that it would be important for the map to be kept up to date, for the Auditor to address the auditable risks, and for MANCO to address those risks which were not auditable. But on that basis, he felt, the Bank could make any statement it liked about the effectiveness of its control framework.

Sir David Scholey commented on the general risk of excessive attention to process, and raised two questions in particular: first, whether S&S had taken a look at the document to see if it would be acceptable coming from a commercial (supervised) bank; and second, at what level a risk manager might be appointed. Mr Foot said that S&S had looked at the document, and had it been from a bank would probably have wanted a follow-up section 39 report once it had been implemented; the Deputy Governor said that we had concluded that a single risk manager for the entire Bank, given the disparate nature of risk across the institution, would not be sensible. Mr Chapman said that Coopers now accepted that conclusion. Sir David Simon said that where risk was easily definable, he felt comfortable with the framework. But in areas like Health & Safety and Ethics, the difficulty was providing the necessary assurance, to supplement the management of risk and control systems. The Governor said that we would revert to this issue.

Draft Banking Act Annual Report (Mr Page in attendance).

With reference to a Minute of 18 January, and in introducing the draft Banking Act Report for 1995/96, Mr Foot said that the first part of the Report was dominated by post-Barings material, and the Arthur Andersen Review. There were references to lending margins, carefully worded, and on the regulation of smaller banks. Part 4 revealed a relative low level of formal action taken under the Banking Act during the year, and a sharp rise in staff numbers, exaggerated by the inclusion of WMSD for the first time. The press might also note the sharp rise in the number of European authorised institutions.

Mrs Heaton asked about Section 39 reports, which were clearly, from the other papers provided to Court, an area of difficulty. She wondered in this context how the remarks on page 6, reporting the post Barings recommendations, would be received. Mr Foot said that we had had no comeback from the accountancy profession in the wake of the notice sent to them on 11 April. We had considered Section 39 reports in the context of the Arthur Andersen review; but the question was one of avoiding excessive expectations, and making staff realistic about what Section 39 reports could do.

Sir David Scholey felt that the reference to merchant banks on page 21 read in an "old-fashioned" way. Asset management and brokerage were not just contributors to profits, but a substantial and integral part of many merchant banks' operations. Mr Foot undertook to review the language of the draft. Sir David Scholey also questioned the Arthur Andersen page: he would prefer to see it signed by Arthur Andersen given that it was written in Arthur Andersen prose - though Mr Foot said that he thought it was drafted by the Bank. It was agreed that the text would be reviewed carefully.

On the Report in general, Sir David Scholey commented that yet again the standard had been improved, and Sir David Simon said that it was a vital read for anybody interested in banking. He suggested, however, that the language on the costs and margins of the large British banks could be reviewed: the implication at present was that if banks were unable to control their costs, it was all right so long as they raised their margins. Again, Mr Foot agreed that that part of the text would be reviewed.

Arthur Andersen Review - progress report (Mr Page, and Mr Tiner and Ms Lay Koon Tan of Arthur Andersen, in attendance)

With reference to a Minute of 20 March, the Deputy Governor said that there had been a useful session last week involving the supervisors from other countries in a review of the comparisons made by the Arthur Andersen team. Mr Tiner said that the Review team had taken note of the comments made at the earlier Court discussion. They agreed that the key to good supervision was the quality of supervisors' judgements, and had looked carefully to make sure that the tools that the supervisors were provided with, particularly the risk assessment model, would support the exercise of judgement. The model was currently being prototyped, and feedback so far from the line supervisors had indicated that it was a helpful framework.

A number of changes were proposed to prudential returns. There was a clear demand, both in the Bank and among the institutions, for electronic data collection, internally consistent returns, better basic analysis on the returns, and more use of management information. The team had carefully thought through the alternatives to Section 39 reviews; these included bilateral meetings with accountants, using non-auditors as reporting accountants, having the Bank itself appoint and pay for the reporting accountants or discontinuing the use of accountants. The conclusion had been that it was best to improve the existing process: scoping the reviews more effectively, having more timely and better structured trilateral meetings, and a more rigorous follow up of exceptions.

It was clear that S&S needed to develop more experience and continuity in its resources, and to recruit more specialists. The AA team were currently working on the recommended profile of S&S resources, and the transition programme. The graphs circulated to Court showed that almost 70% of people in S&S had spent less than two years there, and 90% had spent less than five years. This compared very unfavourably with other supervisors. The average age in other supervisory departments was around 40, compared with 30 here. It was also clear that a more comprehensive and structured training programme needed to be established and that more specialists were needed.

Turning to the suggested profile of staff for S&S in the future, Mr Tiner said that the Divisions should continue to have a number of different types of employee. There would continue to be a significant group of "one bankers" who would be mobile between the two Wings, and probably potential high flyers. There would be a substantial group of semi-permanent S&S staff, who would provide the core expertise of the Division. There would be "experienced hires", generally dedicated to S&S, and specialists and secondees working in the capital markets and derivatives areas. Finally, there should be a group of "grey panthers" who would be experienced people, possibly approaching retirement age, recruited as expert advisers to S&S. The proposed organisation structure had nine separate Divisions reporting to the Deputy Director. One of the Divisions would be responsible for operations, and from within that Division the improvements in the area's use of IT would be driven - although the review team recognised that IT had to be used extensively throughout the Division as a working tool, and that this required changes in culture everywhere.

The Deputy Governor said that he felt that the general direction of the personnel changes was right. We needed good people to stay longer, and more direction of career movements within S&S. There obviously needed to be considerable attention paid to training in the future. Overseas supervisors reported that the provision of superior training was the prime reason they remained able to recruit and retain (for a while at least) good people, in spite of the lower than market salaries they offered.

Sir Chips Keswick felt that there was an omission in the organisation structure, in that there was no box for "new products". Unless S&S were able to focus on products that were going to affect them in the future, they would always be running behind. Ms Masters agreed that IT was important, but in the organisation chart it appeared to be tucked into a support function. There was a huge transition to manage, and a powerful IT/Information Director was needed in S&S, otherwise the role of IT would risk being downgraded in the organisation as a whole. Sir David Lees welcomed the idea of making greater use of management information, but wondered whether a well run organisation should not be able to give some assurance about the integrity of such information through internal audit. He also wondered whether the Bank could hold bilateral meetings with auditors, rather than involve the supervised institution as well, as now.

Responding to these points, Mr Foot agreed that a new products team, including people from outside, would be valuable. There was no intention of denigrating or downgrading IT - resources would be brought in from outside, but it was recognised that the biggest question was how to sell it. We were talking to internal auditors about prudential returns and management information. The question of Section 39 was more difficult. The idea of the auditors talking directly to the supervisors, without the banks present, caused considerable worry among the banks. It also raised the question of who pays for the auditors - who the client was.

Mr Page said that IT was the key to many of the changes. At present S&S had a poor IT function. The new Head of Operations would be the key to making more and better use of IT within the area. He would be a Head of Division, equal in status to the others.

Sir John Hall asked about the timing of the changes. The Deputy Governor said that the new top structure could be put in place quite quickly, perhaps by the summer/autumn. IT changes might take 12 months or so to get settled. The risk model could be quickly introduced, but would take a good two years to roll out fully. Wider changes among the staff might take the same length of time.

Sir David Scholey said that next time Court considered the Review, it would be helpful to be offered a backwards as well as a forwards look, so that Directors could consider the differences between where supervision was before the process started - in the days of BSD - and where we planned to be. It was still not clear to him how wide the gap was. The Governor accepted this idea, but noted that it would be easier for some aspects of the proposals than for others.

The Executive Report

The Governor advised Court that last March, a booklet entitled "A Guide for Divisional Administration" had been issued to senior managers in the Bank. It demonstrated how authority and responsibility for administrative matters cascaded down through the Bank from the Court of Directors. He added that it contributed to the overall internal control framework for the Bank's operations and underpinned the arrangements for the Bank's corporate governance. The existence of the "Guide" was being drawn to Court's attention as its contents sat side-by-side with internal regulations and hence fell within the scope of "Matters reserved to Court".

[redacted]

[redacted]

Howard J. Davies

[illegible] Secretary 15/5/96.

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 8 MAY 1996

Present:
Mr George, Governor
Mr Foot
Mr Kent
Sir Jeremy Morse
Mr Plenderleith

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

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

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

Howard J. Davies   Chairman 15/5/96.

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 15 MAY 1996

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Mr Foot
Sir John Hall
Mrs Heaton
Mr Kent
Sir Chips Keswick
Mr King
Ms Masters
Sir Jeremy Morse
Mr Neill
Mr Plenderleith
Sir David Scholey
Mr Simms
Sir David Simon
Sir Colin Southgate

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

Inflation Report Discussion and Market Charts (Ms Kelly in attendance)

Mr King said that the Bank's May inflation projection had changed little from February's. Over the next year, inflation was expected to fall to below 2 1/2%, before starting to rise in the second half of 1997 and into 1998. In the February Report, two downside risks had been identified for the short term: de-stocking, and exports. The first had not materialised; and although the second had, the rate of growth of total output in the first quarter was only marginally below trend. The short-term downside risks remained, but looked less serious, and would gradually drop out of the picture. The projection now went out to the second quarter of 1998, where the risks remained on the upside. Were official interest rates to remain unchanged at 6% through the next two years, the Report saw it as marginally more likely than not that inflation would be above 2 1/2% at the end of the period. This view was reinforced by the trend of broad money. The source of demand growth was likely to shift from exports to consumption. But how soon it would be necessary for monetary policy to respond depended on how the short-term downside risks evolved. Mr King noted that interest rate expectations were likely to exert their own influence, even in the absence of official policy action.

Mr King also drew attention to the publication of the Quarterly Summary of the Agents' Reports, which had been included with the Inflation Report for the first time.

Mr Plenderleith, commenting on the market charts, said that the pound had risen against the mark recently, but not much in terms of the ERI. Short-term interest rates in Germany and France had been softening gradually, but bond yields had been adjusting, and now showed a steeper yield curve in both countries. Mr King noted that at the 10-year horizon, UK and German rates were close, and substantially above those in the United States.

Sir John Hall, commenting on the Report and on the general stance of policy, wondered how the authorities were going to be able to tackle long-term structural unemployment if every time a sector strengthened monetary policy clamped down on it. He could not see what hope monetary policy was offering, for example, to the unemployed in the inner cities. Mr King said that monetary policy alone could not offer a solution. Monetary policy could only work by pumping up demand, and what was required to deal with unemployment was structural policies. The Governor said that this went to the heart of the debate on monetary policy that had taken place over the past decade. Historically, governments had yielded to the temptation to pump up demand, and had then had to clamp down. What lay behind the new monetary framework was a belief that the consistent application of policies directed to monetary stability would create the environment in which the economy could grow in a sustained way. This was not just theory. We had stuck to the monetary targets, and we had seen unemployment fall from 10 1/2% to 8%. This, over the past 3 1/2 years, showed that limiting inflation and fighting unemployment were not incompatible. We could also point to the fact that by persevering, we had been able to go through an interest rate cycle without huge swings.

Sir John Hall still felt that monetary policy displayed little flexibility: the perception was that any sign of growth would be immediately jumped upon. The Governor said that policy was concerned with the means, not the ends. We were clear that the objective was to promote growth and employment; the means were through stability. Sir Jeremy Morse, while fully supporting this view, said that it would not gain widespread support among the population - perhaps 10%. The problem was that while monetary policy was performing exactly as it should, there was no person or agency able to deliver the structural policies needed to address unemployment directly. The Governor thought that one reason was that those problems were in fact a lot more difficult than macro-economic management. There was an active debate, contrasting the US model (labour market flexibility, but poverty in work) with the European model (strong social policies, but huge unemployment) - people were looking for the point between. It was likely to be a feature of the discussion with the President of France later that day. He agreed that among the population at large, perhaps only 10% would support our view of monetary policy - but it was accepted by influential people, including both opposition parties.

The Deputy Governor felt that there might be wider support, as well. His experience on the Rowntree Inquiry into poverty had shown little pressure for change in the stance of monetary policy. The main interest had been in the composition of public spending: the Social Security budget was seen as excessively biased towards picking up the consequences of failure, and not enough directed to infrastructure and training for the future. And that latter theme was the main focus currently of the "poverty lobby".

Sir David Simon said that we needed to find means of coping with structural change. At the macro level we tended to think in terms of large units, and we did not have the capacity to direct employment into small units - but it was those units which were capable of creating employment; larger economic units were in decline. The Governor agreed, and said that this was why the Bank had placed such an emphasis on work for small firms.

Mr Neill commented that jobs were created by competitiveness, which meant turning ideas into products more quickly, cheaply and better than anyone else. We needed to persuade businesses to accept lower hurdle rates for new investment, recognising that inflation was now low. The other key issue was training, at all levels. The UK ranked very low in this respect. He supported what the Bank had been trying to do: he believed that it was possible to have low inflation with high growth if companies cut costs sharply and persistently.

Turning to the immediate economic conjuncture, Mr Simms said that construction was still weak, and the housing market was not picking up. Mr Neill said that the car industry had recently strengthened surprisingly across the board. In April and early May, sales figures had been very strong. Sir Colin Southgate said that the retail sector was strong, especially in entertainment, and Sir David Simon confirmed that the energy sector was still strengthening. The Governor asked whether the picture painted by the Inflation Report, of a pause, followed by further growth, was plausible. Members generally felt that it was, though Sir David Scholey felt that against a background of strong money growth and rising costs, it might be seen as on the optimistic side. Mr Simms commented that in the construction sector there remained strong cost pressure and some likelihood that prices would rise. Sir John Hall agreed.

Mr King said that in the short run there were two risks: if the downturn on the Continent became too prolonged, then there would be pressure on monetary policy to adjust; on the opposite side, inflation was still above 2 1/2% but only forecast to fall below it; it would be nice to see it actually fall below 2 1/2% before it started to rise.

Report and Accounts of the Bank for the year ended 29 February 1996 (Mr Midgley in attendance)

The Deputy Governor said that the Report and Accounts incorporated the minor presentational amendments mentioned at Court on 1 May, together with other changes listed. With reference to a Minute of 1 May, the Deputy Governor again drew Court's attention to the various points in the accounts where Directors gave a specific opinion. Court confirmed that they were content to be associated with those statements. The Deputy Governor confirmed that the final dividend of £40,902,000 was acceptable to the Treasury.

He added that a copy of a letter from Coopers & Lybrand was in folders and it confirmed that they knew of no reason why the Letter of Representation should not be given. Court agreed that the Letter should be signed by the Deputy Governor and Mr Midgley.

Court gave APPROVAL for the Accounts to be signed and for the Annual Report and Accounts for the year ended 29 February 1996 to be published.

The Deputy Governor reported that, pursuant to Section 1(4) of the Bank of England Act, 1946, a further payment in lieu of dividend, of £40,902,000 would fall due to HM Treasury on 4 October 1996, bringing the total payment in lieu of dividend for the year to 29 February 1996 to £87,952,000. Court APPROVED thereto.

Banking Act Report for 1995/96, and a Resolution

Mr Foot presented the Banking Act Annual Report and outlined the changes made since the draft seen by Court on 1 May. Court noted the Report.

With reference to Minutes of 13 July 1989, 4 February 1993, 16 June 1994 and 20 September 1995, Court noted the names of those to whom the Bank's powers under the Banking Act 1987, the Financial Services Act 1986 and the Financial Markets and Insolvency (Money Markets) Regulations 1995 had been delegated, together with details of the exercise of those delegated powers.

Mr Foot advised Court that because of recent administrative changes in the Bank and recent additions to the supervisory legislation, the Bank had decided to produce an omnibus resolution covering all the powers given by supervisory legislation and their delegation collectively to the Bank's Executive.

It was RESOLVED that with immediate effect:-

1 Each of the persons for the time being holding the following positions, namely:

- Governor, Deputy Governor or Executive Director
- Deputy Director, Supervision & Surveillance
- Head of each constituent Division of Supervision & Surveillance
- Head of Regulatory & Supervisory Policy Division

be authorised to exercise severally on behalf of the Bank any and all of the powers, duties and functions conferred on or vested in the Bank by or under the following enactments, namely:

- The Banking Acts 1979 and 1987 and any secondary enactments made thereunder
- The Banking Co-ordination (Second Council Directive) Regulations 1992

- The Credit Institutions (Protection of Depositors) Regulations 1995
- The Buildings Societies Act 1986 and any secondary enactments made thereunder

and, in addition, be severally authorised to prosecute on behalf of the Bank any proceedings for criminal offences, where such offences arise under any enactment other than those specified in this clause or under the common law.

2 Each of the persons for the time being holding the following positions, namely:

- Governor, Deputy Governor or Executive Director
- Deputy Director, Supervision & Surveillance
- Head of Wholesale Markets Supervision Division

be authorised to exercise severally on behalf of the Bank any and all of the powers, duties and functions conferred on or vested in the Bank by or under the following enactments, namely:

- The Financial Services Act 1986 and any secondary enactments made thereunder
- The Investment Services Regulations 1995

and, in addition, any and all powers, duties and functions of the Bank is respect of the supervision of institutions conducting business in the gilt-edged markets.

3 Each of the persons for the time being holding the following positions, namely:

- Governor, Deputy Governor or Executive Director
- Deputy Director, Supervision & Surveillance
- Head of Wholesale Markets Supervision Division

be authorised to exercise severally on behalf of the Bank any and all of the powers, duties and functions conferred on or vested in the Bank by or under the following enactments, namely:

- The Financial Markets and Insolvency (Money Market) Regulations 1995
- The Bank's Conditions for Admission to the list maintained by the Bank in accordance with section 171 of the Companies Act 1989, as made in August 1995.

4 Each of the persons authorised by clauses 1-3 of this Resolution to exercise on behalf of the Bank the powers, duties and functions therein referred to be authorised on behalf of the Bank to do anything and to execute any document (including without limitation the giving of evidence by affidavit or otherwise in connection with any proceedings) which might appear to him to be necessary or expedient for the purposes of any matter arising under, as a result of, or in connection with the exercise of any such power, duty or function.

5 The authorities conferred by clauses 1-4 of this Resolution on the several persons therein referred to include the power further to delegate, at his sole discretion and on such terms as he thinks fit, such authority to any officer, servant or agent of the Bank.

6 The positions referred to in clauses 1-3 of this Resolution include successor positions to such positions, and references in any of those clauses to any Act, secondary enactment, Regulation or Condition shall be deemed to apply to any such Act, secondary enactment, Regulation or Condition as amended, modified or varied from time to time and to any subsequent related Act, secondary enactment, Regulation or Condition.

7 The Governor, Deputy Governor or Executive Director shall make a report to Court once a year on the exercise of the powers, duties and functions specified therein.

8 The authorities conferred by clauses 1-5 of this Resolution shall with immediate effect supersede and replace any and all previous authorisations in relation to the same matters, without prejudice to anything done pursuant to any such

previous authorisations prior to the passing of this Resolution.

Deposit Protection Board Report and Accounts

Introducing the Annual Report and Accounts of the Deposit Protection Board, Mr Foot said that in future years an attempt would be made to improve the design and presentation. Court noted the Report.

A Report of the Trustees of the Court Pension Scheme

The Governor, having declared his potential interest in the Court Pension Scheme, together with those of the Deputy Governor and Messrs King, Kent, Plenderleith and Foot, invited Sir Colin Southgate, the Chairman of the Trustees of the Court Pension Scheme, to introduce his report which contained the following recommendations:-

(a) the annual pensions in payment to former Governors and Executive Directors and allowances to the widows of former Members of Court be increased, with effect from 1 July 1996, by the amount of the increase in the Retail Prices Index for the twelve months ended 31 May 1996.

(b) similar increases be granted from 1 July 1996 to:

(i) the ex-gratia allowances payable to Lord Richardson, Sir George Blunden and Lord Kingsdown;

(ii) the ex-gratia payments awarded to widows of former Members of Court who retired prior to 1978 and whose allowances were based on their husbands' pensions net of commutation;

[redacted]

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

Court APPROVED the recommendations.

The Executive Report

Regional Investment Fund in the North East (RIFNE)

Mr Kent advised Members that the Bank's Agent at Newcastle had been invited to join the Supervisory Board of the RIFNE and he drew attention to the paper which had been circulated the previous week setting out the details of the proposed appointment. He said that the case for the Bank becoming involved was (a) that the Board was advisory, not decision-making; (b) that the Bank would be in good company; and (c) that it would help the Bank's people in the regions following the Branch closures. The risk was that a debacle, financial or managerial, would damage the Bank's reputation; and while the earlier involvement in Liverpool (Court Minute of 16 November 1994) had not been seen as creating a precedent, this one might.

Sir David Scholey agreed that it would create a precedent, but felt that it was quite a welcome one. Sir John Hall noted that the fund would be supporting speculative ventures which could not obtain bank finance on normal terms. Ms Masters said that there were bound to be mistakes made, and there was a reputational risk for the Bank. The Agent would have to understand this, and ensure that he gave the closest attention to the corporate governance issues. Sir Jeremy Morse said that the other risk was general financial underperformance. Court should hear from time to time how this and other similar projects were developing. Sir Colin Southgate said that while recognising the risks, we should go ahead.

Court APPROVED the appointment, subject to receiving regular progress reports. Court accepted that this decision would create a precedent for other cases.

BCCI

With reference to a Minute of 17 April, Mr Foot commented on the recent judgement in the Bank's favour in the BCCI case. The Judge had confirmed his provisional conclusions, handed down on 1 April, in which he had held that the liquidators' claim did not contain the allegations necessary to meet his definition of the tort of misfeasance in public office. However he left the way open for the liquidators to ask for permission to change the statement of claim yet again. The Bank would object on two grounds: the liquidators had failed to identify which Bank officials knew of the probability of loss at the time of each alleged act of misfeasance, and that there was no factual basis for alleging that the Bank or its officials knew that depositors would probably suffer losses. The Bank would say that the claim was for these reasons "frivolous and vexatious". It was for the liquidators to take the next step.

TSC Hearing

The Governor reported on his recent appearance before the Treasury Select Committee on EMU. He had taken the opportunity of the appearance to put in a paper and to discuss the Bank's approach to transitional arrangements. We had subsequently published the paper. It argued that there would be big changes if the UK did join a monetary union, and that would impact on the retail sector. But we could not know this until the early part of 1998 - and that would give time enough to make the necessary preparations. At that stage there would need to be a huge effort, involving the Government. But there was no point in doing that now. Our immediate focus, therefore, was at the wholesale level, which would be required whether or not we were a member of the monetary union, for London would need to operate in Euro either way. We had been having discussions with banks and markets about the actions that needed to be taken - they were not huge, and did not require a significant investment either, but we needed to be sure that what had to be done was being done. We would be continuing contacts with all those concerned on the basis of the paper.

Supervision Report
(i) Building Society Conversions
(ii) European Banks: international ambitions
(Mrs Sergeant and Messrs Ryan and Raikes in attendance)

[redacted]

Mr Ryan said that over a long perspective the number of Societies had fallen steadily, and the sector had become concentrated with the largest twenty societies now accounting for 94% of assets. The societies' business was still concentrated in the traditional sectors, with funding coming largely from members, and lending going largely on mortgages. The 1986 Act had given the societies an option to convert, but initially only Abbey had exercised it, becoming a bank in 1989. It was surprising that no others had followed at that stage. It was possible that they had decided to capitalise on the better public image that they enjoyed, as compared with banks. But the watershed event had been the acquisition by Lloyds in 1994 of the Cheltenham & Gloucester, which had put the focus on how members could realise the reserves in the societies. The Halifax/Leeds merger had taken this forward, and cast doubt on the viability of the rest of the sector. Eight of the eleven major societies either were converting or had plans to do so. The Halifax/Leeds merger would create a bank between the Abbey National and Royal Bank of Scotland in size.

The conversions raised some non-prudential issues for the Bank, including the prospect of extra income from cash ratio deposits (assuming the cash ratio percentage was not varied); monetary policy implications from the windfalls going to building society members; statistical implications; and implications for the markets of the building societies entering a different liquidity policy regime - the Bank's liquidity standards were more exacting with respect of the type of liquidity to be held. It might also have an effect on capital raising, as societies would need to raise capital to cover priority distribution rights.

Mrs Sergeant noted that within S&S, the inward migration of building societies was being handled within existing resources, and was being spread among a number of senior managers and analysts, partly because of the timetable, and partly to ensure that the societies were integrated with the banking supervisory process, and not treated as a separate group. The Bank had hired a mortgage expert to do on-site visits, and had had substantial help from the Building Societies Commission. The Bank was organising a college of regulators in July to explain the process to other regulators and seek their views. In general, the societies would be supervised like clearing banks, although we had yet to form final views on the appropriate capital ratios. There was inevitably the risk that as the societies gained new freedoms, they would embark on ambitious expansion plans, though in general, societies' business plans showed them sticking to the business they knew best. We would be focusing particularly on their treasury areas, which were relatively unsophisticated, and on any unsecured lending. The raising of priority liquidation capital would, in the short term, place a damper on excessively expansionist ambitions.

Mr Foot noted that in the period since the Abbey had converted it had overtaken the Halifax, though this was partly because of the growth of their treasury operations in US Dollars. An important consequence of the migration of the big societies to the Bank would be that the Building Societies Commission would be left with a rump of small societies. Traditionally, the smaller societies had not failed, as even in the worst cases the large societies had been prevailed upon to bail them out. That option would no longer be available to the Commission.

Ms Masters asked whether the Building Societies Commission in the long run would be seen as unviable, and whether that would lead to pressure for all the societies to come into the Bank. Mr Foot said that it could do so, but that without a change in the law the societies and the banks would be operating under different regimes, which would create significant operational difficulties for the supervisors.

Sir David Scholey felt that the Bank was not sufficiently concerned about the depth of building society management. There was a long history of institutions changing form and making dramatic misjudgments. Mrs Sergeant said that the Bank was certainly not complacent about that. But from what the societies had told us about their intentions and plans, we felt they had perfectly adequate management. Clearly if they started moving rapidly into new ventures we would be concerned. Only the Halifax had said that they wanted to take on more corporate lending. The Northern Rock was quite clear that it wished to be in exactly the same business in the long run.

Sir Chips Keswick felt that the Bank was remorselessly driving everyone into borrowing short and lending long, and that we would need to have a very clear liability and liquidity strategy for the societies. Sir Colin Southgate asked how the Bank had been able to form a view of building society management. Mrs Sergeant said that we had had a number of meetings and visits, that we had seen external accountants' reports, and that we had taken the views of the Building Societies Commission. We were still learning about them, but had found at least some building society managers to be very impressive. Mr Foot said that while the original Abbey National management had been competent but limited, Cheltenham & Gloucester had put together a very powerful management team, and Mrs Sergeant added that the Cheltenham & Gloucester management had had a significant beneficial effect on Lloyds.

The Deputy Governor noted that the migration of the building societies would, as Mr Ryan had said, increase our income, and also increase the demand for our services - but not our ability to respond, because the paybill constraint would remain the same. At some point the Bank would need to discuss possible paybill transfers from the Building Societies Commission to us. And we might need to come to Court for support. Sir Colin Southgate suggested that a bid should be made to the Treasury now: the Deputy Governor said that some discussions were already taking place.

Sir David Simon asked about the quality of the dialogue between the parties involved - Government, Commission and Bank. Mrs Sergeant said that the dialogue with the Commission (Terry Mathews in particular) had been excellent, and we had had enormous co-operation.

The paper on European banks was held over to another meeting.

Howard J. Davies

Jim Footman
Secretary
19/6/96

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 22 MAY 1996

Present

Mr George, Governor

Mr Foot

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.

[illegible]

[illegible]

[illegible] 19/6/96

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 29 MAY 1996

Present
Mr George, Governor
Mr Davies, Deputy Governor
Mr Foot
Mr King
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 reported that the gilt auction held that morning had been successful.

Howard J. Davies

Secretary 12/6/96

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 5 JUNE 1996

Present

Mr George, Governor

Mr Davies, Deputy Governor

Mr Foot

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 reported briefly on the markets and the Official Reserves figures for May.

Secretary

19/6/96

MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 12 JUNE 1996

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

12/6/96

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 19 JUNE 1996

Present:

Mr George, Governor
Mr Davies, Deputy Governor
Sir David Cooksey
Mr Foot
Sir John Hall
Mrs Heaton
Mr Kent
Sir Chips Keswick
Sir David Lees
Dame Sheila Masters
Sir Jeremy Morse
Mr Neill
Mr Plenderleith
Mr Simms
Sir David Simon
Sir Colin Southgate

Court congratulated Dame Sheila Masters DBE on her recent honour in the Queen's Birthday Honours and the Governor drew Court's attention to the CBE for services to banking awarded to Mr Quinn, Mr Foot's predecessor.

The Minutes of the Court of 15 May and the Meetings of 22 and 29 May and 5 and 12 June, having been circulated, were approved.

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

Mr Allen said that our assessment had not changed significantly since the Inflation Report in May. RPI inflation had fallen sharply since the Autumn, but this had been mainly because of movements in mortgage interest rates. Measured by RPIX or RPIY, the rate of inflation had been steadier, though on both these measures it decreased in the latest month. Measures of inflation including house prices had been picking up slightly. Meat prices had risen by 2.7% in April following the BSE scare, but there was no exceptional price change at the aggregate level in May.

Broad money growth appeared to have stopped accelerating, and to have stabilised at around 10% a year. There were some signs of slower retail deposit growth in April. On the lending side, unsecured personal credit had been growing fast, while mortgage lending was up only 4% on the year (though lending commitments had increased in April). The PSBR, excluding privatisations, totalled £7.9bn in the first two months of the financial year, slightly more than in the first two months of the previous year.

Latest estimates showed a rise in GDP of 0.4% in the first quarter, and of 2% in the year to the first quarter. Consumer spending had been strong, and all the surveys had been pointing to continued retail strength. However that morning's retail sales figure, showing a fall of 0.1% and downward revisions for March and April, had come as a surprise. Stocks had continued to accumulate in the first quarter, and the stock output ratio had risen further. The Agents, however, did not think that excessive stocks were a widespread problem among their contacts.

Unemployment had continued to fall, despite the transfer of former claimants of incapacity benefit to the unemployment register. Surveys suggested a generally rising level of employment, though these indicators might give an exaggerated impression of the tightening of the labour market. Wage settlements had continued to be mainly in the 3%-4% range.

On balance, we had no strong grounds for revising the assessment made for the May Inflation Report. RPIX had turned out a bit higher than we expected, because of the levels at which Council Tax had been set. The rise in stocks in the first quarter was larger than expected, so that in the near term the downside risk to activity was a little greater. There was no reason to change our view of demand in Germany or France. Nor was there any reason to change our judgement about the upside risks arising from domestic demand growth, particularly consumer demand, over the medium term. Even before the 1/4% interest rate cut, announced on 6 June, we had judged that we were marginally more likely than not to be above the inflation target in two years' time.

Commenting on the market charts, Mr Plenderleith said that the rate cut of two weeks ago had surprised the market. The earlier strengthening of the pound had ceased - it had since fallen slightly. There remained in the market a strong expectation that rates would have to rise quite steeply before the end of the year. The differential between UK bonds on the one hand, and German and French bonds on the other, remained at historic highs.

The Governor said that the issues remained very clear. We did not see any immediate inflationary pressures, but we had to balance that against the upside risk to inflation in the longer term. The retail figures published that morning seemed inconsistent with all the other retail evidence that we have seen. Sir David Simon commented that gasoline demand remained very strong, with activity on the roads evidently much higher than a year ago. Mr Simms said that in the construction industry, by contrast, industrial and commercial orders were poor, and although housing starts were up they were down substantially on a year ago. Nevertheless there was a prospect of some lottery schemes feeding through. Sir John Hall said that the impact of the lottery on construction would grow very rapidly over the next year. The Millennium Commission had allocated £300-£400mn for projects over the next year. Mr Neill said that the automotive sector was very strong, with demand from both fleet and retail buyers. Along with Sir David

Lees, Mr Neill commented that the UK's productivity performance was disappointing.

The Governor commented that the divergence in the economy was not just between the household and the manufacturing sector - there were distinctions within the household sector as well. Demand was difficult to read, and it was a relief that we were able to move in quarters - it was hard to do too much damage (unless you did too many quarters!). Sir Jeremy Morse asked if there had been a change in expectations about the policy up to and through an election period. The Governor commented that the Chancellor saw the Bank's caution on rates as based on a view that he would not be ready to raise interest rates if the need arose; he disputed this. Mrs Heaton asked whether the Chancellor would be able to sustain this view with colleagues: the Governor commented that the transparency of the arrangements was a real constraint not just on the Chancellor, but also on the Government as a whole.

The Future of Financial Regulation in the UK and the Bank's Role (Mr Clark and Mrs Jackson in attendance)

In introducing the paper addressing the future of financial regulation, Mr Kent said that change was inevitable, and that it was more likely to be of a structural than a philosophical kind. It was important to ensure that the Bank's voice was heard. The SIB had now become a mature regulator, and could claim parity of status with the Bank. We would need to continue to co-operate with the SIB. In the structure envisaged by the paper, we might finish up with three Agencies, one for deposit taking institutions, one for conduct of business regulation, and one, more specialised, for insurance. Mrs Jackson added that the interest of the Bank seemed to be in developing the partnership with the SIB in supervisory issues, and in participating in international supervisory initiatives regarding oversight of global groups.

Sir Chips Keswick expressed concern about the prospect of a new Financial Services Act. The Governor said that we were more likely to be dealing with changes to organisations, rather than changes to the substance of regulation: though Mr Clark added that, with new legislation, there would always be temptations to adapt policy.

Sir Jeremy Morse said that he had opposed the two-tier system at the outset, but was attracted to the three area solution. But it was clear that there would need to be very strong links between them, with intense co-operation and sharing of information. He noted the papers reference to various bodies other than the Bank having "ambitions" - especially the Treasury. It was not clear that the Bank had any and he wondered if it should. Sir David Lees said that he was not clear about our final position on the supervision of building societies. He wondered if there needed to be a fourth area, covering the mutuals, or whether we intended to pick up the non-converting societies ourselves. Mr Kent said that the logic pointed to their being swept into our area, but recognised that there might be political resistance, leading to delay. Sir Jeremy Morse wondered whether we really wanted that. The Governor thought that the change would not happen in a comprehensive way, all at once. It would probably start with securities regulation. In that context, the issue for us was whether we should try to have any new Financial Services Bill extended to include the banking side. On the building societies, we were talking about a small rump. Mrs Heaton said that most of the large building societies were converting themselves: but monitoring the tail could be a problem unless they were joined with the Friendly Societies, under the Registrar.

On the FSA generally, Mrs Heaton felt that the key structural issue was the extent of practitioner involvement. She was doubtful about the three-area approach, with HMT inevitably positioned at the apex. This would give HMT more to do, and create conflicts. She would prefer a single body, which would involve more authority being delegated down from HMT.

Sir David Cooksey said that he shared the worries about putting HMT at the apex of the structure. HMT had a natural tendency to meddle. He was also concerned that a new Financial Services Act might create further regulatory costs for smaller operators, leading to further concentration and lack of choice.

The Governor said that in any system one would have to have somebody responsible for the legislative framework. We saw advantage in there being only one. It was not clear how it could be anything other than a branch of government. Sir David Cooksey felt that the Treasury might be acceptable if they could be counted on to restrict themselves to legislation, but that was not their nature. Sir Colin Southgate, on the other hand, felt that HMT were now displaying a willingness to be more flexible. The Deputy Governor shared Sir David Cooksey's concern about the Treasury's culture. Their prime focus ought to be on legislation, but they had in fact done this very badly. Instead they had chosen to meddle in the detail of supervision, partly to find out what was going on.

Sir David Simon said that the debate had highlighted the difficulty of finding a balance between acceptable political accountability and the highest self-regulatory standards. The only defence against poor legislation was the ability of self-regulatory bodies to instill confidence in their operations. Under any structure they would need to display professionalism and inspire trust. Dame Sheila Masters said that we needed to demonstrate that the three-way structure would be capable of dealing with all criticisms that had been made of supervision up till now, including the difficulties of international co-operation.

The Governor noted that no-one had yet suggested that financial institutions had become so homogenous as to make the three-area separation unrealistic. It remained his view that for the moment the three were sufficiently separate to be regulated in different ways. Mrs Heaton re-iterated her view that it would be better to have a single regulator than three regulators reporting to HMT: Sir Jeremy Morse said that if there were to be three they should form a college that did not involve HMT. Mr Foot said that the Bank would have a lot to bring to such an arrangement, given that we would in effect be the lead regulator for many if not most of the major institutional groups, and that we were far ahead of other supervisors in co-operation with overseas bodies.

Appointments to the SIB and Board of Banking Supervision

The Governor said that we had been giving some thought to the relationship between the Bank and the SIB, and specifically to the relationship between the Board of Banking Supervision and the SIB. He had explored with Sir Andrew Large the possibility of cross-over appointments, and had found him enthusiastic, though his Board more hesitant. We were now working on a proposal under which Sir Andrew Large would become a member of the Board of Banking Supervision, and the Deputy Governor a Non-Executive member of the Securities Investment Board. We had also given some thought to the relationship between Court and BoBS, following the discussions last year, and proposed that Sir David Scholey be appointed an independent member of the Board of Banking Supervision while remaining on Court. This had been mentioned to the Board, who had had some misgivings, perhaps sensing that a "Court watchdog" was being appointed; but ultimately he felt that the proposal would be accepted.

Sir David Lees felt that this was an entirely legitimate move. Court had been uncomfortable about the purely advisory role of BoBS, and the fact that Court retained ultimate responsibility for supervision; inclusion of a member of Court on BoBS would be extremely helpful. Sir Jeremy Morse wondered whether in these circumstances the annual joint meeting with BoBS needed to take place in the present form and Sir Colin Southgate wondered whether Sir David Scholey, when unable to attend BoBS, should have an alternate from the Court. The Governor said that alternates were not provided for in the BoBS statute. Court endorsed the proposals.

The Future of Gilts Registration (Mr Sparkes in attendance)

Introducing the paper, Mr Kent said that we had concluded six months ago that the choice for Registrar's was to cut costs dramatically or die. The proposal contained in the paper was to cut the cost of Registrar's from £12mn to £5mn pa, implying a reduction from £13.50 per account to £5.75 - or lower still if Head Office costs were taken out. The costs of the restructuring would be about £9mn; the cost of closing Registrar's completely would be of the order of £12mn.

Mr Sparkes said that the proposals reflected a joint exercise with consultants, aimed at streamlining what Registrar's did as well as how they did it. The aim was to move to multi-skilled rather than functional teams. The main cost, apart from severance payment, would be in IT systems which would enable staff to deal with all accounts for a specific holder at the same time - work would also be dealt with by one individual rather than being passed from one section to another. Re-engineering Registrar's in this way would lead to substantial reductions in staff - from around 280 to around 120. All of the staff in Gloucester were aware of the proposals, and were awaiting a conclusion. Inevitably morale had been affected. The proposed cuts in staff would leave Registrar's with an excessively large building, and a need to find new premises. Registrar's management and staff believed that the proposed changes would work. The possibility of amalgamation of Registrar's functions with the other gilt registrars - NSSR and the Irish Register - should be part of the proposal, which also had to take into account the possible changes in Gilts Systems which could in time reduce further the Registrar's workload.

Mr Neill asked whether the possibilities of either selling Registrar's to another provider, or organising a management buyout had been considered. The Deputy Governor said that we had talked to Barclays and to several of the converting building societies, without success. Other registrars would not be interested in taking Gloucester over - though they might of course tender for the business on a pure contract basis. Sir Chips Keswick said that Gloucester provided a very high-quality service to stockholders - a service which stockholders were entitled to, given the deceptions practised on them by governments over the years. We had an obligation to look after the staff involved in providing this service.

Sir Colin Southgate asked whether forms of Facilities Management had been considered. Mr Sparkes said that the slimmed down organisation would need to consider putting out a lot of functions to FM, but facilities managing the entire function had not been considered in detail.

Sir Jeremy Morse said that Gloucester had always been recognised as more costly than other registrars, but this was the price paid for a better standard of service. He wondered whether, under the new arrangements, the standard of service would remain the same or improve. Mr Sparkes felt that it might be improved by more flexible working. Sir Jeremy Morse commented that in that case the massive reduction in staff proposed would inevitably raise the question of why this had not been done before. Sir Colin Southgate felt that a cut from £13 per account to £5 per account would certainly inspire HMT to raise questions about past performance.

Sir David Lees noted that the paper offered only one option. The Treasury would have others: one, for them, being to give the whole job to an outside contractor. We would have to show the Treasury why this would not be right. Sir Colin Southgate asked what Lloyds would be likely to bid for the contract. Mr Sparkes said possibly between £2-£4 per account, so the Bank's bid was still a little above the going rate.

Mr Neill wondered what would happen at the end of the five year period of the contract: would Registrar's by then be a good viable business or not? Mr Kent said, given market changes, there might be no business - this was one of the uncertainties. Mr Neill asked again about a management buyout. If Registrar's were given a five year contract for the Government Stock registry business but were at the same time freed to try to take on other things, then at least the staff would have some control of their destiny.

Dame Sheila Masters agreed that there was a problem in an extensive restructuring to create a business that was itself likely to become unviable. She had not yet heard the arguments for our retaining it. Mr Plenderleith said that they were set out briefly in paragraph 17 of the paper: the quality of the service provided, and the need to provide continuity during a period of large change in the market and in the CGO system. The functional changes brought about by CGO2 would create new roles for nominees, and it was conceivable that the Department could compete for those. We had to persuade the Government that they could get a better deal by allowing us to manage the complexities of the evolving gilt registration market rather than simply quitting it.

The Governor stressed that we were not taking the decision for the Treasury. The question for us was whether we put this approach to the Treasury, deploying the argument set out in paragraph 17. The concerns expressed by Members of Court seemed more to do with the strength with which those arguments were presented: but that was a matter for the paper to the Treasury. The Deputy Governor said that the essence of our case was that there were heavy uncertainties in the gilts registration business and, given all those uncertainties, it was reasonable for us to try to manage the process actively while substantially cutting our costs at the same time. Sir Jeremy Morse said that he would strongly support the proposals on that basis.

Sir David Cooksey asked about quality benchmarking: what was the Department's error rate? Mr Sparkes said that the consultants had had great difficulty in finding out the error rates of other registrars.

Sir David Cooksey also asked about the implication for the Bank's paybill ceiling: the Deputy Governor said that this was for negotiation with the Treasury; there was no automatic presumption that the ceiling would either be cut pro tanto or would be maintained and thus create headroom.

Sir David Simon said that the case we were making was essentially one of efficiency versus service. It was perfectly legitimate to make that distinction particularly in a period of transition. His only concern was that we should make the case better. Mr Neill said that we must also, at the same time, give more thought to what would happen after the five-year contract, and he strongly felt that some form of MBO should be considered as a fall-back option.

Court endorsed the paper as a basis for an approach to HM Treasury.

The Bank's Treasury Management Policies

This paper was held over to a future Court in view of lack of time.

Staff Appointments

The Deputy Governor reminded Members that at Court on 1 May, he had advised them that Roy Lecky-Thompson, the Staff Director, would be leaving the Bank at the end of June. Merlyn Lowther would be taking his place and that Members would be informed of consequential staff changes. He said that Merlyn Lowther's position as Head of Market Services Division and Deputy Chief Cashier would be taken by Mike Phillips who is currently the Bank's Auditor, and it was proposed that his position should be taken by Kevin Butler who was, until recently, the Bank's Agent in Birmingham.

Court APPROVED Kevin Butler's appointment as Auditor.

The Deputy Governor said that Roy Lecky-Thompson, in his post as Staff Director, had undertaken a number of responsibilities which had been formally approved by Court and these now needed to be transferred to Merlyn Lowther.

He recommended that with effect from 1 July 1996 when Ms M V Lowther takes up her appointment as Personnel Director of the Bank, MS M V LOWTHER shall become a Trustee of the Bank of England Staff Pension Fund in place of MR R D T LECKY-THOMPSON.

Court APPROVED the Recommendation.

The Deputy Governor also introduced a Resolution concerning changes to the boards of two companies. It was RESOLVED that with effect from 1 July 1996 when Ms M V Lowther takes up her appointment as Personnel Director of the Bank, 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:-

(a) MS M V LOWTHER shall become a Director of BE Services Ltd in place of MR R D T LECKY-THOMPSON. The Board will then consist of Sir David Cooksey (Chairman), Mr Midgley, Mr Jarvis, Mr Watts, Mr Ironmonger, Mr Bartlett and Ms Lowther;

(b) SIR DAVID COOKSEY, or failing him, MR GORDON MIDGLEY, or failing him, MR A W JARVIS, or failing him, MR B T WATTS, or failing him, MR P W F IRONMONGER, or failing him, MR JOHN BARTLETT, or failing him, MS M V LOWTHER be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of BE Services Ltd;

(c) MS M V LOWTHER shall become a Member of the Governing Council of Business in the Community, in place of MR R D T LECKY-THOMPSON and shall be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of the Governing Council.

The Executive Report

The Governor presented the written Executive Report. He drew particular attention to item 5 on the Millennium Fund. He said that the Government had asked the Clearing Banks to contribute £12mn to finance a pavilion at the Millennium Exhibition at Greenwich. Sir Peter Levene had attended a meeting at the Bank the previous week to discuss this with the clearers, and had encountered a degree of scepticism. But subsequently the clearers had seen that they might have a collective interest in joining the exhibition, and that there might be some downside for them if they were seen to stand aside. It was now being arranged that they would attend a presentation by the exhibition organisers. The Governor felt that there might be a case for the Bank itself participating in the financing of an exhibition if it were devoted to the general theme of British banking and finance and he asked for Court's agreement in principle that if the clearing banks agreed to go forward, then the Bank of England would contribute a share, yet to be determined. This would certainly be no more than £1mn, and probably in the region of £500,000. Court agreed that a contribution along these lines would be appropriate. Sir David Simon warned that it would be important for the banks financing the pavilion to be sure that they had total control over the "editorial content" of the displays being mounted. It would be very good to have the Bank involved, as it had not been easy up to now to control the organisers.

The Governor also asked for reactions to the presentation that had preceded Court that morning, to enable us to decide whether further presentations would be helpful.

Howard J. Davies

John Footman Secretary 18/7/96

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The Written Executive Report - Court 19 June 1996

1 The Stock Exchange
Following the appointment of Gavin Casey as Chief Executive, it has been announced that Ian Plenderleith's role as Deputy Chairman will come to an end. However he will remain, as he was previously, a Director of the Exchange.

2 Fed/Bank Memorandum of Understanding
The Bank has signed a Memorandum of Understanding (MOU) with the Federal Reserve Board. This sets out formally the procedures for exchanging information in respect of material supervisory concerns. The development of formal MOUs between regulators was recommended by the Barings Report.

3 Stockholm Meeting
The Joint Basle/Offshore Group paper on the supervision of cross-border banking was unanimously endorsed by the International Conference of Banking Supervisors in Stockholm last week. The paper makes a number of recommendations for improving information flows (particularly from host to home country supervisors), for establishing a routine for home country inspections overseas and for dealing with any gaps in cross-border supervision. A follow-up survey is time-tabled for two years' time to ensure that the subject is not allowed to drift.

4 London Clearing House
The ownership and guarantee arrangement for the London Clearing House (LCH), which provides clearing services for London's futures and options exchanges (LIFFE, LME, IPE, LCE) and for Tradepoint, has been under discussion for about four years. The existing bank shareholders, who also provide LCH's default guarantee, have felt

increasingly uncomfortable with their involvement and have been looking for an acceptable way out.

As reported periodically to Court, the Bank has been involved at various points - often quite intensively - in the negotiations, mainly as an "honest broker". The Bank was also involved in the final stages of concluding the proposals which have now been published. In brief these involve a transfer of ownership to the exchanges (25% in total) and the clearing members (75% in total) and the substitution of a member-financed guarantee fund for the present facility provided by the banks.

Full details are still to be agreed but the intention is that an offering memorandum will be issued within the new few weeks, that the clearing members will be given (probably) a couple of months to decide whether they wish to subscribe for shares - there is a firm expectation that a majority will - and that the new structure should be in place in about three months' time. None of this should affect the day-to-day functioning of the LCH in its clearing role but it should mean significant cost savings for the markets.

5 <u>Millennium Exhibition</u>

The organisers of the Millennium Exhibition have asked the banking community if they would be prepared to take one of the 12 pavilions at an aggregated cost of £12mn. At a meeting in the Bank last Thursday, Sir Peter Levene outlined the idea to Chairmen of the main British banks. It was clear that they were not persuaded that it was a commercially viable project. They were more susceptible to the idea of British banking collectively being seen as a positive element in the economy (and conscious of the potential dangers if they were, on the contrary, to be seen as standing aside from presenting themselves in this way).

The idea now being considered is a pavilion to promote the collective image of the British commercial banking system rather than the interests of individual banks. The large building societies - which will then have become banks - will be invited to consider participation. There is also the question of whether the Bank itself should participate in a relatively modest way.

6 <u>Court</u>

The first 'teach-in' for Directors would be held before Court on 19 June. Feedback on whether it was successful would be appreciated before consideration is given to arranging further similar presentations.

Following the dinner on 28 May, the Governors would like to propose:

(1) To extend invitations to Non-Executive Members to visit parts of the Bank to learn more about its work. Topics that might be covered include the conduct of monetary operations (GEMMD), procedures for closing a bank (S&S), the mechanics of the Inflation Report (MAD), the London Approach (BFD), work on small firms (BFD) and some management issues - graduate training and premises management.

(2) To emphasise the Bank's regional role, a Court meeting outside London. In addition, the Governors would encourage the Non-Executives to attend occasional lunches/dinners at the Agencies, and would like to ask the Agents to extend invitations.

(3) Inclusion on the Court agenda of three sessions a year on the international economy, one of them immediately prior to the Bank/Fund annual meeting.

(4) To invite Non-Executives to attend part of the next off-site strategy meeting - planned for Spring 1997.

(5) That, on an experimental basis, a few Heads of Division be invited to sit in on Court as observers. The purposes of this would be to increase the understanding among the senior management of the Bank of the role of Court.

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 26 JUNE 1996

Present
Mr George, Governor
Mr Davies, Deputy Governor
Mr Foot
Mr Kent
Mr King

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

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

Mr King noted that the gilt auction held that morning had been successful.

Secretary

18/7/96