A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 7 JANUARY 1998

Present

Mr George, Governor

Mr Clementi, Deputy Governor

Mr Clark

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.

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21 January 1998

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A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 14 JANUARY 1997

Present

Mr George, Governor

Mr Clementi, Deputy Governor

Mr Clark

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.

21 January 1998

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 JANUARY 1998

Present:

Mr George, Governor

Mr Clementi, Deputy Governor

Mr Allsopp

Mr Buxton

Mr Clark

Mr Foot

Mrs Heaton

Sir Chips Keswick

Mr King

Sir David Lees

Dame Sheila Masters

Mr Neill

Sir David Scholey

Sir Neville Simms

Sir Colin Southgate

The Minutes of the Court of 17 December and the Meetings of 24 and 31 December and 7 and 14 January, having been circulated, were approved.

Economic and monetary discussion (Dr Julius in attendance)

Mr King, introducing the discussion, said that the main conclusion of the December minutes of the Monetary Policy Committee was that there were uncertainties in the situation and invited Court to help resolve them. These included the data on production, demand and net trade, as well as on the labour market. There were further uncertainties about the effect of the Asian crisis on growth in Europe and about the exchange rate, which had risen above DM3.0 during the week, though it had slipped back below. Mr King asked Court for its response to four questions. They were: the link between retail margins and the price of imported goods; whether the official data on output or the business surveys should be believed; whether the rise in earnings growth was temporary; and what signs were visible of the impact of the Asian crisis on demand.

Mr Buxton said the economy was slowing, but he noted the continuing strength of the service sector. Mr Neill said the car industry was sending conflicting signals. He expected the first six months to continue to be relatively strong but the second half of the year would slow. Sir Neville Simms noted that the construction industry had not changed significantly from a month earlier. It was still being driven by commercial and industrial building and was thought to be set for several years of reasonable but not fast growth. Margins were, however, stubbornly refusing to improve. Sir Colin Southgate said that in the retailing industry, there was a world-wide trend to de-stocking by retailers rather than manufacturers. Asia was posing difficulties for his business and he believed Japan would take a long time to emerge from its problems. He recommended caution on surveys on business intentions and reliance more on official figures. Sir David Lees said that his first-hand experience was that there was already a quite significant negative impact from the Asian crisis which would inevitably hit the UK and Europe, in certain sectors. He believed the first wave impact would be export related and the second wave would be import related. Sterling was having an increasingly negative impact on the manufacturing sector and he noted his previous observation that the lead times from the strengthening of sterling to the effect on manufacturing output was probably longer than many people expected. Turning to earnings, he said growth was reasonably under control, except in specific skill areas.

In response to a question from Mr Allsopp, Mr King said import margins had risen but might fall back. On the inflation front, the outturn was very sensitive to lags in unemployment and earnings. The Bank had tried very hard not to take an optimistic view of earnings growth. There was some upward pressure, but no obvious indication that it was taking off. Sir Chips Keswick noted that transparency of information did not exist east of Suez, and he cautioned the Bank to concentrate on trading performances. He also noted that De Beers, whose largest customer for rough diamonds was Japan, was expecting a drop in sales of at least $1bn from the normal $2-3bn. Demand for copper was also expected by the mining houses to drop away very rapidly. Sales of Mercedes cars in South-East Asia had never been lower. The forward rates in the shipping industry were also coming off very rapidly. He believed that current forecasts about the outlook for Asia were extremely optimistic and he recommended doubling current estimates of the impact.

Dr Julius said the Bank was working on a new analysis of the service sector. It was trying to answer questions about the extent to which the sector looked and behaved differently over a cycle to manufacturing. The focus was on the transmission mechanism in services which had resulted in higher price inflation than in manufacturing over the last ten years.

The International Economy - Financial Turmoil in East Asia (Dr Julius, Mr Drage and Ms Hammond in attendance)

Mr King noted that even six months ago the International Monetary Fund praised Korean Macro-Economic policy. He said there were three questions at issue: the nature of the crisis; how to prevent such a crisis occurring again; and the traditional economic consequences of a financial crisis. He noted that the countries involved differed among themselves, with the initial crisis in Thailand closer to a traditional exchange rate problem. Korea was at the other extreme, and was primarily a liquidity crisis. It was particularly about the country's ability to borrow at international rates and to lend to speculative domestic ventures such as property investment. If international lenders believed that the government was giving an implied guarantee to the banking system or that the Group of Ten or the IMF would bail the country out then it made sense to lend at very low interest rates, because in effect they were lending to the IMF or the G10. This was the problem of moral hazard. In the Korean case, the country ran out of dollars, and was faced with two choices: whether to go down the route of re-scheduling or whether, because of the potential risk of contagion to other countries, not just in Asia but perhaps Latin-America and possibly Eastern Europe, the international community should take action as lender of last resort. What happened in the event was an awkward combination of the two, which arguably was worse than either outcome alone. In the medium-term, the questions were how best to deal with the crisis, including whether there should be an international lender of last resort, and how to prevent future crises by finding ways of limiting moral hazard. One proposal was to include in Bond contracts clauses agreeing that the loans could be rescheduled. Mr King also noted that bank finance could be a source of instability, raising the question of whether countries should be more cautious about borrowing for investment.

Sir Chips Keswick said that one problem in Asia was borrowing without a proper convertible currency. He forecast that the next country to get into trouble on this basis would be China. The Governor noted that the countries themselves did not appreciate the extent to which foreign currency liabilities were building, and if they did they did not let the rest of the world know. The first thing needed was the data. The availability of official money should be a lever to persuade countries to make the data available. Mr Allsopp said that he was worried that the international community had been late in appreciating the impact of the Asian crisis. He asked whether the crisis had the characteristics of Mexico, which bounced very quickly, or of Japan, which after the boom in the late 1980s had hardly grown for five years. To expect only a half a percentage point impact on world growth was to expect a big bounce back fairly quickly. He pointed to the seriousness of the situation if recovery was long drawn out, especially if that were to happen in very high savings countries such as Korea. Turning to the policy response, Mr Allsopp also noted that he had not been particularly impressed by what had come out of the IMF so far.

Mr Buxton said that Japan and Korea would be able to recover, but Indonesia and Thailand were very much more difficult. He believed that the real test of international help was whether it was on commercial terms. He believed the IMF terms had been watered down because the rest of the world could not afford, in the case of Indonesia, to have an internal political crisis in the country. Mr King noted a concern that demands on the IMF were politically motivated, because there was more than a passing resemblance between what the IMF wanted on liberalisation and what the US and Japan also wanted. There was concern that the issues were politicised in both directions. That raised the difficult question of how welcome the IMF would be in future if it was seen as a vehicle for Japan and the USA to push their micro-economic agendas. Sir Colin Southgate commented for countries such as Korea, which were closed for inward investment business, there was a case for refusing to bail them out if they would not open their doors. He approved of the IMF using its leverage to force liberalisation.

Mr King commented that the reason for lending to Korea was to prevent contagion, and if this was not likely to occur, then the solution was an orderly rescheduling. The Governor noted that one of the reasons for over-investment lay with the mechanism for allocating financial resources within the economy. Addressing the workings of the financial system would not, however, tackle the immediate situation. In the medium term, nevertheless, he did not believe the IMF had a choice, because there was terrific resistance in the US to using taxpayers' money to bail out the banks, and overseas competitors of the US. Realistically, it was necessary to balance these two elements. He could envisage the IMF setting only macro-economic conditions, but that was not the present situation. Mr Foot commented that if Japan had gone to the International Monetary Fund seven years ago, one of the conditions would have been that it should take out excess capacity from the banking system. Dr Julius noted that until there was greater transparency in Korean corporate balance sheets, it was hard to get controls in place. She also warned of the risk that greater transparency at the macro-economic level could lead to something close to exchange controls, and that would be an over reaction. The Governor commented that it was difficult to think that we would be able to over-react to a crisis of this kind. Mr King noted that the Asian imbalances could lead to pressures on exchange rates, probably at a world level. The Governor commented that the imbalances in the world economy would be as difficult a problem as stabilising the financial situation and to be as significant as the problem of weak growth.

The Bank Bill and the new Charter (Messrs Footman, Berkowitz and Midgley in attendance)

With reference to a Minute of 19 November 1997, Mr Footman updated Court on the progress of the Bill and the likely timetable for its implementation. The Report stage and Third Reading would take place the following day. The Bill would then go to the Lords. The timetable was not clear, but even with introduction in the Lords late in January it was unlikely that Royal Assent would be secured in March, and the chances of the Bill coming into force by 1 April (the FSA's working assumption until recently) were increasingly small. Currently, given the Easter break, mid-May was more likely.

At the Report stage, the Government would introduce several non-contentious technical amendments. Of most interest to Court was an amendment to set the quorum of NEDCo at seven; this was an oversight in the original drafting, which had been raised in the Standing Committee. The power of NEDCo to delegate any of its functions to two or more of its members was unaffected. In addition, the Opposition had tabled a number of amendments, many of them going over ground already covered in the Standing Committee and likely, for that reason, to be ruled out of order. Giles Radice, the Chairman of the TSC, and five other members of the TSC had put down an amendment that would make Governors and MPC members subject to limited Treasury Committee confirmation procedure. This was likely to be the subject of a serious debate and a Government statement.

The Cabinet Secretary had strongly advised against introducing Select Committee oversight of public appointments in the Bank of England Bill. It would, in his view, politicise the appointment process, deter potential candidates and be a "slippery slope" leading to pressure for confirmation of other public appointments. The Government had not yet reached a view, but in the Third Reading debate, the Chief Secretary was likely to say that there were significant disadvantages with confirmation hearings.

Look further ahead, the Government was already considering whether Bank appointments should be subject to oversight by the Commissioner for Public Appointment, this would be in line with the Labour Party Manifesto commitment that "the Nolan recommendations will be fully implemented and extended to all public bodies". If confirmed, this would mean adopting the Code of Practice for public appointments: this involved making the process "open and auditable", possibly through advertising, certainly through consultation. The Code could apply to MPC and Court appointments, but there remained legal uncertainty as to whether Crown Appointments were covered and how the Members of MPC appointed by the Governor fitted in.

<u>The Charter</u>

Mr Berkowitz drew Members' attention to the revised version of the Bank's Charter which had been circulated the previous week. He said that, as previously reported, one of the aims of the

Government in the preparation of the legislation was to consolidate all the provisions relating to the conduct of the Bank's affairs in the new Act and make the necessary consequential changes to the Bank's Charter. The changes to the Charter would be achieved by granting a new Charter which revoked the Charter granted in 1946. It preserved (as was done in the 1946 Charter) the provisions of the 1694 Charter so far as they incorporated the Bank, constituted its capital stock and authorised it to have a common seal, to hold land and other property and to sue and be sued. It would also restate the provisions in the 1946 Charter facilitating the transfer of the capital stock of the Bank from the current holder nominated by the Treasury to any other person nominated by them, and restate the requirement in the 1946 Charter for declarations from Governors and Directors, but in a form which did not make the declaration a condition precedent to their acting in office.

A draft new Charter had been prepared which had been approved by the Treasury, the Treasury Solicitor and the Clerk to the Privy Council. Mr Berkowitz was content that the draft was in satisfactory form. Subject to approval by Court, it would be printed and submitted with a petition by a Minister to the first Privy Council meeting after the Bill had completed all its parliamentary stages. It was not necessary to wait for Royal Assent. Meetings of the Privy Council were scheduled for 18 March, 22 April and 19 May. Following approval at a Privy Council meeting the new Charter would be sealed and the new Charter granted by the Queen on or before the commencement date.

Court APPROVED the Charter in the form proposed with such minor amendments, if any, as the Governor or Deputy Governor might agree and authorised the Governor or Deputy Governor to acknowledge and/or execute acceptance of the Charter on behalf of Court when it was granted.

<u>Cash Ratio Deposits</u>

In accordance with Clause 10 of the Bank's Charter, Mr Buxton, who had made representations to the Governor on behalf of his fellow members of the British Bankers Association, withdrew for the discussion. Mr Foot also offered to withdraw, because he was wearing both a Bank and FSA hat, and the Governor said that he could do so if he felt uncomfortable and Mr Foot agreed that if he did feel uncomfortable he would leave. He was, in the event, present for the whole of the discussion.

Mr Midgley said that the Government's consultation paper on CRDs was issued on 25 November and responses were requested by 29 January. The Treasury would then prepare a response to the consultation process and a draft order which would need to be ready for tabling the moment Royal Assent was received. The draft order would include the key features of interest to the Bank: definition of Els, bands and ratios.

The Treasury had received a number of submissions from the building societies complaining about the extension of CRDs to them. The key submission, however, would be from the BBA. They would have views on distribution, which did not directly concern the Bank. They would also express views on the size of CRDs. In this connection, the Bank had had discussions with the BBA staff, and had found them ready to meet the Bank's expenses; the debate was only how to add them up. Their real sensitivity was about financing the Bank's payments to Government of tax and dividend. Although some progress was made on this point, it was likely that the CRD ratio they recommended to Government would fall well below the starting point of 0.35% less 0.1% for FSA less 0.025% for the builders. That took the ratio to 0.225%. The BBA were lower than that, and Treasury officials were below 0.1%. The Treasury's main argument for such a low CRD rate was that the Bank's reserves were too high, so that it was necessary to make sure that it had insufficient profits to remunerate the reserves fully, so they would decline over time. This raised echoes of the debate over the Memorandum of Understanding. A 0.225% CRD rate would involve deposits of £1.8bn whereas a 0.1% CRD rate would raise £750mn deposits. The former would provide income of £125mn and the latter £50mn.

The Governor noted that the only commitment in relation to banking supervision was that the Bank would not increase its costs. That meant that £50mn would be taken out of the Bank's costs and that is what it had to deliver. The Bank proposed to stand by a CRD rate of 0.225%. He did not believe that the position taken by Treasury Officials would appeal greatly to Ministers because, to the extent that it reduced the Bank's income, it also reduced the Treasury's dividend, and that had to be replaced. Sir David Lees asked whether Court could be provided, at its next meeting, with financial projections over the next 2-3 years on a variety of cost and income bases. He had no idea what the Treasury proposal would do to the Bank's Profit and Loss Account and its balance sheet. Court needed to understand the financial implications of these proposals. The Governor noted that the Bank was preparing its budget to present to the next Court meeting and it would bring the information Sir David Lees requested. Dame Sheila Masters asked whether work should be done to prepare for discussions on the level of reserves the Bank needed. The Governor replied that he did not believe that Treasury Officials had a clear idea of what the reserves should be. The answer was as long as a piece of string, but where the Bank was at present was not a bad place to be. Mr Midgley noted that, for Treasury officials, the issue was not how much the reserves should be but the principle of whether a central bank should have reserves at all. The Governor noted that there was no mechanism for reducing the capital of the Bank except by a special dividend, and that would have to be agreed by Court.

Quarterly Financial Report (Mr Midgley in attendance)

Mr Buxton rejoined the meeting. Mr Midgley said that the Bank had gained windfall income, as short-term interest rates had risen and the impact of Building Society conversions on CRDs had proved larger than forecast at the beginning of the year. Expenditures were running below budget, mainly because staff numbers had remained below budget as departure rates had exceeded recruitment. The shortfall in staff had left the Bank with significant pay bill headroom this year, a large part of which would be used in introducing the results of the Bank Officer Review and to increase the cash bonus element in merit pay for this year. This additional spending on pay, totalling £5.5mn, was not included in the tables presented to Court. Mr Midgley noted that he would be bringing to a future meeting the question of provisions to take account of the consequences of changes planned at the Bank. In response to a question from Sir David Lees, Mr Midgley said that the Bank had deliberately skewed pensionable pay increases to those groups where there were difficulties with retention of staff. Bonuses reflected the fact that large parts of the Bank had been under increasing pressure. Sir David Lees said it was important to be confident that increased bonuses were attributable to merit, and were not simply a useful way of hitting the pay bill limit. Mr Midgley replied that a large part of the bonuses planned this year were to facilitate the outcome of the Bank Officer Review. The Deputy Governor noted the difficulties the Bank faced in losing some of its most able people in their thirties. The Bank could not compete with City salaries but it could not allow differentials to get even greater, and he was encouraging Heads of Division to be more discriminatory, to try to retain some of their very best people. Sir David Lees commented that it was important to avoid the precedent set by erratic bonuses, which could cause difficulties in the long term. The Governor said that this was an important point, but he noted the difficulty of knowing whether the Bank would have enough headroom on the pay bill for the subsequent year to make a commitment to pay salary rather than bonus.

The Deputy Governor noted that Members of Court questioned the nature of the quarterly financial report and he said that within a short period he expected to appoint either Ernst & Young or Arthur Andersen to discuss the form in which reports were made.

The Executive Report

<u>Matters Reserved to Court</u>

Court agreed that the annual review of the 'Matters Reserved to Court' document would be deferred until the new Bank Bill was in place.

<u>Opportunities for People with Disabilities - a charitable donation</u>

The Governor said he would like to raise a matter concerning the Bank's charitable donations. He was seeking Court's approval because he proposed to make donations of £15,000 beyond the amount already approved in the Bank's Charitable Appeals Budget.

The charity in question was Opportunities for People with Disabilities, whose main mission was to find jobs for the disabled. It was founded some 20 years ago by a group of City institutions, including the Bank. The Governor was Vice-President. The Patron was the Duke of Edinburgh, who was an active supporter.

Opportunities had grown impressively. In 1997, it placed more than 1,200 disabled people into jobs. It maintained a network of regional offices which kept registers of disabled people looking for work. Applicants were guided through the process of job applications and interviews by Opportunities staff, and were put in touch with appropriate employers. Opportunities also ran job clubs for disabled people, and rehabilitation programmes, on behalf of the Department of Employment.

The last two roles were funded by Government, but the core role of finding jobs for people with disabilities received <u>no</u> official support. Instead, it was funded largely by corporate donations either in cash or through secondees. The number of secondees had fallen sharply. Consequently, the Charity had increased the number of paid staff. But, despite the engagement of a professional fund raiser, funding had not kept pace. In the last two years, Opportunities had run at a loss, the size of which had accelerated in the last six months. By Christmas there was even the prospect of liquidation as reserves were down to unacceptable levels. However, the Board on which the Bank was represented, and the Executive had taken decisive action both to cut costs by some 20% and to boost income, by around 25%. This should be sufficient to restore the Charity - in due course - to financial equilibrium.

The Governor said he was very concerned at the reputational damage to the Bank and City if Opportunities were allowed to fail. It had a unique mission in actually putting disabled people into jobs. Demand for its services - already buoyant - was likely to grow further if the Government's welfare policies forced more of the "marginally" disabled to look for work. The Bank had not made donations to Opportunities in recent years, although it did provide rent-free accommodation in Bank Buildings for the Head Office staff. Nor did it currently provide any secondees.

The Governor said he had authorised advance payment of £5,000 to help immediate cash flow problems, and instructed the Bank's Director (John Bartlett) to say that, if other companies represented at the Board were prepared to contribute £10,000, then the Bank would consider matching this sum. He was pleased to say that this brought immediate pledges from two companies, with two more undertaking to see if money was indeed available. The other two companies on the Board had already pledged a similar sum.

The Governor asked Court for authority to make a special donation of £15,000, outside the Appeals Budget, which for this year had already been largely spent. He would be contacting those corporate members of the Charity who no longer supported it, to see whether they too would contribute a similar sum. Together, this should provide Opportunities with adequate financial underpinning for the next six months or so. Beyond then, the Governor was confident that the proposed restructuring, combined with better fund raising, would deliver a sustainable future.

Court APPROVED the payment.

<u>Forex Swap transactions</u>

The Deputy Governor said that at its last meeting, Court asked about the accounting treatment in the Bank's end year accounts of the foreign exchange swaps which would be undertaken in January and February as part of the Bank's normal money market operations. The Bank had raised this issue with Coopers & Lybrand. They advised that the Bank would book the spot leg of the swap (that is, the dollar deposits), accrue the proportion of the interest rate differential at the year end and disclose the forward leg in the notes to the accounts. However, the Bank still needed to agree the precise treatment - and in particular whether the currencies should be translated at the year end exchange rate and the swaps marked to market - with Coopers & Lybrand and with Audit Committee (which would meet next on 26 March).

<u>New Head of Business Finance Division</u>

The Deputy Governor reported that Peter Brierley was to be appointed as Head of Business Finance Division with effect from 17 April 1998, following the retirement of Mike Smith.

Bank of England Symposium on the Euro and London

The Deputy Governor reported on the Symposium on practical preparations for monetary union in the City held in the Court Room of the Bank on the previous day. He said that the Symposium covered seven markets during the day, and the Chancellor had attended the final session of 1½ hours. He particularly thanked Dame Sheila Masters for acting as rapporteur for the session on professional services. The general view emerging from the Symposium was that the City was working very hard at preparations and recognised that the euro would be the main currency of the wholesale markets. There was possibly a feeling that some companies had not recognised the huge amount of work needed at the conversion weekend over the New Year weekend just before monetary union. He believed the Symposium had been a success and reflected well on the Bank.

Sir Chips Keswick commented that it had been brilliantly organised and Mr Townend deserved a lot of credit for a magnificent day. Mr Buxton said that the Bank of England enhanced its reputation by acting as a catalyst and leader in the City. The Governor said that he took Sir Chips' point about Mr Townend and he would also like to say that part of the credit should go to the Deputy Governor for the success of the Symposium. The Deputy Governor would, in February, be going around the world promoting London's readiness for the euro. In response to Mr Buxton, the Governor said that the Bank believed it could take a similar role in the context of preparations for the millennium, and Mr Clark would shortly be producing a document on millennium preparations similar to Practical Issues. Mr Buxton commented that the BBA was very keen that the Bank should do that.

Sir David Lees, returning to the question of Matters Reserved to Court, said he agreed with the Governor's point but noted that there would be an interregnum from Court's point of view from 1 March, because the Bill would not become an Act until April, May or June. Under the Bill, there were a number of issues that Court would have to address that it had not had time to address before. The Governor replied that this was a very sensitive issue, concerning not just the role of Court but the role of the Non-Executives on Court, and it would be easier to see the way ahead if it was known who the Senior Non-Executive Director was going to be. The Governor said he had raised the question with the Chancellor who had indicated that he would decide in his own good time. If there was anything that Sir David Lees believed the Bank should do in the meantime, it would be considered. In response to a further question by Sir David Lees about the timing of the decisions, the Governor said he believed that the Chancellor was going to have to do something by 28 February because a number of people would be retiring from Court, and hopefully they would have their appointments renewed. He hoped that the Chancellor would focus on the issue shortly. The Governor suggested that an agenda could be drawn up of the issues facing the new Court to put to the existing Court, if that were helpful. Sir David Lees agreed that it would be helpful because the Bill had far-reaching implications. Starting early had merit, even if the team might change. Mrs Heaton supported Sir David. The Governor said that the Bank would try to take the first steps before the next Court meeting.

The Governors' Engagements

The Governor noted that this would be Sir David Scholey's last attendance at Court because he would be in India at the time of the February meeting, though he would join Members of Court on 27 February for a formal farewell. He asked for his personal gratitude to Sir David to be recorded in the minutes. Sir David had been a tremendous support to him, particularly over the last 12 months, and he was sure that Members of Court greatly appreciated the contribution Sir David had made to the life of the Bank over very many years. He thanked Sir David very much indeed.

The Governor also noted that Sir Maurice Laing, a Director from 1963-1980, would be 80 on 1 February.

In accordance with Clause 10 of the Bank's Charter the Governors and their fellow Members of the Executive withdrew. Sir David Scholey took the chair.

A Report of the Remuneration Committee

In his capacity as Chairman of the Remuneration Committee, Sir David Scholey drew Court's attention to an item of unfinished business. It arose from the decision nearly five years ago that the Governor's remuneration should be fixed for the period of his appointment. The Chairman of the Remuneration Committee at that time had pointed out that, where the Governor's pension was concerned, it was at the discretion of Court at the time it became relevant. It was proposed that every time the Executive Directors' remuneration was reviewed the Governor's remuneration should also have been notionally reviewed. The implication, which was clear in the papers, was that this was to keep an eye on the pension impact of not changing the Governor's remuneration. At that time, the Chairmanship of the Remuneration Committee and the Secretaryship of the Bank had changed, and the intentions noted in the minutes had not been carried on to the next stage. At no stage during the subsequent 4½ years had the Remuneration Committee reviewed, notionally, the Governor's remuneration. But with the end of the Governor's first current term, Sir David believed it would be wrong and unfair not to set it on a clear footing. Therefore the Remuneration Committee had been considering various ways in which this matter might be remedied. The basis on which the Remuneration Committee concluded that this should be done was noted on page 5 of the minute of the Remuneration Committee meeting on Wednesday 17 December 1997.

The Committee agreed that it should recommend to Court, on the basis of notional average remuneration of £253,407 pa, calculated on the basis of average increases to Court Scheme members since 1993, a maximum pension of £168,938 pa, with a spouse's allowance of £85,147 pa, and a maximum commutation of £47,275 pension forgone to realise £639,590 tax free. The cost to the Bank in the event of it becoming payable on that basis would be an ex-gratia payment from the Bank of £13,000 pa. If that were to be the decision of Court, it would be for the Bank, with the help of the Audit Committee, to decide how it should be provided in the future. The Governor might well be reappointed, in which case the remuneration and pension would be discussed again. If he were reappointed, since he was approaching 60, it would be for him to decide if his future remuneration should in part be by way of pension.

Court APPROVED the recommendation of the Remuneration Committee.

18.2.98

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 28 JANUARY 1998

Present

Mr George, Governor

Mr Clementi, Deputy Governor

Mr Clark

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

18.2.98

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 4 FEBRUARY 1998

Present

Mr George, Governor

Mr Clark

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.

18.2.98

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 11 FEBRUARY 1998

Present

Mr Clark

Mr Plenderleith

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

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

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

18.2.98

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 18 FEBRUARY 1998

Present:

Mr George, Governor

Mr Clementi, Deputy Governor

Mr Allsopp

Mr Buxton

Mr Clark

Sir David Cooksey

Mr Foot

Mrs Heaton

Sir Chips Keswick

Mr King

Sir David Lees

Mr Neill

Mr Plenderleith

Sir Neville Simms

Sir Colin Southgate

CRDs - Proposal from HMT (Mr Midgley in attendance)

The Governor said that Mr Buxton would join Court after the discussion of Cash Ratio Deposits. With reference to a Minute of 21 January the Governor invited Court to look at correspondence from Alistair Darling. He said his objective had been to protect the existing level of Bank expenditure after allowing for £50mn transfer of Banking Supervision costs to the Financial Services Authority. His second objective had been to ensure that the real value of the Bank's capital was maintained. These objectives were acceptable to the Chief Secretary and were met in the arithmetic disclosed in the letter. It had been agreed that the expenditure block that could be financed out of CRDs was around £79mn on a fully allocated basis. To enable the Bank to achieve that income, but also to allow for the remuneration of its capital as a whole, the Bank needed Cash Ratio Deposits of £1,130mn. The Governor said he did not know what that would translate to in terms of a ratio. The Treasury still had to decide how to structure the CRD charge. One possibility was to have a sum, perhaps from £300-£500mn of eligible liabilities where there would be no cash ratio deposits, and beyond that there would be the full amount. Even without knowing the ratio, however, the Bank's position was protected by the arrangements set out in the letter.

The Governor noted that the last paragraph of Mr Darling's letter discussed the reduction in the Bank's property requirements. The intention was to contract into one building, but this would take time and expenditure to make possible. The thrust of what the letter said was right. The Governor noted that he explained to Mr Darling that Court would take an interest, and that the profit or loss on a sale would feed into the profit and loss account in the usual way, and be subject to tax and the 50:50 dividend formula. Mr Darling had accepted that that would be the case.

In response to a question from Sir Chips Keswick, the Governor said that the intention was that the CRD arrangement would be set for five years. In response to a further question by Sir Chips about the impact of a sharp reduction in interest rates, the Governor said the return would be sufficient to maintain the value of the Bank's capital on all reasonable assumptions. Sir David Lees asked whether it was felt that any benefits from the cost reduction programmes would, in effect, be for the benefit of the Bank rather than subject to Treasury scrutiny along with the Bank's annual operating costs. The Governor commented that that was one of the advantages of making an agreement for five years. He said he was comfortable with Mr Midgley's assurance that the arrangement preserved the Bank's capacity to staff the business over the next five years. The structure gave the Bank a great deal of protection. In response to a question from Sir Colin Southgate, Mr Midgley confirmed that the Bank had carried out a risk analysis for variations in interest rates. Court APPROVED the Governor's intention to confirm to Mr Darling that the Bank approved of the arrangements.

The Governor noted that the British Bankers Association had raised the question of why the Bank could not repay some CRDs ahead of 1 June. The Governor asked Court's guidance on whether that should be done, bearing in mind that it would be voluntary because it would be in advance of the new arrangements coming into force. The Governor said that he was not particularly concerned about making the concession, not least because it would help the Bank in its money market operations. The Deputy Governor commented that it would be odd for the Bank willingly to hand back money to the private banking sector, unless given instructions to do so. The Governor noted that early repayment could avoid an unnecessary dispute with the banks, and would not cost the Bank very much.

Mrs Heaton commented that it would be a windfall for the banks and that Court was responsible for looking after the Bank's finances and maximising the returns. She hoped that the Bank would not do it. The Governor noted that, with the demutualisation of the building societies, the CRD ratio should have been lowered in the past. The Government was pushing back £50mn to the banking sector which was £50mn more than needed for the transfer to the FSA, and that was also a windfall. He proposed listening to the case made by the BBA. He would tell the BBA that he would reflect on it, and he would come back to Court on the matter. Mr Neill said that on purely emotional grounds he would not give up on the issue too early, and he would ask the banks to catalogue the times when they had given up anything to their customers. Sir Chips Keswick said that this was a good moment for the Bank to squirrel away as much money as possible. Sir Colin Southgate agreed with Sir Chips, and commented that it would be odd for the Government to give £50mn back, and he suggested the money should be put into the FSA. The Governor said he understood the points Court members were making. At issue was a three month phasing-in period, which would not cost much. He said he would test the waters and come back.

Mr Buxton returned to the meeting.

The Minutes of the Court of 21 January and the Meetings of 28 January, 4 and 11 February, having been circulated, were approved.

Budget for the coming year (Mr Midgley in attendance)

The Deputy Governor said it was a difficult budget to present. It showed the Bank in transition. The Supervision & Surveillance Department was deemed to move on 1 April but a more likely date was 1 June. On the cost side, the more important issue was when Supervision & Surveillance physically moved, towards the end of the year. That was when refurbishment of the Bank would get under way. So there would be a heavy capital expenditure, as well as spending on projects such as monetary union and the euro. Turning to accounting conventions, he noted that some of the schedules referred to Budgeted Running Costs and some to Current Expenditure. The reconciliation between these two revolved around differing treatments of depreciation and staff costs and direct expenditures in investment projects. Staff costs and direct expenditures associated with IT investments were capitalised in the budgeted running costs calculation but were a cost item in the Current Expenditure figures, which were higher. The Deputy Governor said his preference was to concentrate on the Current Expenditure numbers, which would appear in the published accounts, for which Court would be held publicly responsible. He noted that, after a contest between Ernst & Young and Arthur Andersen, the Bank had appointed Arthur Andersen to determine how financial information was presented to Court. The consultants would interview the Audit Committee and each Executive Director of the Bank and would come back with proposals on how quarterly or monthly information should be presented.

The Deputy Governor then drew attention to table 1, on staffing. Monetary Analysis and Financial Stability both showed staff increases, market operations staff remained roughly unchanged, and the Printing Works staff were falling. He noted that Central Services, a key area, was where the main part of the problem lay. There were 916 people in this overhead area, so the back office was 36% of the total head count, which would rise to close to 43% in the next year, while at the end of the target period he expected it to go below 40% again. This percentage could not be allowed to go too high.

He would like to get back to where the number was today. He noted that from 916 today, Central Services would have shrunk to 688 by 2001/02, an 18% reduction over the budget period. Sir Colin Southgate commented that the Bank needed to do a lot more work on overheads. 40% was a high figure. Much of the reduction took place in the final year of the plan, and it should be done in a more even way. Mrs Heaton said that the reductions could be criticised for being slow. The Deputy Governor noted that there was an initial 8% reduction and a further 10% over the next 2-3 years. A difficulty was that S&S was not moving out until the year end, so the Bank could not get on as quickly as it would like with the changes. Replying to a question by Sir Colin Southgate, the Deputy Governor said that the reason the fall in the Personnel Department happened so quickly and so late was that to get the numbers down required a change in procedures. There was a need for a benefits review, and also a look at the question of further sub-contracting. Sir David Cooksey asked why, if a benefits review was required, was it necessary to take such a long time to carry it out. The Deputy Governor said that that was an issue that the Bank would think about. But he noted that the Personnel Department was currently under enormous pressure. He also noted that it was hard to achieve savings in some departments, because many of the statutory responsibilities of the Bank remained and in some areas, for example Press Office, the demands on staff were growing, notwithstanding that the Bank overall was reducing in scale.

Mr Buxton said that what was needed was a management culture where the managers were looking for efficiency all the time. He also commented that the Bank's IT spending was too low. Mr Plenderleith said he shared Court's view that there was an obligation, as a public body, to reduce overheads in line with the Bank's front line functions. In looking at how to do this and at the timing, there were a number of requirements placed on the Bank, which had to be careful where it cut overheads. For example, there was a hugely increased requirement for accountability and transparency, which produced a greater burden in providing material for publication. There was also greater emphasis from the Treasury and elsewhere on the need for the tightening of control apparatus. The Bank could inculcate across business areas the need for efficiency, could increase the amount of outsourcing and could change the nature of its activities, for example personnel benefits. But it would be a big step if it removed a raft of benefits available to staff in previous years, which was a risk to staff motivation. Sir David Lees said he supported the Deputy Governor in engaging accounting consultants. He proposed taking it one step further. With the enormous day-to-day pressures on top management and on senior management, getting costs out was impossibly difficult if it was only managed by top people, in-house. He believed that the Bank should invest seriously in value for money consultants who would investigate how overheads could be taken out. Such a study would cover not just overheads, but should look at how the Bank could operate efficiently and effectively in direct expenditure areas. He commented that it was very very difficult for the management to do that itself. He strongly recommended that the Bank should give serious consideration to a major value for money study, to identify cost savings that could be forward towards the end of the planning period. Mr Neill said that he strongly agreed. It was quite difficult to make such changes happen on a top down basis.

The Governor noted that three points had been made: the most important was that there should be consideration of a major outside consultants' review that should go through to the point made about culture; second, there should be an advance of the benefits review; third, the Bank should look at the question of Information Technology. The Bank would come back to Court over the next few months with proposals in these three directions. Those Members of Court who had experience of outside consultants could share their experience with the Deputy Governor, the Governor suggested.

Mr Midgley drew attention to table 6, which after taking out the Printing Works indicated an annual replacement cost of currently installed hardware and software of £9mn a year. New investment was now above trend, but he agreed that in the last budget year, at £4.5mn, it was too low. The Governor commented that there was no reason why the Bank should not look at the question. Mr Midgley noted that each one of the projects forming the investment programme was subject to separate authorisation, and the major ones would come back to Court for approval.

Turning to property, Mr Midgley said that the Bank currently occupied five buildings in the City or nearby: Head Office, Bank Buildings, King's Arms Yard, Eagle House and New Change. Outside London, the Branches other than Leeds were up for sale and the Bank had been trying to sell Southgate House in Gloucester, now with the Registrar's remaining as a future tenant. The Bank was also part-way through establishing new offices for the Agents. Once Supervision staff had physically moved out, assumed to be by December, there would be sufficient space in Head Office to accommodate the current occupants of Bank Buildings and Eagle House. In addition there would be room to move staff catering out of KAY into Head Office, which was something intended anyway, but there were now more options as the catering operation could be smaller, given fewer staff. The budget assumed that by the end of 2001 Head Office was fully occupied, Bank Buildings was looking for a tenant, with no Bank occupation, and KAY had been sold. At New Change, the shunt space would be let, while CCBS, the South-East Agency, the flats and the car park continued as now. Eagle House would remain as Bank contingency site until the lease expired, because the Bank was unlikely to get out of the lease without undue penalty. Outside London, the budget assumed that all the branches, other than Leeds, were sold, as well as Southgate House, with the Registrar's as tenants.

Mr Midgley said that the budget assumed that the Bank moved to open plan offices, which would lessen the costs of future changes, though it would cost more to achieve. Sir David Lees asked whether the Bank really needed to spend £30mn on refurbishing its Head Office. Did that represent an economical use of resources? The project paper had to very clearly set out why the Bank was spending these large sums, and what the economic returns were. In response to a question from Mr Allsopp, Mr Midgley said that to move catering from King's Arms Yard to Head Office would cost £4mn, and the Bank had assumed a sale price of £4mn for KAY. In response to another question from Mr Allsopp, Mr Midgley said that the benefit of modernising the offices was that they would accommodate more people. It would also be easier to deal with future change, in terms of moving people about the Bank, and there were other benefits related to the cultural and communications side of the working environment. He noted that £30mn was not all new spending, because part of that would be bringing forward expenditure from future years. There were parts of the building last refurbished 15-20 years ago which were in need of refurbishment again because of the requirements of modern IT and communications systems. The Governor commented that the Bank needed to go to Court with a more detailed project. He also took it that the Bank should be very cautious about moving down this track until it had considered the idea of an outside review. The Bank would take on board both those thoughts.

Mr Midgley then drew Court's attention to table 3 and said that total investment added to £43mn in 1998/99 and three areas were responsible for the great majority of the projects proposed: Market Services £9.4mn, Printing Works £8mn and Property Services and Security £19mn. In Market Services, the major projects were related to EMU preparation, covering the Bank's own internal systems, interlinking, and those for the City, CMO and CGO and Year 2000 preparations. Many continued the programme of work already begun or identified as necessary during this year. At the Printing Works the pinchpoint, the cash centre and sheet examinations, accounted for over half of the spending. In Property Services and Security, the major components were £12mn for the buildings and £6mn for security systems.

In reply to a question from Sir Neville Simms, Mr Midgley said that a substantial part of the £3.8mn shown for the year for Head Office refurbishment represented fees, because the Bank could not start work until this time next year. The Deputy Governor said the main project was to get the Bank into one building. He did not believe anybody on Court would criticise that objective. The issue was what form the refurbishment would take. That would be brought to Court. But he was seeking Court's approval for the proposal to move the Bank into one building. The Governor noted that the Deputy Governor's proposal was accepted about the table.

Mr Buxton noted that some of the costs, for example for catering, seemed large. He also noted with surprise that the Bank was spending so much on the Sports Club and said it should be looking to somebody taking over the Sports Club and giving employees of the Bank special rates. In reply to a question from Sir Chips Keswick, the Governor said it was easy to display the comparative costs of central banks. The Bank of England was a very cheap and cost-effective central bank. The Bank of France employed 16,000 and the Bundesbank 18,000. He noted the surprise displayed by President Chirac when he heard the numbers employed by the Bank of England.

The Deputy Governor said that the Bank would bring back to Court a carefully worked out Property project. Ultimately, the judgement about whether it was a cost effective use of money would be the Bank's. The building was a warren, and an ineffective communications background for professional work. Mr Neill commented that it was a good idea to go from five buildings into one and the time for debate on the cost was when the projects came back to Court. He supported the Deputy Governor in going ahead.

Mrs Heaton asked whether there should be a debate on moving the Bank somewhere else, to a modern efficient building. The Governor said he would not find such a proposal acceptable. The Deputy Governor noted that it would be difficult to find a building of the appropriate size in the City, and the costs of moving staff of around 2,000 people would be hugely expensive and well in excess of the costs of refurbishment. Sir Colin Southgate commented that the building itself was part of the culture and soul of the Bank.

The Governor left the meeting to make an urgent telephone call, and the Deputy Governor took the chair. Sir David Lees commented that Court should rest its case and wait for the projects to be presented. This view was endorsed by Court.

Court APPROVED the Budget for 1998/99.

Pay Settlements and Officers' Review (Ms Lowther and Mr Midgley in attendance)

Ms Lowther described the annual salary review for Officials which had three elements in an individuals' total pay award. There was a general pensionable increase payable to all Officials judged to be satisfactory performers. BIFU had accepted the Bank's offer of 2½%. There was, in addition, an individual pensionable merit element determined in accordance with a progression, or merit, matrix set for the relevant salary band. A sum of 5% of the Officials' salary bill (compared with 4% in 1997) was being made available for these increases. Thirdly there was a non-pensionable bonus payment equal to 7½% of the Officials' salary bill (compared with 5% in 1997), reflecting salary bill savings in the Bank which have arisen partly through less rapid than expected recruitment to fill identified gaps. Ms Lowther noted that pensionable salary increases were weighted towards the junior end of the scales. Ms Lowther believed it was important to reward the commitment and effort that people had put into their work this year, and she felt that the Officials' Review had led to a satisfactory outcome.

Turning to Officers' pay, Ms Lowther said that the Bank had offered a financial package, conditional upon acceptance of the proposals presented to staff in December. Part of this package was a bringing forward of the general increase from July to March. A 2½% general increase similar to that for the Officials had been offered. There was also a merit based increase of 5% in salary, and a bonus element averaging 10%, with a flat rate underpinning of £1,000 to all staff. This last element in particular was regarded as an inducement to view the new scheme positively. The ballot on the scheme had been very positive with 74% in favour and 26% against.

Implementation of the arrangements for Officers were therefore proceeding as planned. Ms Lowther said that the Bank had almost completed the allocation of jobs into the new structure. She also noted a clear bias in salary increases towards the junior end of the structure. In response to a question from Mr Buxton, Ms Lowther said that the turnover rate among Officers was dependent on their seniority. At the senior end there was no turnover because remuneration was very generous. At the junior end, however, turnover was between 10% and 15%. She described the structure of the pay awards as flexible, with scope to pay a wide range of percentage increases. She agreed with Mr Buxton that, with senior people above market rates and junior people below market rates, the Bank was seeking to manage the situation over a period. She also noted that the new integrated grading structure would mean that from next year, there would be common salary review arrangements for all banking staff.

Turning to the pay settlement for EDP staff, she said that the same market pressures were being experienced as last year, and they affected the whole of the IT industry. There was a structured pay settlement with a relatively low general increase of 2.5% and large merit pot of 7.5%, with bonus funds of 10%. The Bank had been able to target the money very

[redacted]

carefully, and its turnover in IT staff had been remarkably low for the market conditions.

Printing Works Expenditure (Mr Jarvis in attendance)

The Governor returned to the chair. Mr Jarvis explained the project to move the cash centre to Debden, which was approved by Court in principle in May 1997. It was hoped to complete the work by June 1999. He also described the final part of the Printing Works site development. Mrs Heaton commented that the arrangements might be less flexible than those in Threadneedle Street but Mr Jarvis replied that a considerable amount of modelling had been done with the clearing banks. [redacted] It was felt sensible to cut costs at the expense of only a small risk of occasional delays. [redacted] In reply to a question about whether, if the Printing Works were privatised, the cash centre could stand alone, Mr Jarvis said that physically it would be quite difficult as it would not have its own vaults and the production and cash centre systems were integrated. In reply to a question from Sir Neville Simms about whether the Bank could handle the project managerially, given other items on the agenda such as the millennium, Mr Jarvis said that, as it was being handled by the same team that managed the retrenchment and refurbishment of the Printing Works, he was confident it would be completed successfully. In reply to a question from Mr Neill about cost benefit analyses, the Deputy Governor said that the concept had been agreed last year. The proposal benefited the Bank by freeing space in Head Office, and it [redacted] from Sir David Cooksey, Mr Jarvis said a sliproad onto the M11 had been in the Ministry of Transport plans for some years, but he did not know when work would begin. [redacted] He was also reasonably confident on the basis of forecasts and modelling that the project would cope with a change from sterling to the euro. He noted that the Bank had not yet selected contractors but was looking at tenders in detail, and he would be happy to report back on the variations in the tenders. Sir Neville Simms congratulated the team on the approach that was taken to the project.

Court APPROVED both items of expenditure.

Court Appointments

The Governor said that new appointments to the Court would be announced at 2.30pm that day. He said that he had been asked by the Chancellor to serve a second term and he had agreed. Sir David Scholey and Sir John Hall had asked to step down from Court, and that would be announced as well. Howard Davies would be appointed to Court on 1 March, in an ex-officio capacity as Chairman of the Financial Services Authority. There would be five new Non-Executives: Jim Stretton, Chief Executive of Standard Life, Graham Hawker, Chief Executive of Hyder plc, Bill Morris, General Secretary of the Transport & General Workers Union, Roy Bailie, Chairman of W & G Baird and a former President of the CBI (Northern Ireland), and Sheila McKechnie, Director of the Consumers' Association. In addition, Dame Sheila Masters was to be appointed Chairman of the Non-Executive Directors under the new Act. The Governor [redacted]

[redacted] He asked Members of Court to give Dame Sheila all possible support because she would need it in her new role. Sir David Cooksey and Dame Sheila would be re-appointed as Directors. Court agreed to Mr Plenderleith continuing in his present role following his reappointment as a Director.

Turning to the terms, he said that for appointments commencing on 1 March, they would continue until the Bill came into force which the Bank believed would be 1 June. At that point all the Directors on Court would stand down, as required, under the new Act. With the exception of Messrs Plenderleith, Foot and Clark, Directors whose current terms had not expired would be reappointed until the end of their existing terms. The five new Members would be appointed in effect for two years, to stagger the rollover of the sixteen Non-Executive Directors on a five, six, five basis. The Governor thanked Mrs Heaton for expressing her pleasure at his reappointment.

Executive Report

(i) <u>Foreign Exchange Swaps</u>

Mr Plenderleith said that Court had approved the use of foreign exchange swaps on the Bank's balance sheet with a limit of £2bn. Since then, the Bank had seen substantially larger revenue flows to the Government than it had been expecting. To handle these additional flows to the Government, which led to additional shortages in the money market, it would be helpful to increase the limit from £2bn to £3bn for three months. Court was content.

(ii) The New Bank Bill - Role and Organisation of Court

The Deputy Governor said that the Bank had been giving some thought to the new arrangements for Court. There were some quite difficult questions about how the Audit Committee and the Remuneration Committee, which were clearly responsible under the Bill to the Committee of Non-Executives, should fit in with Court and the new Committee. The operation of the new Committee, NEDCO, was for the Non-Executives themselves to determine. The Bank proposed to bring a written report to the next Court.

(iii) EMU Roadshows

Turning to the roadshows led by himself to promote London as a financial centre, the Deputy Governor said that there had been a generally good reception in New York and in Switzerland. He was increasingly confident that, in most markets, London would be in the lead but it would be a more competitive situation in some of the derivatives markets. In general the message had been well received. He would be travelling next week to Tokyo, Hong Kong and Singapore.

(iv) Year 2000 publication

Turning to the computer problems surrounding the Millennium, Mr Clark noted the importance of benchmarking, testing, and contingency arrangements. He said that the Bank was about to launch a new two or three monthly publication which would cover practical questions relating to the Millennium problem.

(v) Supervision & Surveillance

Mr Foot reported to Court a number of changes in the responsibilities within the Supervision and Surveillance Department which aligned it at the senior level with the structure of the new Financial Services Authority.

A Report from the Chairman of the Trustees of the Court Pension Scheme

The Governor noted that the Members of the Executive had an interest in the Court Pension Scheme and he requested Court's agreement that it was not necessary for them to withdraw.

Sir Colin Southgate reported that in the light of the discontinuance of abatement in the Staff Pension Fund, agreed by Court the previous December, the Trustees of the Court Pension Scheme now recommended that abatement should be discontinued in the Court Scheme and that the Scheme's rules should be appropriately amended to reflect this change of practice.

Court APPROVED the recommendation.

The Governor apologised to Court because he had to make an urgent telephone call and he handed the chair to the Deputy Governor.

Inflation Report discussion and Market Charts (Sir Alan Budd, Professor Buiter and Mr Hatch in attendance)

Mr King apologised for arriving late at Court, but his plane from Washington had been diverted to Manchester. He said that last week he had presented the 21st Inflation Report, which included a new executive summary, or overview. He noted that monetary policy was more finely balanced than at any time over the previous five years. The economy had been in the easy part of the cycle. But the combination of above trend growth and falling inflation was unsustainable and almost certainly coming to an end. That was the reason why policy was extremely difficult, and finely balanced. It was at that point that the difference of view would be most likely to emerge. One of the encouraging features last week, at the time of the publication of the Inflation Report and the January minutes, was the realisation by the media that this was an expression of transparency, where the differences were visible in public with their accompanying arguments. There were not two views in the MPC in January, but a spectrum with different weights attached to each. One view was that there was a strong case for a rise; another was that though those arguments had some force, there was a good deal of uncertainty and it was necessary to wait a month until a fuller analysis could be undertaken in the context of the Inflation Report; and a third view was that there was no need for an interest rate rise. Mr King noted that the following morning the Governor, himself, Professor Buiter and Professor Goodhart would appear before the Treasury Select Committee and their individual views would be apparent. The MPC had decided on a period of purdah which prevented individual comments until the TSC hearing had taken place.

Mr King said that the central projection in the Inflation Report was close to the target level two years ahead, but the balance of risk was on the upside and there were three main upside risks: a more rapid fall in the exchange rate that was implied by interest rate differentials; higher earnings growth in a tight labour market; and rapid money growth which could lead to faster growth in nominal domestic demand. The main downside risk was that the downturn in growth would be larger than in the central projection. The current projection meant that the odds were that a further rise in interest rates would be necessary to hit the inflation target. But there were large and real uncertainties about the magnitude of the slowdown that was now visible. Monetary policy was finely balanced, said Mr King, and there was no mechanistic link between the Inflation Report projection and decisions on interest rates. There were a number of paths for interest rates that would bring inflation to the target.

Turning to the markets Mr Plenderleith said all the major markets had shown very little fluctuation from recent trends. There were two stories, the strong Dollar and Pound and the weaker Yen. The capital markets, both bonds and equities, were well bid. He believed that markets were taking quite a rosy view of the outlook, given the Asian problems, the prospect of conflict in the Gulf and the actual approach of monetary union, as well as questions about unemployment on the Continent.

Mr Allsopp commented that the Inflation Report had been well received in the press. The most contentious point was the statement that interest rates were more likely to go up than down. Was it right to wait and see or should there be pre-emptive action and a possible reversal? The question was whether the Committee was behind the curve or not. He commented that there would be many questions about the underlying basis of the Inflation Report forecasts.

Mr Neill commented that the car industry had had its best January on record and the first 10 days of February were very much better than anybody had expected. Consumer demand was very strong. Mr Buxton said that business confidence surveys showed that confidence, having dropped, had stabilised. He believed it was more pressing to raise interest rates than to stay as they were. Sir Neville Simms said the construction industry was going to continue to grow for the whole of the year but there was still a shortage of skilled labour. The industry was pretty certain that the rate of growth was going to slow down next year. Sir Colin Southgate said that the retail business was very difficult to read. He noted that salary levels were flat and that pay rises were difficult to obtain because margins were under pressure. Sir David Cooksey said the companies in which he was involved were suffering from export and import substitution. Further interest rate rises would hurt the former category. It was necessary to be cautious and try to damp consumption without further damaging exporters. In reply to a series of questions Mr King said that there had been a long discussion of the forecasts at the February MPC meeting, and Court should be able to have a good discussion of that once the February minutes were released. He noted that consumer demand was extremely strong, as the retail sales figures had shown that morning. He also noted that earnings in the private sector were growing at more than 5% a year and that they had to fall to hit the target. It might be that the fall in output would bring the rate back but that remained to be seen. Turning to the exchange rate, the central forecast was that the pound would fall and the risk was more on the downside. But if Sterling became stronger after monetary union that issue would play a major role in the MPC deliberations. The MPC had to hit the inflation target, but the difficulty was that the numbers were very finely balanced.

Sir Alan Budd said there was no need to remind anybody of how uncertain forecasts were. Professor Buiter said that if an MPC member subscribed to the forecast, as the Committee had unanimously done, the expectation would be that interest rate increases were more likely than not. It was a non-contentious statement, given the forecast. The Committee was certainly capable of producing several forecasts if there were a disagreement about forecasts. Mr Allsopp said the worry was that that expectation had less beneficial implications for the exchange rate. The Deputy Governor said that the Monetary Policy Committee discussion concentrated on the costs and benefits of waiting, given the uncertainty.

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.

The Deputy Governor thanked Court and the meeting ended.

25.3.98

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 25 FEBRUARY 1998

Present

Mr George, Governor

Mr Clark

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

25.3.98

COURT OF DIRECTORS

For the period ended 28 February 1999

Declaration Made before	Date	
		Edward Alan John George, Esq, Governor
		David Cecil Clementi, Esq, Deputy Governor
		Mervyn Allister King, Esq
		Sir David Bryan Lees
		Sir Colin Grieve Southgate
		Mrs Frances Anne Heaton
		Sir John Chippendale Lindley Keswick
The Deputy Governor	2.3.98	#Ian Plenderleith, Esq
The Governor	25.3.98	#Sir David James Scott Cooksey
The Governor	25.3.98	#Dame Sheila Valerie Masters, DBE
		Sir Neville Ian Simms
		Michael David Kenneth Willoughby Foot, Esq
		John Mitchell Neill, Esq CBE
		Andrew Robert Fowell Buxton, Esq
		Thomas Alastair Clark, Esq
		Christopher John Allsopp, Esq
The Governor	25.3.98	*Howard John Davies, Esq

Reappointed 1 March 1998
* Appointed 1 March 1998

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 4 MARCH 1998

Present

Mr George, Governor

Mr Clementi, Deputy Governor

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

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

25.3.98

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 11 MARCH 1998

Present

Mr George, Governor

Mr Clementi, Deputy Governor

Mr Clark

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.

25.3.98

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 18 MARCH 1998

Present

Mr Clementi, Deputy Governor

Mr Clark

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.

25.3.98

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 25 MARCH 1998

Present:

Mr George, Governor

Mr Allsopp

Mr Buxton

Sir David Cooksey

Mr Davies

Mr Foot

Mrs Heaton

Sir Chips Keswick

Mr King

Sir David Lees

Dame Sheila Masters

Sir Colin Southgate

The Governor welcomed Mr Davies back to Court and congratulated Dame Sheila Masters and Sir David Cooksey on their reappointment.

The Minutes of the Court of 18 February and the Meetings of 25 February, 4, 11 and 18 March, having been circulated, were approved.

Economic and monetary discussion together with the activities of the Agents (Dr Julius, Sir Alan Budd and Messrs Allen, Iles and Kemsley in attendance)

Mr King said the issues of the month were the February MPC minutes, the Budget, changes in prices including that of sterling, the realignment of the punt, the entry of the drachma to the Exchange Rate Mechanism and - today - the EMI convergence report, which was about to be published.

The February minutes showed that policy was more finely balanced than in January with a four:four vote, decided by the Governor's casting vote. The February Inflation Report suggested that with unchanged interest rates over the next two years inflation was more likely to be above 2.5% than below. Mr King drew Court's attention to paragraphs 24-28 of the Monetary Policy Committee minutes, which explained in some detail the arguments for and against a rate rise. Mr King commented that the description of hawks against doves was misleading because all the MPC members had the same objectives. There were from time to time technical differences of view about the meaning and interpretation of data.

Turning to the Budget and the MPC, he said the Committee had been given the broad outline of the fiscal position in time for the March MPC meeting, and immediately after that it was given a full briefing by a team from the Treasury. The Budget was a significant tightening, but that was largely inadvertent because revenues were stronger and Government spending was less than planned. The outlook was healthy, with a surplus possible at the turn of the century. The Budget itself was broadly neutral. He noted that the forecast for activity was similar to that in the Inflation Report but it showed slightly higher inflationary pressures in the near term. Mr King drew Court's attention to the financial market charts in Members' folders. The exchange index had reached 107.5, the highest since February 1989, and compared with 104.8 at the last Court meeting.

Mr Buxton asked what was the significance of the fact that the three Executives of the Bank - the Governor, the Deputy Governor and Mr Plenderleith - all voted one way and the economists split four to one the other way. The Governor commented that there had been an assumption that all those in the Bank would vote the same way, and this was not necessarily true. He and Mr King had made that translucently clear to the Treasury Select Committee. Members of the MPC voted as individuals and it was coincidental that this particular split had arisen at this time. He could imagine different splits occurring. He commented that people closer to the markets might believe that they were more sensitive to possible market implications of their actions and cautious about taking steps that they were not necessarily sure were necessary. Those on the economic side might take the view that variability of interest rates was not necessarily a matter of concern.

Mr King noted that the factors that drove people to take one view or the other were in the end the state of the labour market, asset prices and how much confidence they had in the forecast in February. These technical differences drove the discussions rather than any philosophical difference. In reply to a question from Mr Allsopp, the Governor said that he did not believe that anybody in the Bank believed that it was possible to protect particular parts of the economy in any way. Where there was a debate, it was partly about the approach to the short-term variability of interest rates. The overriding issue, however, was about what was happening to the rate of slowdown, particularly domestic demand. In addition, there was a tactical issue about how to do what was necessary in demand terms, without exacerbating the exchange rate. Sir Alan Budd said he was greatly irritated by the attempt by the press to divide the MPC into hawks and doves, because all members were equally committed to the inflation target. The Governor commented that the present situation was one to which the MPC would become entirely accustomed, whenever a situation emerged in which differences were marginal. Mr Davies commented that the minutes had not gone down badly and none of the comments he had picked up had suggested a particularly negative interpretation of the division within the MPC, and neither had they criticised the process. In reply to a question from Mr Davies about the extent to which the recent movement in the exchange rate was a result of monetary policy, Mr King said there was no simple explanation. But it was very difficult to explain the magnitude of the appreciation in terms of portfolio shifts within Europe. In response to a question from Mr Allsopp about intervention on the foreign exchanges, the Governor noted that the MPC had looked at alternative techniques such as overfunding and intervention. It took the view that only intervention played a serious role in today's markets. It would only work if it went with the grain. Unless the MPC could convincingly say the exchange rate had reached a peak it could not say that intervention would do less harm than good. The MPC could draw such issues to the attention of the Chancellor but had not got to that point.

Sir David Lees said he had never heard so many expressions of concern from business about the effect of the exchange rate. He asked whether it would be possible for the MPC to indicate that interest rates had peaked. In reply the Governor said it was quite difficult to establish where the top was. In reply to a question by Mr Allsopp, the Governor said that the Bank had explained consistently how the exchange rate entered into the forecasting process. There was not a rule of thumb trade-off between the interest rate and the exchange rate. In response to a question from Sir Chips Keswick, the Governor said that the politicisation of the European Monetary Institute was a big factor in the market's mind. He did not believe that this would lead to a softer monetary policy but he had no doubt that that was the market perception, and that was partly responsible for driving up the pound. Turning to the question of hawks and doves, Mrs Heaton said that the MPC should not be exercised about the terms because they were simply a shorthand way of describing how different people got to the same objective. She was more interested in the differences of view between the MPC and the Treasury. The Governor said that the MPC discussed what message the Treasury representative should be giving to the Chancellor. That was in relation to the potential impact of the Budget on monetary policy. That was not a minuted part of the MPC's discussion because it was felt that publishing advice to the Chancellor would not be helpful. However, the MPC would be discussing, within the minutes of the next meeting, the likely impact of the Budget on its view of inflation. Dame Sheila Masters noted the criticisms from industry and asked whether it was possible to communicate in language businessmen related to, rather than language for City economists. Mr King said that there were two issues - the position of manufacturing, and communications. The problem was that manufacturing was not representative of what was happening in the UK economy as a whole. Where communications were concerned, he did not believe the minutes were particularly technical, although it was true that they did not contain a heart-rending analysis of the problems of particular manufacturers. The summary of the Inflation Report went very widely to industry, and he noted that it was a less technical discussion. The MPC recognised the difficulties of manufacturers but its response was that its job was to prevent a repeat of boom and bust. Members made speeches and perhaps would have to do more. But it was not a matter of changing the language of the minutes. The decisions it made would not necessarily be welcomed anyway.

Sir Colin Southgate commented that while multi-nationals were having a difficult time in translating overseas profits into sterling, the domestic economy seemed to him to be still quite strong. He also said that if interest rates were raised, it should be sharply, and they should come back down slowly. He believed ¼% rises were not necessarily going to provide the shock waves necessary to the economy. The Governor noted that the Bank was very conscious of the translation issue.
Mr Allsopp commented that the most reliable mechanism for monetary policy was through the exchange rate, industry was beginning to understand that that was the way monetary policy worked. One certainty was that it was going to hurt. Dr Julius said that there was a perception problem that the MPC needed to overcome. She noted that MPC members were going out to see Agents and had found a hunger for information among Agents' contacts about what the Committee was doing and how it worked. It was quite an important part of MPC members' jobs to communicate what they were doing and why. She did not believe the minutes were the way to do that. It was important to continue to improve the Inflation Report and to consider whether there were other techniques that the Committee ought to use. In response to a question by Sir David Cooksey, the Governor said that the Bank had an annual exercise on the financing of small firms, which took place in January, and he had never known the relationship between small business and the banks to be as positive as it had been this year.

In response to a question from Sir David Lees about the psychology of small quarter percentage point interest rate changes, Mr King said that his view was that it was necessary to focus on the level of interest rates, and it probably made little difference which routes were followed to reach it. He also took the view that it could be useful for the MPC to give an indication of whether rates were likely to fall or rise over a period and this could have an impact on the exchange rate if people's current perceptions were different. It was not clear to him that at this stage this was the case. The Governor commented that if the exchange rate had not moved in the way it had, he had no doubt that the MPC would have moved to tighten interest rates more rapidly. In reply to a question by Mr Allsopp on the Budget, the Governor said that the MPC had passed messages through the Treasury representative indicating that certain actions in the Budget would have certain implications for monetary policy. In reply to Sir David Cooksey, the Governor agreed that the intention of micro-measures in the Budget was to raise the growth potential of the economy.

Turning to monetary union and Europe, the Governor commented that the fact that 11 countries were judged to be ready to go forward to monetary union was a historic step, leading up to the decision in May. Commenting on the informal meeting of Finance Ministers and Central Bank Governors in York the previous weekend, the Governor said that there had been a more widespread recognition than he had known before in that particular forum that monetary union was going to make supply-side reform even more important. That principle was accepted without any qualification.

<u>Activities of the Agents</u>

Mr King noted that in the Bill, Court was required to ensure that the Monetary Policy Committee took proper account of regional, sectoral and other information. There were 12 Agencies, and MPC members visited them regularly. The Monetary Policy Committee had given a very clear focus to the work of the Agents. The pre-MPC meeting, the Friday before the decision making meeting, was attended by three Agents who made a direct presentation to the MPC and discussed whether the information from their own surveys was consistent with the statistics. They also presented the results of a special survey undertaken at short notice with about a dozen companies each, giving a national sample of around 150 companies. This added a very useful supplement to MPC work.

Mr Allen in presenting his paper on the activities of the Agents said that three of the Agents had some involvement with bodies responsible for allocating funds derived from official, in some case, EU, sources to investment projects in their regions. He drew attention to the references in his paper to the Agent for the North-East and Cumbria, the Agent for the North-West (Manchester) and the Agent for the North-West (Merseyside) and Northern Ireland. The Governor invited Mr Kemsley to comment on his own involvement in the North-West. Mr Kemsley said that there had been reservations about moral hazard in connection with the Venture Capital Fund but the fund had been constructed to minimise that. The Board had appointed an IMRO-registered fund manager to manage the funds. The decision had been taken to ring-fence the three separate funds - Venture Capital and two loan funds. The funds had been running for 18 months so had not run into a period of bad debt yet. They were holding their breaths, waiting for that to happen in the next few months. In response to a question from Dame Sheila Masters, Mr Iles noted that the Agents had started panels of businesses, particularly for smaller firms. In his area he had several small business panels. They displayed an enthusiasm to come along and learn from the Bank as well as to tell it what was going on. He also noted a dramatic increase in speeches, presentations and talks by Agents, all directed more towards small companies than large.

Mr Buxton noted that Agents had two important roles, feeding information back to the Bank, and representing the Bank. He also noted that the report did not say anything about costs and suggested that an eye should be kept on this aspect. Sir David Lees said he was very favourably disposed towards the Agency system and he believed it worked extremely well. However he had reservations about Agents' involvement in other activities such as investment because of the risk of reputational damage to the Bank. In reply to a question from the Governor about the Agents' involvement in regional policy, Mr Allen said that many of the Agents were in contact with regional development authorities and they had also had a presentation by Richard Caborn and Barbara Roache in London on the matter. Mr Kemsley commented that the development of the RDAs varied in pace and enthusiasm around the regions. He said that he would, however, resist becoming a member of an RDA because he believed that there would be a very much better relationship with them if it were kept on an informal basis. Mr Buxton said he believed it was a good idea for the Agents to take part in other organisations and take Non-Executive positions but they should be very careful about the reputation of the Bank of England where they were taking potential financial liabilities. The Governor noted that Court wished to keep under review the external activities with which Agents were involved. In reply to a question by Mr Buxton about Information Technology, Mr King said that all the Agents' IT facilities had been upgraded under a scheme approved last year which was now complete. Mr Buxton commented that he did not think it was necessary to give Court a special paper on the costs of the Agents, but next time a presentation was made to Court there might be another sheet at the back of the paper about costs.

The Quarterly Supervision Report:- How Banking Supervision is taken into the FSA (Mr Page in attendance)

The Governor noted that this was probably the last quarterly Supervision report before the activity was transferred to the FSA.

Mr Foot apologised to Court for a change of plan on the Banking Act Report which he had indicated would be published by the Financial Services Authority but now, because of the delay in coming into force of the Act, would need to be published by the Bank of England along with its own annual report on 20 May. He explained the elements of the Banking Act report and the timing of delivery of the draft to Court, and the change of plan was accepted by Court.

Mr Page introduced a paper on the transfer of banking supervision to the FSA. A total of 456 staff were transferring, the majority going to Mr Foot's area. Of these 214 would go to Carol Sergeant's Banking Division and 131 to his own Complex Groups Division. It was still expected that the transfer would take place on 1 June although this was not definite. The building the FSA would eventually occupy at Canary Wharf would be ready for occupation towards the end of the year and before that the FSA would be setting up a temporary headquarters operation in Morgan Stanley's office in Canary Wharf. The creation of the FSA had involved Bank supervisors in a heavy additional workload though it was fair to note that in the previous year they had also had a special factor to deal with, namely implementation of the Arthur Andersen review. Mr Page drew attention to nine papers relating to banking supervision which had been put out by the FSA. Mr Davies noted that both the timetable and the budget were tight. The budget was slightly lower next year in real terms than if all the components this year were added together.

In response to a question from Sir Colin Southgate about whether the process had disturbed the train of events set off by the Arthur Andersen Review, Mr Davies said that in general the Arthur Andersen process had been an extremely helpful precursor to the move. If it had been done three to four years ago the culture clash would have been more dramatic. Mr Page said that virtually all the Arthur Andersen work remained relevant and the bulk of what had to be done had largely been achieved. IT had not got as far partly because it was necessary to integrate the plans with the FSA's IT strategy. In response to a question from Sir David Lees, the Governor said that the date at which the Act came into force was the date on which all the costs of supervision moved to the Financial Services Authority and the FSA would begin to charge banks for their supervision.

Cash Ratio Deposits (Mr Midgley in attendance)

Mr Buxton, as Chairman of the British Bankers Association, left Court for this item.

The Governor said there was a question of how the Bank should respond to a question from the BBA asking that some Cash Ratio Deposits should be repaid ahead of 1 June. The Governor said he had promised to consider this issue and revert to Court.

The financial framework the Bank had used in planning its expenditure adopted three medium-term objectives in relation to income and capital: full recovery of costs including an appropriate share of overheads, for services identifiably provided for specific customers, including the Government; a benchmark rate of return on the Bank's capital and reserves to ensure a reasonable return to the public sector; ensuring no real increase in the burden on the banks of placing CRDs with the Bank. He drew Court's attention to a chart tracking the main changes in Cash Ratio Deposits over the last three years. Over this period the level of deposits had grown by 70%, in large part due to the conversion of several major building societies to banks.

The Governor said that his sense was that the Bank had not kept to an internal understanding, which was also implicit to the banks, that there would be no real increase in the burden. The Governor proposed that at the end of March the Bank repaid 0.1% of the 0.35% Cash Ratio Deposits reducing the deposits to 0.25% which was half-way towards the 0.15% expected from the date at which the Act came into force. That was equivalent to giving the banks £8.5mn income during April and May of which £3mn would be at the Bank's expense and the rest of the expense would be with the Government in the form of lower tax or dividends. The Governor said that this would be warmly received by the banks and he understood that the Government would be quite happy with that. There had been a suggestion that if this was done, the banks' gain could be used in effect to fund the activity of banking supervision on transfer to the FSA, by providing a working cash balance. The initial reaction of the banks was that this was a complicated idea because the constituencies were not the same. But it was possible that a way could be found to allow the amounts the Bank would effectively be repaying to the banks to be offset against future charges, thereby providing the FSA with working capital. That was not a matter for Court and would not be the primary purpose for the Bank in making this gesture. He asked Court to agree that this would be a reasonable gesture in the circumstances. Dame Sheila Masters said that the Bank was not a profit maximiser and should not hang on to the money if there were advantages from the gesture. In response to a question from Mrs Heaton about the rationale for the amount, the Governor said that the transition to the new arrangements recognised the growth in CRDs during the year, and it could also be justified in terms of money market operations at the present time. He also noted that the Treasury did not seem sensitive to the possibility of Parliamentary questions on the point, and presenting it as a transitional matter was probably grounds enough. Court AGREED to the proposal to reduce the CRD rate from 0.35% to 0.25% with effect from 1 April.

Mr Buxton rejoined Court.

Payment to HMT in lieu of dividend (Mr Midgley in attendance)

Mr Midgley said that the interim dividend had been discussed with Treasury officials, who were content.

Court AGREED that, pursuant to Section 1(4) of the Bank of England Act 1946, an interim payment of £34.7mn be paid to HMT, in lieu of dividend, on 3 April.

A letter of resignation

The Governor laid before Court a letter of 25 February 1998 from Sir John Hall, giving notice of his resignation from Court with effect from 28 February 1998 as a Director of the Bank.

It was RESOLVED that the Secretary be directed to communicate to the Chancellor of the Exchequer the notice of resignation pursuant to Clause 8(e) of the Charter of 1 March 1946.

The Executive Report

<u>The Staff Library</u>

The Governor reminded Court that at their meeting the previous month approval had been given to the Bank's budget for 1998/1999. One of the cuts suggested in that document related to the Staff Library and the Governor mentioned that earlier this month Bank staff had been informed that the Library would close its doors on Friday 29 May. He pointed out that the constitution of the Library stipulated that, inter alia, the Library could be dissolved only by an Order of the Court of Directors of the Bank of England. He drew Members' attention to a recommendation in their folders for the Library to be dissolved with effect from 29 May.

It was a very sensible step to take, sad though many of the staff found it. The recommendation was approved.

<u>Standing Committees of Court</u>

The Governor reminded Members that it was convention at this time of year to review and approve the membership of both the

Audit and Remuneration Committees and confirm those Members of Court acting as Trustees of the two Pension Funds. Given that recent changes to Court's membership had been minimal but there would be more changes later in the year when the new Bank Bill came into force he suggested that it would be appropriate for existing responsibilities to be retained. With regard to the chairmanship of the Remuneration Committee, he also suggested that Sir Colin Southgate had indicated that he would be prepared to take over from Sir David Scholey.

Court endorsed these proposals.

Directors' commitments

The Governor reminded Members that they should notify the Secretary at least 7 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. Under the agreed arrangements for reporting Directors' commitments to Court, he pointed out that copies of each Member's commitments were to be found in folders.

Debt management

The Governor noted that responsibility for debt management would be transferred to the new Debt Management Office on 1 April though for the time being the Office would continue to use the Bank's dealing rooms.

Centre for Central Banking Studies (Mr Fry and Ms Place in attendance)

In introducing his report on the work of the Centre for Central Banking Studies, Mr Fry said that there had been two main questions when he discussed the role he was taking on: one was increasing the intellectual level of courses, visits and other activities, and the other was becoming a more useful direct resource to the Bank. He hoped the report, to which he drew Court's attention, reflected this remit. To be as useful as possible to the Bank, the Bank would have to allocate time to its staff to allow them to take advantage of what the Centre had to offer. He said he was slightly worried that pressure of work in the Bank had made this difficult but that after the changes had settled down he hoped Bank staff would be able to come to the Centre and explore the frontiers of central banking in collaboration with colleagues throughout the world. This year, more prospectuses have been sent out and he was surprised to find that many more OECD countries had been contacting the Centre to see if they could attend particular courses. These included Sweden, Norway, Denmark, Switzerland and Canada. But the Centre continued to put most of its effort into helping transitional and poor countries. He noted that it had just started a programme with Vietnam. The Governor commented that he rarely saw a central bank Governor without hearing what a very considerable help he was receiving from the CCBS. In response to a question from Mrs Heaton about banking supervision, Mr Fry said that for the rest of the calendar year the CCBS was offering to provide its resources to the FSA to run supervision courses. Next year, the FSA might use the Centre's facilities and the CCBS would provide administration. Costing arrangements were still being worked out. However, it was not possible for the CCBS to run supervision courses because the Centre would be one removed from the field of supervision, which was changing very rapidly. Mr Buxton commented that the activities of the Centre contributed to the standing of London as a financial centre and he was pleased to hear that there was increasing demand for its services. But he hoped that this could be translated into more income than the 16% recovery of costs at present. The Governor commented that this might be the case given that the Centre was dealing more frequently with OECD countries. Mr Fry said the important judgement was about the trade-off between the goodwill generated and the income. The Governor said that this was a question that could be looked at in the context of changing structures. Dame Sheila Masters said she was concerned at the relatively high unit cost of delivery of material and recommended a look at other lower cost methods such as distance learning. Mr Fry said that the Centre had published 14 handbooks over the last two years and was looking into interactive CD Roms with the publishers Routledge.

Mr Davies said no-one could contest the point that the CCBS needed to look for income wherever possible. But it was highly unlikely that it could get to break even because of the competition. Other central banks offered the facility for nothing and on the whole the Bank of England charged more than others. Typically the Bundesbank and the Banque de France would pay accommodation and other related costs as well. In response to a question from Mr Buxton about whether the CCBS worked with other organisations, Ms Place said that in Vietnam, which she had visited, the CCBS had liaised closely with the British Council and the Crown Agents (and part of its funding was from the British Council) but had not provided a joint seminar. The CCBS did liaise very closely with other organisations, partly to ensure no duplication. It had recently run joint courses with the BIS and the Commonwealth Secretariat.

A recommendation from the Remuneration Committee

The Governor asked Sir Colin Southgate to introduce a recommendation from the Remuneration Committee on Mr Vickers, whom Court approved last November to succeed Mr King when he takes up his appointment as a Deputy Governor this year. Mr Vickers would start work part time in the Bank next month and become full time on 1 July.

Sir Colin Southgate said that the Committee had agreed to recommend a salary of £125,000 a year, pro-rated during the period in which Mr Vickers worked part time. Mr Vickers would be invited to join the Court Pension Scheme.

Court APPROVED the recommendation.

The Governor drew Court's attention to his engagements but said he had nothing in particular to note. Court rose.

23 April 1998

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 1 APRIL 1998

Present

Mr George, Governor

Mr Clark

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 Court, having been circulated, were noted.

23 April 1998

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 8 APRIL 1998

Present

Mr George, Governor

Mr Clementi, Deputy Governor

Mr Clark

Mr Foot

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.

23 April 1998

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 15 APRIL 1998

Present

Mr Clementi, Deputy Governor
Mr Clark
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.

23 April 1998

A COURT OF DIRECTORS AT THE BANK

THURSDAY 23 APRIL 1998

Present:

Mr George, Governor
Mr Clementi, Deputy Governor
Mr Allsopp
Mr Clark
Sir David Cooksey
Mr Foot
Mrs Heaton
Sir Chips Keswick
Mr King
Sir David Lees
Dame Sheila Masters
Mr Neill
Mr Plenderleith
Sir Neville Simms

The Minutes of the Court of 25 March and the Meetings of 1, 8 and 15 April, having been circulated, were approved.

The Governor welcomed Mr Vickers and introduced him to Members of Court.

Economic and Monetary Discussion, including Market Charts (Dr Julius and Mr Vickers in attendance)

Mr King said there were three topics for the discussion on the economy, as starting points. First, there were the minutes of the March meeting of the MPC. Second, there was a paper on the motor industry, an industry which was affected by the appreciation of sterling, which had links to the rest of the economy and which had an important involvement in the labour market. Third, this was the main week of the month for publication of key statistics, with data for inflation, public borrowing, the labour market and for retail sales.

Mr King referred to the extensive press coverage the previous week of minutes of the March MPC meeting which revealed a continuation of the equal division of the Committee between those favouring a rise in interest rates and those preferring to leave rates unchanged. He noted that the arguments on both sides were set out at length in the minutes.

Part of the Monetary Policy Committee's remit was to ensure that not only did it examine regional information, but it also paid appropriate attention to sectoral information. Turning to the Bank's note on the car market, Mr King said it would be helpful to have Court's reaction to what was happening in the motor industry and whether such discussions of a particular sector were useful. Turning to the statistics, Mr King noted that there would be a rise in inflation in April, May and June because excise duty increases came in earlier this year than the effect from last year dropped out. The MPC would let it be known in its minutes that it anticipated this effect. Mr King also noted that in the labour market the pace of tightening had slowed markedly and at some point unemployment was likely to turn up, on present evidence sooner rather than later. In relation to earnings, he said there was no change, with 4.5% growth for the economy as a whole, 4.6% in manufacturing, 4.8% in services, and a marked dichotomy between the public and private sectors. For retail sales, he said that there was no change of view of the trend.

Mr Plenderleith said that market movements had not been very different from the recent past. Sterling, having risen to DM3.10, had come back to just below DM3.0. The main explanations of what had been driving it up were a combination of cyclical differences and EMU effects, with heightened investment demand for sterling as a diversification from the Euro, driven particularly by a perception that the Euro would be weak and the ECB would be a politically-influenced central bank. Rather little of the further rise in sterling could be explained by interest rates. In April sterling had come back, which might partly be due to more confident view of the Euro. All the data was being scrutinised in terms of what it told about the future of UK interest rates. There was also a possibility that the Bundesbank might be considering raising its rates.

Sir Neville Simms said that the construction industry recovery continued. There had been a hiccough at the beginning of 1998 but it looked as if volume growth would be stronger than indicated. However, there were constraints in some areas. For the first time, cost pressures were showing for some materials. The labour market was now back to the employment levels of 1990 and wages were rising ahead of the national figures. Pressures were moving away from London and the South East and were becoming much more visible. 200,000 labour only sub-contractors had also come back onto the industry's books. There was a view that demand may slow and the end of the cycle may begin to be seen, but Sir Neville Simms commented that in his view it would run on for at least a couple more years and there would be wage pressures certainly through this year and into next. In response to a question from Dr Julius about the Millennium project, Sir Neville Simms said they were as significant as the Channel Tunnel had been, representing 4 or 5% of output. He did not believe work would cease immediately at the Millennium but the effect would be less strong beyond 2002.

Mr Neill thanked Mr King for a very interesting paper on the motor industry. Mr Neill commented that internationally the Japanese market was down very severely, as was South East Asia. Europe was attractive and the most attractive market in Europe was the UK. But April had not been anywhere near expectations. In response to a question from the Governor on margins, Mr Neill said that the UK was a higher margin market but the retail prices seen were not a very good guide to what was paid. Fleet car purchases were more than 50% of the UK market and fleet buyers received large discounts, which was not true in Europe. Consumers were also able to get very good deals. He agreed, however, that consumers paid more at the retail level than in European markets. Mr King agreed to investigate how these factors were reflected in the Retail Prices Index. The Governor commented that the car industry was a good example of a more general problem, which was that the strength of sterling was not much reflected in retail prices or indeed in wholesale prices. In response to a question from the Governor on why importers kept their margins up and did not reduce prices, Sir David Lees said that this was because they were still able to get their volumes and keep their margins. Cars were a series of components, and it was necessary to look behind the car to see the pattern of supply. A UK car with a lot of imported components had a very complex cost structure. Sir David also wondered whether the surge in private car buying was a reflection of bonuses. He said he was very sensitive to the way bonuses and other factors at the top end of the salary scales leaked down to lower levels. In response to a question from Mr Allsopp, Sir David Lees said that one of the factors that would reverse earnings growth would be a slowing in profits growth. Sir David Cooksey, noting the experience of the textiles and apparel industry, said that there was a split in the economy.

The Governor asked for comments on the minutes of the Monetary Policy Committee. Sir David Lees said they read extremely well. He believed that a weakness in the process was that Court, in discussing the minutes, was one meeting adrift. All were aware of the decision made on 8 and 9 April but it was very much more difficult to get enthusiastic about minutes relating to a decision which had been overtaken by events. The minutes were good but the timing was poor. The Governor commented that a number of people held that view, and it was an issue that would need to be addressed. The MPC was at the cutting edge in this process, there were arguments in both directions and the MPC would need to feel its way. An argument against earlier publication was that it was quite conceivable that the MPC would reach a position in which it was not sure about an action to take this month but may wish to take it next month. This would generate unnecessary uncertainty if the minutes were published ahead of the next meeting. The MPC would discuss that issue but he would rather address it when the Committee had had a bit more experience. Sir David Lees noted that, where the Committee was equally divided, the media speculation centred on who thought what rather than on the decision. This was unhealthy. There was too much in the media about hawks and doves. That particular problem would be reduced if the minutes were published closer to the event. The Governor commented that it was because the MPC published the way people voted that coverage focused on hawks and doves. He noted that timing was something that the Committee needed to have a debate about. However, the arrangements had been in place for less than twelve months and it was not necessary to rush into a debate. Dame Sheila Masters said she agreed with Sir David Lees. She had been unhappy with the six-week delay with the minutes of the Governor/Chancellor meetings. Now the focus was on the vote. She believed it would be worth revisiting the issue at an early stage. The quality of the debate would improve if the deliberations were made available earlier. Mr Plenderleith noted that the only other central bank that published minutes was the US Federal Reserve. The MPC had based its practice, of publishing after the next meeting, on the Fed. The Governor said that he was not at all closed minded on this. But he commented that it was necessary to have a serious debate about the issue rather than just respond to the mood of the day. It was necessary to stand back and produce a focused paper. If such a paper were produced, it would be brought to Court.

In reply to a question from Mr Allsopp about the forecasts, the Governor said that all recognised and agreed that it was not possible to take a ready reckoner to the forecast. If it was marginally above or below target it did not have automatic implications for interest rates. In reply to another question from Mr Allsopp, Mr King said that each individual member of the MPC was personally accountable to the public, the Treasury Select Committee and the Chancellor, so would have to explain to the public why the interest rate for which that member had voted was consistent with the inflation target. That was equivalent to making a forecast. Decisions had to be justified by reference to the forecast. The Deputy Governor drew attention to paragraph 51 of the MPC minutes and noted that there was no mechanical link between decisions and the forecast. Mr King said that the whole point of the fan charts was to explain that the MPC did not know what was going to happen. It had views about the range of probabilities. The fan chart was fundamental to its ways of thinking about these problems. The Governor commented that the MPC had some way to go in explaining its thinking about this.

The Bank Bill - Governance Issues

The Governor noted that Royal Assent was expected before the end of the week. It was hoped that the Bill would come into force from 1 June, and in particular there were a number of governance issues to discuss ahead of that day. He asked the Deputy Governor to introduce a paper written by the Deputy Governor and Dame Sheila Masters. The Deputy Governor noted that the responsibility for the operations of NEDCO rested with NEDCO itself. Dame Sheila would wish to call a meeting shortly after 1 June to discuss that responsibility. The presumption was that support for NEDCO would come from the Bank, but it was open to NEDCO to call on other support if it wished.

It was suggested in the paper that the Remuneration Committee should be a sub-Committee of NEDCO. It was sensible at this moment for Dame Sheila and Sir David Cooksey to join the Remuneration Committee and this had been agreed with Sir Colin Southgate. The Deputy Governor said he would like to have Court's approval for this proposal.
Turning to the Audit Committee, he said the suggestion was that it remained as constituted but that it could take matters under direction from NEDCO.

Turning to the Review of Non-Executive Directors' pay, he said this had to be put to the Government before 1 June. But the Bank would be talking to Non-Executive Directors before it put its proposal.

Dame Sheila noted that she had circulated an earlier draft of the paper to all the existing Non-Executive Directors. She said there was a general feeling that Directors did not wish Court to take up any more time. They would prefer to take advantage of some Courts being a little shorter, and shoehorn NEDCO meetings into regular Court mornings. She noted that Court had slightly fewer things to do, for example with the departure of Supervision & Surveillance. An important area Court would keep under review was its responsibility in relation to MPC procedures. This was generally a difficult area to get to grips with and something it would have to feel its way through in the first year. She noted that although the Deputy Governor had said there would be another look at NEDCO procedures when the new Court convened after 1 June, she herself would be briefing the five new Members in advance. She also noted the importance of obtaining a clear view at an early stage of what NEDCO was reporting against. Were the strategy, the objectives and the financial management objectives clear enough? That was an early task NEDCO would undertake. It would not get it absolutely right when it started, but the issue would be kept under review. There should, furthermore, be some formal review process for NEDCO's procedures at the end of the first year.

She noted that a number of Directors had said that they did not wish to have a divisive relationship with the Court. The Act gave the Non-Executive Directors a number of responsibilities and the requirement to report on them in public and they should focus on that and not on setting up a rival to a unitary Court. The Non-Executive Directors wished to find a harmonious way of working through their new responsibilities under the new Bank of England Act. The Governor commented that he agreed with Dame Sheila's last remark. He acknowledged the Non-Executive Directors' particular responsibilities and he said the Bank's intention was to help them fulfil them.

Sir David Lees noted that, providing Court as a whole addressed its own responsibilities under the Bill, there were really only two areas in which the Non-Executive Directors were on their own and these were the points made in V and VII in the paper under discussion. Sir Neville Simms said that NEDCO needed to have a meeting to sort these issues out. He commented that he was not happy with the paper as it stood. As with any unitary Court, the Non-Executive Directors had fairly similar tasks which they generally ought to be able to do in a unitary board meeting, not in a parallel meeting. It was, on the other hand, entirely normal to go away once or twice a year to discuss things that should not necessarily be discussed in front of the Executive Directors. He said he would not go through the paper in detail with comments at this stage. His preference was that before the new Directors arrived the existing Directors with experience of Court should sit and talk about these issues. This would all have to be done very quickly. He did not believe the framework proposed in the paper was right.

The Governor commented that this issue was for Dame Sheila. Sir Neville said that he did not wish to find that the Court minutes noted that there was broad agreement with the paper.

Dame Sheila said that Directors should try to squeeze time out of the May Court to discuss the issue. Sir Neville said it was necessary to get as many as possible of the existing Directors in a room together to think about the issues. Dame Sheila said she would talk to Sir Neville after the Court meeting.

Sir Chips Keswick said that he found the paper excellent and he noted that he was at the opposite end of the scale in his views to Sir Neville Simms. Dame Sheila said she accepted the point that Court had to be satisfied with the performance of the Bank. But the fact was that NEDCO had to report on it and it was quite likely that the Treasury Select Committee would haul her or other Non-Executive Directors in to examine them on the basis of that report. It was therefore necessary to have procedures that would be proof against that kind of challenge. NEDCO would have to have demonstrable procedures to carry out its statutory responsibilities without necessarily detracting from the responsibilities of the full Court. Mrs Heaton said she supported the proposal for a meeting to thrash out this issue. The Governor said that the Bank would facilitate whatever the Non-Executive Directors wanted to do. He noted that Dame Sheila had said that they could use a part of the normal Court meeting period for the NEDCO meetings. The Bank was agreeable to that and the sense he got from the meeting was that it would be about an hour, once a quarter. The Bank would take account of that in trying to organise Court agendas.

The Governor asked Court whether it was content with the proposed expansion of the Remuneration Committee. Court was content.

The Governor noted that every year for the last few years there had been a meeting of the Non-Executive Directors and the Board of Banking Supervision and the time for that meeting was approaching. Immediately after that meeting BoBS would depart to the Financial Services Authority. BoBS did not see a great need for the meeting and Non-Executive Directors might agree.

Were they content to stand that meeting down? Court was content.

The Executive Report

There was one item, central bank guarantees for TARGET payments, introduced by Mr Plenderleith. He noted that an important feature of the legal framework of the TARGET real time gross settlement system was an explicit guarantee that each sending central bank gave to the receiving central bank as to the finality of each payment originating from its domestic RTGS system. There was a small risk from the guarantee but potentially involving very large sums. The guarantee however protected the Bank from the equivalent risk in respect of other countries' laws. Court was content with the proposed guarantee.

The 1998 Annual Report - in draft (Mr Midgley and Mrs Bishop in attendance)

The Deputy Governor commented that the Report was rather heavy and slightly repetitive. It was proposed this summer to begin a major look at the Report and Accounts in the light of the new Act and responsibilities of NEDCO and to agree with Court how the Report of NEDCO would appear in it from next year.
The Deputy Governor said that in his view the Annual Report should not include the budget numbers. The Bank was committed next year to include ex-ante budget numbers and comparisons with the outcome. The argument for including them this year was transparency, and the argument against was the difficulty of setting out how the comparisons were made. Discussions were continuing internally on what comparisons would be needed. They would be agreed with the new Court. The Deputy Governor said he did not wish to use one accounting convention this year and another next, which could lead to accusations of cooking

the books. His own strong preference was not to include budgets this year but he would like Court's views. Court agreed with the Deputy Governor.

Members of Court then made a number of comments on the draft which were noted for inclusion. Sir David Lees commented that the figures for staff remuneration and numbers indicated an average percentage increase across the Bank of 9.2% and he hoped that a public response would be prepared on this point. The Governor replied that a brief had already been prepared. In response to comments on a reference to the Memorandum of Understanding, the Governor said it would be published in the Bank's Quarterly Bulletin next month but he also wished it to be published as a free-standing document as well, which would be made freely available.

Quarterly Financial Report (Mr Midgley in attendance)

The report showed the actual outturn for 1997/8 compared with the budget forecasts made in February a year ago. Income was higher than budget - by £27½mn - and expenditure was lower - by £11.5mn. But neither of these points was new information so the position was not significantly different from that reported to Court in January.

Mr Midgley noted the main reasons why income was higher and expenditure lower for the year as a whole. Income was higher for two main reasons: the impact of building society conversions last summer was bigger than forecast and short term interest rates were higher.

The expenditure shortfall was mainly due to the response of management to last May's announcements. The timing of the original budget, was based on having S&S in the Bank, and implementing the recommendations of the Arthur Andersen review, which implied more staff, more training and better IT. For the

Bank as a whole, there was also a planned push for more and better training, particularly of Officials, following on from the reviews of Officials and Officers. The May announcements disrupted the implementation of both of these programmes. The recruitment drive had been gearing up but in the second half of the year the focus had had to be on the transfer of existing staff and less on recruiting new staff. There had been increased training and IT expenditure, but not to the extent originally planned.

The move of half of the Bank's Officials to the FSA changed the shape of the Bank's analytical workforce, making the previous plans no longer appropriate. The proposed new graduate training programme (MBA) was stopped, and a management training initiative deferred. Personnel had to concentrate on the transfer, Mr Midgley noted.

In addition the budget was put together before the full impact of EMU preparations on the pre-existing work programme in some areas had been assessed. It was soon apparent that the EMU work required a re-prioritisation of plans. There were insufficient staff to do both, and insufficient time to build up staff numbers with the necessary experience.

The main impact had been on direct expenditures - particularly IT and training-related. Staff numbers had been below budget - but the impact on costs had been offset to some extent because of the need to tie in staff to projects, to ensure that pay rates were aligned to the market in key areas such as settlement office staff and IT staff. Implementation of the Bank Officer review was an important factor. And in addition, the creation of the MPC had lead to an expansion of both number and staff costs.

Mrs Heaton said there was only one issue, which was whether there should be a commitment to make changes during the year to keep to the budget. Alternatively, if there were an overspend should the Bank simply accept that costs were up? Dame Sheila said that during the year just ending, Court would not have expected otherwise. The budget assumptions were re-written two or three times by the Chancellor as the Bank got into its financial year. It was not necessary to re-budget, in financial control terms. Dame Sheila commented that she was not uncomfortable with that. The Deputy Governor noted that the Audit Committee had the previous day had a preview of the new package of financial information. The proposals would be brought to Court on 6 May.

A Report from the Chairman of the Audit Committee

Sir David Lees noted that the Audit Committee met on 26 March and 22 April. Matters to do with the Accounts would be discussed at the Court meeting on 6 May. The Audit Committee spent some time at its most recent meeting looking at progress with the Euro and Millennium systems projects, which had been to Court. The Euro project under Mr Plenderleith and the Millennium project under the Deputy Governor were progressing well. The timetables, particularly on the Euro, were tight, but the explanations given left the Audit Committee not complacent but comfortable in the belief that appropriate progress was being made towards these key dates. There would be a paper to Court in July on the Euro and Millennium projects. He drew Court's attention to the discussion in the Audit Committee minutes of a £10mn retrenchment provision. The whole issue of retrenchment would be dealt with in more detail on 6 May but it had been agreed with the Auditors that that part could be left open. Sir David Lees also drew attention to the Audit Committee's re-visiting of the Risk Matrix issue. Coopers & Lybrand would be reporting to Court that the Audit Committee had reviewed the effectiveness of internal financial controls. Court would receive a comfort letter from Coopers & Lybrand saying the Audit Committee had carried out its remit. The progress made in establishing a risk matrix and identifying risk within the Bank had been considerable and Sir David Lees was sure his colleagues on the Committee would endorse that view.

Sir David said the Committee did not review its Terms of Reference pending completion of arrangements for the new Non-Executive Committee when the Bank of England Act comes into force though it had done so in the previous two or three years. He also noted some concern within the Committee at the combined administration cost of running down NMB and Minories Finance. This had been reviewed the previous day with the Deputy Governor. The clear objective was to liquidate Minories Finance this year. There were no comments on the Report of the Audit Committee.

The Bank in the Community 1997/98 - Community Affairs review [redacted] in attendance)

The Deputy Governor commented that [redacted] did a good job keeping an eye on this area.

Introducing the report, the Deputy Governor noted that the cost of the Bank's community involvement in 1997/98 was £1.46mn, almost unchanged from the previous year. This represented 0.86% of pre-tax profits, compared with the Business in the Community Per Cent Club target of 0.5% of pre-tax profits, which was taken by the Bank as a yardstick. However, he explained that the cost of community secondments represented some 60% of the total, and that the number of secondments had declined over the year from 32 to 14; thus, as matters stood, this element of the Bank's contribution would be significantly reduced in 1998/99. He added that the report brought home the scope of the Bank's community involvement, which he thought was highly commendable.

[redacted] said that the former Community Relations Unit in Personnel Division had been disbanded in March 1997; Personnel

Division had retained responsibility for community involvement activities which compacted on staff development, while Linda Barnard had moved to Secretary's Department as Community Relations Manager, and was responsible for delivery of the community policy, dealing with charitable appeals and donations and managing the Staff Volunteering Award Scheme (SVAS). As regards the charitable donations budget, he drew Members' attention to a shift in resources from responses to ad hoc appeals in favour of donations under the SVAS, which provided a vehicle for recognising staff's time; contribution and fund-raising efforts for charities which they supported. Picking up on the Deputy Governor's point about the spread of the Bank's community involvement, he noted that this relied on the willingness of staff to be involved and the organisation efforts of [redacted] and others: he expressed the hope that the general pressures on the Bank and its staff would not drastically squeeze these elements.

[redacted] said that the Bank's community affairs policy statement formally adopted by Court in 1995 put the focus on encouraging the staff's community involvement and supporting organisations which created employment opportunities for disadvantaged people: the paper noted some of these organisations and she highlighted the work of St Mungo's. She believed that the two strands of policy had developed well over the three-year period under review and remained relevant and appropriate. A range of evidence bore out the contention that the policy benefited the staff, the Bank and the communities and organisations which had been supported. Moreover, the focus on organisations working to create employment opportunities for disadvantaged people fitted in well with the Government's Welfare To Work Initiative. Accordingly, she hoped that Court would approve the policy statement, with minor drafting changes, for a further three-year period and also agree the principle of collaboration with other City institutions on a Millennium Community Project.

In response to Dame Sheila Masters, [redacted] said that discussions on the latter project were at an early stage, but noted that a reading partnership scheme with schools in Tower Hamlets - perhaps with the objective of producing 1000 reading partners - was one possibility. Mr Neill commented that, as a member, he knew that the objective of the Business in the Community Per Cent Club was now to distribute 1% of pre-tax profits to the community. He said that he was impressed by the range of the Bank's community involvement and felt that more could be made of these in the Annual Report, particularly in view of the example which the Bank could set to City and other institutions. Sir Neville Simms highlighted the benefits of a staff appeals committee. The Deputy Governor said that, given the proliferation of committees in the Bank, he had been satisfied to learn of a function where none was involved, but he agreed to consider if there was scope for such a committee.

The Governor commended the work of the Community Affairs Unit and asked for approval of the revised community affairs policy statement.

Court APPROVED the revised community involvement policy and collaboration with other City institutions in identifying a community involvement project for the Millennium.

Houblon-Norman Fund Report

The Deputy Governor said he would be happy to answer any questions on the Report but there were no questions. Mr King, as a representative of the Advisory Committee, noted that there were 24 applications and two new senior fellowships were awarded: to Professor Xavier Freixas, Professor of Economics at the Universitatite Pompeu Fabra, Barcelona; and to Professor Ronald I McKinnon, Professor of Economics, Stanford University, California. A fellowship was awarded to Dr Niall C Ferguson, Fellow and Tutor in Modern History, Jesus College, Oxford. Professor Freixas would be examining the inter-bank market and lender of last resort intervention; Professor McKinnon would be working on constraints on governments, the regulation of banks in federal systems, and the implications for the European Monetary Union; and Dr Ferguson would be working on the political economy of the international bond market from 1780-1930. Mrs Heaton noted that last year there had been concern about the quality of the applicants and she asked whether there were similar concerns this year. Mr King said that the Advisory Committee had been very pleased with this year's applicants.

The Governor noted his engagements and, as there was no further business, Court was up.

6 May 1998

MINUTES OF A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 29 APRIL 1998

Present

Mr George, Governor

Mr Clementi, Deputy Governor

Mr Clark

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

6.5.98

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 6 MAY 1998

Present:

Mr George, Governor
Mr Clementi, Deputy Governor
Mr Allsopp
Mr Clark
Mr Davies
Mr Foot
Mrs Heaton
Sir Chips Keswick
Mr King
Sir David Lees
Dame Sheila Masters
Mr Plenderleith
Sir Neville Simms
Sir Colin Southgate

The Governor asked for approval of the Minutes of 23 and 29 April. Sir David Lees proposed a correction to page 87 of the Minutes of 23 April concerning the Report of the Audit Committee and the correction was accepted and incorporated.

Reporting on the summit in Brussels the previous weekend, the Governor said that a sense of achievement had been recognised by everyone. But after the debate in the European Parliament on Saturday morning, events had gone rather dramatically downhill. The root causes were egotism, nationalism and a rather different perception from others, on the part of President Chirac, of what a central bank independent of political influence meant. The President did not signal in advance the extent to which he was going to insist on a French candidate for the presidency. The Governor also expressed puzzlement at the behaviour of Chancellor Kohl. If he had really dug in his heels, it would have been very difficult to see what President Chirac could have done, except back down. After a period of vacillation, the Germans in the end achieved some better wording which could be presented in a way that was not specifically contrary to the Maastricht Treaty and was protected in Germany from legal challenge. But the substance of the arrangement was effectively unchanged, with Mr Duisenberg taking four years, to be followed by an eight-year term for Mr Trichet. The Governor noted that because of the time discussions took, other Heads of State, Finance Ministers and Foreign Ministers had been left kicking their heels, and this led to considerable back-biting in the corridors. There were allegations that Mr Blair was at fault, but the Governor commented that Mr Blair could not possibly have foreseen Mr Kohl's vacillation. Mr Blair had kept going rather heroically, and had achieved what was achievable. The Governor's impression was that this very significant moment in European monetary history was overshadowed by a great row.

At the end of the day, Mr Duisenberg and Mr Trichet would be perfectly good presidents and would pursue indistinguishable policies, and the other five members of the Executive Board of the ECB were very convincing. The eight-year term of Mr Issing had been very warmly received. The Governor commented that the market reaction to the events of the weekend had been calm, but it had been a rather miserable experience.

The State of the Markets

Mr Plenderleith said there was no surprise for the markets in the choices for the Executive Board or the conversion rates. There had been little market reaction. As for the politics, the market had looked through that to the choice of people.
Mr Plenderleith noted that sterling was 5% below its peak in late March/early April.

[redacted]

The Banking Act Report 1997/98 - in draft (Mr Evans in attendance)

The Report, in final form, would be presented to Court the following week when there would be a report on the name of those parties to whom powers under the Banking Act, the Financial Services Act and other pieces of relevant legislation had been delegated, and provide details of the exercise of those powers.

Mr Foot said that it had been a rather unusual year for the Banking Act Report. It was to have been put in as part of the Financial Services Authority Annual Report but, because of the delay in the coming into force of the Bill, this did not seem appropriate. The Report fulfilled the remit of reporting to Parliament on the stewardship of the Bank of England during the year. In reply to a question from Mrs Heaton, Mr Foot said that, since the Report was written, it had become clearer that the FSA was committed to publishing a major approach document that would pick up all the issues the FSA had inherited. He suggested that a note of the fact that this document was coming and what it would contain should be put in the first section of the Report. Mr Davies agreed. There were no other comments.

The Bank's future property strategy (Messrs Midgley, Everett and [redacted] in attendance)

In introducing his Report, the Deputy Governor said he had tried to give Directors an overview of the Bank's property portfolio, and some of them had just been on a tour of part of the offices, including the new open plan area in S&S. The paper he was presenting was important, and would substantially influence the working environment of Bank staff. In terms of controllable expenditure, this might be the largest item Court would look at in the next few years. The Bank's advisers were St Quintin, as property consultants, and Davis Langdon & Everest, Quantity Surveyors and Davis Langdon Management were the project management team.

The Deputy Governor noted that Head Office was a very difficult building, in one sense, because of the way noise transmitted from one point to another, so strenuous efforts would be made to get the period of refurbishment down to two years. This carried some additional costs offset by the need to keep to the minimum the amount of time there was building work on site, and also by the fact that only when the work was complete could the Bank take advantage of the cost benefits. He noted that the cost estimates did not include the contingency figure, and that could be covered in Court's discussions. The Bank believed the cost of the project to be about £40mn.

There were three main issues: the consolidation into Threadneedle Street made self-evident sense and the quicker that was done the quicker the Bank could realise the many cost benefits that would flow from that; the move of catering to Head Office, which was in the paper on the assumption that the Bank would continue to provide the service in-house; and the refurbishment, of which a substantial amount would have to be carried out over the next two to three years because of the nature of the building, not least because of the need for shunt space during consolidation. There were three choices for the refurbishment: a cheap and cheerful open plan scheme, which it had been decided was not an option; a cellular office plan; and a reasonably high specification open plan office in line with the pilot scheme, which was the option staff preferred.

The proposals had been considered at the Governor's Committee, which was in favour of open plan because of the greater flexibility in moving people. The Bank had not considered letting space, but if that were done, it would be easier with high specification offices. Open planning and high specifications reflected the type of organisation the Bank wished to be. In a cellular office, staff could spend all day unaware of anyone else's presence.

The Deputy Governor drew Court's attention to the summary of costs on page 12 of the paper. The total was £36.6mn, of which £18.6mn would be put through the profit and loss account. The figures did not include a contingency number, so Court should look at the proposal as a £40mn project. A range of provisions for retrenchment had been discussed. The principle on which Coopers & Lybrand had advised that the provision should be based was that it should cover the cost of decommissioning and the minimum cost of relocation. The proposed provision was £10mn. The Deputy Governor also drew Court's attention to the initial estimate of the savings set out on the bottom of page 12 of the paper. The Bank would be able to operate Property Services with about 100 fewer people by decanting five buildings into one. The final item to which he drew attention was the £7.5mn extra spending that would be necessary to go to a reasonably high specification open plan scheme. He said he intended that it would not be a gold plated option. His own view was strongly in favour of open plan because it encouraged team work and would be very well received by staff. Compared with the amounts which large banks in London spent on property, he believed Court would find the cost reasonable.

Sir David Lees said that apart from accounting treatment, which would be discussed later, he had three comments. First, he was delighted to hear that there was no support for a cheap and cheerful solution, at least from management. He was impressed by the prototype office scheme. Second, he was unclear why the Bank was contemplating renting out unused space rather than selling it. Third, turning to catering, he noted that the capital cost was £5mn. He was sure it was well thought through as to why the Bank wanted to do that. He was not however sure that £5mn bought a deluxe standard of catering. He would wish to hear more about the catering proposals on another occasion. Sir Chips Keswick said that, having worked in an open plan office for 30 years, the prototype was quite excellent. He noted the importance of having rooms that were private as well. Dame Sheila Masters commented that the catering at first blush looked quite expensive and she asked what the benchmark was for large organisations in the City. KPMG had moved considerably downmarket and was now not offering much more than an upmarket takeaway. She also asked whether the savings in moving people about were genuine. She agreed that, if a decision was being taken to go open plan, it should be at a high specification. However she asked whether it was clear that, across the whole range of Bank activities, this was the best way to produce the right answer. Supervision & Surveillance, she knew, believed this, but she would be interested in hearing from other Directors about their areas. Sir Neville Simms said he had little doubt that the Bank should go for the model that Directors had been shown that morning, which looked excellent. He agreed that the work needed to be done as quickly as possible and noted that it would not be a pleasant experience while it was being carried out. It was not inconceivable that it could be achieved in one year. Turning to catering, he asked whether consideration had been given to the idea of offering a catering franchise in which another organisation would take the investment risk. He also noted that blinds could be a very simple addition to make sure at least one room could be private in an open plan office. He also asked whether the Bank believed it had an experienced enough project manager to handle the operation. It would be excellent if it did have such a manager but, if not, somebody should be incentivised to perform on the Bank's behalf, and should not be paid by the hour.

Mrs Heaton said she was a strong supporter of high quality open plan office space. It would enormously improve the method of working of people in the Bank, where she had concerns about the hierarchical and deferential atmosphere. She expressed the wish that the most senior executives would also go into open plan offices. Often the senior management of an organisation set up an open plan scheme but kept their own offices. Having top people working in the open enabled them to know what was going on and allowed the teams to know the top people. Sir Colin Southgate commented on the importance of treating everybody as equals, so the Bank should go to the highest specification to achieve the right working environment. That applied also to catering. If equal treatment did not apply, the Bank was not going to move into the next century in particularly good shape. Sir Colin also recommended writing off the whole cost in the current year's accounts. Sir Neville Simms noted that his company had a listed building in the Wolverhampton area whose Treasury Department had been refurbished at £100 per square foot and, although the circumstances were different from London, he believed that price could be used as a marker. Mr Foot commented on the importance of open plan for flexible management of teams and of information technology. He also noted that there was likely to be much special pleading for closed rooms, and he urged that it should be resisted. Mr King, in response to the request from Dame Sheila for the views of other Directors, said that the Supervision & Surveillance model would apply in his area of the Bank and staff were keen to move towards it. Mr Plenderleith also commented that his area was very much in favour of a move to open plan.

The Governor said that he took the view of Court to be that the Bank should aim to retrench into Head Office, that it endorsed the high specification open plan option and that there was a significant question about catering which Court could return to at the end of the discussion. There were specific questions to answer as well: why was the Bank renting not selling, was it really sure of the timescale of two years, how was management of the project to be carried out, and finally there were questions concerning the cost of the project. He also noted that Sir Chips had advised that there should be quiet spaces, and this had been endorsed by Sir Neville Simms and others.

Turning to the question of renting as opposed to selling, the Deputy Governor said there was a presumption that the Bank would sell King's Arms Yard, and it had been valued at £4mn in the paper. Eagle House's lease expired early in the next century. There was an issue about Bank Buildings and New Change. One way to demonstrate the potential for savings was to set out what the Bank would receive if it rented out the space. But there was no firm plan either to sell or to rent these two buildings. New Change was, largely, rented to Allen & Overy and the Bank retained only one floor. The Bank was in discussion about whether to rent that floor to the firm. If there was one tenant, it would be a very saleable proposition. The Deputy Governor noted that he did not intend to bind Court either way to renting or selling and he apologised if his paper was not sufficiently neutral on that point. He invited Mr Everett to comment on management.

Mr Everett said that he had steered the interface between the Bank, contractors and consultants. The intention was to use professionals from the consultancies in the various facets of the work. Davis Langdon and Everest were the Quantity Surveyors but did not have an exclusive arrangement with the Bank, which used four and rotated them. It was the intention to use Davis Langdon Management on the refurbishment project, as the project management team. Mr Everett said he would welcome the opportunity to discuss incentivisation schemes with Sir Neville Simms. Mr Everett said that he himself would continue to direct operations and act as the interface between Directors, Heads of Divisions and users. He also noted the significance of noise and dust problems during the work. Although the original timetable given had been three years, the logistic experts at Davis Langdon Management had said it was possible to do it in two years. He noted that this would require a contractor willing to work seven days a week, 24 hours a day. This had to be balanced with the requirement to move people out of the Bank, because shunt space was limited. It would be confined to the recently refurbished ground and mezzanine floors at Bank Buildings. It would be possible to clear the second floor by sending some people to Bank Buildings and of course Mr Foot's people were going to Canary Wharf which would include some on the third floor, so two floors would be vacant. If the Bank wished to speed the operation further it would have to find shunt space in the City. This would have been easy four years ago but rents were now £40 - £45 a square foot. The problem was whether anybody would lease space to the Bank for just a year without charging a premium and the cost of putting the space back into original condition. Turning to the costs, after taking out certain elements of detailing required by English Heritage, the figure came out at about £100 a square foot. This was below the median of about 15 City institutions whose fitting out costs had been used as a benchmark. On Davis Langdon Everest's calculations, the Bank's proposals would be in the third quartile. Sir Neville Simms urged the importance of leaving as many potential options open to the contractor as possible, including the timescale, in order to get the best results. The Bank should not presume that there was only one way of doing things. Mr Everett noted that the Bank proposed appointing a Construction Manager in a partnership with the Bank. Turning to Sir Neville Simms' suggestion on blinds, he said they had not been provided in the pilot scheme because the consensus was that they were not wanted. But it was important that there were rooms set aside for appraisal of staff. However, he said that the Bank would provide some accommodation on each floor which could be blanked off with blinds for privacy.

The Deputy Governor noted that the Bank's catering had already been outsourced. He agreed with Sir Colin and Mrs Heaton that there was no question of separate dining rooms for different staff unless it was to entertain guests. If the Bank did abandon catering, kitchen facilities would still be needed, and that would mean expanding those which already existed on the sixth floor after the closure of the guest dining facilities in Kings Arms Yard. He noted that in-house catering was the norm, and most major banks employed it. He also noted that the FSA felt that it required in-house catering. In-house catering also allowed the Bank to control alcohol intake, which would not be the case if staff went outside. In-house catering was also perceived by staff as a right and if it were removed it would lead to additional demands in the pay review. Mr Davies said it may well be worth pursuing Sir Neville Simms' idea of offering a catering franchise. Sir Colin Southgate recommended that the Bank should buy the equipment because it gave very much more control over the caterer. The Governor noted that Court accepted the principle of in-house catering.

Turning to the provision, Sir David Lees said the Bank should provide as much as it sensibly could in this financial year. It could provide on the basis of de-commissioning and removal but could not provide for quasi-revenue expenditure. He supported the £10mn provision in the accounts under the heading of retrenchment provision. He commented that it was important that the Bank should not come back with another retrenchment provision next year, so if more costs were found they would have to be taken as maintenance costs. The Deputy Governor said that the issue had been discussed at length with Coopers & Lybrand and he was content to leave the figure at £10mn. Any additional costs would be taken through the profit and loss account as a regular annual charge. In response to a question from Sir Colin Southgate, the Deputy Governor said that the £10mn represented the whole of the de-commissioning charge and a very small part of the costs of relocation. Where there was an element of upgrading it could not be considered as a retrenchment cost. He had sympathy with Sir Colin Southgate's view that all £18.6mn should be written off but, because there was a certain element of upgrading, it could not be done and that was the accounting rule. Sir David Lees said he was sympathetic with the view expressed but the number was beaten down by the accounting principle. In response to a question from Sir David about whether it would be possible to raise the figure to £12mn, the Deputy Governor said that the Bank had in principle agreed the 'dividend' with the Treasury and did not wish, on materiality grounds, to change the accounts for the sake of £2mn.

The Report and Accounts of the Bank for the year ended 28 February 1998 - in draft (Messrs Midgley, [redacted] and Smith and Higgin of Coopers & Lybrand, in attendance)

The Governor said he had asked Peter Smith, the Senior Partner at Coopers & Lybrand responsible for the Bank's annual audit together with his fellow partner, Michael Higgin, to join Court for this item.

Copies of the draft financial statements for Banking and Issue Department, were circulated together with the Report, having taken on board comments made at Court on 23 April. A letter from Messrs Freshfields concerning the claim against the Bank by the liquidators of BCCI, together with a detailed breakdown of profit and loss and year-end valuation of unlisted securities, a draft Letter of Representation to the Bank's Auditors and a draft letter from the Auditors covering the Directors' statement on internal financial controls were in Members' folders.

The Deputy Governor noted that all the points made by the Audit Committee at its meeting on 22 April had been taken into account. He drew Court's attention to the profit & loss account, where none of the main operating numbers had been changed and the 'dividend' had been agreed at 50% of post-tax profits. Turning to the balance sheet, he noted how the footings had risen over the year because of overfunding by the Government. On cash flow, he said he did not really understand what was gained by the statement but it was necessary to include it. He next drew attention to the detailed profit & loss account, and the items that were shown below profit before provisions. He mentioned the three biggest of these. First were post-retirement benefits, principally healthcare. He noted that the right to carry BUPA into retirement had been stopped for new entrants. The provision also included housing benefits. The second item was the £10mn for Head Office retrenchment, discussed earlier. The third item was support operations, which referred to NMB and where we felt able to release a further

£10mn provision. Mr Kentfield was preparing a paper on how to dispose of the company.

The Deputy Governor then drew Court's attention to Directors' specific opinions, in addition to the general opinion on the accounts:

(a) the note on page 79, that the Banking Department constituted a single business all conducted in the United Kingdom, which avoided the need for a segmental profit and loss account.

(b) the last part of note (d) on page 80, which related to the Bank's property holding in New Change and the compliance with SSAP19.

(c) note 11 on page 88, the Directors' valuations of investments, where the figure of £67mn referred to the Bank's holding in the BIS in Basle. The figure of £63mn related to the European Monetary Institute; the Bank would receive its contribution back in January.

(d) Note 12 on the same page referred to the fact that a number of subsidiaries including NMB were not consolidated.

He also drew Directors' attention to the comment on BCCI litigation on page 97 and said that Freshfields were content with the words, and so was Mr Berkowitz.

In response to an invitation from the Governor to comment, Sir David Lees said that the last Court had dealt with all the matters considered by the Audit Committee on 22 April other than those pertaining to the Accounts, and the Deputy Governor had given a full run through on the main issues. The points made by the Audit Committee were reflected in the draft before Court. The Audit Committee was content.

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

Sir David made a number of drafting points which were accepted. Mr Higgin said that the audit was complete and the Auditors expected to issue unqualified opinions on the Banking Department and the Issue Department in the form in the draft Accounts. The Auditors were content with the provision of £10mn for refurbishment on the basis that the decision had been taken in February of this year. The sum largely represented decommissioning costs arising from that decision and reflected a decision by Court, which was committed to a reorganisation of the property portfolio from which it could not reasonably withdraw.

Turning to the Directors' statement on internal financial controls in the Directors' Report, Mr Higgin said the Audit Committee had undertaken sufficient and appropriate procedures to be able to say that it had reviewed the effectiveness of the Bank's internal controls and this was not inconsistent with the Audit. He noted that Court had the Auditors' opinion in the papers before it.

The Governor said that the Report and Accounts would lie before Court until 13 May. Court would then be asked formally to approve the Accounts, for them to be printed, the Letter of Representation to be signed, and for the final payment, in lieu of dividend, to be made to HMT next October. It was intended to publish the Report and Accounts on 20 May.

The Executive Report

Money Market Operations

Mr Plenderleith said that the Bank planned to make two technical adaptations to its daily money market operations, probably from 1 June. He noted that a substantial reform had been undertaken just over a year ago. There had, as a result, been a distinct improvement in the effectiveness of the Bank's operations and in the competitiveness of the London money markets. The Bank was proposing two further adjustments. The first reflected the fact that CHAPS would be moving to a later timetable daily from 1 June to prepare for participation in TARGET, so the Bank would adjust its timetable. Second, when the reforms were introduced there had been a two-year transition provision for the Discount Houses giving them continued access to a liquidity facility at the Bank, to allow adjustment in a gradual way. The Discount Houses had now adjusted, and such access would cease at the end of May. The Bank would, as a result, re-cast the timetable of its operations through the day. There would be a single round of open market operations in the morning and a single round after lunch, at 2.30pm. At the end of the day there would be a final round of overnight operations. The effect would be to streamline the Bank's procedures and remove the need for special facilities for the Discount Houses.

<u>Sports Club</u>

The Governor noted that he had chaired the Annual General Meeting of the Sports Club on 23 April, and the Deputy Governor had also attended. He was always impressed by the numbers mustered for the AGM, which reflected their enthusiasm. The members always made a particular point of asking him to pass to Members of Court their great appreciation for the facilities provided.

There being no other business, Court was up.

13.5.98

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 13 MAY 1998

Present:

Mr George, Governor
Mr Clementi, Deputy Governor
Mr Allsopp
Mr Clark
Mr Davies
Mr Foot
Sir Chips Keswick
Mr King
Sir David Lees
Dame Sheila Masters
Mr Neill
Mr Plenderleith
Sir Colin Southgate

The Minutes of the Court of 6 May 1998, having been circulated, were approved.

MONETARY STABILITY

Inflation Report discussion, including market charts (Professor Buiter and Messrs Vickers and Hatch in attendance)

In introducing the Inflation Report, which had been published that morning Mr King said that the main message was that the MPC's central inflation projection was a little lower than in February, and remained close to the target over the next two years. But monetary policy was still finely balanced: interest rates over the next few months would depend critically on the speed at which domestic demand growth slowed down, the future path of the exchange rate and developments in the labour market, especially earnings growth.

In the short term the environment for inflation remained extraordinarily benign. The combination of a strong exchange rate - still some 25% above its level of August 1996 - a 20% fall in dollar oil prices over the past year, and an average fall of 9.5% in other commodity prices was holding down retail price inflation. The latest projection for RPIX inflation stayed close to the 2½% target for most of the 2-year forecast period. But towards the end of the forecast period, as the one-off effects of the rise in sterling wore off - which they would unless sterling appreciated further - the central projection for inflation was rising, with the balance of risks on the upside.

There were two main reasons, he said, for the fall in the central projection shown in the Inflation Report. First, the level of GDP was projected to be about ½% below that assumed in February, partly because the ONS' estimate of output in Q1 was below that projected in February and partly because the MPC had lowered its projection for both exports and investment. This meant that the output gap, whatever its size, was smaller than had been thought in February, although there was stronger evidence of activity in survey data, and growth had been depressed by unusually weak energy production in a mild winter.

The second reason for the reduction in the central projection was that the exchange rate used in the projection - an average of the closing rates in the fifteen working days before the previous week's meeting - had been over 2% higher than that projected in February. However, over the past ten days the exchange rate had fallen to be about 3% below the level used in the current projection. If this lower level of sterling were to persist then, depending upon the MPC's assessment of the reasons for the decline, the outlook for inflation would have to be reappraised.

Over the next three months, inflation was likely to rise quite sharply, to almost 3% on the RPIX measure, and 4% on the headline RPI measure. This was because Budget changes to excise duties took effect earlier this year than last, but this effect would disappear in the third quarter and, from then on, inflation was expected to remain close to its target throughout the forecast period.

Mr King indicated that the outlook for interest rates depended critically on a number of factors, none of which could easily be predicted. The first was the path of the exchange rate and, as already pointed out, the fall over the past week had more than offset the rise between the February and May projections.

Second, no account had been taken in the projection of the effects of the minimum wage - something to which the MPC would return once the Government had announced the level of, and any exemptions to, the minimum wage.

Third, the extent to which domestic demand growth slowed was crucial. In the year to Q4 last year, consumption had grown by 5%. The central projection embodied a slowdown in domestic demand towards trend. That slowdown was likely to be brought about by the fiscal and monetary tightening over the past year or so. But there were major uncertainties. Real personal disposable income had increased by 4.2% last year, and the ratio of financial wealth to income had reached an all time high: these factors would support the growth of personal consumption.

A final factor was the behaviour of earnings. Figures published that day showed a large rise in the rate of earnings growth - up from 4.5% to 4.9%. Earnings in the private sector were growing at no less than 5.6%. To hit the inflation target those rates of earnings growth would have to fall back. The gap between earnings growth in the public and private sectors was unusually large at present, but it was not at all clear that the gap was sustainable. Although the ratio of public to private sector earnings had been on a downward trend since the early 1980s, if the private sector measure was a better indicator of inflationary pressures in the labour market, then there would be cause for concern. That was something which the MPC would be monitoring very carefully. It was interesting to note that much of the rise in earnings growth was in manufacturing, at 5.3% in the year and as much as 1% in March alone: whether there were special factors in that needed investigation.

Mr King ended by noting that MPC would monitor carefully those factors which were especially important in determining the future direction of interest rates - the strength of domestic demand, the future path of the exchange rate, and developments in the labour market. There was no pre-ordained path for interest rates: what happened would depend upon the data and the MPC was ready to move in whichever direction was necessary in order to hit the inflation target.

Responding to a question from Mr Allsopp on the growth of domestically-generated inflation, Mr King said that all the various measures of the latter were affected by the exchange rate and it could be a misleading measure - for instance, if a rise in the exchange rate was assumed to be temporary and profit margins were not adjusted but were boosted in the short term. He saw, as a better measure, unit labour costs - the growth in which was currently around 3.5%pa and was expected to stay at that level during the forecast period.

Mr Davies asked whether the MPC had considered the effects of the introduction of the minimum wage, and if so, whether the mooted figure of £3.60 per hour would be a worry. Mr King said it was too soon for the Committee to have focused on the question. The figure was to be announced a year before it came into effect and there would then be time to assess its impact, taking account of any exemptions which were granted. He invited views from Members on how far employees earning just above the minimum wage would be able to bargain successfully to restore differentials, and whether firms affected would be able to raise prices accordingly.

Mr Neill said that, in his experience, the pressures were to contain the overall pay bill and remain competitive. Thus productivity increases had at least to match any pay rise.

Mr King commented that the official data showed flat productivity over the past year but a 5.3% increase in manufacturing pay. One explanation was that manufacturing had to compete with the service sector for recruits, but he acknowledged the possibility of mismeasurement in the published productivity figures. Professor Buiter said he too was suspicious of the data but, on the face of it, the UK's productivity growth was disappointing.

Sir Colin Southgate was also concerned about the evidence on productivity growth but suspicious of the data. He was reluctant to read too much into one month's figures, which could be affected by a range of special factors.

Picking up on Mr King's comments about the exchange rate, Sir David Lees outlined the following hypothesis: if the exchange rate weakened, the inflation target came under pressure; if MPC responded by raising interest rates, the exchange rate could be expected to strengthen in response. Would it be reasonable to conclude from this that the exchange rate would be stable for a period at around its current level?

In response, Sir Chips Keswick said that the markets were more interested in economic fundamentals than interest rate movements in valuing currencies. Mr King added that the consideration for the MPC was why the exchange rate had weakened. One explanation was expectations of lower rates.

But the response could be different if the evidence was that the "safe haven" support which sterling had enjoyed hitherto was at an end. This was clearly a matter for the MPC to consider.

Mr Plenderleith agreed, adding that there were two factors in sterling's recent reversal: greater confidence in the Euro and a shift in expectations about interest rates in the UK and also in the United States and Germany, where increases were anticipated. The change in sentiment on these factors, which had previously led sterling up, was now pulling it down. Sterling had, he noted, been steady over the previous week, following the fall over the preceding month.

Mr Allsopp recalled the discussion at the previous Court of the fact that the exchange rate was an exogenous force which affected targeting in a temporary but not fundamental way: he was concerned about how asymmetries in the impact of a rise and subsequent fall in sterling were dealt with. Mr King responded that the MPC took a symmetrical view.

Dame Sheila Masters asked about the importance of the public sector earnings figure. Mr King replied that it was included in RPIX and therefore had an impact on the inflation forecast. It was the change in the rate of growth rather than the absolute figure which was significant, and was taken account of. In considering inflationary pressures from earnings, the Committee focused on average earnings growth but, if the differential between public and private sector earnings growth did not narrow, greater attention might need to be given to the latter in future.

Reverting to Mr King's earlier question on the minimum wage and differentials, Sir David Lees said that if few staff in a business were affected - as was expected to be the case throughout manufacturing - the effect on pay bargaining would be minimal. But the situation would be different in organisations where a large part of the labour force was affected.

Sir Colin Southgate said that the minimum wage could affect some sectors, eg catering, some retailers, but agreed that the overall impact would not be great. He was more concerned by the figures for manufacturing earnings growth, which sat oddly with manufacturers' concerns about the strength of sterling.

Sir David Lees said that those hit hardest squealed loudest, and received disproportionate attention. But a change of tone was emerging from CBI surveys. Mr King noted that this was consistent with the Agents' reports. He agreed with Mr Davies that the impact of the strong exchange rate had been greatest on those companies whose products were exported or competed directly with imports.

FINANCIAL STABILITY

The Banking Act Report (Mr Morris in attendance)

Mr Foot said that the Banking Act Report had taken on board Members' comments made at the previous week's Court meeting, and he hoped that Court would be content with the text. He also reported that the paper on delegation of powers was in much the same form as the previous year and that the correct monitoring had been carried out. Court noted the names of those to whom the Bank's powers under the Banking Act 1987 and other relevant pieces of legislation had been delegated, together with details of the exercise of those delegated powers.

In response to a request from the Governor for comments, there were none on the Banking Act Report. On delegated powers, Sir David Lees asked what determined whether an Executive Director took a decision or whether it was referred to the Governors. Mr Foot said all decisions taken by Executive

Directors were seen by the Governor in writing after the event because they were put to the Board of Banking Supervision. But it was the Director's decision as to whether to go to the Governor. The Governor noted that another check was that there were regular meetings at a senior level in Supervision & Surveillance and he saw accounts of these. There were no other comments.

The Deposit Protection Board Report & Accounts (Mr Morris in attendance)

Mr Foot introduced the Annual Report & Accounts of the Deposit Protection Board which Court duly noted. Mr Foot commented that the move to the Financial Services Authority would be helpful in the sense that the Deposit Protection Board would have the use of the infrastructure of the Investors Compensation Scheme.

Executive Report

Mr Clark commented on the Securities Settlement Priorities Review. He said that a merger with CREST appeared to be the way to go and a report would be produced in about a month's time. It would then be necessary to consider with CREST and others how to carry it forward. If there were a merger it would subsume gilt settlement into CREST, which would have an effect on staff in the Bank.

MANAGEMENT OF THE BANK

The Report & Accounts of the Bank for year ended 28 February 1998 (Mr Midgley in attendance)

The Deputy Governor said that Court had to approve formally the Report and Accounts due for publication on 20 May 1998, the final payment in lieu of dividend, which would be paid on

5 October, and the giving of the Letter of Representation to the Auditors, Coopers & Lybrand, in relation to their audit of the accounts. There were textual amendments to the Report since the previous week. A list of these was in Members' folders. The Deputy Governor drew Court's attention to a number of the amendments. In particular, there was a new paragraph at the end of the Monetary Policy Committee section describing the April minutes. Sir Colin Southgate commented that it was ridiculous to give the names of individual members of the MPC and their voting record in the Annual Report. Sir Chips Keswick agreed that names should be taken out. Mr Davies commented that, since the names had already been published in the minutes, it would raise questions if it were seen that names were not present in the Annual Report. In response to the discussion, the Governor suggested that the names should be left in. Court was content. A discussion also ensued on whether the reference to the normal size of the Bank's balance sheet was acceptable. Court agreed to leave the reference in the Report. The Deputy Governor drew Court's attention to various points in the accounts where the Directors gave a specific opinion in addition to the overall fair presentation of the accounts. These had been mentioned at Court on 6 May.

The Deputy Governor said the final divided of £35,283,000 was acceptable to the Treasury.

Members' folders contained a letter from Coopers & Lybrand confirming that they knew of no reason why the Letter of Representation should not be given. The Letter of Representation was approved by Court on 6 May. The Bank had also received a letter of comfort from Cooper & Lybrand on corporate governance; this too was in Members' folders.

The Deputy Governor therefore asked for Court's approval for: the Report & Accounts to be signed and printed, with publication on 20 May; the final dividend of £35,283,000 to be paid on 5 October; and the giving of the Letter of Representation to Coopers & Lybrand.

Court was content with all the points put by the Deputy Governor and gave approval for the Letter of Representation and Accounts to be signed and for the Annual Report & Accounts for the year ended 28 February 1998 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 £35,283,000 would fall due to HM Treasury on 5 October 1998, bringing the total payment in lieu of dividend for the year to 28 February 1998 to £69,983,000.

Court APPROVED thereto.

Revised Quarterly Financial Report format (Mr Tiner of Arthur Andersen and Mr Midgley in attendance)

The Deputy Governor said that the issues to consider were the frequency, the format and the principles. These were the three issues Mr Tiner and his team had been asked to look at. Mr Tiner noted that Arthur Andersen had interviewed the Non-Executive Directors on the Audit Committee and the Executive Directors. It had reviewed the existing reports and had a number of meetings with Mr Midgley and the Deputy Governor. A pro-forma quarterly report had been prepared for consideration by the Audit Committee, and was in Members' folders.

Mr Tiner said there were seven key messages. The quarterly report should be simple, clearly presented and well structured; the information should be sub-divided in accordance with the Bank's management structure to provide clear accountability; the primary purpose of the quarterly report should be to provide information related to financial control rather than to efficiency and resource allocation. This was with a view to satisfying Court's responsibility under the Act to keep under review the internal financial controls of the Bank, to secure the proper conduct of its affairs; the financial information in the quarterly report should equate to that in the financial accounts and should be on an accruals basis; more detailed project information should be included in the quarterly report including a "traffic light" system for major projects; actual year-to-date figures should be included in the quarterly report; and the financial reports should continue to be prepared quarterly since there was no demand for a review of financial control matters on a monthly basis. Mr Tiner also drew Court's attention to the proposed new schedules. A number of detailed comments were made on the content of the schedules which it was agreed would be taken into consideration.

Mr Neill commented that the proposals were a good first step and he was pleased that the question of budgets and forecasts had been resolved. He liked the proposed traffic light system for assessing major projects. Mr Neill suggested that there should be an explanation of concerns, of the causes of concerns and of counter measures which would help Directors to make judgements. He also hoped the Bank would consider how the reports could be delivered and read electronically. He proposed greater use of graphics and the assignment of standard meanings to particular colours. Sir David Lees noted the importance of a brief, succinct and readable statement of the real issues about which the Directors should be concerned, which should be placed at the front of the Report. Court should be able to rely heavily on that statement while using the supporting schedules for information. Mr Midgley noted that the first of the new reports would be before Court in July. There would be one or two small changes. For example, it was not possible to show depreciation in exactly the way that Mr Tiner had recommended. Court was content with the proposals.

The Governor thanked Mr Tiner and his colleagues for all the work they had put into this exercise.

Non-Executive Directors' Remuneration

The Governor drew Court's attention to a copy of the proposal that the Executive members of Court proposed to put to the Chancellor. The proposed fee for Non-Executive Directors of £10,000 was less than in the private sector but was in the same general area as public sector analogues. The Bank also proposed the continuation of free charity functions for Non-Executive Directors. The Chairmen of the Audit, Remuneration and Staff Pension Fund Committees would receive £12,500 and the Senior Non-Executive Director £15,000. Sir Colin Southgate said that his strong opinion was that fees should stay as they were or go to zero. There was no need to pay the Non-Executive Directors. Dame Sheila Masters said that, while it was easy to make that point for existing Directors, it was not necessarily right or appropriate for new Members. Sir Colin said that he would always be honoured to serve the Bank for zero remuneration. Dame Sheila agreed that that would be the sentiment of most of those at Court but she commented that it was difficult to set the rate at the 1946 level and she believed that new Directors probably would expect a fee. Sir David Cooksey had also asked her to express his concern, in his absence, that it would be registered by the public as a fat cat pay rise.

The Deputy Governor said that the Bank was trying to run professionally and in that sense should pay the proper professional rate. £25,000 was the going rate in the private sector, while the public sector was below that level. A fee of zero would give the wrong impression, however. £10,000 was a reasonable level of fee. The Financial Services Authority paid £14,000, and the BBC was also close to the level the Bank was suggesting. It was open to Directors to waive their rights but wrong for the Bank to propose a fee of zero or £500. The

Governor commented that he would feel uncomfortable if the Bank did not pay a fee. £10,000 was just less than the indexed value of £500 from 1946. It was a reasonable number that was entirely defensible against fat cat allegations. If Members wished to waive the fee it was entirely a matter for them. He hoped that Directors would accept the proposal.

In response to a question from Mr Davies, the Governor said that those who waived the fee would still keep the use of the Court Room. Sir Chips Keswick said that the point about fat cattery was absurd, and the Bank should point out publicly that the proposed fee was close to the figure of £500 indexed from 1946. Mr Neill said all of the Directors had been very happy to join Court at the level of remuneration at the time. He commented that it was important that, if there were higher remuneration it should be less than in the private sector. It was enormously important that no risks were taken with the reputation of the Bank. He said he supported the Governor's judgement.

The Governor said he respected the view that Directors would undertake the task for nothing and he was very grateful for that. He was also very conscious that over time Directors were unhappy with the fee of £500 a year because it was not fair to the companies for which they worked, since the Bank took a lot of their time. So their companies needed some recompense for the time spent working for Court. That was why the Bank had introduced free charity occasions for Directors. Not everybody wanted to take advantage of those. If Directors wished to, it was entirely for them to waive the salary, or part of it. But the Governor noted that he did not wish to be in a position where the Bank asked people to undertake tasks that took them away from their work without recompense. The proposed fee was low compared with the effort Directors put into their work for the Bank.

Sir David Lees said that he had some sympathy with Sir Colin Southgate's view, and he agreed with Mr Neill's sentiments, but it was now a new Bank. On balance he was in favour of the proposal. Dame Sheila said it was defensible against public sector and private sector analogues. The Governor said that he felt the same. It also had to be recognised that, once the amount was changed, there was no guarantee that it would be changed again for another 50 years. The Governor agreed with the comment by Dame Sheila Masters that there was no guarantee that the Chancellor would accept the proposal. The Governor noted a complication. The quorum for Court was nine but only three Executives on the new Court could make the decision. Court would be asked to agree, at the first meeting of the new Court in June, to the formation of a sub-committee of three Executive Directors to make the recommendation to the Chancellor. The Governor noted that this was necessary to abide by the Constitution.

The Securities Management Trust Ltd - A Directorship/ Chairmanship

The Governor reminded Members that Michael Foot would be leaving the Bank at the end of May to take up his duties at the Financial Services Authority. As Michael was Chairman of the Securities Management Trust Ltd, a wholly-owned subsidiary of the Bank which provided nominee facilities for securities owned by the Bank and various customers, it was necessary to appoint a new Director and Chairman. He drew attention to a recommendation contained in Members' folders.

Court APPROVED that consequent upon the departure of Mr Foot to the Financial Services Authority Mr T A Clark should become a Director and the Chairman of Securities Management Trust Ltd in place of Mr Foot. It was noted that the Board would then consist of Mr Clark, Mr Midgley, Mr Kentfield and Mr Sparkes.

The Governors' Engagements

The Governor, in noting that this was the last long Court meeting that Michael Foot would attend as a Director of the Bank, asked that the Minutes should record his gratitude and that of present and past colleagues on Court for the contribution he had made whilst working for the Bank and in discussions at Court. He reminded Members that there would be a Court Room dinner on 15 June to mark Mr Foot's departure.

The Governor also noted that this was the last Court that both Ian Plenderleith and Alastair Clark would attend as Members of Court although they would of course attend in the future for the discussion of topics relating to their own particular areas of responsibility. He expressed his appreciation for their contributions relating to a wide range of topics in the past.

Court rose.

17 June 1998

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 20 MAY 1998

Present

Mr George, Governor

Mr Clementi, Deputy Governor

Mr King

Mr Plenderleith

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

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

17.6.98

A MEETING OF DIRECTORS AT THE BANK

WEDNESDAY 27 MAY 1998

Present

Mr George, Governor

Mr Clementi, Deputy Governor

Mr Plenderleith

Mr Clark

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

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

The Governor said that the Meeting was the last to be held under the 1946 Charter, which required the Directors to meet at least weekly. He recorded his appreciation of the contribution of those Executive Directors who would no longer be Members of Court when the provisions of the Bank of England Act 1998 came into effect from 1 June.

17.6.98