12A110/27



**A COURT OF DIRECTORS HELD AT THE CIVIC HALL, LEEDS**

**WEDNESDAY 17 JANUARY 2001**

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
The Baroness Noakes, Chairman, Sub-Committee of Directors
Ms Blow
Mr Buxton
Sir David Cooksey
Sir Ian Gibson
Mrs Heaton
Sir Chips Keswick
Ms McKechnie
Sir Brian Moffat
Mr Neill
Ms Kathleen O'Donovan
Sir Neville Simms
Mr Stretton

Absent:

Mr Bailie
Sir Howard Davies
Mr Morris

The Minutes of the Court of 20 December, having been circulated were approved.

**MONETARY STABILITY ISSUES**
**Economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Bean, Clark and Plenderleith together with Professor Nickell and Mr Allsopp in attendance)**

Mr Bean noted that the main news of the month was a cut by the Federal Open Market Committee by 0.5 percent on 3 January. The MPC left interest rates unchanged. One concern was that the US was possibly slowing a little faster than the Fed and others would like. He noted that the US purchasing managers index showed a fairly sharp downturn, looking forward. A similar fall had been seen in consumer confidence. The key question was whether the Fed action would prevent a further downturn in US equity markets, and the jury was out on that. The message from the Fed, the IMF and other forecasters was still that the US was in line for a soft landing overall, though the downturn might be sharper in the first half with some recovery in the second half. Turning to the implications for the UK, there were a number of unknowns. The direct trade effects should be relatively muted, of the order of a quarter per cent off UK growth. The worry was that this could be higher if there were further significant falls in equity markets in the US that spread to the UK, and if there were contagion effects through confidence in the UK.

Turning to the rest of the world, he said there was some evidence of a slowdown. Euroland seemed to be returning to the underlying trend rate of growth. In Japan, growth seemed to be stalling. This might have implications for other Asian economies. The general picture outside the US was of some deceleration in growth.

Mr Bean noted that the sterling exchange rate had fallen 2.5 per cent since the last Court meeting and there were also quite strong moves of the pound and dollar. The pound euro rate had fallen 3%. The recovery in the euro against the dollar was a very good aspect of the US slowdown, leading to more sustainable exchange rates and current account balances. The UK, though there were worries about the international picture, was still relatively satisfactory. Third quarter growth was 0.7% and a little less than 3% year on year. Within that, consumption growth was more robust than the Bank had been expecting, and the signs were that retail sales were reasonably buoyant. Investment had been rather weaker than expected, particularly in the services sector, but the level relative to GDP was still historically quite strong. Overall, the evidence over the last month implied that fourth quarter growth was going to be as strong as in Q3. On forward looking measures, consumption was likely to remain reasonably strong. It looked as if there would be some underspending for the year as a whole by the Government, but it should not fall very far short of plans. The labour market was tight but had stopped getting tighter; and he noted the employment and unemployment figures which had just been published, with the Labour Force Survey showing a fall in the three months to November, which was rather small, however, in the context of 25 million employed. There was little news on earnings, but wage settlements showed some upward trend, though not particularly strong. Input prices fell in December, mainly because of oil, which would help to reduce inflationary pressure, while RPIX was 2% in December, reversing the blip to 2.2% in November. HICP fell very slightly to 0.9%.

Mr Plenderleith, turning to the markets, noted the weakening of the dollar and the strengthening of the euro which was quite substantially up, reflecting a slowdown in the US and a turn in sentiment about the euro. Though the dollar was falling from a peak, it had not gone a huge distance and this might indicate that the foreign exchange market was not expecting a US recession, rather it foresaw an easing of growth. He noted that the yen was weakening substantially, and this was related to the disappointing performance of the domestic Japanese economy. Sterling was following a middle road between a slightly easing dollar and a recovering euro. The markets still felt sterling was reasonably valued.

The money markets were expecting some easing in UK rates fairly soon, but with rates then rising later on in the year and into 2002. This indicated expectations that the easing of economic activity would be transitory. Turning to equity markets, there was a concern that there might be further falls in the US that could accentuate the downturn. Substantial adjustment had been seen in hi-tech stocks such as telecoms, but the mainstream markets (the Dow Jones and FTSE) had peaked in the Spring of 1999 and had essentially been moving sideways since, though with a good deal of volatility. The decline had been in particular sectors and there had not been sharp directional changes in the main markets for nearly two years.

The Governor invited Professor Nickell and Mr Allsopp to comment. Mr Allsopp said he was hoping that Court would help with information on some of these uncertainties.

Ms McKechnie said that the Consumers' Association quarterly consumer trends survey confirmed what Mr Bean had been saying. Consumers were on the whole fairly optimistic and they were more optimistic about future labour market conditions than they had been since the survey began. The level of precautionary savings had fallen to its lowest level, and more consumers were planning to make a major purchase. Consumers were also predicting less inflation in the coming 12 months than in 2000. However confidence in the future value of investments had fallen over the last year, giving the first signs that people were reacting to what had been in the media. Expectations of future property values showed no change over the last few months but were less than in 1999 and the first half of 2000. More consumers planned to restrict their spending on non-essentials. The broad picture was fairly optimistic, but there was evidence that people were registering the changes in market conditions. In answer to a question from Mr Bean, she said the survey had taken place between 5 and 11 January, which Mr Bean noted was after the Fed cut and the stories about the economy over Christmas.

Mr Neill said that between November 1999 and November 2000 the retail car market had risen 13% while production had fallen 14% and the profitability of the industry was dire. But December was much better than people had been expecting, and the first ten days of January were still very healthy. Overall, the expectation was that 2001 would be better than last year. Sir Ian Gibson said nobody was sure whether destocking and the reduction of production would last one quarter or three quarters. But the feeling was that it was going to run at least two quarters. There was the same sort of decline in Continental markets, some of which were seeing a version of the pressure on margins that the UK had seen for the last couple of years, Spain and Italy in particular. They were generating volume through price reductions. The underlying trend was the consolidation of production sites. The stronger movement in this trend was in the component sector. Total output in Europe, and probably in the world, would be less than last year, and those major companies that were still profitable were less profitable. Nobody was making much money in Europe by the fourth quarter of 2000. The industry would give a sigh of relief if the price of oil continued to decline, which could raise volumes in the second or third quarter, but the issue was still one of excess capacity.

Mr Buxton said the banking figures supported Mr Bean and Ms McKechnie. For some time it had been expected that growth in consumer and mortgage lending would ease. All the forecasts were based on lower consumer credit, but November continued to grow at the same high rate as October. He believed that sooner or later consumer confidence would be reduced and growth rates would fall. Corporate borrowing was also rising in double figures, he noted, though there were increasing differences in profitability between companies, which was showing in corporate income gearing. He noted the Bank of England had done work in that area and believed it was worth continuing to keep an eye on it. There was no rise in corporate problems, but if borrowing was not going into investment it must be going into working capital.

Ms O'Donovan said that in most large industrial companies borrowing was going up in an attempt to cover working capital. One reason in the US was to finance stocks. This was primarily because, looking at the two main sectors in which the company was involved in the US, some products fed into the white and red goods sector where there had been profit warnings from all the main distributors. Electronics products went into process industries where there had been a late cycle downturn, with not a single large contract let in the last six to nine months. These late cycle companies should be going into their upturns now.

Sir David Cooksey noted that nine months earlier he had remarked on the stupidity of the prices of hi-tech stock. The NASDAQ had come down very rapidly, and the 0.5 percent reduction in US interest rates was very welcome. He noted that his organisation's IT companies were all growing but not as fast as they had been. Because of anticipated growth there had been recruitment ahead of time, but the growth did not emerge. Some were cutting numbers and rephasing recruitment, which he thought was causing a lot of problems. Margins were squeezed somewhat and expenses were growing. He expected profit warnings to result from this. He noted that an area where there was a real concern of bankruptcies was business to a consumer e-commerce, and business to business e-commerce was also now affected. Dot com companies were not able to get finance at all.

Sir Neville Simms said that in the construction industry the Agents' report had got the tone about right. Progress was satisfactory. In Yorkshire and Humberside costs were shooting ahead while in London costs had slipped back, he noted. Ms McKechnie said that in the dot com area the Consumers' Association was active. A lot more people had internet access and shopped on the web. There needed to be education about the risks. Models for making money in business to consumer e-commerce were not emerging clearly and the objective still seemed to be to grab market share.

Mr Stretton noted that wage settlements in the financial sector were a complex situation. Year on year rates of increase were largely higher than the national figures showed, but unit costs had led to real signs, for the first time in a long time, of increasing productivity in the sector. Mr Buxton said that a large number of companies had tinkered with IT systems ahead of the millennium changeover, but the more he looked at the situation the more he believed that there was a great deal more that could be done. Sir David Cooksey said he did not disagree. There was a downturn in growth but that was not to say there was a recession in the industry. Ms Blow said that it was not clear what the rate of investment was. Questions being asked were what technology should be implemented, what will be the business return and how much money would be spent. It depended which sector was concerned and what investment plans were under consideration. Mr Neill said that dot com had over promised and under delivered. It did not have the industrial strengths to deliver, but it would happen eventually. He also believed that the logistics had not worked. He noted that Sainsbury's had got its logistics wrong and was losing money whereas Tesco had got them right.

**Non Policy Meetings of the MPC**
**(Messrs Bean, Clark and Plenderleith together with Professor Nickell and Mr Allsopp in attendance)**

Mr King noted that the paper was on the table for information. In reply to a question from Baroness Noakes he said that the Bank would make sure it sent a paper on the ONS to Court in time for the Annual Report.

**Agent's Issue of the month – Pay prospects for 2001**
**(Messrs Bean, Clark, Plenderleith, Allsopp, Jenkinson, Strachan and Professor Nickell)**

Mr Strachan said that the Agent's survey on pay prospects for 2001 contained questions very similar to two previous surveys, so it was possible to look at the results over time. Describing the questions, he noted that the survey was undertaken against a background of general concern about labour market tightness. It had achieved a fairly good spread across sectors and by size range. It was not possible to target the same companies every time because of possible survey fatigue, but it was possible to say that there could be a comparison with the previous year's survey because the sector breakdowns were very similar. 77% of respondents against 57% in the previous survey suggested that pay settlements would remain flat or rise in 2001. The pressure was fairly even across sectors. 47%, against 38% last time, expected rising pressure on total pay per employee, with greater pressure in financial and other services than in manufacturing, as expected. The survey also showed evidence of particular pressures in the area of recruitment and retention of staff, which was widespread but a little more muted in manufacturing. Overall the evidence of tightening pay pressures was clear, but it was more through pay per employee than through overall settlements. The principal influences on pay pressures related to recruitment and retention difficulties and restraining factors appeared more muted than in the previous survey.

In response to a question from Mr Neill, Mr Strachan said that the mitigation of cost pressures would take a number of forms. Companies would, within the overall pay bill, adjust to reflect issues of skill shortages. In many professional firms, pay was being skewed to professional staff at the expense of clerical and support staff. Overall figures contained a range within them. He suspected that some companies were labouring under the illusion that they were recouping additional costs. Total pay was probably being held for most companies, but that was at the expense of staff numbers in more marginal areas.

**FINANCIAL STABILITY ISSUES**
**Domestic developments and international issues**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Clark noted that the Bank had hosted a press conference for the Bank for International Settlements on core principles for payment systems, and jointly with IOSCO on a similar exercise covering settlement systems. Mr Trundle had chaired a working group which produced the payment systems report. The principles were intended to lay out some of the key elements of the design and operation of payment systems, and had become part of the standards and codes promoted by the IMF. The paper covered similar ground on securities settlement and was in the consultation stage and would be translated into recommendations in due course. He noted that, on the following day, a new consultation document on bank capital had been announced by Mr McDonough, President of the Federal Reserve Bank of New York, with the press conference relayed to London. Mrs Jackson had attended the relay at the Financial Services Authority. The document was up for consultation until the end of May and would be finalised before the end of the year. He also noted that the following week the Bank would host a briefing at which Roger Ferguson, Vice Chairman of the Federal Reserve Board, would present to the press a report of a group sponsored by the G10 deputies. It looked at the impact of consolidation in the financial sector. Finally, on 5 February the Bank was putting out, at an event in Edinburgh, its latest report on the financing of hi-tech small firms and was proposing to have a number of press briefings in Scotland.

Mr Clark reminded Court of the concerns expressed at the December meeting about Argentina and Turkey. In both cases there had been stabilisation in the short term, partly on the back of IMF programmes. Argentina had been assured of financing this year of the order of $25bn. There had been a significant fall in domestic interest rates and a commitment to a variety of fiscal measures. A big question was whether Argentina could get back to stronger and sustained growth, an issue which had been at the root of its difficulties. Turkey had agreed a programme in December, in particular to take action in the banking sector. A number of banks were under public supervision and support. Interest rates had fallen and spreads were back nearer to two percentage points on Turkey's international debt. Outflows had been stemmed and might be reversed. There were questions about the deliverability of some of the measures to which Turkey had committed. One of those was to give the Turkish central bank greater operational independence. In response to a question raised by Mr Buxton, he noted that there had been an article in the June 2000 Financial Stability Review about dispersion of financial performance in the corporate sector. At that stage it had been difficult to see what accounted for it and the Bank was still looking into it.

The Governor said that the technical quality of the work carried out in the Bank on the Basel Accord and on payment and settlements had been very impressive and was very positive in terms of interaction with the market place. Mr Trundle had very high marks for chairing the paper on core principles. Mr Clementi noted the important role played by Mrs Jackson in the work on the Basel proposals, where co-operation with the Financial Services Authority had been very good.

**FINANCIAL MARKET OPERATIONS ISSUES**
**Current Issues**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Plenderleith noted that the Bank was taking over the Treasury programme of issuing, each quarter, three-year euro notes. The first issue the day before Court had gone extremely well. €500 million had been sold. The sale would be repeated each quarter to build to €2 bn and, in a steady state, the amount in issue would be €6 bn. The sale was three times covered and the rate was broadly similar to when the programme had been carried out for the Treasury. After reinvesting the proceeds, the Bank would earn a margin of about ten basis points and this, if it continued, would generate around £1mn profit.

Mr Plenderleith said that the National Audit Office report on the sale of gold had come out satisfactorily and had reported that the Bank of England had handled the auctions well. Bank staff in the Foreign Exchange Division had put a lot of work into assisting the National Audit Office and it was satisfying that the report concluded that the Bank had worked hard to keep the gold market well informed and to secure a technically successful sales programme that had been applauded by almost all gold market participants. He said how the National Audit Office found that the prices achieved at the nine auctions had been competitive and well in line with the best available price benchmark - the London Gold Fix price. They also found that the decision to sell gold through a series of auctions met the policy criteria very well, providing a very transparent and fair sales mechanism. The National Audit Office found that London Gold Fix was the next best method for selling gold. It was less transparent in that total amounts sold were not disclosed but it offered the opportunity to vary the volume and timing of the gold to be sold on a daily basis. The National Audit Office considered that the Treasury could give further thought, in consultation with the gold market, to using the London Gold Fix as an alternative or additional means of selling gold. Mr Plenderleith said there were also some minor suggestions in the report of ways in which some details of the operation could be varied and these ideas would be considered. They would be gone through with the market again, though it was hard to see positive benefits in them. The press reaction had been minimal. He noted that he was to appear in front of the Commons Public Accounts Committee to answer questions on the report at the beginning of February. The Treasury would be in the lead. The Governor noted that there had been effusive thanks from the Treasury for the contribution to the NAO report made by Mr Plenderleith's team.

Mr Plenderleith noted that the Bank had launched a reorganisation of its sterling deposit facilities for other central banks. This was a result of cash management going to the Debt Management Office. It had been well received by customers so far.

Mr Plenderleith noted that one of the Bank's agency functions for the Treasury was that it implemented financial sanctions, notably against Iraq. The Treasury was under pressure from Parliament to step up the vigour with which it enforced sanctions. This issue had been passed to the Bank but the Bank had asked the Treasury to indicate what it wished to be done. The Bank was resisting any general instruction. It would be negotiating a slightly expanded work programme. Questions of effectiveness were the responsibility of the Treasury. In response to a question from Baroness Noakes about whether the Bank was paid for the service, Mr Plenderleith said no, which was why it was resistant to setting up a more elaborate structure. If that were wanted, the Treasury would have to pay the Bank's costs.

**Executive Report**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Clementi said there were some positive comments in the ISR report on the survey it had undertaken, but the main body of their results was quite negative and in some cases strongly so. Most of the complaints had been heard before, but some things had surprised the Bank. There were strong complaints about the new leave arrangements, and he noted that a paper had been prepared on this by Mr Footman for the GovCo meeting to take place the day following Court, which would discuss the ISR report which had been presented to GovCo the previous week. The Bank needed to take a view about the extent to which the complaints were justified. They covered most aspects of management. Two factors complicated the situation. One was the issue of whether to do further work. There were problems with the methodology (ISR admitted it had a negative bias) and the coverage was low so that it was not possible to give a proper breakdown of the responses in relation to different parts of the Bank. Secondly, there was an issue of publication. There would be strong pressure to publish. The Bank's wish was to be open with staff. Whatever was published internally would almost certainly end up being available externally. He noted that the Financial Times and the Treasury Committee had taken an interest in morale issues. He hoped to make a longer presentation to Court on the subject in the not too distant future.

Mr Neill recommended briefing staff on the outcome while trying very hard to avoid formal publication. Baroness Noakes said that the report would have to be rewritten. The Governor noted that the form of the report was simply quotes from individuals, and it was inappropriate to put that into circulation. But it could be used to identify the issues. The Bank would consider how to respond and how to communicate. He was very clear that this was an area where the Bank needed to take immediate action. He noted that flexi-leave, and LDL, were issues that rankled enormously, and this was partly because of the uneven application of LDL across the Bank. He noted that ISR had invited 90 staff to contribute but the take up had only been 35, which was a very small cross section. There were also about 50 e-mails. ISR had suggested that the poor take up indicated a view among staff that management did not listen, so there was no point in wasting their time.

Mr Neill said that if there was a briefing to staff saying "here was what the management had discovered and here was what would happen", it could produce a very positive result. He was very concerned indeed about the misuse of that information outside. There was no need to publish the qualitative results in the outside world or in the Bank. The benefit of focus groups was that they allowed management to get more clearly to the underlying issues. The underlying objective was to improve morale in the Bank. Mr King said he shared Mr Neill's view. He was extremely disappointed with the way the survey had been carried out. ISR claimed that it gave a picture of morale. But the Bank knew the issues were very different in different parts of the Bank. The survey had approached only 90, and only 35 had turned up. This was all very unsatisfactory. ISR asserted that this low response was because of the level of morale in the Bank, but provided no evidence to defend that. The survey provided no information that would help break down the views of one part of the Bank compared with another. The Bank did not need these results in order to know that the recipients of LDL, and the managers implementing it, found it unsatisfactory. In terms of finding out what the issues were he did not think the report was terribly helpful. It was the Bank's response, not what it learned from the survey, that mattered.

Mr Plenderleith agreed. The report was disappointing. The raw material showed a variety of grumbles but it was not clear whether it represented a general view or whether it was an accurate read-out of the differing concerns in different areas. There needed to be a proper read-out on these issues before the Bank could decide how to deal with them. This was not least because some of the grumbles were in areas where people were leaving and where the Bank was bringing in new staff to do the work in a different way. The survey was negatively biased. Baroness Noakes said that the survey could be used as a precursor to a quantitative survey. She noted the difficulty with the low response rate. Mr Plenderleith suggested that the Bank ask for its fee back. Mr Clementi said that the issue would be discussed in GovCo the following day, and one question was the unsound statistical quality of the survey. But it was wrong for the management to be seen to be in denial when faced with complaints and it was necessary to be seen to be taking them seriously.

Ms O' Donovan said it was not a report one would ever want to publish, and she agreed with Baroness Noakes that it should be seen as a precursor. Sir Brian Moffat said there was also an issue of how to build on the work going forward. It was necessary to have a statistical basis that was meaningful. His company had carried out such work for 20 years. His company surveyed 2,500 people once or twice a year in a cross-section of the workforce. Sir Ian Gibson said he supported that point. The Bank had to feed back the results to staff, but there were no results in this case. What had to be fed back was the Bank's analysis of the information that had been gathered. He noted the importance of taking care. Part of the feedback ought to be about what the Bank would do next. He noted the importance of gathering a consistent picture over time. Part of the feedback should be telling people how the information was going to be gathered over time. He believed oral feedback to staff was better, and that was quite apart from the issue of keeping outsiders out of family business. The objective should be to identify a mechanism for distributing and collecting future surveys. Identifying that next stage in the process was as important as deciding how to identify the issues that arose.

Baroness Noakes noted the interest expressed when the Non-Executive Directors appeared before the Treasury Committee. Sir Ian Gibson said it was time to be robust. The Bank was at the first stage of feedback and was setting up a process. It should say to the Treasury Committee that it did not intend to discuss the survey in public, because that would not be helpful to those managing the Bank. Mr Neill and Mr King said they agreed with Sir Ian. Sir Brian Moffat said one of the results of developing a dialogue was that people would become quite willing to participate. People were initially suspicious, but became more willing when they thought about it. His company's fall-out rate was between three and five per cent in such surveys. Sir Ian Gibson said that was comparable with the fall-out rate at Nissan. The company surveyed all staff on an annual basis, using forms in the first place, with a follow-up through focus group discussion. This was driven forward by teams with particular interests in particular areas of the company. Focus groups were chosen accordingly. Oral feedback encouraged familiarity and opened up discussions. This process built trust and confidence. He believed it was not possible to manage relationships with staff in a public spotlight. The public and Government would not like that, but should be told it. Ms Blow said she assumed that everybody working in the Bank was concerned about the reputation of the Bank. There should be an appeal to those who did not contribute to surveys to do so.

The Governor said the discussion had been extremely helpful. In the Bank there was a perception that, while staff may express opinions, no one listened. He had heard a similar view at the Staff Conference, where the conclusion was that there was a need to transmit upwards what was said below and also to speak downwards to make staff feel that an interest had been taken in their problems. This discussion could perhaps be picked up during the informal Court dinner.

**MANAGEMENT OF THE BANK**
**Quarterly Financial Report**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Clementi noted that income in the third quarter was rather strong, with higher foreign exchange deposits. Expenditure in the third quarter was much in line with the first and second quarters, when it was below budget. The Bank was still not very good at planning its budget. But it would get close to the budgeted expenditure agreed last February. He noted the Bank had sold New Change. Profits would go into miscellaneous income. The property was in the books at £155 mn and had been sold for £177 mn. He noted that the sale was reflected on page A7 where tangible assets had fallen in the balance sheet. Turning to the footings, he said that the balance sheet had more than halved, reflecting the fact that there was now a more satisfactory position on Target balances, following a move to daily netting. Mr Trundle, Ms Lowther and their staff had been instrumental in getting the ECB to make these changes. Mr Buxton invited Mr Clementi to comment on the recommendation of the Audit Committee that there should be a revaluation of property this year to take into account a sale. Mr Clementi said the Bank agreed that it should this year revalue properties it was selling. It had not decided whether to sell Bank Buildings, which should be valued at market value.

**The Annual Pay review**
**(Messrs Bean, Clark, Plenderleith and Footman in attendance)**

The Governor said that the Bank had started a negotiating process with the Union on the pay round, and Court had been given a paper on the claim and the offer. Mr Footman drew Court's attention to the table on page two of the note. The Bank had not moved significantly in the last couple of weeks. Among the three main bargaining units, Banking had asked for a possible 6% and had been offered 2%, EDP had asked for the same and had been offered zero across-the-board and Services had asked for 5 % and had also been offered zero. The negotiating councils for EDP and Banking had not met since December but would meet later in the month. The Bank had met the Services Bargaining Unit, and it was clear that it was disappointed at the Bank's intention to concentrate on merit awards rather than across-the-board awards, but that had in the past been a feature of this unit and had in fact been accepted. The merit funds were relatively large compared with across-the-board funds. A year ago, Court had encouraged the Bank to move as far as it could in that direction. For EDP, where the recruitment and retention problems were sharpest, the Bank was proposing 8% merit and 8% bonus funds. In Banking it was proposing 4.5% and 7.5%. It was unlikely that the Union would willingly agree to 2% across-the-board for Banking and there might be scope for a very little more. He noted that in previous years negotiations had continued for a while, possible leading to a little enhancement of the offer, and had then run into the sand. The Bank had paid the amounts and the Unions had forgotten about the issue. That might be how it proceeded in 2001.

In response to a question from Mr Neill, Mr Footman said the offer comprised three stages: across-the-board or no across-the-board depending on which unit, followed by a merit pot followed by a non-pensionable bonus. He noted that last year the range of payments in the merit pot had been from 0 - 21% of salaries. In response to a question from Sir Brian Moffat about the strategy going forward, Mr Footman said the strategy for Services pay was to try to avoid across-the-board increments and focus all payments on merit and discretionary bonuses. A significant proportion of that group was relatively well paid compared to the market. In EDP, the Bank's aim was not to match the market, which was very strong, but to put itself in a position to recruit good people and retain the best it had. In Banking, the Bank had not yet had a settlement that had excluded an across-the-board award. This was clearly a very important issue for a lot of staff. He was conscious of the morale and motivation issues. These were reflected in what the Bank did. It should try to reward people on the basis of the contribution they made and the size of the job they were doing, as well as other factors.

Baroness Noakes said that the classifications described were related to pay bargaining but that was not how the Bank necessarily approached groups within the larger units, for example the economists in Monetary Analysis. She noted the large number of sub-groups in Banking. Mr Footman agreed, but said that within Banking there was a skew in the merit awards. In some parts staff were relatively well paid, whereas in other parts staff were relatively low on the scales, particularly Monetary Analysis, Financial Stability and some at the very bottom of Banking. The skew distributed the 4½% in relation to how well paid each area was. 4½% would become 3% in the relatively well paid areas. It could become 6% in areas that needed more money, such as Monetary Analysis. In response to a question from Baroness Noakes, Mr Footman said all that was negotiated with the Union was the across-the-board award and the other two elements were management decisions. This did not apply to Services, where all was negotiated. Mr Clementi noted that the unions were solely concerned with the across-the-board and that was written into the Union agreement.

Mr Neill asked whether the Bank would get to the point where discussions about what individuals were paid were between management and individuals. Mr Footman said that that was almost where the Bank was. Mr Neill suggested that the objective should be to get away from any kind of across-the-board award. Ms McKechnie said they key was whether people thought it was fairly applied. She had been working in her organisation for two to three years to improve the quality of management of performance assessments. Weak people managers would compound the morale problems. Mr Clark said the skew was a way of setting a starting point for discussion between parts of the Bank. With relatively small numbers, such as in Financial Stability and Monetary Analysis, it was possible to bring views of individuals together. This could ensure reasonable consistency. But it was a different story in dealing with groups of 2,000 people.

**Report from the Chairman of the Audit Committee**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Buxton said the last Audit Committee meeting had identified operational risk as an area of attention. It was looking forward to a report on the subject. The last Audit Committee meeting received a report on risks in different parts of the Bank and on the importance of those risks. Operational risk fell out of that report as a natural area to look at. Baroness Noakes asked how this fitted in with Turnbull issues. Mr Clementi said that a large part of the work on Turnbull would need to be done in April. As part of that, the Bank had said it would bring a paper to Court in February on what it saw as the most serious risks overall. There would be a more detailed paper in April as collateral for signing-off on Turnbull issues in April. The Audit Committee's discussion in June would be something of a post-mortem. Mr Buxton said he would have preferred to do the latter in April but the agenda was very full. Baroness Noakes said it had been expected that the Audit Committee would do a detailed examination to feed into Court considerations. Mr Buxton said some of the operational risk areas should have been brought to Court before that, but the Audit Committee needed time to have a major discussion on the question. Mr Buxton and Mr Clementi agreed with Baroness Noakes that the question of scheduling should be looked at afresh next year.

Turning to losses, Mr Buxton noted the annual report from Mr Butler. All the major losses were operational, though the level was not very great. The Audit Committee was concerned that one of the potential losses was the result of the failure to test a system change. People carrying out the change did not realise that it was more than procedural, so they judged that it did not need to be tested. The Bank's potential loss was £2.7mn. The Committee wished to emphasise that every time there was a change of this sort it should be tested. This was a fundamental discipline. Mr Plenderleith said the point was taken. Steps had been taken to ensure that people recognised the effect of minor changes in practices. This was a difficult case because it was not a system change; the software was already there and it had been tested and trialled. But the people using the system tried to make efficiency savings by running two tapes simultaneously, and they did not realise that the software was not set up to accommodate that. They should not have done it without checking. He was saddened that it had been done, though for the best motives. The Bank had recovered most of the money and was getting back about £5,000 a week. The risk had been recognised and it would not happen again.

Mr Buxton also noted two losses in the fund management service. The Committee wished to highlight this to management and question whether the risk of this business was worth taking. It arose because of the actions of inexperienced staff in a small section with high staff turnover combined with a reluctance to invest in systems that were critical for controlling the risk. The two losses were both about £100,000. They were not exceptional in this type of business. But the Committee questioned whether it was worth running the risks of the business. The Governor said that the point was that if the Bank was going to do this business and could see risks in the way it was managed then the appropriate decisions had to be taken. He had heard a suggestion that it was due to inexperienced people. The Bank would be exploring the question of the cost of putting in protection.

[redacted]

Mr Buxton noted that the Committee had asked the external auditors to look at the way the internal audit department was working following the changes over the last 12 months. There had been a big reduction in staff and more focus on qualitative not quantitative issues. The Committee thought it was working quite well but it believed the external auditors should take a look.

Finally the Committee recommended that it should not meet immediately after the next Christmas lunch.

Court was up.

21 February 2001

21 February 2001

## A COURT OF DIRECTORS AT THE BANK

## WEDNESDAY 21 FEBRUARY 2001

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir Howard Davies
Sir Ian Gibson
Mrs Heaton
Sir Chips Keswick
Ms McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Sir Neville Simms
Mr Stretton

Absent:

Mr Buxton
Sir David Cooksey
Ms Kathleen O'Donovan

The Minutes of the Court of 17 January, having been circulated were approved.

## MONETARY STABILITY ISSUES

**Inflation Report together with the economic and monetary discussion, incorporating the monthly MPC Report to Court**
**(Messrs Bean and Jenkinson, Professor Nickell and Dr Wadhwani in attendance)**

In introducing the monthly MPC report to Court, Mr Bean noted that the Inflation Report had been published the previous week and the minutes that morning. He also noted that the Federal Reserve had cut interest rates by ½% bringing the total to 1% in January. The US economy had slowed quite sharply in the second half of 2000 and there was a discussion about the shape of that downturn. The MPC forecast's central projection showed something like a V-shaped slowdown with relatively little growth in the first half, bouncing back in the second half. This was partly because the fundamentals were reasonably strong and productivity growth in the US was still apparent, and this was supported by the actions of the Fed in cutting interest rates and the prospective tax cuts promised by the Bush Administration. The central forecast assumed a second half recovery. The MPC was, however, aware of the downside risks that the slowdown would be more prolonged and deeper in the US, and the forecasts for the UK embodied that risk.

In the euro area there were some signs of slowing, but nothing very serious. The anaemic recovery in Japan was petering out. Mr Bean drew attention to UK provisional estimates of GDP, up 0.3% in the 4th quarter, though temporary factors were cited. Consumption growth was still strong, confidence was holding up, and surveys suggested a GDP bounce back in the lst quarter. The February Inflation Report took the view that, while the rest of the world was slowing, domestic demand growth in the UK was robust. The fan chart showed UK growth slowing to around 2% this year, then picking up, but the risks were on the downside. Employment growth had slowed, while earnings growth was moving up, but it was still early days in the pay round. The MPC's expectations were of some continued slight upward movement, but it did not expect any major explosions on pay. It was being noted that the latest RPIX for January was 1.8%, and there had been some discussion in the press about the possibility of the Governor having to write a letter to the Chancellor. Surveys suggested some firms may raise prices.

Turning to the markets, in Mr Plenderleith's absence Mr Bean said that there was some movement in the foreign exchange markets between the euro and the dollar, but the sterling effective index had been little changed over the last month, as shown in chart 1. The euro recovery was running out of steam, and the dollar was recovering mainly because the markets were retreating from an over-gloomy view of the US. There was very little action in the short sterling market. The markets continued to expect further moderate loosening of monetary policy this year, with the possibility of increases in rates next year, but there had not been much change in their assessment over the month.

In the US, there had been a sharp movement in short rates on 3 January, when the first interest rate announcement had been made, but the 31 January announcement had had little effect, because it had been largely discounted.

Despite what had happened in the US, there had been very little movement in US long rates, implying that the markets thought that what was happening was largely cyclical and not structural. In other words, it did not imply a fundamental revision in the prospects for productivity growth. Turning to stock markets, there was relatively little action in the UK and the US, but behind that were some further falls in ICT stocks. Overall, the cuts in interest rates had offset the downward revisions of profits.

The Governor invited Professor Nickell and Dr Wadhwani to comment. Dr Wadhwani said that he had a question for Court, which was: why was all the bad news from the US having so little impact on business confidence, measured by surveys.

Ms Blow asked whether the UK election had an impact on the forecast. Mr Bean said it was not something which had explicitly been taken into account. It was a moot point how to cope with an election that was likely to be close where there were very large differences in economic programmes. That would be taken account of in the risks, and it would probably be put into the fan chart. But as for the forthcoming election, the MPC had not put anything explicitly into the chart. In response to a question from Ms Blow about whether the US election was reflected in the forecast, Mr Bean said that the MPC had not put anything explicitly into the US forecast in November, and he believed the view then would have been that the differences in the programmes of the two candidates were not large enough to have a material effect on the prospects for the UK. But it was quite possible that the timing of the downturn could be associated with the extra uncertainty at the end of the year.

Mr Bailie said that, in the Republic, confidence had been dented quite considerably by the dip in the US. It had been a relatively short time since these events had occurred and they had not had time to filter through to many companies. In both the North and the South there was less confidence in the attractiveness of inward investment. The Groups for which he spoke did not expect to see increases in prices. Mr Bailie noted that the printing industry settlement was expected to be below 3.2%. He also noted the continuing importance of the political situation, which was reflected in investment. Textiles and agriculture were going through a horrendous time. But having said that, employment was not so bad, and there was anecdotal evidence of the influence of the Republic. Trains between the North and the South were jammed on Monday mornings and Friday evenings. Overall, people were hoping that things would not get worse, but thought that they might well do so.

Mr Morris, turning to pay settlements, said that public sector bargaining was about to commence and this covered large numbers, for example, in local government. The general expectation was that there would be some catching up with expectations because resources had lagged behind the private sector. There was an issue of how the public sector's position and morale could be boosted. He reported that he had been to the US the previous week, particularly the west coast, where he had heard a number of politicians speaking, including the new Labour Secretary. He had picked up indications of underlying confidence, but most investment decisions were on hold until the debate about tax reduction measures proposed by the President was concluded and also while waiting to see the effect of cuts in interest rates. When confidence returned there would be a splurge of investment.

Sir Neville Simms said that the construction industry was becoming predictable. The picture was the same this month as last month, with continuing growth, a weak final quarter related to bad weather, and new orders taken in 2000 up 4.6%, which implied growth of 5.5% over the period that the orders ran. He noted that orders were rarely cancelled. The industry was still predicting quite a substantial growth over the next two years. Turning to input prices, he said they were reasonably under control. There was a small further lengthening of delivery times, and prices were up for the 24th month in a row, though the rate of increase was falling. It looked as if there was a peak or plateau in input prices. In response to a question from the Governor, he said there was no setback in confidence, and the last quarter was seen as a blip by the industry and its clients.

Sir Chips Keswick said that investors were piling into the market for new private house building, and the company with which he was associated was ahead of its position this time last year. It was confident that it could achieve prices 6% higher on average. Mr Neill said that sentiment in the US vehicle industry was very depressed, but the industry was trying to put a reasonably brave face on it. The lack of confidence had not permeated the UK market, and February had continued to be quite strong. Industry forecasts were suggesting ~~2.3~~ 2.25mn units this year. There was reasonable confidence that there would be no downturn in consumer confidence, and lots of new models were coming on stream.

Ms McKechnie said the latest European Commission figures on car prices showed only about a 10% decline in UK prices overall. Longer term, it depended on the decision by Mr Monti on block exemption. It was clear that something would replace that. There might be a shift in new car prices over the next few years. She noted the complexity of the tax picture on cars between different countries. She believed there was more room in the UK for further cuts in new car prices, while the second hand car market was still in meltdown. Sir Ian Gibson said that car prices would continue to decline in the UK over the next two years. Data from the European Commission depended on the exchange rate at the time of the survey, and that was beginning to move, he noted. He supported Mr Neill in saying that there was not a bounce back in confidence in the industry, which was looking at the US and fearing that developments there would lead to the equivalent of a meltdown in Europe. All forecasters for Europe had been reasonably consistent, with suggestions of between 0.25% and 1% sales growth in Western Europe, until one of the newer forecasters had predicted a 20% decline in the second half, which led the others to look at their numbers again. There were limited signs of some producers in Europe winding back production from mid to late March onwards. This was a long process, except in the UK. Europe was also very much slower to take out stock than the US. He noted a great deal of concern about the length of the downturn in the US. If it were for two quarters there would be a sigh of relief, but if it were for four quarters or even two years the impact would be further rationalisation. Ms McKechnie said it was important to be very careful about the peculiarities of the UK market where people were moving from company cars to private ownership. The huge discounts for bulk purchases needed to be looked at.

The Governor noted that at the Palermo G7 meeting it had been made clear how important it was to stimulate Japanese consumption, yet in the papers he had just read the Japanese Government planned to increase Value Added Tax.

Sir Brian Moffat said he had noticed a great difference in attitude between corporate bankers in the UK and on the Continent. On the Continent he had heard two of the largest lenders challenging their own economists on their forecasts, which he thought might be because of their lending experiences in the US, where they were having to move ratings on companies downwards. Credit had tightened significantly in the last six weeks and was going to get worse. The bankers' attitude would percolate to industry in Europe. Banks in the UK were taking a very different position.

Mr Stretton, commenting on changes in the mortgage market, noted reports that implied that interest rate reductions would translate immediately into money in people's pockets. But changes in standard variable rates did not necessarily affect a lot of ~~lenders~~ borrowers yet. With regard to some of the announcements, for example the Halifax, it was not clear what percentage of ~~lenders~~ borrowers would be affected.

**Resources available to the MPC**
**(Messrs Bean and Jenkinson, Professor Nickell and Dr Wadhwani in attendance)**

In introducing the paper which addressed the provision of support provided to the MPC, Mr King said there was expected to be a continuing rise in resources spent on the MPC. He noted that table 2 of Mr Jenkinson's paper showed a further modest increase in staffing levels and allowed for increases in the relative pay of younger economists. There were four main points in the paper: first, following the review in November 1999, the Bank had successfully implemented the new arrangements; second, some of the changes recommended by Mr Kohn had been implemented; third, one of the main conclusions of Mr Kohn was that he did not perceive that the Bank was spending money on analysis that should not be spent, or that there were holes that needed to be filled. Significant changes in resources were not anticipated. Fourth, the main challenge was not to increase the budget but to increase the retention rate of staff, so that Monetary Analysis could fulfil the budget it had been allocated.

Mr King noted that Monetary Analysis had achieved the budgeted number of economists in the Autumn, but the numbers had then fallen away again. There had been an attempt to skew pay to younger economists, and a senior economist scheme had also been introduced to help to retain experienced staff. The Bank had done what was necessary and would see whether these actions were adequate over the next year or two. There was a further increase in the budget over the coming year that was not trivial. But the key challenge was to retain the high quality staff the Bank had.

In response to a question from Mr Neill, Mr King said that the aim was to recruit above budget so that over the year the Bank could stay nearer to the actual budget. Mr Jenkinson said that the Bank had got to budget in the autumn of last year but should ideally have been above at that time, and that there were no constraints on being above budget for a spell. Mr Jenkinson, in answer to a question from Ms Blow, noted that there were still possible improvements in processes, for example too much pre-discussion of research priorities before the issues came to the Committee. One of the issues for discussion in the Committee was whether there was a better way of setting priorities next year. Ms Blow asked whether, with a pool of clever people, the Bank got the best use of them in the way they reacted with each other. Mr King said there was a great deal of interaction between staff, and the team nature of research was one of the things that attracted people to the Bank, giving an opportunity to work with other bright people. In answer to a question from Mr Morris Mr King said, that more than any other central bank, the Bank of England had an international recruitment base. The Bank could only maintain the number of economists it required by going outside the UK, but this raised longer term questions about the development of staff at senior levels. Mr Jenkinson noted that there were a number of opportunities to work with central banks overseas, by attending meetings or participating in joint programmes of work, and also working with domestic and overseas academics. He noted that Bank economists had been able to spend a week in the ECB, and it was hoped to do more of that type of arrangement. A number of consultants had also been brought in. There were about 100 economists in Monetary Analysis of whom about 25 were non-UK nationals and he noted that the Bank had just recruited its first economist from Japan. Mr Bean noted that, of the new recruits, there was an even higher proportion who were non-UK.

In response to a question from Mr Bailie about retention rates, Mr King said the Bank's key objective was to retain very high quality people, hence the establishment of the post of senior economist to allow them to move up the salary scale by proving themselves as economists, rather than by creating management roles for them which were not needed. The Bank was quite happy to see some of the staff recruited move on, and many were now coming with the intention of spending some time with the Bank and moving on, seeing it as a staging post in their careers.

Ms McKechnie said that Section 3.2 of Mr Jenkinson's paper highlighted a worry. She asked whether the Bank ought to look at some major initiative across a number of organisations to increase the number of people going into economics. Mr King said the Bank was very conscious of the fact that it was probably the largest single employer among non-academic economists. Many were going into the City. But outside the private sector the Bank had become the employer of first choice. It was difficult for the Bank to change the trend, which was occurring also in the US, in which economics was seen as a less attractive subject than before at all levels. But the Bank could play a part and was working with others. He noted that Professor Nickell was President of the Royal Economics Society. The schools competition was helpful in that it could show people that economics was exciting and interesting and related to the world about them. One student had told a judge that the competition had changed her mind, so she now wanted to do economics. If the Bank was seen to be intellectually exciting, with key policy responsibilities, that was worth a great deal. But it was not going to be easy to move against the tide. It had been a problem for the Bank for 10 years, and so it had had to rely to an extent on the recruitment of non-nationals.

Baroness Noakes noted that later on the Court agenda was the approval of the budget. The external members of the MPC would not be there. She asked whether they had any comment on budget issues, and she also asked whether somebody would like to comment on table 4 in Mr Jenkinson's paper, which gave the relative numbers of economists at the Bank and at other central banks. Professor Nickell said that in his opinion the two economists allocated to each external member was a sensible number. He would be happy if that level of back-up continued. In Monetary Analysis overall, he believed an organisation of that kind could always do with more. There was a lot of prioritisation of requests and the MPC did not get all it wanted. His instinct was that the MPC could perhaps do with more resources on the model. In response to a question from Baroness Noakes about whether he thought that required going beyond the budget for 2001/02, he replied yes, but noted that there was another issue about whether the Bank could fulfil the numbers already in the budget. Dr Wadhwani said he endorsed Professor Nickell's comments on the need for additional resources for the model, and he knew they were budgeted for. He also noted that there were issues outside the MPC's area about whether there should be a reallocation of economists within the Bank.

Mr King noted that in table 4 there were only three institutions that set monetary policy and the Bank of England was the smallest. He did not believe that better monetary policy was necessarily achieved by adding more people. They could create management problems. At the Federal Reserve, there was a very large group of people doing work closer to academic research. He noted that the Bank had consciously outsourced work, to get the benefits without devoting too many people to the research concerned. There was a distinction between total resources and total staff. The Governor noted that there were 18,000 staff at the Bundesbank, 16,000 at the Banque de France and 2,000 staff at the Bank of England. Mr Jenkinson said that it was necessary to put more resources into forecasting and modelling, but there was a question about whether doing it at present left holes elsewhere without additional recruitment to fill the holes, which was the preferred solution. If current plans came to fruition the Bank expected by June to have five of its twelve senior economists working on forecasting and modelling issues.

## FINANCIAL STABILITY ISSUES

### Domestic developments and international issues
### (Mr Bean in attendance)

Mr Clementi noted that Mr Clark was in Basel. Reporting on Japan, which had been discussed at the Financial Stability Committee and Tripartite Committee, he said that, notwithstanding action by the public authorities, the financial sector in Japan was very weak, bad loans were rising and there had been a large number of recent corporate failures, and if anything insurance was in worse shape than banking. It was not obvious that normal monetary and financial policy mechanisms would be successful. From the financial stability point of view there was an implied guarantee given by the authorities to insurance and banking. The Bank of England was continuing to monitor the situation carefully.

Turning to London Securities Settlement, Mr Clementi noted the introduction of central counterparty equity settlement from the following Monday. The Bank was involved, though the prime mover was the London Clearing House. It was not yet a full service because netting would be added later. The Bank believed this was a sensible enhancement of the strength of the system.

**EXECUTIVE REPORT**
**(Mr Bean in attendance)**

The Governor confirmed that the next Court meeting outside London would be in Cardiff on 17 October.

He noted that Mr King had mentioned opinion polls to Court in December. These were to help the Bank acquire a feeling of people's understanding of what it was doing. The paper had been sent to Court in January. Mr King said the paper spoke for itself. There was a proposal to change one of the questions and to drop two others. There was also a proposal to poll quarterly for some questions but annually for others and the annual polls would have a double sample. There were also proposals for the method of publication, with an article once a year in the Quarterly Bulletin, and a quarterly update in a press release and on the website to publish the quarterly results. The arrangements would start this month.

Mr Clementi reported that, following Mr Thompson's appointment as Mr Jarvis' successor at the Printing Works, it was necessary to make changes to the board of Debden Security Printing Ltd and he drew attention to a recommendation in folders:-

that pursuant to Section 375 of the Companies Act 1985, as appropriate and until otherwise resolved by the Court of Directors-

(a) with immediate effect MR M A THOMPSON shall become Chairman of Debden Security Printing Limited in place of MR A W JARVIS;

(b) with effect from 1 March 2001 MR PETER KENNEDY shall become a Director of Debden Security Printing Limited in place of MRS M A P SHEPPHERD; and
MR MARK ROBSON shall become Director of Debden Security Printing Limited;

(c) with effect from 1 March 2001 MR MA THOMPSON, or failing him, Mr M D JONES, or failing him, MR PETER KENNEDY, or failing him MR R F SORRELL, or failing him MR LEE DOBNEY, or failing him MR MARK ROBSON be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of Debden Security Printing Limited;

(d) with effect from 1 September 2001 MR C J EGGLETON shall become a Director of Debden Security Printing Limited in place of MR R F SORRELL; and

(e) with effect from 1 September 2001, MR M A THOMPSON, or failing him Mr M D JONES, or failing him, MR PETER KENNEDY, or failing him, MR LEE DOBNEY, or failing him, MR MARK ROBSON, or failing him MR C J EGGLETON be authorised to act as a representative of the Governor and Company of the Bank of England at any meeting of Debden Security Printing Limited.

Court APPROVED the recommendation.

Mr Clementi advised Court that Mr Jonathan Horsfall-Turner, one of the three original founders of the Allen & Overy banking practice, had been offered the post of Legal Adviser to the Governor in succession to Mr Berkowitz. If he accepted, he would join in June.

He also advised Court that Peter Higgs would become the Head of Property Services and Security Division following the retirement of David Pennington in April.

Turning to the London Stock Exchange, Mr Clementi said that at the time Clara Furse was appointed it was agreed that Mr Plenderleith would stand down from the Board. That brought to an end the formal relationship between the Bank of England and the London Stock Exchange though the Bank intended to monitor closely its progress. The Bank did not think it was appropriate to have a Director in a private, for profit, business.

[redacted]

Turning to staff issues, following discussions in Leeds, at the informal dinner and at GovCo, the Bank had reached some conclusions. He noted the discontent with the ISR report expressed by Directors in Leeds, because of its negative bias. Nonetheless, the Bank felt it must communicate something to staff and make clear its response. The Bank did not want to publish the report itself but did intend to summarise some of the concerns and its own response. The first and most important point was leave, which was the most acute concern. The Bank intended to put round staff a new summary of how LDL should be used. The complaints were that staff were uncertain about what they could ask for, and that there was management inconsistency. In order to clarify the position, Govco agreed to publish the original indication to HoDs that up to five days LDL could be granted to any member of staff. And the note to staff would give greater details of the circumstances to which it could be asked for. But the discretion as to when the leave would be taken would remain with HoDs. He said a number of other concerns would also be addressed in the response. The Bank would commit to work harder at all aspects of its communication, upwards and downwards.

The Bank would commit to a review of the performance review system, to get greater upward feedback. New training provisions were put into place a year ago and the results had not all come through. The Bank had introduced a very good range of training but it was early days and the Bank's response would re-emphasise the opportunities available to build skills. The Bank would also re-emphasise the role Personnel must play in career advice and support at all levels and would build up the induction programme.

The Bank intended to consider ways of doing more routine reviews of staff attitudes and would like to find a better way. He noted that one or two Directors had discussed their experience in this area and he would take this forward with them.

Turning to relations with the Union, Mr Clementi noted the unhappiness in the recent past because of *BenefitSelect*. The Bank had been trying to restore relationships and had achieved some response. The payround was easier and the Union was taking a realistic approach, so there had been quite a lot of improvement on that front. He noted that a number of the staff most critical of the management were Union members. The Bank still had the tribunal ahead and it was not clear when that would be and, until that was in the past, it might be difficult for the Union to say anything nice about the management. But overall the tone was slightly easier.
Ms Blow said there had been a lot of interest at the Treasury Committee in morale, and the press was interested. She asked whether there were plans to communicate with either.
Mr Clementi said staff would receive the proposed note about leave and the five point plan he had just described. He recognised that that might get into the press. The Bank should not be

defensive. He noted that the Bank may be asked to respond on the issue at the Treasury Committee meeting the following week.

## MANAGEMENT OF THE BANK

### The Bank's budget for the year 2001/02
**(Messrs Bean and Midgley in attendance)**

Mr Clementi said that Mr Midgley's paper sought Court's approval for the Bank's budget for the coming year, reviewed the level of cash ratio deposits (CRDs) based on an assumed rate of return and sought Court's authorisation for the Governor to write to the Treasury relaying Court's conclusions in relation to CRDs and agreement to the proposed wording for Bank Objective 9.

Drawing up the budget, which flowed from the strategy approved by Court at its meeting the previous November, was a huge exercise with a large iterative element. Business needs were discussed at a local level and there was, therefore, a reasonable buy-in to the budget well down the Bank. He drew attention to Table A1 in Budbook which reflected how the Bank's business was run and the quarterly financial reporting to Court, and showed total budgeted income and the expected profit; the projected rate of return was about 8% of opening capital. Income was projected to be lower because of reductions in interest rates and fees paid by banking customers, and also the absence of any windfalls such as the sale of New Change provided in 2000/01, but the 7% benchmark rate of return was still projected to be exceeded; he also noted that the Bank was innately conservative in its income budgeting.

Control of expenditure was, Mr Clementi stressed, central to the Bank's budget approach. The on-going strategy, he recalled, was to achieve economies in the process areas, to build up resources in the analytical areas and to cut overheads. The table on page 8 of Mr Midgley's paper showed the progress to date in terms of staff numbers: the processing areas had seen a significant reduction, with a more modest decline still in the pipeline; numbers in the analytical areas were continuing on an upwards trend; staff in internal services had risen because of the recruitment of IT specialists for banking and payment/settlement projects; and there had been a substantial cut in staff in the overhead areas. In summary, there had been a considerable change in where manpower resources were allocated and there would be continuing change in the same direction, but at a slower pace.

Mr Clementi highlighted two key themes: first, the investment in people as shown on page 11 of Budbook. The training budget had doubled to £4.1mn in two years, reflecting such initiatives as the ECDL – which had had a very good take up among staff – and the policy of sending graduates back to university to complete Masters' degrees – some 20 staff were currently in full-time higher education, compared with only 5 four years ago. Second, expenditure on IT was budgeted at £15mn, including the C21 project in Banking & Market Services but also strategic developments in both the Monetary Analysis and Financial Stability areas. Mr Clementi noted that Mr Brookes, the recently-appointed head of Management Services, would be making a presentation to Court in March which would cover in more detail the themes of the Bank's IT investment and projects. He added that, while the budget for the outline years projected lower nominal spending and IT investment in years 4 and 5, this was unlikely to occur in practice because new projects would be identified in that timeframe. This did not matter from the budgeting standpoint but he believed that the Bank should publish its outline budget for the next five years in the Annual Report, and had accordingly asked Mr Midgley to consider the matter further. Mr Midgley would also shortly be meeting with Treasury officials to take them through the budget.

Turning to CRDs, Mr Clementi recollected that the agreement reached with the Treasury in 1998 was intended to run for five years. The level of CRDs was set to create an income to cover the Bank's unrecovered costs on Monetary Analysis and Financial Stability. The amount of CRDs had grown, off-setting lower yields on gilts. Accordingly, there was no need to request a change in the level of CRDs or the 7% benchmark rate of return this year. He expected that the position would be much the same next year, but foresaw serious negotiations in the Spring of 2003 when the current five year agreement would expire. A draft letter on CRDs to the Treasury was in Members' folders.

As regards Objective 9, which dealt with the Bank's finances, Mr Clementi drew attention to the revised wording set out on page 10 of Mr Midgley's note, which referred to the spending target for the immediate year ahead and the £20mn reduction in overheads over the five-year period to 2002/03. As the paper showed, the Bank was well on track to achieve the latter, by which time the refurbishment would be complete and Bank Buildings sold or let.

In answer to Mr Bailie, who noted the potential for a huge investment need at the Printing Works in relation to the euro, Mr Clementi confirmed that there was a detailed approval process for any capital projects foreseen in the budget.

As regards the draft letter to the Treasury, Mrs Heaton recommended that the wording should be changed to say that the £20mn reduction in overheads would be achieved by 2003 and not "in due course" as in the draft. Sir Ian Gibson agreed. The Governor accepted that this amendment should be made.

Sir Howard Davies recalled the understanding with the banks, when the FSA de-merged, regarding the overall burden of supervision (ie the cost of CRDs plus the fees paid to the FSA). For the forthcoming year, the FSA's costs would be flat, and the cost to the banks would fall by 10% because of increased balance sheets. Therefore there should, in the year ahead, be no difficulties in relation to the understanding on the overall cost of supervision to the banks.

Court APPROVED the budget, the letter to HMT in relation to CRDs (subject to the amendment agreed) and the wording proposed for Bank Objective 9.

The Governor thanked Mr Midgley and his team for all their efforts in preparing the budget.

**Investment of the Bank's endowment (Messrs Bean and Midgley in attendance)**

Mr Clementi recalled that Court had last considered the investment strategy for the Bank's endowment (ie its capital and reserves plus the CRDs) in August 1999, in the light of the reduction in the level of CRDs following the creation of the FSA and of the anticipated transfer of the cash management function to the Debt Management Office. Court had then endorsed continuing the strategy of holding 40% of the endowment in short term money market assets and investing the remaining 60% in gilts, but agreed that the strategy should be reconsidered in 2000/01 when the Bank's revised operational requirements had become clearer. That review had now been completed and, while the Bank's overriding investment objectives in respect of both elements of the endowment continued to be for reasonable certainty of income flow and security of capital invested, two changes in investment strategy were now proposed for Court's approval.

First, it had been agreed by both the Market Operations and Financial Resources sides of the Bank that it would be sufficient to hold only 10% of the endowment in money market assets, leaving 90% for investment. Second, the Bank wished to widen the investment portfolio from gilts (where yields had fallen significantly) to include a broader class of AAA rated fixed income debt issued by supranational financial agencies and the governments of developed countries, denominated in both foreign currency and sterling. The exchange rate exposure of any investment of the endowment in such foreign currency public debt securities would be fully hedged. Expanding the portfolio in this way would offer attractive investment opportunities consistent with the certainty of income and security of capital objectives. The possibility of including equities, investment property holdings and corporate bonds in the portfolio had all been considered during the review but, for various reasons, rejected. Mr Clementi asked for Court's agreement to the two changes in investment strategy.

Sir Neville Simms said that the case was well argued and he endorsed the proposals.

Court APPROVED the revised strategy for investment of the Bank's endowment.

**Turnbull guidance on internal control: reporting procedure & key risks (Messrs Bean and Butler in attendance)**

Turning to the paper addressing the Turnbull guidance on internal control, Mr Clementi said that the work on the risk matrix had been an interesting and useful exercise for the Bank's management. The paper covered the proposed procedure and evidence for the sign-off on internal controls in the Annual Report and the ten key risks facing the Bank, based on the more detailed information in the risk matrix. A further paper for Court in April would bring together the collateral for the sign-off and the issues which arose. A form of words, set out in paragraph 6 of the current paper, was proposed as the conclusion to the reports which each Director would make in respect of the risks in their area of responsibility. The wording reflected that the

Bank's approach was to manage and control rather than eliminate risk. Both MANCO and GOVCO were closely involved in agreeing the collateral for the Turnbull sign-off. Appendix 1 of the paper was a first draft of the paragraphs which might appear in the Annual Report. It drew on both the HSBC's report, which had already been published, and internal judgements on the Bank's own position. Mr Clementi invited comments, but reminded Members that the matter would come to Court again in April.

Mr Butler had, Mr Clementi recalled, made a presentation to Court the previous September on the on-line risk matrix. As Court had then requested, ten Bank-wide risks having the highest impact had been identified, and were described in Appendix 2. While there was no particular order, the first three risks were clearly especially important. He believed that Audit Committee and Court probably had a good feel for most of the risks but invited views on whether the right key risks had been picked out and on whether more information on them was needed.

Baroness Noakes said that the Bank had progressed by leaps and bounds in its risk management processes. She particularly welcomed the categorisation of risks and the introduction of the sign-off by Directors. On a specific point, she noted that the loss of the safe deposit box, mentioned earlier under the Executive Report, was one of a small cluster of incidents in Banking & Market Services over the past year and asked if the Executive were happy with the quality of controls in that area. Mr Clementi said that the question was a fair one. GOVCO and Court needed to be satisfied on this; a review was under way and the outcome would be reported to Court.

Mr King emphasised how useful the risk matrix exercise had been. The Bankwide approach had been enormously helpful - particularly in an area such as Monetary Analysis where processes had hitherto been more informal - in motivating managers to recognise the need to be more rigorous in looking at risk and to explain that need to their staff.

Sir Neville Simms, drawing on his experience as a member of the Audit Committee, also recognised the progress made. The ten key risks were very high level and he felt that the Directors' reports to form part of the April presentation would be very important to Members' understanding of the issues. He noted that the Turnbull sign-off was in respect of controls in place throughout the year, so Directors would need to be specific about this. He also thought that greater clarification was needed about how the shared responsibilities for the ten key risks worked in practice.

Ms McKechnie found it odd that there was no single key risk on security issues, including IT issues (both security and access), disaster recovery, leaks and information and physical security. These were all areas of concern which impacted on reputation. Mr Butler believed that risks 7 and 8 between them covered the aspects Ms McKechnie had cited: information and physical security were implicitly included under 7 and systems under 8. The Governor agreed. Responding to Baroness Noakes, Mr Butler said that MPC and Monetary Analysis systems were certainly viewed as key systems. He accepted the need to articulate the underlying risks and control processes for risks 7 and 8 in a way that explicitly captured the issues raised.

Mr Neill said that the risk matrix was a good piece of work which gave confidence in the Bank's approach to risk recognition and mitigation. But he stressed that, in his experience, it was necessary to embed an organisational philosophy that a visible part of line management's role was to ensure that standard procedural controls were understood, monitored and continuously developed. The Governor said that this was indeed part of management's responsibility, supplemented by the work of internal audit. Mr Butler added that his Division undertook checks on operational controls as part of their periodic audits but that the main responsibility for implementing and monitoring controls lay with line management.

Sir Ian Gibson noted that it was a heavy but worthwhile investment of management's time to explain right down the organisation that risk controls were important and why. Line management needed to own that process and make it transparent that they did so. Real value was added when staff appreciated what the risks meant in doing their jobs and understood the need to debate the impact of process changes.

Ms Blow endorsed all the previous comments. It was important that what was said in the Annual Report reflected the effort and the real progress made. Sir Brian Moffat stressed that the Turnbull sign-off in the report should state that the Bank had conformed with the internal controls guidelines throughout the year, but the current draft was not explicit on this.

Baroness Noakes recommended that Audit Committee should look at the matter in the context of emerging best practice. The words for the sign-off were very formulaic and the Bank did not want to get ahead of the game. Sir Brian responded that the Bank had what looked to be a good system building up, but he did not believe it could be said that all of the current elements of control had been in place throughout the year under review, so it would be necessary to explain that this was the case. Sir Neville Simms noted that the risk identification and reporting procedures had been built up over 3-4 years and that the annual review process had been overseen by Audit Committee on behalf of Court. In April, the full Court would need to be convinced that the evidence supported the statement to be made in the Annual Report.

Mr Clementi said that while most of the main elements of control had been in place throughout the year, Sir Brian Moffat and Ms Blow were right that there had also been enhancements during the year. The further work to be undertaken before the April meeting would include consulting the external auditors and others on what the Bank's statement in the Annual Report on Turnbull could say.

**Sealing Committee authorisations for inspection**

In accordance with the terms of reference of the Sealing Committee, the record of authorities granted by the Committee was laid before Court for inspection.

Court was up.

21 March 2001

21.3.01

## A COURT OF DIRECTORS AT THE BANK

## WEDNESDAY 21 MARCH 2001

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir David Cooksey
Sir Ian Gibson
Mrs Heaton
Sir Chips Keswick
Ms McKechnie
Mr Morris
Mr Neill
Ms Kathleen O'Donovan
Mr Stretton

Absent:

Mr Buxton
Sir Howard Davies
Sir Brian Moffat
Sir Neville Simms

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

### MONETARY STABILITY ISSUES

**Economic and monetary discussion, incorporating the monthly MPC Report to Court and including international economic developments**
**(Messrs Bean, Clark, Jenkinson and A Bailey together with Drs Julius and Wadhwani, Professor Nickell and Mr Allsopp in attendance)**

Introducing the discussion Mr A Bailey said the international issue was not so much whether the international slowdown would take place but how quickly and in what form. He noted the particular uncertainties relating to the United States, some of which were picked out in the note in the folders. He noted that the statement from the Federal Open Market Committee highlighted the fact that eroded profit margins were restraining investment spending. So far, consumption data were stronger than expected but it was too early to draw firm conclusions. He noted a number of key issues including the extent to which strong productivity growth would be persistent, which was important for the prospects generally; how the new economy would behave in a downturn, including the role of just in time inventories and the use of technology which allowed a faster response; how the new economy would affect investment behaviour; the impact of the downturn on wealth and consumption; and how much immediate support fiscal and monetary policy could provide. Europe so far had been more immune from the slowdown than the US, and there was also quite strong investment demand in some countries, especially France. But inflation in the euro area had been more persistent than expected, and that might affect expectations. Meanwhile, Japan, was in the slough of despond, though many of the essential problems were not new. If anything, the deflationary pressures had increased. There was also uncertainty about policies and politics. The Bank of Japan had eased policy and had linked the life of the new regime to inflation, though it was not an explicit inflation target. Moves on the fiscal and structural sides were still awaited.

An important question was what this implied for the UK. He noted that the MPC minutes suggested that evidence of a significant impact on the UK was slight. There was valuable information from the Bank's Agents on this front. Each could point to individual cases of effects from the US but these were still reasonably isolated and there was countervailing evidence from the more steady outlook in the euro area. The Agents had been asked to do a special topic this month looking at the impact on the UK.

Turning to the domestic front, Mr Bean said that a very significant event had been the global fall in equity prices in the last few days, as shown in chart 1, and this partly accounted for the Fed cut. The exchange rate index was fairly stable, but there were some bilateral movements. He noted that fourth quarter GDP was still showing an increase of 0.3%, but excluding the "alignment adjustment" it was 1.2% in Q4 and he would not be surprised if the official number for Q4 was revised upwards eventually. He noted that there had also been revisions to past data. The mix of demand now showed that consumption was lower and investment was higher. Whether this fully explained the puzzles would have to wait for the next forecast round, but the revisions did help to clarify the evolution of the components of domestic demand. Industrial production was unchanged in January, entirely driven by a big fall in telecoms, which was down 29%, and the question was whether this was erratic or significant. The outlook for consumption remained firm, confidence was holding up and there were no surprises in the Budget. He noted that employment continued to grow reasonably strongly and claimant unemployment had fallen below one million. Earnings growth had slowed, largely due to a millennium echo. RPIX rose to 1.9% in February. Overall, the international picture was a bit weaker and the domestic picture was a bit stronger. He noted that the MPC minutes, published that morning, had disclosed a vote of seven in favour of unchanged rates and two in favour of a reduction of 0.25%.

Turning to the markets, in Mr Plenderleith's absence, Mr Bean said that the effective exchange rate had not changed very much, in spite of the bilateral movements. The yen continued to weaken. Chart 3 showed that short sterling had shown some significant changes over the last month with a downward move in the term structure of interest rates of about 0.25%, or slightly more throughout the two years, reflecting the fact that the markets were more confident in their belief that the Committee would be lowering rates during the year. Chart 4 showed a continuing decline in short rates in the US with the three month rate tending to decline in anticipation of Fed cuts. Longer term, there had been some decline in long government bond yields, particularly in the US. Real yields, in chart 7, had remained largely constant in the UK, but in the US they had declined somewhat.

Mr Bailie noted a new estimate of a 10% drop in national advertising, with a lot of cancellations and cutbacks, some led by US companies. Another major issue was foot and mouth, where the situation was pretty damaging, certainly in Northern Ireland. It was now emerging that the major impact would be on tourism, with a lot of cancellations of conferences, and business travel and problems for holiday bookings. The British Tourist Authority estimated the cost at £100 mn a week, rising to £250 mn. He noted that there was always a danger of exaggeration, but the problem with tourism was that this was decision making time and there was considerable evidence of people switching from the UK to European holidays. The BTA was concerned about the impact of that. The situation was extremely serious. Finally he noted that the printing industry had settled for a national pay increase of 2.5%.

Sir David Cooksey said that he had attended a briefing on foot and mouth two days ago, and it was clear that it would last for six months. This had not been taken into account politically, and therefore Mr Bailie's comments were very important. Turning to the technology area, he said there were huge delays in capital spending projects on IT, where authority had been given but a hold was placed on orders. The other area that was giving concern was mobile telephony, because companies that had won 3G licenses were not rolling out the technology but were using the band width they had gained from the new licenses to extend their existing business. That led to a substantial hold up in capital expenditure in the area. Turning to e-commerce, he said there was a complete failure to raise funds that companies needed to survive, and there were going to be a large number of bankruptcy proceedings in the sector over the coming months.

Turning to the motor industry, Mr Neill said that March 2000 was very good and March this year was currently 5% ahead of that. The predictions for the month as a whole would not be sustained and would be something less than 5% ahead. The picture was, however, reasonably encouraging. The private buyer had come out to play again. The industry was reasonably confident that in a full year the outcome would be 2.25 million vehicles though it would not be very profitable. Underlying demand was quite strong. In response to a question from Dr Wadhwani at the February meeting about the US impact on the UK, he noted that Coca Cola had cut its advertising budgets 50% because of concerns about the US, not about what was happening here. The most senior executives he had talked to were concerned about the future but did not see it coming through in the data. Sir Chips Keswick said that the Dow Jones index had given a very clear message the day before. Rates were cut 0.5% and the market fell 2%. He saw that as a crisis of confidence, and recommended care in the analysis of the situation from an economic point of view.

Sir Ian Gibson noted that business in the US had probably got a lot better at dealing with stocks. The strong run in consumer demand had not given much opportunity to improve on that front but the downturn had allowed a set of established procedures to swing into action, and destocking was the fastest he had ever seen in the motor industry. It would allow people to operate at a new and even lower level of inventory. Anecdotal evidence suggested that the newer economy was importing people wholesale from the old economy to advise how to do this. The newer economy was facing a lesson that it had not had to learn until now. A rebound in production might not be seen until some time after the rebound in demand. He would not expect to see capital equipment orders until much closer to the point of recovery this time round. They would not be as much of a leading indicator as they had been in the past. Turning to the euro area economies, there was a mixed picture in the automotive industry. Germany continued to decline, as did Spain, while Holland was heading downwards. Forecasts for eurozone car sales were being revised down in a number of major markets. In Japan, because of the softness of the yen, those businesses that remained as exporters from Japan were suddenly seeing a rise in margins, and those that had dealt with the strong yen by relocating did not have that margin coming back in. In regard to the benefits of relocation, the picture was therefore looking unclear to the Japanese.

Ms O'Donovan noted the importance of the presence of the multinationals in the UK. Those with a heavy international business that faced a problem in the US would cut everywhere, and the UK would be affected by that. This applied to her company. In relation to destocking, she commented that this had been done in the easiest places with no thought as to how it impacted on the economy further down the supply chain. This had caused huge inefficiencies. She also commented that the current generation of managers had no experience of managing through a recession this deep and fast, which applied particularly in the US, where there had been such a good run for such a long time. Some very senior management were finding it difficult to know what to do, and that was why confidence had got so bad. Mr Morris said there was apprehension and some uncertainty, and an expectation that whatever happened in the US would have an impact in the UK because of exports to the US. But underlying all this was a certain degree of confidence that the efforts to build a constituency for low inflation were paying dividends. The labour market was very tight but there were no rampant demands on the pay side, and the situation was very stable. It was as if a dividend were being reaped in the context of the stability the UK economy had enjoyed. There was no conclusive evidence that the UK ought to do a huge nose-dive. It should hold steady. Some decisions would be deferred and there were one or two areas of uncertainty. He noted the foot and mouth problem. He did not expect the minimum wage would have a significant impact on the picture. That demonstrated a degree of maturity among pay bargainers. Nobody he knew wanted to lose the benefits created as a result of the low inflation policy.

Ms McKechnie, turning to car distribution, said that the restructuring of the retail distribution markets was beginning to kick in as a consequence of expectations about the European decision on the block exemption, which was imminent. She also noted a survey her organisation had undertaken of the take-up of digital television, which was much slower than predicted. In the

ISP sector, it looked as if there was going to be as big a shift as when Freeserve launched. Companies were trying to find models that worked. Charging was going to be introduced across-the-board. The Governor invited other external and executive members of the MPC to comment. There were no further comments. [Sir David Cooksey left the meeting].

**Peer Review comments on the pre-MPC process**
**(Messrs Bean, Clark, Jenkinson and Footman together with Drs Julius and Wadhwani, Professor Nickell and Mr Allsopp in attendance )**

In introducing the paper Mr King noted that visitors to pre-MPC were impressed by what they saw, but there were two questions: was there too much detail and could staff provide more analysis. Both points had been raised by Mr Kohn, and the Committee had made changes. The pre-MPC had been shortened to a morning only and staff had been asked to give more analysis. The MPC felt that the pre-MPC was a very important part of its briefing, but it was not a place where it wished to discuss the issues. The response to the changes made as a result of the two general critiques had been good.

In response to a question from Baroness Noakes, Mr King said he did not believe there was a fall in the number of visitors who responded by giving their views on the pre-MPC. However there were more visitors arriving out of curiosity, and perhaps some of that larger number were less inclined to comment. Baroness Noakes agreed that some comments were more valuable than others. In response to a question from Sir Ian Gibson, Mr King said that once Court had discussed the paper it would be circulated to staff. Baroness Noakes said it would be interesting to see if the comments on information overload and analysis were repeated, given the changes made.

**Review of the Service Level Agreement with the ONS**
**(Messrs Bean, Clark and Jenkinson together with Drs Julius and Wadhwani, Professor Nickell and Mr Allsopp in attendance )**

Mr Jenkinson introduced his note describing the links with the ONS across a number of areas, and particularly focussing on the national accounts, prices and the labour market. He also noted that the Service Level Agreement had been important to strengthening the links. Baroness Noakes welcomed it as a very helpful paper, which indicated that the relationship was working well between the ONS and the Bank and that there were good channels of communication. However she did not believe that the Service Level Agreement was really a Service Level Agreement, because it was set out in terms of a framework for commenting and for input into planning. It lacked the bite of a proper SLA. She asked whether there was any scope for sharpening the nature of the relationship with the ONS by trying to put it into a customer supplier relationship.

In response to a question from Ms Blow about corrections to earlier data and whether conditions could be set to limit those, Mr King said that the concern was the opposite at one time. There had been concern under earlier arrangements that very strong incentives would encourage the ONS to ignore important new information that came in, in order to meet such criteria. In relation to the SLA, Mr King said there were criteria and the ONS did meet them. But the most important part of the relationship was less to do with the detailed wording of the SLA - and he noted that there was a parallel agreement in relation to the Bank's provision of statistics to the ONS - than with ONS willingness to set the priorities in a way that reflected the Bank's wishes. That could not be part of the SLA, because the Bank was one of a number of customers of the ONS. Baroness Noakes commented that the SLA was about the development of the agenda, not just about monthly statistics. Mr Jenkinson noted that there was a particular focus on the development of statistics in the paper. But there was also a section on general issues which covered items of the customer supplier type. For example, there were some issues related to the improvement of access to statistics, some of which had not been obtained as quickly as they should have been in the past. The SLA had objectives, in that particular area and progress had been made. With regard to performance indicators, there was material in the SLA on the quality of statistics, although this was a rather thorny area. The ONS, Bank and Treasury view was that the existing criteria could be improved. The question was whether over time the Bank, the Treasury and the ONS might develop better performance indicators. There was some concern about whether that was the highest priority in relation, for example, to the development of existing or new statistics.

In response to a question from Mr Bailie, Mr King noted that there were other sources for information about the labour market. He also noted that the Bank was concerned to get access to further breakdowns of the average earnings data, and he had written to Mr Cook on this subject. If there was no progress next year he would go back on this. He noted two avenues open to the Bank in general: making representations to Mr Cook, and to the new Statistics Commission, which would take a great interest in the views of customers of the ONS about its performance. The Governor noted that opening links with the Commission was very important and Sir John Kingman had come to pre-MPC to see how reliant the MPC was on the statistics. Mrs Heaton said that whether or not the ONS had duties to other customers was irrelevant because non-executive Directors had a responsibility to ensure that information the MPC needed was made available. The defence that they were not getting it quickly enough because of competing priorities was not one she would wish to put to Parliament.

Mr King, in citing the example of National Health Service statistical priorities, said that he believed ministers would not agree. The MPC and the Bank had set out their priorities to the ONS, for example an index of services output. If Court felt such priorities were imperative, and were not being provided, it should allocate money and the ONS could provide the work on contract. Mr King said there was no such thing as an absolute need for statistics. Of course the MPC would like more data, bigger samples and more timely delivery. There was no limit to what it could spend, but it was not very helpful to approach the issue in that way. What the Bank did was tell the ONS its ranking of priorities, but it was not its responsibility to tell them which of the many competing priorities for nationals statistics should come first.

The Governor agreed that there were no absolutes, and the question was whether, if there were more and better information in some areas, it would help the MPC to do its job better. Mrs Heaton said the question was how much resource the government should put into the MPC and its statistical requirements. The MPC judged what it thought a reasonable request and asked Bank staff to negotiate with the ONS. She did not believe arguments about other priorities such as health statistics were relevant. It was a question of what level of resource was needed for the statistics required by the MPC. The Governor said the Bank wrote to the ONS about that issue. He was not aware of any missing material which would lead the MPC to say it was unable to do its job. Dr Julius said that the issue was not black and white. She believed the issue of SLA's was relatively new and the relationship was still being built. Perhaps the MPC had not been as tough as it might be able to be in the future. It had made important progress in setting priorities but there was scope to tighten deadlines more and also the times to completion of programmes. Some matters were dealt with more slowly than MPC members would like. Dr Wadhwani agreed and expressed sympathy for points made by

Baroness Noakes. There was significant progress but he did not feel like a customer with the ONS. He had seen examples of decisions, such as the ICT issue where it had been decided to wait for Eurostat, where the MPC had not had a comeback as potential customers. Mr King said that if there was work which should be done more rapidly that point could be put to ONS managers. The Bank had been pressing the ONS, which had responded on a number of issues, for example the labour market, where the Bank wanted standard errors in the data. For a very good reason, because it proved intellectually more difficult than expected, this was delayed and there was no agreement on a new deadline. The question of the balance between complaining and negotiating was not black and white. The Bank's dissatisfaction had been more with people lower down the organisation, who were doing the work, than in terms of concerns about setting of priorities. The Bank had concerns particularly on the labour market side about the quality of management, more so than on the National Accounts side. Points of substance such as that were made regularly through a committee of which the Bank was a member.

Mrs Heaton commented that the Bank was an agent of the MPC in this discussion, and asked whether MPC members present believed that role was undertaken effectively.
Professor Nickell and Dr Wadhwani agreed it was. The Governor said that the MPC as a whole discussed the letter to the ONS and if people were not happy they had an opportunity to raise questions in that context. Baroness Noakes said she took the point that there was nothing mission critical, and that at any point in time it was an incremental process. But in view of some of the concerns expressed it would be useful to have a half year report so that the issue did not drop out of the sight of NedCo until this time next year. The Governor said that if NedCo wanted a half year report it could be done, though how valuable that would be was questionable. The Bank would be very happy to do it. Mr King said it was important to think about the difference between mechanical aspects such as the timing of delivery, where there were no problems, and aspects of the work which were improvements, which had to be traded off against other demands on the ONS. It was not for the Bank to set budgets and run managers. It could express its view of priorities and say it was disappointed if they were not met. But it was not part of the contractual aspect of the SLA that improvements should be delivered at a particular time. Responsibility for the budget and overall priorities must lie with the ONS. Baroness Noakes commented that it lay with the Treasury too. The Governor said that there was no question that if there were a case in which it was absolutely clear if particular information was needed, one of the levers the Bank could pull would be the Treasury.

**FINANCIAL STABILITY ISSUES**
**Domestic developments and international issues**
**(Messrs Bean and Clark in attendance)**

Updating Court on international issues, Mr Clark noted that Turkey had come spectacularly off the rails in terms of its IMF programme. The lira had been floated and had depreciated by 30%. Negotiations with the Fund were on-going and the Turks were looking for substantial support – some $25bn – but it was unclear what policy measures they were offering, nor if the country's debt position was tenable. The authorities wanted to recapitalise the banking system but, since the latter was operating under government guarantee, this was a questionable priority. If Turkey merited support for wider, strategic considerations, this should be provided bi-laterally rather than through the Fund. The IMF board would be discussing Turkey again in April.

Turning to Argentina, Mr Clark said that the situation in that country had also gone backwards and there was a lack of confidence that the political machinery could deliver the fiscal and labour market reforms which were seen as necessary. The IMF programme was off-track, not least because the growth assumptions were over-optimistic; and there were concerns about the debt dynamics. Lopez Murphy, the Economy Minister, had resigned.

Considering how much the current problems in Turkey and Argentina mattered, Mr Clark said that contagion was a possibility, but not yet in evidence. The IMF's credibility was an issue, particularly as the new Managing Director had been closely associated with the programmes which were now foundering. Meanwhile, the concern was that these would not prove to be isolated problems, as there was a real question of the knock-on effects of the current difficulties in Japan and the US for the developing countries generally. Japan was currently far and away the most serious threat to financial stability. The real economy had not moved forward in the way expected 6-9 months ago, and the Nikkei index was dramatically down. There were serious implications for the Japanese banks and the financial sector generally and concerns over what new bad loans had been accumulated.

Mr Clark noted that, in two recent speeches, Mr Clementi had raised the question of credit risk transfer. Though not at present seen as a threat to financial stability, there were underlying concerns. In itself, the capacity to move credit risk around was generally helpful towards achieving optimal risk distribution, but the actual process of moving credit risk brought with its own risks – legal, pricing (because of lack of transparency) and concentration. And there was an emerging concern that some activity was driven by arbitrage between different regulatory regimes, for example where it appeared cheaper to carry the risk in an insurance company rather than on a bank balance sheet. The Bank was looking at this issue together with the FSA.

Turning to the new Basle Capital Accord, Mr Clark noted that there was a general drift towards calibrating prudential capital requirements more closely with risk. This could have significant implications for small firms partly because of the treatment of security in the form of leasing and inventory finance facilities. The Bank was working with the FSA to identify potential problems and possible solutions before publication of the new Basle Accord at the end of the year.

**FINANCIAL MARKET OPERATIONS ISSUES**

There were no issues for discussion.

**EXECUTIVE REPORT**
**(Messrs Bean and Clark in attendance)**

Mr Clementi reported that [redacted] who was to have been appointed as Len Berkowitz's successor, had recently advised the Bank that he was now unable to take up this appointment. The Bank was looking again at the short list of potential candidates which had previously been drawn up. In the meantime, John Heath would continue as acting Head of the Legal Unit.

Mr Clementi reminded members that the previous November, Mr Berkowitz had circulated a note concerning BCCI and the second hearing of the claimants' appeal before the House of Lords; the hearing commenced in January 2001 and the issues before the Court were whether the allegations made by the claimants, if proved, would meet the test of misfeasance in public office and, if so, whether the claim had a real prospect of succeeding. The House of Lords was due to announce the outcome the following day. If the appeals were dismissed, that would be the end of the story; if they were allowed, the case would be heard in the Courts and the matter could drag on for several years. If there were a trial, though much work had been done there would be a lot more still to do. Mr Clementi took comfort from the fact that Mr Berkowitz was now with Freshfields and would keep an eye on matters if the need arose.

With reference to a matter raised at Court the previous December, Mr Clementi said that the Bank had given further consideration to the level of spouses' benefits paid on the death of a Bank employee or pensioner. Under the current staff pension fund arrangements, the spouse's allowances was 50% of a fund member's base pension. While a number of companies had moved to the Inland Revenue maximum of two thirds, the Bank was proposing to increase the spouses' allowance to 60% of base pension; the contribution rate would be 0.3% of payroll but there would be no immediate cost to the Bank because of the current contributions holiday. If the proposal were acceptable to members, he would arrange to bring forward the necessary formal resolution to Court in due course. In response to Sir Chips Keswick, he said that parallel changes would be made to the Court Pension Scheme and he understood that Sir David Cooksey would be bringing forward a recommendation to that effect from REMCO.
Mr Clementi noted, for subsequent response, questions from Mrs Heaton on the position of divorcees and from Ms McKechnie on whether anyone other than the spouse could benefit.
Sir Ian Gibson, supporting the proposal, highlighted the potential for the Bank to promote itself to staff as a concerned and caring employer when announcing the change. Mr Clementi said that he recognised the opportunity.

Mr King noted that the ad hoc House of Lords Committee on the Monetary Policy Committee had been replaced by a formal House of Lords Economics Affairs Committee. Lord Peston chaired the new committee and its membership appeared almost identical to the current ad hoc committee. The ad hoc committee had now reported on the hearings conducted with MPC members and had produced a number of recommendations including some which seemed odd – eg that the Governor should write to the Chancellor in anticipation of a breach of the inflation target, and the suggested exploration of simultaneous voting at the MPC. The most significant recommendation, by which Lord Peston set most store, was that, with Court's approval, the Bank should finance a review of the method of forecasting inflation in order to check that it was state of the art. Lord Peston saw this as a serious intellectual exercise in which a recognised academic expert would explain what forecasting could and could not achieve.
Mr King agreed that it would not be easy to find someone of suitable calibre for the task, which might be undertaken during 2001. Baroness Noakes confirmed that this was the sort of

timescale the committee had in mind. In response to Ms McKechnie, who recalled an earlier paper from John Vickers advising against doing an analysis of the forecast, Mr King explained that Mr Vickers had been commenting on a rather different suggestion, to compare outcomes with the central projections. The current recommendation was for a peer review, which was preferred.

The Governor said that the proposal was, in effect, for a more focussed Kohn Report, which he saw as potentially valuable if the right academic could be found. If Court agreed, the Bank would respond to Lord Peston that it was considering how to take the forecasting review forward. Members supported this approach.

Mr King reminded Members that the final of the Target 2 Point 5 schools competition would be held in the Bank over the following two days. He agreed to Mr Neill's request to provide a report on the competition overall at a subsequent Court.

## MANAGEMENT OF THE BANK

### Payment to HMT is lieu of dividend
### (Messrs Bean, Clark and Midgley in attendance)

Mr Clementi confirmed that the arrangement with HMT remained that the Bank paid over a sum amounting to some 50% of post tax profits. It was estimated that the total payment for the year to February 2001 would be £65mn, which would be finalised when the Accounts were approved in May. In the meantime, it was appropriate to make an interim payment of half of this sum. Court AGREED that pursuant to Section 1 of the Bank of England Act 1946, and Section 8 of the Bank of England Act 1998, an interim payment of £32.5mn be paid to HMT, in lieu of dividend, on Thursday 5 April.

### IT in the Bank and IT and business processes in Monetary Analysis
### (Messrs Bean, Clark, Midgley, Jenkinson and Brookes in attendance)

By way of introduction, Mr Clementi reminded Members that, the previous June, the report produced by Organisation Consulting Partners (OCP) had encouraged the Bank to be more pro-active in bringing IT to the heart of current strategy and business planing processes, as well as to take on an IT champion. Gordon Midgley had recommended Andy Brookes, then on secondment to the Reserve Bank of New Zealand, as the person to head up Management Services Division, and the latter had now been in post for some five months. [redacted]

The presentation Court was about to receive was, accordingly, an important one and Mr Clementi encouraged feedback both at Court and to him subsequently.

Mr Brookes explained that his presentation sought to set the context and direction of the development of IT capability in the Bank, building on the work done the previous year by the OCP. Since taking up his post, he had spent a lot of time talking to MSD's customers around the Bank. This had elicited a range of feedback, both positive and negative. He believed the Bank had smart and able people working in IT (and the 95% retention rate was astonishing for an IT department) with particular strength in analytical ability and knowledge of the Bank's business. The Bank had shown itself to be good at IT applications for its externally focussed markets and payments functions but less good in relation to the knowledge-based work of the analytical areas. There was certainly room for improvement, and the need to align IT more closely with business strategy was recognised: this would take time and there were no easy road maps.

Mr Brookes characterised what MSD wanted to be: as enabler of business change, not simply the supplier of IT; as excellent and as close to the business and good at the things which mattered most for the Bank – so that the case for in-house provision rather than outsourcing was clear cut; and as an example of how to use IT. It was important that these aspirational aims were supported by appropriate values, in particular to be seen as a trusted – and transparent – supplier.

Mr Brookes reported that there had been substantive progress in relation to the Monetary Analysis business support unit, internet access, development of the intranet, remote access and the ECDL – which focussed on personal productivity using IT. Tasks in hand included work on data in the analytical coalition; process mapping in the process coalition; piloting of IT impact training for management; development of knowledge management through EDM+; and on-going work with Secretary's on the intranet. These initiatives spread Bankwide.

Meanwhile, initiatives in the pipeline included evaluation of customer feedback from the coalition consultancy; recruitment of dedicated technology support managers for each of the coalitions and of more analytical capability including new graduates; rolling out the IT impact training Bankwide; developing communications (remote access, internet access and secure e-mail); reviewing the infrastructure through to the desktop, looking at the appropriate balance between homogeneity and local discretion; and introducing customer measurement of quality of service. These were all tangible deliverables. In subsequent reports to Court, Mr Brookes expected to be able to indicate how well MSD was doing, perhaps through customer satisfaction survey results, external benchmarking and performance measures, and to say what external partnerships were being developed.

Introducing his paper, Mr Jenkinson said that considerable progress had been made in implementing the strategy to improve business processes in Monetary Analysis, which had been described to Court in December 1999 following an earlier review by OCP. The main findings of that review had been that productivity could be significantly enhanced by investment in improved business processes, that the business support functions in MA were significantly under-resourced and that the knowledge and use of IT was below external best practice.

Commenting in detail on the progress achieved, Mr Jenkinson said that a new business support unit had been established in April 2000; the challenge had been to identify and appoint the right staff, and this had taken longer than expected but the desired technical and support resources were now largely in place. Also as OCP had recommended, management boards had been established, under the chairmanship of Heads of Division, which bought together economists and support staff in projects to improve business processes. Mr Jenkinson himself chaired the Steering Committee which oversaw this effort. Meanwhile, MA was building on Bankwide initiatives including ECDL to enhance IT skills and training in order to match external best practice in the knowledge and use of IT.

Mr Jenkinson highlighted the particular strides made over the past year in accessing and sharing knowledge and data, in improving technical support and infrastructure, and in developing an IT competency framework based on an audit of IT skills required for each type of job in MA. For the year ahead, the priorities were a programme of improvements to FAME, the main time series database, and of data management; evaluation of the corporate information portal as part of the Bankwide knowledge management EDM+ project, which should enhance access to and the sharing of information; and the launch of a major IT training initiative. The challenge was to commit sufficient staff and management resource to delivering the strategic business vision while maintaining the high level of quality analysis and research required to support the MPC.

Mr Neill welcomed having a Powerpoint presentation in the Court Room, and said that he had found the content and tone of Mr Brookes' presentation and the thinking which lay behind it to be most encouraging. The point about IT being an enabler of business change was most important. Based on his experience at Unipart, he said that it was more difficult for people to think into a new way of acting than to act into a new way of thinking. A fortnightly Technology Action Showcase, comprising several short presentations to share IT knowledge, had had a profound effect throughout the Unipart business. For him, knowledge management was a key business issue.

Mr Bailie asked whether Mr Brookes had identified any hard outcome figures to show that investment in IT could deliver either improved information or the same information with less people. Mr Brookes said that, in short, he had not; hard feedback from customers was difficult to get, particularly in relation to the quality of outcomes rather than the quantity of inputs. Responding to Mr Stretton, who asked if the Bank was ready to re-think work processes to take advantage of IT, Mr Brookes said that work on process mapping was currently at the draft stage but he saw it developing into a provocation to business areas to identify process changes. Mr Jenkinson added that the approach in MA was very much centred on trying to think about doing things differently and more efficiently.

Ms Blow commended both papers. She had especially liked the attention to people issues, which, in her experience, made the alignment of IT with the business rather easier. It was important to get to the stage of thinking through the business case for IT projects but also to ensure that the old way of doing things was switched off by focussing on the savings to be delivered.

**Annual Report:-**
**Review of the Bank's performance**
**Review of MPC Processes**
**(Messrs Bean, Clark, Midgley and Footman in attendance)**

Mr Footman introduced drafts of Sections 4 and 5 of the Annual Report. He noted that the structures were very similar to last year and the year before. He also noted that the new framework for controlling risks on page 30, at the end of Section 4, referred to the Report from Members of Court in which last year there was a section on risk control. The Auditors had suggested that that section should be taken out and put either in Section 4 or possibly into a new section. The Governor asked for comments. At Baroness Noakes' suggestion it was agreed that comments would be made directly to Mr Footman.

**Employment Policies – Ethnic Minorities**
**(Messrs Bean, Clark and Footman together with Mrs Betts in attendance)**

As Mr Morris had had to leave Court just before the discussion, the Governor said he would ask Court to focus on the Leadership Challenge, but he nevertheless hoped to bring the paper back to Court when Mr Morris could attend. One of the commitments being looked for in the Leadership Challenge draft was a quota system. The Bank Executive felt that it could not sign up to quotas for the Bank. It could undertake to do all it could think of to give opportunities to people from different backgrounds. But to have quotas raised conflicts with the business need to have the best available people. The Governor said he had made that point to Mr Singh, Chairman of the CRE, and he had understood, and had asked whether it could be discussed so a way could be found of reconciling views. The Governor asked Court for its support for the Bank Executives' view. Court agreed.

In response to a question from Ms O'Donovan, Mrs Betts said that, when used by the CRE, the term 'ethnic minority' generally meant non-white. Ms O'Donovan said that should be made clear. In response to another question from Ms O'Donovan about the importance of completing ethnic information on forms, she said this question was voluntary. It was included in the application form for eg graduates. For mid-career entrants who applied on CVs the information was often missing. The Bank was introducing a desk-top system in which employees could access and input their own data and it was encouraging them to give such information. The Governor said that in asking them to do that the Bank explained that the reason was the importance of the information in the positive not a negative sense. Mr Bailie said that the major issue was equality of opportunity not of outcome. The Governor said the Bank had no hesitation about publishing data. Mr Neill said he strongly supported the view the Governor had taken on quotas. Ms McKechnie said that although she would not wish to work with fixed targets she believed the Bank should work with some sort of benchmarks. It was wrong to appoint people just to meet targets, but it was necessary for the Bank to know what it was trying to achieve. She also noted that organisations had images that prevented people applying and that was often the bigger problem with organisations such as the Bank. The Consumers Association had advertised in the ethnic press and set out the job categories available in recruitment. Mrs Betts said the Bank, too, had been very concerned about image. It had put some adverts in the ethnic minority press and had sent some recent ethnic recruits to careers fairs. Discussions with Mr Morris had covered how a more welcoming image of the Bank might be put out.

Court was up

18 April 2001

18 April 2001

**A COURT OF DIRECTORS AT THE BANK** SEC 21

**WEDNESDAY 18 APRIL 2001**

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Mr Buxton
Sir David Cooksey
Sir Howard Davies
Sir Ian Gibson
Mrs Heaton
Sir Chips Keswick
Sir Brian Moffat
Mr Morris
Mr Neill
Sir Neville Simms

Absent:

Mr King, Deputy Governor - Monetary Policy
Ms McKechnie
Ms O'Donovan
Mr Stretton

The Minutes of the Court of 21 March, having been circulated, were approved.

**MONETARY STABILITY ISSUES**
**Economic and monetary discussion, incorporating the monthly MPC report to Court (Drs Julius and Wadhwani, and Messrs Allsopp, Bean, Clark and Plenderleith in attendance)**

In introducing the monthly MPC report to Court, Mr Bean noted the slight weakening of the economy in the US, the fall in the equities market and the decline in investment and in production, though data for industrial production published the day before Court reversed that picture by rising in March. He warned that it was too early to declare a reversal of the trend because the data bounced about month by month. There was some evidence of confidence stabilising but at lower levels than last year. The Agents' survey in the UK reported fewer UK exports to the US, but other survey data suggested a slowdown in the euro area countries, though the ECB did not in the event cut rates. Turning to corporate finance, Mr Bean said that blue chip stocks were roughly back to the level they had been at the time of the February Court, but technology stocks were still well down indicating a reappraisal of earnings prospects in the sector. The number of profit warnings was up, though corporate bond spreads had fallen in the UK and the US, implying reduced expectations of default. Turning to activity in the UK, Mr Bean said Q1 looked weaker, but retail sales were still strong. Production was weak in February, and the CIPS surveys were soft. Commenting on the foot and mouth crisis, he said that the MPC at its last meeting spent some time discussing the issue. The effects on agriculture should be relatively limited, with perhaps a short run upward impact on inflation because of meat imports. But, generally, the agricultural effects should be relatively moderate. However there would be a more significant effect on tourism, particularly from abroad, and there was some evidence of a fall in visitor numbers, particularly from the US and also from other countries. Questions to ask were how persistent this would be and could it affect consumer confidence. There was some uncertainty about the scale of the impact, but the best guess was 0.2% off GDP with the bulk in the second quarter. In the short run there would be a small upward pressure on inflation, but in the median term, he expected a reduction in demand for tourism and leisure services because of a small downward pressure on inflation, leading to 0.1 - 0.2% off RPIX a year or two down the road.

Turning to wages and prices, he noted that employment was still growing faster than the labour force and unemployment on the labour force survey measure was down to 5.2%. Earnings grew by 5.9% in the year to February, well above the 4.5% consistent with the inflation target. A good part of that increase was due to bonuses in the City, and some was a shifting of the timing of bonuses from January to February and to some extent from March back into February. At this stage the exact contributions were not known. The Bank certainly did not expect numbers like 5.9% to continue, and he believed they would come back to more reasonable levels. He noted that RPIX would be published the day after Court, and that the minutes had just been published showing a vote of 6 in favour of a quarter per cent reduction in rates and three in favour of a half per cent reduction in rates.

Mr Plenderleith said that the dollar remained reasonably firm, surprisingly little affected by the slowing in the US economy. But the euro was lacklustre because sentiment continued to run against it, while the yen was weakening, which was arguably desirable, and was happening gradually. Sterling was firm, at around 106 on the exchange rate index, but was largely on the sidelines. Chart 4 showed short term interest rate cuts around the world including the US. In the UK expectations had shifted up a bit over the last month or so but there were still substantial expectations of further cuts this summer. In equities, the markets had been a little steadier in the run up to Easter, as Chart 6 showed. But he would not call that stability, because there was still a great deal of volatility.

The Governor invited Dr Julius, Dr Wadhwani and Mr Allsopp to comment. Dr Wadhwani asked Members of Court whether they could comment on the key issue of the timing of the recovery in the US and whether there was light at the end of the tunnel. Mr Allsopp asked Members of Court whether they could comment on what was happening to demand pressures in the UK. Sir Chips Keswick noted that the rough diamond trade had run at 1% below GDP growth in the US in the last 30 years and was quite a good indicator. There had been a very substantial drop off this year, even allowing for the good millennium year. The fall had been 15% and would probably increase. There was no doubt that there was a genuine recession in that business.

Mr Bailie said that national advertising in April and May was expected to show a further 19% drop, very largely driven by subsidiaries of big American companies. Advertising was now back to 1999 levels, with no confidence that it would pick up in the foreseeable future. Turning to tourism, he noted the difficulty of getting figures because of the fragmentation. The British Tourist Authority had noted that if foot and mouth was cleared by July the cost would be £1.5bn but if it was not cleared until January the estimated impact was £2.5bn. He also noted estimates that the shortfall on tourism in London could be £1bn, though that would not all be due to foot and mouth. It would largely be because Americans were deciding not to travel because of the downturn in the United States. There was supporting evidence in the figures from airlines. Turning to Northern Ireland he said that growth may be better than the UK generally, despite foot and mouth, but there was a big unknown in the effect on businesses. Those he talked to did not believe that a reduction of a quarter or a half per cent in interest rates would have improved business confidence.

Sir Ian Gibson said that car manufacturers in the US were debating whether there would be a fourth quarter recovery, implying there would be no third quarter recovery. The UK was the only good car market in Europe this year. In March, there were less incentives on new car sales implying new prices were firming, but this was not true of second hand cars. Across Europe as a whole the industry was now moving in the direction of the gloomier forecast that he had mentioned at an earlier Court meeting. Outside the UK there was likely to be a return to 1999 levels if not below, and Germany was a particular worry. The bad forecasts coming from big US component suppliers a few months ago were now being heard from European suppliers. Mr Buxton said that the retail sector was still rolling along, with substantial growth in mortgages, personal borrowing and credit card borrowing. He noted that he had been saying it must fall for the last six months. The corporate banking sector was not seeing much strain but was beginning to see company cash flow affected with borrowing rising and deposit growth falling. But overall the strain indicators, such as the number of companies in intensive care, were not showing much difficulty. Mr Neill noted that car production was down 23% year-on-year in February, but retail car sales in March were 1.5% more than last year, which itself was a record. April could be an all time record and the first ten days sales were currently 43% above last year, though he noted there was one extra day, and Sir Ian Gibson noted that March was normally a high volume month, so it was necessary to be careful about April, which was not high volume. Mr Neill said that if the trend continued there would be an all time record retail share, rising from 38% last year to 44% this year. But he cautioned that there were changing dynamics in the market, for example between fleet purchases and companies giving cash to employees to buy their own cars. He also noted that he had asked his company's leisure division about the effects of foot and mouth, and in the affected areas it had proved quite dramatic with dealers seeing a 50-70% reduction in sales. However, overall, current forecasts were quite buoyant for the car industry. The data appeared acceptable, but people were gloomy nevertheless.

Mr Morris said the experiences described by Members of Court were very common. He noted the importance of political uncertainty in Japan, as opposed to structural problems. He also noted the continuation of mixed messages in manufacturing. On foot and mouth, he noted brewing industry figures showing 92% of public houses were affected, and faced with that and other evidence, an important question was how the government would respond on capital expenditure, which was a key to whether the situation was held. Forecasters, including the

CBI, were looking to a significant reduction in growth. It was important for the government to hold firm on planned public expenditure.

Sir Neville Simms said that in the US power generation market there had been a swing over the last 6-9 months from overcapacity to a situation in which permits for investment were very much easier to obtain. In the construction industry in the UK output was still very strong, though the rate of expansion was slower than last year and the second half of 1999. At the moment forecasts were heavily underpinned by a very large commitment to public expenditure and quasi-public expenditure such as the railways. He noted the risks if that spending were not to happen, but there was no strong evidence that it would not. He also noted that foot and mouth could have an impact, though not a very significant one, on the construction industry, because it was the beginning of the earth-moving season and there might be some restrictions on farmland sites. Sir David Cooksey commented that with regard to bonuses the situation was somewhat different looking forwards. The venture capital industry was, for the first time in five or six years, finding intermediaries and advisers offering special deals, he noted.

**Review of the Work of the Agents**
**(Drs Julius and Wadhwani, Messrs Allsopp, Bean, Clark, Plenderleith, and Jenkinson, Iles, Falls and Brown in attendance)**

Mr Jenkinson, introducing his paper, said there were five headings: the continued high profile of the Agents in the MPC process; a summary of the latest internal review of Agents' reporting; a fuller description than previously of how the Agents went about the business of organising their monthly programmes of business contacts; an update on staffing, where there had been relatively little change; and an update on links with Regional Development Agencies and Regional Investment Funds.

Sir David Cooksey noted the mention in the paper of using the British Chambers of Commerce as an interface to small firms, and he suspected that that was not the best route, because the bulk of small firms did not know what the BCC was. It was linked more to the old economy. Declaring an interest as Chairman of the Small Business Investment Taskforce, he also said that the Agents' role in regional investment funds carried less danger of exposure than Court had previously anticipated.

Dr Julius endorsed the report's generally positive view of the work of the Agents, which she had found extremely useful, for example at turning points, and also when trying to assess the supply side and structural change. Their work was what was needed when trying to look forward rather than backwards. Mr Bailie said he took two main messages from the paper: the first was that the Bank was listening to the business community, which was a very positive development - and the Governor noted that the MPC was hearing as well as listening. Mr Bailie also said that with independence there was a great deal of confusion in the business community about what the Bank was doing, and the Agents had explained what the Bank was about, the benefits of low inflation and the workings of the MPC. Very few parts of the business community would now be confused about these points. Sir Ian Gibson noted that the 50 or so presentations by MPC members in the regions played a very important role. In his region that had been very successful. He asked whether that was the level which would continue, or whether the objective was to take it further. Mr Iles agreed with Sir David Cooksey that the BCC membership tended to be old economy firms, but it was just an example of Agents' contacts, and the Agents used a variety of other sources including business clubs and links through accountancy firms. He also noted, in terms of representation, that the Agents had expanded what they did, to include inflation report briefings in every Agency, and more of that would probably be done.

The Governor, turning to Regional Investment Funds, apologised for having failed to write to the Chancellor a year ago to explain the Bank's policy. However no problem had arisen in the meantime. He proposed not to write out of the blue on the subject but if the issue arose and the Bank was pressed on the subject he would write to the Chancellor saying that the Bank did not wish to take on a deeper involvement in such funds. Meanwhile, the policy stance had been reinforced by the Agents. It still remained open to an Agent to make a particular case for involvement in a Regional Development Fund, as with the two Agents who already had such involvement.

**Non-Policy Meetings of the MPC**
**(Drs Julius and Wadhwani, Messrs Allsopp, Bean, Clark and Plenderleith in attendance)**

Commenting on the research priorities meeting, Mr Bean said those who had been in the Bank longer than him believed that the meeting had worked better this year than last. It was more labour intensive, taking 10 staff weeks of preparation, and next year the Bank would try to look for a more efficient way of conducting it. He also noted the MPC procedures meeting.

**Draft Response to the House of Lords Committee on the MPC**
**(Drs Julius and Wadhwani, Messrs Allsopp, Bean, Clark and Plenderleith in attendance)**

The Governor noted that on page 3 of the draft there was a reference to a review of the method of Inflation Report forecasting, and the MPC was proposing to say that it endorsed that recommendation and would carry it forward. The Bank would come to Court with a proposal on who would undertake such a review, which would be next year. An amendment by Baroness Noakes was accepted. Baroness Noakes commented that the review of the method of forecasting was an excellent idea.

**FINANCIAL STABILITY ISSUES**
**Review of the Financial Stability area, incorporating domestic developments and international issues**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Clark noted that his paper provided a half-yearly update on the work of the FS area. He picked out just two of the issues raised, which were themselves only a subset of the issues on which FS was working.

As regards crisis management, he said there were two stimuli to the current interest – an exercise completed in 2000 under the auspices of the G10 Deputies on the impact of consolidation in the financial sector, and discussions within Europe on how crisis management arrangements would work in the event of a problem in a major European financial institution. A common theme concerned information flows, what information was needed, by whom and under what formal or informal constraints? The debate on these matters was continuing. Another characteristic of crisis management was that it involved regulators and a range of other players, so that the question of co-ordination was key. Scenario analysis and "war games" could potentially contribute to the testing of co-ordination arrangements. Apart from the focus on information and co-ordination, there were a number of other questions, for example, who carried the financial can if a large group with operations in many countries got into difficulties.

Mr Clark also mentioned that meetings of the so-called G4 – the Stock Exchange, LIFFE, CREST and the London Clearing House – had resumed recently. The Bank had organised a series of meetings beginning three years ago with these organisations, which represented key elements of London's market infrastructure, to exchange views on the challenges they faced with the aim of a better consolidation of strategies. The meetings had come to a halt when the Stock Exchange had entered merger negotiations with the Deutsche Borse at a time when horizontal (ie cross-border) integration had been the favoured model. The proposals had, of course, failed to come to fruition, and vertical integration of exchanges, clearing houses and settlement systems in a single country was much more back on the agenda, with Europe now apparently close to having three "silos" – in Germany; in France, Holland and Belgium; and in London (including the Swiss). Against this background, a meeting of the G4 at Chief Executive level had been convened by the Bank in early April. This had seen a helpful discussion and three further meetings were scheduled over the next six weeks. Mr Clark hoped that the output would be a shared perception of issues and challenges and, perhaps, a co-ordinated if not integrated strategy to address them.

Turning to the international financial architecture, Mr Clark said that this was not mentioned in his paper, although it remained an issue of active interest, because matters had been on hold while the new US Treasury team assembled. He expected discussions to be re-engaged soon, particularly on the question of private sector involvement.

Mr Clark noted that one section of his paper described his area's research programme. He noted that three of the Divisions had links with individual outside academics on a part-time basis; the aim was to ensure that the Bank's research on financial stability was informed by expert outside thinking.

Sir Chips Keswick suggested that the chaotic handling of the current foot and mouth crisis and the inter-play between government agencies and Europe provided a salutary benchmark for the management of an international crisis in the financial sector.

Referring to the section in Mr Clark's paper on settlement accounts, Mr Morris asked about application of the Bank's criteria in decisions on offering such accounts and whether the holders would be UK or international banks. Mr Clark replied that decisions on settlement accounts involved balancing a number of different factors. The Bank recognised that this was an area in which central banks had a role to play, but it had no ambition to disintermediate commercial banks or other financial institutions from their business functions. Granting a settlement account could be interpreted as a signal of willingness to support a firm if it ran into difficulties. The Governor added that the matter would be brought back to Court when current work on the criteria for granting settlement accounts, which the Bank intended to publish, had been finalised.

Sir David Cooksey raised two points. First he thought the work of the International Accounting Standards Board had become increasingly important, given the need to understand and rely on accounts across international borders. Second, he said that NASDAQ were seeking to establish a bridgehead in Europe: efforts should be made to make London their choice.

In response, Mr Clark said that NASDAQ had spoken to various parties in London about their ambitions. The story was continuing. As regards accounting, he saw this as part of the international financial architecture question. The previous year had seen an advance in bringing US and European interests together, but there had since been a sense of backsliding, eg on fair value accounting. The Governor noted that the Bank was funding the IASB to the tune of US $50,000 per annum for three years.

Mr Buxton commented that banks generally were extremely worried about the principle of extending fair value accounting which, because of the impact on their loan books, they saw as completely impractical. But the accountants appeared to be taking no notice of these worries. On crisis management, he thought the discussions worth pursuing provided that there was a tangible result. However, given that private sector involvement would always be a maverick factor, he was sceptical how far the reaction to an international financial crisis could be specified in advance.

Sir Howard Davies agreed that it was right to have modest ambitions in this area. Nonetheless, it was worth working in advance to try to identify and remove any roadblocks in the international financial architecture, for example, as regards different bankruptcy provisions and information - sharing gateways.

Mr Clark agreed that the agenda was an ambitious one, so it was important to look where to focus first. Insolvency law was certainly one area for attention, and he recalled the difficulties experienced in this connection as regards Barings' activities in Japan. Turning back to the question of international accounting standards, he said that the Bank was neutral on the question of fair value accounting. He sensed that the debate between the accountancy profession and the banks had not been open or constructive, and said that the Bank was seeking to engineer a genuine debate.

Mrs Heaton observed that accounting for pensions was also a problem area. Flows of funds in pensions were a huge factor in financial stability, and she asked if this was an area under study by the Bank. Mr Clark replied that the question was a fair one: while the Bank did look at flows, there had been no recent work on issues such as the impact on pensions on demographic trends in Europe. For the future, he was keen that the Financial Stability area should broaden its research focus from banks to other financial sectors.

**FINANCIAL MARKETS OPERATIONS**
**(Messrs Bean, Clark and Plenderleith in attendance)**

[redacted]

[redacted]

[redacted]

Turning to more welcome matters, Mr Plenderleith updated Court on the distribution of bank notes around the country, which was undertaken through banks' regional cash centres. The previous Notes Held To Order Scheme needed reorganisation and, following negotiations, a new Notes Circulation Scheme was being implemented in stages, and going encouragingly so far. Under the new scheme, the banks' holdings of notes would be more limited and they would now be providing intra-day collateral, instead of just end of day collateral as hitherto.

Mr Plenderleith next reported on two recent auctions. The March gold auction had gone well and the programme for the final stage of gold auctions had been agreed, with 120 tonnes to be sold in bi-monthly auctions over the coming year. The pacing was thus as before but the amount on offer would be reduced from 25 to 20 tonnes per auction on the Bank's advice that the market had become thinner. Meanwhile, the second of the quarterly auctions of Bank of England three year Euro Notes had been held the previous day and had been well covered, in line with expectations.

Last, Mr Plenderleith noted that a detailed remit with HMT covering the Bank's operations and performance targets in managing the foreign exchange reserves for HMT through the Exchange Equalisation Account had recently been agreed for 2001/02.

Sir Brian Moffat said it was unfortunate that this occurred at a time when the internal controls sign-off was under consideration, and he asked for reassurance that it was no longer possible for one individual to infiltrate the system. Mr Plenderleith confirmed that the controls had been reviewed and procedures tightened. There were always lessons to be learned in these circumstances but it was impossible to give absolute assurance. Mr Neill commented that such occurrences were unavoidable even in the best run institutions, as there was always a small risk from the actions of a maverick individual. The Governor asked Mr Plenderleith to circulate a short paper to Members on the review of the relevant controls and how these had been tightened in the light of the incident.
[The Inland Revenue prosecution was, in the event, postponed at the last minute until (probably) 2002.]

**EXECUTIVE REPORT**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Bean reported the creation of an additional division in Monetary Analysis, to be headed by Mark Cornelius, which would bring together staff who write the Inflation Report with those who produce the Quarterly Bulletin. The purpose was to give more focus to the writing of the

Inflation Report, to improve its role as a vehicle for conveying the thrust of MPC thinking and to consolidate prime, hands-on responsibility for its drafting and production.

Mr Clementi noted that the Financial Stability side was considering whether a similar move would be appropriate in respect of the Financial Stability Review. He then reported the appointment of Joanna Place as Head of the Monetary Financial & Statistics Division in succession to Philip Turnbull, who was taking early retirement.

Noting that Court had agreed in May 1998 to the relocation of the Bank's catering facilities into Head Office, Mr Clementi reported that the sale of King's Arms Yard building to Friends Provident PLC was now proceeding. A further paper on property issues would be brought to Court in June.

With reference to the discussion of spouses allowances the previous month, Mr Clementi answered the two questions he had taken away. First, under the pension fund rules, only children under 18 were eligible for additional allowances; any other allowances were discretionary. Second, divorced spouses had no automatic entitlement to an allowance unless this was specified in the divorce settlement. Mr Clementi confirmed that the Bank intended to proceed, from 1 May, with the increase in spouses allowances (ie the pensions paid after the death of the pension holder) from 50% to 60% of the relevant base pension. Sir David Cooksey added that RemCo had discussed the issue in respect of the Court Pension Scheme and recommended a parallel change.

Court agreed that spouses allowances under the Staff Pension Fund and Court Pension Scheme should be increased to 60% of base pension with effect from 1 May.

**MANAGEMENT OF THE BANK**
**BCCI**
**(Messrs Bean, Clark, Plenderleith and Heath in attendance)**

The Governor noted that the House of Lords, in its recent deliberations on BCCI as to whether the Liquidators' claim was bound to fail without the need for a trial, had arrived at the wrong decision – so far as the Bank was concerned. It was, however, important to note that the judgement expressed no view on the merits of the Liquidator's claim or on whether the Bank had committed misfeasance.

John Heath, who was Len Berkowitz's deputy and was standing in until a successor has been appointed, had circulated a note the previous week summarising the key factors of the judgement and outlining the position, together with a copy of the full judgement.

The outcome was clearly a disappointing one for the Bank and an obvious milestone in the process. It was timely, therefore, to consider whether the Bank should carry on with the action or look for a settlement. Grounds for contemplating a settlement were the hassle of the trial, the burden on the Bank, the likelihood of embarrassment when certain documents were disclosed and the stress and anxiety the principal witnesses would feel. However, there were very powerful practical arguments against seeking a settlement:

- As a matter of principle, there was the question of the dynamic effect of an institution such as the Bank being seen to cave-in in these circumstances – which might encourage others to "have a go" – and thus a responsibility for it not to do so.
- A settlement would no doubt be expensive, both because the liquidators were under pressure from the BCCI creditors to justify their costs and because of the documents shortly to be disclosed to them.
- It was doubtful that the Treasury would agree to a settlement, particularly as the unanimous view of the Bank's legal advisers was that its defence was strong. The legal advisers were preparing the defence, and if their advice on the strength of the Bank's case changed, Court would be so advised.

After careful consideration, the Governor strongly believed that the Bank should continue with the case but he invited Members to express their views. He added that Freshfields had seen the relevant draft disclosure in the Annual Report and were content, and accordingly, that the Bank intended to make no provision in the Accounts.

Mrs Heaton noted that the directors of Equitable had been advised that they had a strong case but had lost. She suggested formally seeking comfort from the Treasury in relation to their stance should the Bank lose the substantive case, because their response might alter the decision on provisioning. The Governor said that he would be briefing the Chancellor on where matters stood and how it was intended to proceed but he thought that to make a provision now would send the wrong signal about the Bank's view of the strength of its case.

Sir Howard Davies said that the FSA clearly had an interest in the case, which had two dimensions: what amounted to misfeasance in relation to the actions of a banking supervisor and did the Bank's performance in supervising BCCI amount to that. The financial supervision regime would be unworkable if the law were to be interpreted as being in accordance with the minority judgement in the Court of Appeal which held, in essence, that any bank which failed to meet any of the regulatory criteria should be shut down. If the current case could be halted now with a modest settlement, say around the price of the future action, Sir Howard would advise going with that because the case would not have redefined the law of misfeasance in public office, but left the test for misfeasance much higher than mere negligence: he could not, in these circumstances, advise that the law had been left in such as unsatisfactory state that it was essential to proceed. But a sizeable settlement might be interpreted as suggesting that the test of misfeasance was different from – and lower than – currently understood, and thus encourage speculative court actions in future. In those circumstances, Sir Howard's advice would endorse the line the Governor had taken.

Mr Clementi said the case was a complex one. He foresaw the real likelihood, a year or so ahead, of it absorbing a lot of senior management – if not Court – time. Paragraph 42 of the House of Lords' judgement set out clearly what the plaintiff would have to show in terms of intent and causation. Even then it should be apparent that the loss to depositors was caused by the fraud of BCCI's senior management. The action would be long, expensive and potentially embarrassing and disclosure of a number of annexes to the Bingham Report not previously in the public domain would show a trail of failure to grasp the nettle. He took comfort that Bingham had been through the matter including a number of Bank documents not yet released, and, while tough on the Bank in a number of instances, had found no evidence of bad faith. Mr Clementi saw no case for a provision now or to approach the Treasury for comfort: the Bank was in a different position from a private company in view of government ownership and was well capitalised for its operations.

Sir David Cooksey agreed, and suggested that the time to make a provision would be if the Bank lost the case in the High Court. As regard the proposed note for the financial statements he recommended changing the reference in the last sentence from "Members of Court" to "Court".

Mr Morris recognised that the issue was the strength of the Bank's case and the state of the law. Both aspects needed to be looked at in case one outweighed the other. He was comfortable with the strength of the Bank's defence but noted that this could change, dependent on the circumstances. Both the Bank's reputation and the public interest should be kept in mind. He was quite content for the Governor and Executive to have the flexibility to react if the other side recognised the state of the law and sought merely to recover its costs, and to recommend a settlement at any time: Court only needed to be involved in any decision to take the case on to the Court of Appeal or the House or Lords.

The Governor accepted Mr Morris' points. He reiterated that the question of whether to proceed might arise again during the preparation of the defence over the next 6-9 months. The trial itself was likely to last a year, so any question of appeals to the Court of Appeal or House of Lords was well down the line. He reaffirmed the Bank's current intention to proceed to trial and not seek a settlement. Mr Neill was concerned that the downside of conceding was too much. Sir Chips Keswick asked about support for principal witnesses who had left the Bank. The Governor agreed that this suggestion should be considered and come back to Court in due course.

**QUARTERLY FINANCIAL REPORT**
**(Messrs Bean, Clark & Plenderleith in attendance)**

In Mr Midgley's absence, Mr Clementi presented the Report which, he noted, contained end year numbers to be considered at Audit Committee in the following week and at Court in May. He highlighted that income was some £40mn higher than anticipated through higher investment and banking income and the profit on the sale of New Change. Expenditure was more or less on target, though there were a number of offsetting variances against budget. Features of the balance sheet were the netting of TARGET balances, which reduced the footings by about £14bn and the revaluation of the Bank's properties. He was particularly pleased that, in the light of the refurbishment programme, the valuation of the Head Office building had increased from £125mn to £171mn on the basis of notion rental values.

Mr Clementi noted that four projects showed red traffic light warnings. These included:

- The MFSD project to re-engineer statistics gathering, reported to Court for the first time because it was previously budgeted to cost less than £1mn. The project – which was perhaps more complex than originally appreciated – had been consuming a lot of management time and showed the need for a tighter management grip which the change in Head of MFSD reported earlier was expected to bring.
- The refurbishment project for the Ground/Mezzanine/First Floors which, on the basis of competitive tender prices now received, would cost some £6mn more than first estimated. Costs of work on the Ground Floor were substantially higher than for other floors and options were being reviewed for GOVCO and for a paper to Court in June. Mr Clementi commented that this was a good example of the project status reporting system serving its purpose.

**COMPLIANCE WITH TURNBULL – GUIDANCE ON INTERNAL CONTROL (Messrs Bean, Clark, Plenderleith, Butler, Footman, Thompson & Hitchins [PwC] in attendance)**

Mr Clementi said that his note summarised the process, the collateral assembled and thoughts on the sign-off wording. The heart of the work had been the review of the risk matrix but supplemented, for the first time, by reports from individual directors: while there had been a template for the latter, it was apparent and satisfying that each director had written their reports in their own words. The exercise, not simply one of box-ticking, represented a significant cultural change for all areas of the Bank other than Financial Market Operations which had done similar exercises in previous years. The system did not eliminate all controls risks but ensured that information came to Court when necessary (cf Annex 6). Mr Clementi stressed that there was no absolute or explicit statement as to the effectiveness of the controls in place, though it was implicit that the mechanism was fit for purpose. The papers had been reviewed at a joint GOVCO/MANCO meeting which had concluded with a recommendation that Court should be in a position to agree the sign-off statement. He noted the support which Kevin Butler, and also John Hitchins of PricewaterhouseCoopers, had provided to the process.

For the sign-off wording, the Bank had looked at precedents from HSBC, Lloyds TSB and Abbey National. Court needed to consider if it was happy with the procedure followed and the collateral and, if so, were Members content to give the Statement of Internal Controls in the Directors' Report?

Mr Buxton added that, as Chairman of Audit Committee, he was quite content. The process had clearly focussed management's minds on the risks in their business, which was exactly what Turnbull had intended.

Baroness Noakes was also content with the sign-off for the past year. However, she noted the number of apparently isolated problems in the Banking area as reported in Annex 6. This was something which needed attention in the year ahead as she felt Court would not be comfortable with a similar list in twelve months' time.

Mr Plenderleith said that a run of figures provided to Audit Committee had shown that the number of incidents was static (actually less in the last year) but the monetary amounts were larger than previously. He and his Deputy Director had considered carefully, when drafting their collateral report, whether this reflected a greater exposure to risk. They were satisfied that there had been no diminution in the control environment: zero defaults could not be ensured but the tolerance remained low.

Mr Buxton noted that the philosophy of the internal audit team had changed from quantity to quality. Instead of the previous wider programme of audits, some parts of the Bank were now audited less frequently, but those where the risks lay were looked at more often: this should pick up on the point Baroness Noakes had made. Mr Butler confirmed the move to a risks-based audit programme, with Financial Market Operations as the main focus. Internal audit were alive to the risks that had been mentioned and described by Mr Plenderleith in his report. The C21 programme would address some of the operational risk issues apparent in FMO by automating controls, underpinned by the internal audit programme.

Ms Blow questioned whether the sign-off wording reflected the Bank's intention to improve. Sir Ian Gibson agreed, but also supported Mr Buxton's view about the evident value of the process. He thought that the Bank was in a good position this year but, going forward, attempts should be made to quantify failure and so inform management judgements. Baroness Noakes commented that there was always a cost/benefit question in managing risk. She recommended strongly that the proposed sign-off wording should not be changed.

Mr Clementi noted that the process of risk management was on-going. In the year ahead, Audit Committee was going to focus on various risk areas, including operational risk.

Mr Neill said that Six Sigma (an industry process describing tools and techniques designed to reduce costs and improve efficiency) was a tool which had been used in manufacturing to achieve zero parts per million defects. It was now usable in service organisations and could be worth trialling in an area of the Bank.

Court Members confirmed that they were content with the Turnbull sign-off process, the collateral, and the proposed wording for the internal controls statement in the Directors' Report.

**The Bank's Annual Report - in draft**
**(Messrs Bean, Clark, Plenderleith and Footman in attendance)**

Mr Clementi drew Court's attention to a note by Mr Midgley about the medium-term expenditure chart. The Bank's proposal was that, relative to the budget in years two to five, £10mn in aggregate should be added to overall costs. This gave a revised red line. It still showed the Bank would be reducing costs, but was more realistic than the lower line in the chart.

Mr Footman noted that the text would come back to Court with the Accounts on 9 May. The Bank had been intending to publish on 23 May, and the issue was whether Parliament would be sitting and the Report could be laid there. For the moment the plan was to carry on with the signing-off timetable. If it was found that the Report could not be laid and published the Bank would have to wait until the election was over. Mr Footman noted that Sections 2-3 were similar to last year, there were changes on pages 4, 27 and 29 of Section 4 and on page 2 of Section 5. Mr Clementi had covered the main change in Section 7. Section 8 was new to Court but was not dissimilar to last year's. Section 9 on remuneration included the arrangements for

Mr Allsopp. Section 10 was the Report from Members of Court. The Governor asked Members of Court to give detailed drafting comments on the Annual Report outside the meeting. He asked for comments on material points. There were no comments.

**Houblon-Norman Fund Report**
**(Messrs Bean, Clark and Plenderleith in attendance)**

There were no questions on the accounts. In response to a question from Mrs Heaton about the level of satisfaction over the quality of the candidates, Mr Bean said there was still a concern about the pool of applicants. In the coming year three good people had been lined up, but beyond those three the rest of the pool was not impressive. For the next round, it was proposed to go out more actively and try to solicit good people to come to the Bank. He agreed that this was going to be a problem, and that there was more work to do, particularly in the US, where academic salaries were high. Mrs Heaton said it was important to carry out this activity well, and if necessary Court should revisit the amount available from the Fund.

Court was up.

Noakes
9 May 2001

Peter Rodgers
9 May 2001

**A COURT OF DIRECTORS AT THE BANK**

**WEDNESDAY 9 MAY 2001**

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Mr Buxton
Sir David Cooksey
Sir Howard Davies
Sir Ian Gibson
Mrs Heaton
Sir Chips Keswick
Sir Brian Moffat
Mr Neill
Ms O'Donovan
Sir Neville Simms
Mr Stretton

Absent:

Ms McKechnie
Mr Morris

The Governor reminded members that Baroness Noakes, Mrs Heaton, Sir Chips Keswick and Mr Buxton would be leaving Court at the end of the month. He expressed his appreciation on behalf of Court for their significant contributions to Court and confirmed that a farewell dinner had been arranged for 31 May.

The Governor confirmed that the four new appointments to Court, with effect from 1 June, comprised Sir John Bond, Group Chairman HSBC Holdings plc; Mrs Mary Francis, Director General, the Association of British Insurers; Graham Hall, the Chairman of Yorkshire Forward, who most Court members would have met in January when Court met in Leeds, and Dr DeAnne Julius, who would be leaving the MPC at the end of May.

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

**MONETARY STABILITY ISSUES**

**Economic and monetary discussion, incorporating the monthly MPC report to Court (Drs Julius and Wadhwani, Professor Nickell and Messrs Allsopp, Bean, Clark and Plenderleith in attendance)**

The Governor noted that Court was meeting ahead of the May MPC meeting, so the discussion was unusually ahead of, rather than after, the monthly MPC interest rate decision.

Mr Bean began by commenting on the international scene. He noted that the US GDP data for the first quarter had been surprisingly strong (at 0.5% quarter on quarter). Underlying the aggregate figure was continued robust consumption growth. This had more than offset a large negative contribution to growth from inventories – the destocking cycle might be almost complete. The net trade position was stronger than in the previous quarter, reflecting a fall in imports. Investment was subdued. The question looking ahead was whether the first quarter data signalled the worst was over. Mr Bean felt the answer was probably not and he cautioned against reading too much into the figures. Investment was likely to remain low. The main uncertainty was how well consumption would hold up. Data on employment in April recorded a fall – non-farm payrolls fell by 223,000 over the month. This might result in consumers retrenching in the months ahead, leading to a prolonged slowdown. Overall, the evidence was moving away from a sharp bounce-back towards a more prolonged if shallower downturn.

Turning to the UK, Mr Bean said that GDP growth of 0.3% in the first quarter was below expectations. Growth in services output was 0.7%. Manufacturing output fell in the 3 months to February by 0.1% and was estimated to have fallen by around 0.5% in Q1 as a whole. Construction output was also likely to have been weak in Q1 but the outlook was perhaps more positive in that sector. Mr Bean said some temporary factors were likely to have depressed GDP growth in Q1 – the warmer but wet weather probably resulted in lower utilities output and oil and gas extraction. There had also been a very large fall in telecommunications output in January which looked erratic. So the underlying trend in output was unclear. In addition, the 'foot and mouth' outbreak might have depressed output a little in the first quarter but was likely to have a bigger effect in the second and third quarters. The puzzle in the latest data was weak output alongside reasonably strong expenditure, notably consumer spending. Retail sales volumes increased by 1.5% in Q1 and British Retail Consortium data pointed to strong growth in April. Consumer confidence measures also remained steady. House price data continued to suggest underlying growth around 6-7% annually – the Halifax and Nationwide series were currently in line with each other – and this would support consumer spending in the near future. Overall, the outlook for consumer spending looked reasonably good. The outlook for investment also appeared positive. The BCC survey showed strong investment intentions over the short term. Further ahead, we might anticipate more of an impact from the global slowdown. The net trade position would probably deteriorate if imports held up alongside strong domestic demand, alongside weaker exports. This tension between the expenditure picture and that for output would be reconciled statistically via the alignment adjustment added to inventories data. But this would need to be balanced further ahead and posed problems for assessing the strength of growth at the present time.

Turning to wages and prices, Mr Bean said employment grew by 113,000 in the three months to February. This had resulted in falling unemployment – the LFS rate was 5.2% in February and the 'claimant count' rate was 3.3% in March. So there had been a further tightening in the labour market in terms of quantities. On the earnings side, growth had jumped in March but this reflected the different timing of bonuses compared with last year. The 'headline' earnings figures were therefore misleading. Mr Bean judged the underlying picture to be reasonably steady. Annual RPIX inflation had increased to 1.9% in March, in part reflecting a small upward contribution from higher meat prices.

Mr Plenderleith added that financial markets had been fairly stable over recent weeks, perhaps to a surprising extent alongside further reduction in interest rates in the US and current uncertainty about interpreting economic data and the macroeconomic outlook. This was particularly so in the foreign exchange markets where the dollar had been very steady despite lower interest rates and growth prospects relative to Europe. It was possible that currency markets were looking beyond the near term prospects or perhaps sticking with the dollar in a period of uncertainty, particularly in view of the lack of attractive alternatives. The dollar was now as high in effective terms as it had been for fifteen years. Mr Plenderleith stressed that all this did not, of course, mean the dollar would not fall. Indeed, it might experience a sharper and more prolonged correction if the current situation merely proved to be a delayed reaction. He added that an excessively weak dollar could bring its own problems to many countries. In relation to equity markets, Mr Plenderleith said that the decline of last year had halted: the direction now was whether the markets were in a 'holding' phase while investors assessed the outlook, or whether the downwards adjustment would resume.

Sir Neville Simms said recent weak construction output was weather-related and most in the sector expected a strong year. Public expenditure remained the main driver but, in addition, commercial construction was also buoyant. Sir Neville felt the positive industry expectations were perhaps underplaying the downside – he was overall less optimistic. Order books were full over an 18 month horizon but, beyond that timeframe, the picture was more uncertain. He felt the recent Agents' Reports were a reasonably accurate reflection of the current state of trade.

Mr Neill said UK car sales were rising but imports accounted for 77% of the total in March. Domestic output fell sharply in March to stand 21% below its level a year earlier. Some of this was temporary but the extent to which the UK now imported vehicles would have been unthinkable just ten years ago.

Mr Buxton reaffirmed his comment at April Court that retail financial services business remained strong but confidence in the corporate sector was declining.

Ms O'Donovan noted that, with regard to the US, electronic business was slowing, notably telecommunications and computer related activity. In contrast, oil and gas processing business equipment was recovering after around two years of recession, but more sluggishly than had been anticipated. The Governor added that the mixed sectoral picture more generally was a characteristic of the current conjuncture.

Sir David Cooksey said business activity was similar to the pattern painted by Mr Bean. It had been stronger earlier in the year. Demand for software by industrial users was slowing and there was evidence of delays with investment spending. He felt industry was marking time with capital projects.

Mr Neill mentioned speculation that 'black' market activity ahead of the launch of euro notes and coins was driving demand for the dollar as people sought to switch out of DMs. The

Governor said it would be interesting to look at note issue information over time. Mr Plenderleith said the numbers were likely to be relatively small as a proportion of the total notes and coins in circulation. Mr King said estimates suggested that demand for broad money would be around 1% lower if holdings of euros by Eastern Europeans were extracted. This was backward looking but the ECB was monitoring demand for notes going forward.

Mrs Heaton said she was surprised to see rising yields for index-linked gilts over the past few months. Mr Plenderleith said this was partly a reflection of government issuance and there had also been other issues of index linked stock in response to lower yields, notably by the EIB. It was also possible that yields were just returning to a more normal level following the prospective removal of the minimum funding requirement, which was likely to have artificially lowered yields.

**MPC response to TSC**
**(Drs Julius and Wadhwani, Professor Nickell and Messrs Allsopp, Bean, Clark and Plenderleith in attendance)**

The Governor invited comments, noting the paper had been discussed with the MPC. Sir Howard Davies asked about current HM Treasury thinking about TSC confirmation hearings. The Governor said he did not think the position had changed. Mr King added that the matter raised issues beyond the MPC itself. The Governor noted that there was one addendum to the response in the form of comments on NedCo's role. He hoped Court would endorse those comments. Court agreed. The Governor said the response would be sent if Court was content.

**Agent's issue of the month – The impact of the US slowdown on the UK Economy**
**(Drs Julius and Wadhwani, Professor Nickell and Messrs Allsopp, Bean, Clark, Plenderleith, Jenkinson and Iles in attendance)**

Mr Iles, the Bank's Agent for Southern Central England, presented the findings of, and offered conclusions drawn from, the Agents special topic – the impact of the US slowdown – undertaken for the pre-MPC meeting on 30 March. Survey responses had been collected in the latter half of March. The survey had asked about changes in export, output and investment expectations in view of the US slowdown. The survey had distinguished between firms with US parents and non-US owned firms. Overall, two-thirds of firms questioned had revised down their expectations for exports to the US, offset partially by stronger expected growth to other markets. Expectations of output growth had also been revised down, and this was being reflected in current order books. Investment expectations were also lower but by less than for exports and output, though uncertainty had increased. Large firms with US parents and those in the ICT sector had reduced expectations by the greatest degree. Vehicle components firms were affected significantly; food and pharmaceutical firms appeared to be more positive.

Ms O'Donovan asked if the fall in export expectations was largely due to exports to US parent companies or to third parties. Mr Iles replied that it was across the board. In general, smaller, more domestically - orientated firms had appeared less affected by the US slowdown to date.

Mr Neill said the car industry had anticipated the US slowdown in the first quarter and had reduced inventories – short lead times meant it was possible to respond quickly. He asked if there was any sense of things starting to recover. Mr Iles said this was not apparent from the survey. In general contact with companies, he said the slowdown has exceeded original expectations.

Sir Ian Gibson noted that there remained little appetite in the industry to reduce capacity and producers still preferred to reduce stock. Mr Stretton asked whether the propensity to answer questions in the survey might be less amongst those companies that were undertaking or contemplating more significant adjustments. Mr Iles said not all companies answered every question but it was difficult to draw conclusions from that.

Ms Blow suggested the speed of response to the US slowdown of output and investment was likely to vary. Firms might well be continuing with current capital spending plans but might intend reducing future spending. Mr Iles said there was some slowing in investment spending evident and a view amongst firms that expectations were likely to worsen further over the coming three months. Ms O'Donovan asked if the survey had asked if investment was greater or less than depreciation. It had not, though Mr Iles said that was a typical line of enquiry with Agents' contacts.

Following the discussion, the Governor said that this was Dr Julius's last attendance at Court as an MPC member; he thanked her for her contribution over the past four years and looked forward to her contribution as a Member of Court. Dr Julius said she had greatly enjoyed her involvement with Court and expected to continue to do so in the future.

**FINANCIAL STABILITY ISSUES**
**Domestic developments and international issues**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Clark said, following his report on FS work at the previous Court meeting, that he wanted to mention just one additional item – the IMF's Financial Sector Assessment Program (FSAP). The program was part of the IMF's effort to give greater prominence to financial system issues alongside its traditional macroeconomic focus. The substance of the FSAP was to review countries' compliance with standards and practice in areas such as payment systems, regulation, transparency of policy and market rules, etc. 12 countries had been reviewed in the first year of the Programme and 24 reviews were scheduled for the second and third years. All so far had been small or medium-sized countries with the exception of Canada. The UK committed itself to an FSAP last Autumn, in part to demonstrate G7 commitment to the program as a whole. In addition, this presented an opportunity to influence how FSAP's were undertaken for major international financial centres – the UK would be the first such centre to be reviewed. The UK FSAP was planned to begin in the first half of 2002. It would involve the FSA, HM Treasury and the Bank of England, with resource implications for all but the FSA in particular.

Following completion of the exercise there would be a question about publishing the results. In principle the UK was keen on such transparency, but the question of what and when would need to be considered further.

**FINANCIAL MARKET OPERATIONS ISSUES**
**Current Issues**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Plenderleith said that he did not have any items to report on this occasion.

**EXECUTIVE REPORT**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr King reported to Court on the Target 2 Point 5 competition for schools. He noted there were six schools in the final from all over the country and the winner was the Harry Carlton Comprehensive School from Loughborough. The judges were Mr Bean, Dr Julius, Anatole Kaletsky, Economics Editor of The Times and himself. He noted that, in his column, Mr Kaletsky had said "On Friday I had a hugely enjoyable personal experience, which came close to an economic epiphany. I had the honour to be one of the judges in the final of the Bank of England's monetary policy competition for schools. In this competition, co-sponsored by *The Times*, teams of economic students from 167 schools across the country put themselves in the shoes of the Monetary Policy Committee to decide the appropriate level of interest rates for the UK economy. In Friday's final, the six teams that had won the regional contests were each given 40 minutes to offer - and justify - their views about the appropriate stance of monetary policy for Britain today. The performance of all six teams was truly inspiring for anyone concerned either about the state of the British economy or of the education system. These six analyses of the present economic situation in Britain and around the world came to different conclusions, but all were based on exhaustive investigation of the evidence and all were presented with extraordinary clarity and a welcome degree of scepticism as well as humour. Most importantly, they demonstrated a deep understanding of economics and of the role of monetary demand management in sustaining low inflation and steady growth. Ten years ago, such a contest could not possibly have been held, since most of the time would have been wasted arguing about what demand management should be trying to achieve rather than how to achieve it. In the European Central Bank, the old arguments are going on to the present day about whether economic policy should only worry about inflation or try to sustain demand. With the degree of economic understanding, the level of education and the sheer intellectual talent I saw on display at the Bank of England last Friday, the prospects for economic prosperity really are better than they have been for generations." Mr King said the competition was a tremendous success and was widely reported, and great credit went to Mr Wardlow, who wrote the material for competitors, which teachers described as the best text book they had seen on the subject and to Mrs Bishop, whose team organised the competition. He noted that absolutely nothing went wrong. The Bank was ready to launch the competition again the following year with a few minor adjustments and probably with more entrants, and The Times was very keen to be involved again. The Governor said that it had been a terrific success and Mr King should be congratulated as the instigator and thanked on behalf of the Bank.

Mr Clementi noted that the Bank had been looking for some time for a replacement for Mr Berkowitz and had appointed Malcolm Glover who had worked as solicitor for clients, Natwest and Citibank, and had much litigation experience. He would join in June.

He also noted that a lot of time had been spent redesigning the website for the Bank which had just been relaunched. The architecture of the site had been improved as well as the look and feel and he drew attention in particular to the new home page. It was an excellent redesign. Mr Buxton noted that he had been advised that Court was personally responsible for the accuracy of the Bank's accounts published on the website.

The Governor mentioned that he recently attended the Sports Club AGM and he had been asked to pass on a vote of thanks to Members of Court for their support during the course of the year. He also noted that Members of Court had been invited to Governors Day in July.

**EUROPE**
**The Work of the Co-ordination Unit for Europe**
**(Messrs Bean, Clark, Plenderleith and Townend in attendance)**

Mr Townend elaborated on his paper to Court. He noted that the next Practical Issues would be published in early June and would cover the evolution of euro markets, infrastructure, London's position and preparation for entry. He also noted that 36,000 copies continued to be distributed in London and internationally. After describing the problems and scale of the notes and coin changeover the following January, he commented that the cash changeover would not be as smooth as the markets changeover in January 1999, but this was not surprising given the nature and scale of the task involved.

Mr Buxton noted that the difference between the continent and the UK was that the continent had had years to prepare for this. The view coming out of the Euro Preparations Unit at the Treasury was that the changeover in the UK was going to be very fast. However, at the top of the Government there was an unwillingness to plan for the future. This was building a problem. Mr Townend said he could not comment on the political side but he understood the technical difficulties which resulted if a relatively fast entry track were pursued. He believed there was an understanding within the Treasury, and not just at junior level, that if there were a relatively short period between a Government decision and the entry date, it was inevitable that many preparations would not be complete at the very outset, and that most obviously affected the retail financial area. This made inevitable a phased approach to any UK transition. This had been mooted in the second outline National Changeover Plan last year, and his understanding was that, at the last meeting of the Standing Committee in January, Treasury officials regarded the minutes as endorsing, at a senior level, a phased approach, though that minute had, of course, not been published. In answer to a question from Mrs Heaton, Mr Townend said that the question of 'out' country banks' access to frontloaded euro notes had been raised with the ECB the previous autumn. The ECB was primarily concerned not with the three 'outs' but with central and eastern European accession countries, because of their great use of the deutchmark. The Governing Council had sensibly agreed that, in principle, the front loading exercise could be extended to banks outside the euro area including in the three out countries and the accession countries. There was a question in practice about how this was going to be implemented, which banks in the UK were now considering. Arrangements for foreign currency notes in the UK were very concentrated, primarily via Royal Bank of Scotland. The Bank was in touch with RBOS, which had written to the ECB to see if they would be prepared to help if it did not prove possible to find sufficient notes from a commercial source. Mr Townend said he was not sure at this stage whether the ECB would help. In reply to a question from Mr Stretton about historical data, Mr Townend said there was a distinction between the beginning of transition issues, including phasing, and end of transition issues like record keeping, when records in national currency or sterling would have to be converted to euro. He had been encouraging as much contact as possible between the UK financial services industry and their peers across the first wave countries, so they could learn as much as possible about the first wave approach. He knew that the insurance sector was attempting to learn from the first wave, and he hoped they would prepare a paper for the City Euro Group. The Governor congratulated Mr Townend for doing a fantastic job and looked forward to him continuing in the role for as long as it took.

**MANAGEMENT OF THE BANK**
**The Bank's Annual Report and Accounts (in draft) together with a Report from the Chairman of the Audit Committee**
**(Messrs Bean, Clark, Plenderleith, Footman, Midgley, Darbyshire and Butler and Mr Hitchins from PricewaterhouseCoopers in attendance)**

The Governor welcomed Mr John Hitchins from PricewaterhouseCoopers to Court. He said the draft Report and Accounts took on board comments made following the previous month's Court and in Members' folders there were also copies of his foreword, a detailed breakdown of profit and loss together with a year end valuation of unlisted securities, a draft letter of representation to PwC, a letter from PwC covering the Directors' statement on internal financial controls and a letter from Freshfields covering statements on BCCI. Mr Clementi, introducing the Report and Accounts in more detail, said the numbers were very close to those that Court looked at the previous month and there were very few changes. Mr Clementi drew Court's attention to the profit and loss account, where the dividend was shown on page 58, and to various aspects of the balance sheet which he noted was strong. He drew attention to references to Members of Court on pages 61, 63, twice on page 76, on page 83 and page 84.

The Governor invited Mr Buxton to comment as Chairman of the Audit Committee. Mr Buxton said the Committee went through the provisions in the Accounts and satisfied itself, and it also looked at valuations, in particular the BIS, and satisfied itself. The Committee also discussed compliance with FRS 17 and decided it would like to see what other organisations were doing this year. Compliance was currently voluntary. The Audit Committee did not have much confidence in FRS 17 and did not see much point in complying. Overall, the Committee had been through the figures in some detail and were satisfied that the Accounts were presented in the right way. The Governor expressed gratitude to the Audit Committee on behalf of Court for the effort it had made. He invited Mr Hitchins to comment. Mr Hitchins said he had nothing to add and there were no points of disagreement between the Auditors and the management. Mr Footman said that the Report would be published after 20 June. Parliament was expected to reassemble two weeks after the election and at that point the Bank could ask the Chancellor to approve the laying of the Report before Parliament. The Bank had been advised to put it on ice. Only very minor points might need to be looked at again. The Governor agreed that it would be preferable to sign off the Report with a date in the week of the Court meeting.

Court was content to sign off the Report and await the Chancellor's decision on the time of laying before Parliament. Court was content that the Letter of Representation should be signed. Court was content with the final dividend payment to the Treasury of £35,150,000.

The Governor expressed his gratitude to Mr Hitchins. Sir Neville Simms suggested drafting points for the Governor's Foreword, principally to avoid confusion between the Bank's financial year and the calendar year. In response to a suggestion from Mr Neill that the foreword should, with respect to the morale issue, indicate that a number of the changes made had been welcomed by staff and that the negative publicity had been focussed on a small number of people, the Governor said he did not share that analysis. Although only six had gone to the tribunal, resentment was extremely widespread, and a petition had been signed by 700 people. The issue went very wide and deep across the Bank, and if it were downplayed in the Foreword it would send a false message. He believed, however, that things were improving, and the Bank had been able to address some of the issues that concerned staff, particularly the flexi leave arrangements, which with hindsight he thought had been unwisely folded into the benefits package.

The Governor agreed with Mr Buxton that, as Court had approved the Report and Accounts, the Sub-Committee did not need to be established to consider further questions.

Mr Buxton said there were two other matters in relation to the Audit Committee which he wished to note. The first was that internal audit in the Bank was focussed on the highest risk areas. Assessment of these risk areas may vary from year to year. The Audit Committee had asked for comparative figures each year to show if risk areas in the Bank had been moving. It had asked for a chart to be produced and for the same chart to be produced again in a year's time. Secondly, the Audit Committee was concerned that some of the losses during the year under review had arisen as a result of personnel policies. It was suggested that, at some point in the next year, the personnel function in the Bank should be asked to make a presentation on the impact on risk of their policies. This would include items such as turnover of staff which contributed to risk. The Governor welcomed the suggestion.

**Court Pension Scheme – annual adjustment**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Turning to the Report from the Trustees of the Court Pension Scheme, the Governor, having declared his interest in the Scheme together with that of the two Deputy Governors and the Executive Directors present, invited Sir Chips Keswick, in his capacity as Chairman of the Trustees of the Scheme, to introduce the Report which contained the following recommendations:-

a) the annual pensions in payment to former Governors and Executive Directors and allowances to the widows of former Executive Members of Court be increased, with effect from 1 July 2001, by the amount of the increase in the Retail Prices Index for the twelve months ended 31 May 2001.

b) Similar increases be granted from 1 July 2001 to:

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

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

iii) the deferred pensions payable at age 60 or later granted to Mr Pennant-Rea and Mr Vickers.

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

Court APPROVED the recommendations.

**Any other business**

The Governor said he wished to acknowledge the contribution of the four retiring non-executive Directors. Baroness Noakes, as first Chairman of NedCo, had done a tremendous job which he had very much appreciated. He also wished to thank Andrew Buxton, who had contributed as Chairman of the Audit Committee, Mrs Heaton, who most recently had chaired the Staff Pension Committee, and Sir Chips Keswick, Chairman of the Trustees of the Court Pension Scheme. The Governor said he wished to record the Bank's deep gratitude to all four of them. In a different world he would prefer to see a less rapid turnover in membership of Court. He noted that four new Members would be welcomed to Court at the next meeting. He looked forward to saying farewell in a less formal way at the dinner for retiring Directors.

Court was up.

Peter Rodgers
20. 6. 2001

## A COURT OF DIRECTORS AT THE BANK

## WEDNESDAY 20 JUNE 2001

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Mr Hall
Dr Julius
Mr Morris
Mr Neill
Ms O'Donovan
Sir Neville Simms

Absent:

Sir John Bond
Dame Sheila McKechnie
Sir Brian Moffat
Mr Stretton

The Governor welcomed Mary Francis and Graham Hall as Directors and noted that Dr Julius would be joining the meeting shortly after the discussion of the Remuneration Committee report.

**Report from the Chairman of the Remuneration Committee (Members of Court in attendance, except for Dr Julius – conflicted out)**

In his capacity as Chairman of the Remuneration Committee, Sir David Cooksey said that he would like to make recommendations to Court on behalf of the Committee. He said that in the case of members of the MPC it was agreed by Court that they would be asked to take up three months purdah if they intended to enter into appointments that would have commercial significance. So members who went into academic life or, for example, to the Office of Fair

Trading were not required to enter purdah, but Sir Alan Budd was requested to delay his appointment as a Director of Old Mutual for three months. This latter position applied to Dr Julius, and the Remuneration Committee was proposing that the equivalent of three months MPC remuneration should be paid to her for the three months purdah period. Due to the market sensitivity of her work on the MPC, she had avoided taking up any of the offers received to date.

Turning to the remuneration of Mr Malcolm Glover, the Governor's new Legal Adviser, Sir David said that it was proposed to offer him the same contract as Len Berkowitz, [redacted]. Turning to Ms Kate Barker, who had replaced Dr Julius on the MPC, Sir David said that she would be working a four day week, and it was proposed to offer her the standard 4/5 contract of £107,691 plus 15% in lieu of pension, plus BUPA. In respect of the Governor's annual increment, Sir David said that in 1998 Court had agreed the principle for determining the level of increment to the Governor's remuneration each year, and accordingly it was proposed to increase his salary by 2.5% as from 1 July, to £250,567.

Court APPROVED the recommendations.

The Governor welcomed Dr Julius to Court for the first time as a Director.

The Minutes of the Court of 9 May, having been circulated, were approved.

## MONETARY STABILITY ISSUES

**Economic and monetary discussion, incorporating the monthly MPC report to Court together with international economic developments**
**(Ms Barker, Professor Nickell and Messrs Bean, Clark, Plenderleith and Bailey in attendance)**

In introducing his paper, Mr Bailey said the slowdown across a very large part of world economy had continued over recent months. In the US it was clear that the slowdown was not just an inventory correction, but also involved a sharp correction of investment and industrial production, particularly in the ICT sector. On the production side this was also evident in data from Japan, Asia and indeed the UK. There was likely to be a strong impact on world trade because ICT goods were heavily traded, particularly in Asia.

In the US the first quarter had seen renewed sharp falls in ICT prices. This most probably reflected a demand shock rather than a new supply shock from innovation, consistent with sharply weaker corporate earnings in the IT production sector.

There were some difficult questions in assessing the US outlook: to what extent was there an overhang of past excess investment that would need to be worked off; and would the fall in relative ICT prices stimulate investment – bearing in mind that it might be more a demand shock. The outlook for productivity growth was a key part of the overall picture. It was expected to slow as the cycle turned down, but that provided no clear view on the underlying forces and therefore future productivity growth.

Another set of questions concerned household consumption. One of the common features of the US and UK was a fall in manufacturing output not accompanied by weak consumption. For the US it could mean that consumption would not slow as much as expected. The Fed had acted decisively, and an agreement on tax cuts had been reached. But there was a risk in the US of a sharp correction in household saving which had fallen quite sharply over recent years.

In the euro area the issues were somewhat different. Domestic demand in the first quarter had been much weaker than expected, even though overall output growth had been in line with expectations. The source of a remarkably large part of this had been a very sharp correction in German construction activity. And inflation had accelerated more rapidly than expected. This reflected a number of influences: oil prices had remained higher than expected, at least until recent days when they had fallen to the $26-27pb range; food prices had risen more rapidly, particularly meat prices, largely connected to animal diseases; and there was likely further pass through from the depreciation of the euro exchange rate. The inflation upturn had been more pronounced in the second quarter, but there were grounds for thinking that the May headline rate for the euro area was near to the peak. The ECB had projected the average for next year to be somewhat below 2%. But the core rate had now risen above 2%.

A key question for the euro area outlook was whether the inflation upturn would turn out to be temporary, and this uncertainty made the ECB's position more difficult. The duration of the inflation upturn would likely have an important bearing in the context of the coming winter's wage round.

Mr Bean noted that oil prices were now at about the same level as at the time of the May Inflation Report. Sterling had fallen in early June on expectations of early euro entry but the exchange rate index was unchanged overall. He noted that the estimate of first quarter GDP had been raised to 0.4%, a little less than the trend rate of growth. April industrial production fell 0.1%, and he commented that the imbalance between manufacturing and services had been widening, with the volatility in manufacturing driven by the hi-tech sectors. There was a tale of two cities, as Mr King had put it in a speech earlier in the week. On the demand side, official consumption data forces were weaker than we had expected, yet retail sales had been strong and confidence was steady. Investment was also weaker than expected, but it was difficult to understand the sectoral movements: manufacturing was recorded as relatively strong, and services weak, with business investment falling, which did not fit the picture the MPC had had on output in services in manufacturing and the data on housebuilding and construction.

The big picture going forward was reasonably healthy domestic demand with a depressing impact from net trade and the trade deficit widening further. Mr Bean noted that in the labour market employment was slowing but unemployment continued to fall. Underlying earnings growth rose with regular pay up by 5.3% in the year to April, largely due to public sector pay increases. Turning to prices, he said that RPIX inflation rose to 2.4% in May, mainly due to seasonal food, particularly potatoes, and petrol prices. The Foot and Mouth disease effects were also more persistent, with an impact on meat prices, and services retail price inflation rose slightly. He expected the inflation rate to dip in the coming months, but because of erratic movements a year ago there would be echo effects into inflation rates for this year. He noted, for the record, that the MPC had cut interest rates by 0.25% in May, but there was no change in June.

Turning to the markets, Mr Plenderleith said it had been an extremely interesting few weeks, partly because of a bout of weakness in sterling but also because of a substantial backing up of interest rate expectations, as shown in chart 1. The pound had fallen particularly steeply against the dollar, to the lowest for 15 years, which was related to speculation in the market that the UK might enter the euro on an accelerated timetable. It took some time for the market to think through the fact that if the exchange rate went down it would also imply higher interest rates, and that implied that early entry was not so likely, therefore sterling went back up. He expected greater market volatility as expectations about euro entry moved about. Turning to chart 3, short interest rates, he noted that a month ago the picture was of expectations for further easing this year and a rise next year. As an effect partly of sterling weakness, and also several pieces of data, the market felt the likelihood of more cuts this year was less. Now it was not at all clear that the market was expecting any further cuts, and it was indeed expecting rises next year, possibly reaching 6%.

Sir Neville Simms said that construction orders were up on last year and output about level, and the change was in the mix. The industrial sector of the market was down in workload last year, and in new orders, and more money was going into infrastructure investment. The picture looked as if it would continue, with quite a strong market, and employment higher than this time last year. Costs were reasonably well under control though there was some tightening in the supply line. He noted a very low rise in the level of subcontractors' demands for higher levels of payment in the previous month. He noted that a number of private client hospital projects had been held back while discussions went ahead on whether hospital staff for these projects were employed by the NHS or by contractors. He noted the importance of the question of whether the government was to continue the transfer of spending to the private sector. Turning to the West Midlands he said there was more gloom among manufacturers, but they had decided that it was no longer worth tilting at the exchange rate windmill, and may have to do something about it themselves.

Mr Neill said that in the auto manufacturing industry the picture was still pretty gloomy and margins were low or non existent. The component sector in the US was deeply in the red in the first quarter, and he noted a number of difficulties faced by UK manufacturers. However the retail sector in the UK was quite buoyant, with an increase of 18-20% since October. The first ten days in June showed an increase of 11.6% and the retail component of that was an increase of 20%. The outlook for the year was 2.25 mn vehicles, which meant that it could be a record year. It was another tale of two cities. Manufacturing was finding life extremely difficult.

Mr Bailie said there was a distinct lack of confidence among those he talked to, even though the indications were positive, with unemployment falling and employment rising. A printing industry survey due in ten days time was likely to show that throughout the UK it was the worst scenario in ten years, though packaging was still in reasonable condition. Turning to tourism, this was extremely badly affected throughout the British Isles, and London was expecting quite a drop in July and August. National TV revenues were down 20% in June. Ms Blow said the IT services market was also a tale of two cities. The public sector was going very well but the commercial market was weakening. Dr Julius said she had spoken recently at an international energy conference attended by OPEC ministers. There was much stronger confidence among OPEC members that they could price target with oil than she had seen before. The Saudis preferred $22 -25 a barrel and seemed quite confident that they could bring prices back and hold them there.

Mr Hall said that Yorkshire and Humberside had a £58 bn economy, 25% of it in manufacturing, and had a number of traditional industries that were exporting. The exchange rate was a critical issue. Over the medium term, manufacturing needed a gradual depreciation to be competitive in the global market place, though he was aware of the difficulties of that. He also noted the increase in the RPI and tightness in the labour market. The Governor noted that the pound was at a 15 year low against the dollar.

In response to a question from Sir David Cooksey about trade imbalances, Mr Bean said that it was possible to run deficits for longer than in the 1950s and 1960s, because of the existence of large capital markets, but there clearly came a point at which that became much more difficult. He believed the UK could probably live with the deficits it had for a year or two, but it was not something that could be lived with indefinitely, and there had to be a correction of the imbalance. In response to a further question from Sir David about what actions that implied, Mr Bean said it depended whether there was a good idea of how the imbalances were going to be corrected and some idea of the time period. The big worry in monetary policy was about a sudden correction, as had happened in the early 1990s. If it was possible to engineer a more gradual correction it would be easier to cope with. The difficulty for monetary policy was that it had one weapon. It could not target inflation and at the same time act on imbalances, but those imbalances had implications for inflation further down the road, and fed into it via that route.

Sir Ian Gibson said that the dominant auto manufacturers in the US had downgraded their production schedules for the fourth quarter. The closures and run downs that had been discussed in Court a year ago had started to happen in components, and the data suggested that there would be an acceleration to the end of 2002. However there was going to be some increase in assembly work. UK sourcing of components for assembly was going to be down by about 1/3 which meant less component activity by the end of the following year. The expectation was that UK retail motor sales would be more than 80% imported vehicles by the first quarter of the following year. Finally he noted that the European truck market was entering one of its cyclical downturns.

The Governor invited Professor Nickell and Ms Barker to comment but they declined. Ms O'Donovan said the US picture could only add to the gloom that she had been expressing since the previous September. She gave a number of examples including computers and semi conductors where business had fallen sharply. Companies believed that it was necessary to have a steady oil price at about $22 in order to invest. Mrs Francis said that as an indication of consumer confidence in the UK there was an 80% increase in life insurance and pension sales in the first quarter compared with a year earlier. There was a general increase in confidence in the sector, with the exception of one notable failure. In response to a question from Mrs Francis about wage pressures in the UK, Mr Bean said that the Bank's view had been cautiously optimistic for the last few months about what was happening to earnings. For that to continue rested heavily on the labour market not tightening, and indeed loosening a bit.

**FINANCIAL STABILITY ISSUES**
**Domestic developments and international issues**
**(Messrs Bean, Clark and Plenderleith in attendance)**

In updating Court on financial stability matters, Mr Clark outlined the coverage in the forthcoming Financial Stability Review (28 June 2001). He said that the overall assessment was not much changed since the previous FSR (December 2000). Some risks identified then had materialised, notably the US slowdown. The present US picture was somewhat mixed – there was continued uncertainty. Equity markets in both the US and the UK showed expectations to be more evenly balanced than they had been, on the basis of observing the skews of expectations for future price movements.

Mr Clark said some specific risks remained on the radar screen:

- the Japanese situation had worsened over the past six months, with more bad loans accumulating and larger exposures being revealed. Intended action by the Japanese government would not be clear until after the upper house elections in July;

- in the telecoms sector, little had changed, though the FSR would be drawing attention to the increase in finance provided to the sector by suppliers in the form of vendor finance;

- emerging market economies remained an issue, but the assessment of risks remained largely as it had been;

- the position of financial intermediaries was reasonably favourable in view of the profitability of recent years (with the exception of Japanese institutions).

Mr Clark then drew Court's attention to four articles being published in the FSR alongside the assessment:

- an article reviewed the credit derivatives market and looked at developments and issues in the light of the growth of this market over recent years;

- an article reviewed the literature on estimating the costs of financial crises, which on average suggested something in the order of output losses equivalent to 15-20% of GDP;

- an article analysed the flow of funds to offshore financial centres. This was not the typical focus of work on OFCs which had often revolved around money laundering and tax.

- an article looked at the determinants of corporate liquidations.

Mr Clark then discussed the current state of play with the new Basel capital accord. A number of issues were under discussion:

- the overall level of capital across the system that might result given that individual bank's capital would be linked to an assessment of the risks of their business.

- the cyclicality of credit under the proposed system.

- the treatment of operational risk.

A meeting of the Basel Committee was scheduled for mid-July, ahead of which the Bank was working with the FSA to establish positions on these issues.

Mr Hall said he sensed many banks would see their capital requirements change and a number were complaining. He asked if the Bank had concerns in this respect. Sir Howard Davies said banking liquidity was not a major issue. The analysis centred on who would be affected in which way, given the aim to keep the overall level of capital in the new framework roughly equivalent to the present. Naturally, those with more risk would have higher capital ratios. He added that elements of the package were not as robust as they would need to be – for example, operational risk. This was rightly an area banks were concerned about.

Mr Clementi said that while a vast amount of effort had gone into the capital requirements in the New Accord proposals, it was important that regulation of liquidity was not overlooked and, in this respect, he noted the FSA's forthcoming handbook on bank liquidity, in which the Bank was taking an interest.

**FINANCIAL MARKET OPERATIONS ISSUES**
**Current Issues**
**(Messrs Bean, Clark and Plenderleith in attendance)**

Mr Plenderleith said that he had three issues to report, which he had highlighted in a note circulated to Members of Court the previous week. The first related to a minor adjustment to daily money market operations aimed at moderating periods of softness and volatility in short-dated (overnight) rates. The reasons for this were unclear. It could reflect the environment of falling interest rates, accentuated by the new arrangements for cash management and the 3G telecoms licence monies being placed in the market by the DMO. The Bank did not want to constrain the market, but excess volatility could damage the effectiveness of the market. The Bank would provide an end-of-day deposit facility – at a sub-market rate – which would, in effect, be a symmetrical arrangement to the lending facility already in operation. The new arrangement had no monetary significance. This was largely related to the Bank's third core purpose.

Second, Mr Plenderleith described the progress of four market infrastructure IT projects underway in the Bank's Financial Market Operations area, detailed in his paper. Third, he reviewed the Bank's management of the UK's foreign exchange reserves, as agent for HM Treasury. Mr Plenderleith explained the Bank's plans for further management information in order to monitor and control risks. Following the discovery of an error in the data, more resources had been allocated to the unit involved, to upgrade the 'open link' system.

Ms O'Donovan asked if external consultants had been used on the IT projects. Mr Plenderleith said they had been at various stages. Mr Clark noted that most of the main systems were outside the Bank. Mr Hall asked about the specifications of the projects, and whether they had been delivered on time and to budget. Mr Plenderleith responded by saying that the specifications followed established procedures and were on budget. One system being developed by the banks and IBM was behind schedule and ahead of its budget, but this did not reflect work being undertaken by the Bank. The Bank's quarterly budget report would identify any major items in the normal way.

**EXECUTIVE REPORT**
**(Messrs Bean, Clark and Plenderleith in attendance)**

There were no items under the Executive Report.

**MANAGEMENT OF THE BANK**
**The Note Issue Function – a review of current activities**
**(Messrs Bean, Clark, Plenderleith and Thompson together with Ms Lowther in attendance)**

In introducing her paper reviewing the note issue function carried out by Banking and Market Services, Ms Lowther said that bank note issuance was at the heart of the Bank's functions. It was high in the public view of the Bank and contributed to one of the Bank's top ten risks. In many senses the note issue objective was very simple – it was to provide banknotes for use when people wanted them. The business functions related to ensuring the Bank produced a quality product fit for its intended purpose and that it was efficiently distributed to the general public. The distribution channels were a particular focus – in terms of their effectiveness, number, incentives and size (number of notes). The cost of holding inventories was also a key consideration in the business.

Ms Lowther said that, not withstanding the similarities between the functions, a distinction needed to be drawn between the note issue and a normal commercial enterprise. The note issue was not driven by sales or profit maximisation, and did not operate on a price mark-up basis as the product moved from producer to ultimate customer. A further distinction was that the product was returned at the end of its useful life. Ms Lowther then referred Court to the projects described in the paper and said she was happy to respond to questions.

Ms O' Donovan asked about the £5 note and what the Bank planned to do about it. Ms Lowther explained that the main distribution channel for the £5 note was the retail sector. It was not generally available through ATM machines. Retailers were keen to get better quality notes, and the Bank was assessing ways of interacting with them, via the British Retail Consortium (BRC). There was an issue of what incentives would ensure better quality notes were in circulation.

Mrs Francis asked what assumptions were being made about the supply of euro notes – for example, for retailers in Oxford Street, London. Ms Lowther said the main issue that had been raised with the Bank was how banks supplied customers requiring euro notes for travel purposes in the early stages after the launch of the currency. She said there was less of a concern about retailers needing euro notes for trading purposes in the UK. Mr Hall asked about the strategy for the £5 note and at what point it would make sense for it to become a coin. Ms Lowther said market research continued to indicate that the public had a preference for a note.

Mr Bailie asked if the printing works would be scaled back if more of the functions were being undertaken by banks. Ms Lowther explained that the Bank remained responsible for the destruction of notes but that the banks were involved in sorting and assessing notes for recycling.

Sir Neville Simms said the Audit Committee papers mentioned the reduction in both risks and costs associated with the note issue, and these were to be commended. Mr Plenderleith said the quality of £5 notes was a concern, and could expose the Bank to reputational risk. He said the banks reported that customers appeared satisfied, but market research revealed some public discontent. But the issue in terms of circulation was located beyond the banks in the distribution chain, and so the Bank put a high priority on exploring the issue with retailers though the BRC.

Dr Julius asked to what extent the public withdrew cash from retailers (the cashback option). Mr Plenderleith said the growth of this facility was one of the reasons for talking to the BRC. Ms Lowther said it nonetheless remained a relatively small channel.

**Report on the Printing Works**
**(Messrs Bean, Clark, Plenderleith and Thompson in attendance)**

Before asking Mr Clementi to introduce the Annual Report from the Managing Director of the Printing Works and the Report and Accounts of Debden Security Printing Ltd, the Governor pointed out that a further paper, reviewing the Printing Works strategic plans and setting out detailed proposals for the future, was being prepared, and that he hoped it would be ready for Court the following month.

Mr Clementi said that the arrival of Mr Mike Thompson as the new Managing Director of the Printing Works had helped clarify the distinction between the Issue Office as a customer and the Debden works as a supplier. The two sides of the Bank's activities were brought together in the Notes Committee. Mr Clementi said the paper dealt with current operational issues. The strategy paper would first be considered by GOVCO and then be brought to Court.

Mr Thompson reviewed his paper on the Printing Works. He said it was still early days, but so far he felt there was a solid and secure working environment at the works – employees were generally proud of their association with the Bank. Levels of investment were also healthy. In broad terms, the Works was a centre of excellence of banknote printing. It was one of the lowest cost central bank operations worldwide. Looking ahead, there were probably fewer opportunities to drive costs much lower while ensuring the workforce remained motivated and supportive.

Mr Thompson said his focus would be more on the culture of the Works, particularly in the area of quality. The Printing Works produced a quality product but quality control was largely an end-of-line operation ie checking finished notes. He wanted to develop extensive 'in-process' quality control. To this end, he was organising visits to companies such as Toyota, to look at quality cultures and processes. He also wanted to look at supplier relationships – another area he was less than happy about. He felt suppliers were managing the Printing Works rather than the other way around. He also wanted to develop contracts with internal customers.

Alongside these objectives, Mr Thompson said he believed it to be crucial to be open with staff about the future strategy of the business once that had been established and agreed.

Mr Neill encouraged the Bank to think strategically about increasing its commercial business. He asked if the Printing Works was using the 'Six Sigma' process tool for improving quality. He also asked if the Printing Works had enough freedom vis-à-vis its suppliers. Mr Thompson said 'Six Sigma' was an appropriate tool but his concern was whether, at this stage, the Printing Works was culturally ready for this in terms of its approach and language. He was looking at increasing commercial work, and this was a central issue for the future. For this to happen, the business would need to have commercial targets, with incentives and rewards for staff. Again this would represent a cultural change. He added that there were no constraints operationally in terms of suppliers.

Ms Blow said winning new business was central to the future, and she asked about the competitiveness of the business. Mr Thompson said that in terms of central banks, the business was competitive. But it was less competitive in commercial printing terms – not related to capital equipment but the limited commercial culture across the business. It was a relatively small business with little product changeover compared with a company such as De La Rue. There was a strong foundation and considerable process expertise on which to build.

Dr Julius asked to what extent the Printing Works strategy was to look for new customers. She said one of the challenges over the next five years would be the continuing decline in demand for notes, reflecting reduced use of cash. Additionally, there was the issue of UK adoption of the euro, if that were to go ahead. Given the large overhead costs, alongside the issues of likely demand and capacity, this would certainly be a matter of concern for the workforce.

Mr Thompson said the current picture was one of stable rather than falling demand. There was overcapacity across Europe in banknote printing. After the initial launch of euro notes – around 15 billion notes – the annual requirement would be in the region of 6 billion notes. Capacity was around 30 billion, so it was self evident there was no need for additional capacity should the UK join. Debden Security Printing was created to look at commercial opportunities but it had not been fully tested. The major presence in the UK of De La Rue was also an issue.

Mr Morris asked about the timescales of the business strategy. He said this interacted with capital replacement and staff resourcing as well. He said the strategy should be discussed earlier rather than later. The Governor explained that the strategy would first be discussed by GOVCO and then brought to Court.

Mr Bailie said that the Printing Works did not seem to be overmanned, and against industry benchmarks appeared to compare well. But he said this was a false comparison, as the outlook was for, at best, static output. The strategy paper needed to address this. He also felt the intellectual property of the Bank in terms of printing expertise and knowledge should be freed up. Mr Hall said the Printing Works needed a commercial competitive edge. It was important for the overhead cost to be properly allocated, to avoid giving a false impression of the profitability and return on capital. This had happened in some businesses.

Sir David Cooksey asked how far down the head count reduction had gone, through increased automation. Mr Thompson said note examination was one area of continued automation. Sheet, as opposed to single note, examination machines were not satisfactory. They rejected too many good notes and an end of line process was not best practice. The aim was to have single note examination within the production process. Mr Thompson said he was looking at the whole issue of investment in quality control through the line.

**The Bank's Insurances**
**(Messrs Bean, Clark, Plenderleith, Midgley and Evans in attendance)**

In introducing the paper updating Court on Bank-wide insurance cover, Mr Evans said his role was to take forward the Bank's insurance strategy and look for opportunities for change. In the event, little had changed over the past year and he was generally comfortable with the costs of insurance and the controls in place to monitor policies. Mr Evans noted the advances in general awareness of personnel insurance. Looking ahead, he was looking to develop more formal arrangements to talk to business areas about risk and the insurance of risk.

Mrs Francis asked what the basis was for identifying areas that did not require insurance cover, and the arrangements for financing risks when they were identified. Mr Evans said experience and vigilance were the main approaches. He was actively reviewing the Banking area as business processes changed. The costs of insurance were part of the Bank's profit and loss accounting.

Mr Hall asked whether the Bank had looked at risk sensitivities in cover for gold and notes and whether it was appropriate to cover the entire risk or only a proportion. Mr Midgley said he could not recall whether this had been considered, and he would revert on this question. Ms Blow asked if the Bank was content with the ratio of claims to premiums. Mr Midgley said this was reviewed each year. He acknowledged that the number of claims was very low. He said the building refurbishment had resulted in surprisingly few incidents, and far fewer than previously experienced. On the personnel side, he said the insurance regime was modern and leading edge, but again there were few claims. Three present incidents all involved outside contractors, including the Bank's previous caterers. Ms Blow said the Bank should ensure it was claiming where it should, in order to ensure value for money from its insurances.

Court ENDORSED the insurance arrangements as set out in the paper.

**Bank Property**
**(Messrs Bean, Clark, Plenderleith, Midgley, Higgs and Shepherd (Drivers Jonas) in attendance)**

The Governor said that there were three papers to consider regarding the Bank's property. These related to:-

i) confirmation of the strategy for retrenchment into the Head Office building and plans for some of the Bank's remaining buildings,
ii) a review of the budget for the refurbishment of the ground, mezzanine and first floors in Head Office in the light of a projected overrun, and
iii) proposals for the better use of space at Debden.

By way of introduction, Mr Clementi said that the first paper looked at the current portfolio of property and the strategy to consolidate the Bank's London business in one property. The main recommendation was to delay the decision to sell Bank Buildings until the Bank's space needs were clearer, but preparatory work for a sale would be commenced, so that the Bank was in a position to proceed if subsequently a decision to sell was taken. In relation to the Leeds Cash Centre, it was recommended that the space was sold and leased back.

[redacted]

Mr Clementi said the second paper identified the costs of the ground, mezzanine and first floors refurbishment which were now estimated to be above the budget agreed in July 2000 (£17 mn). The additional cost reflected three factors: first, a higher specification than originally envisaged; second, the original floor plate had been misjudged; third, higher prices in the industry. Mr Clementi said he was not happy with the size of the gap but he was pleased that the budget monitoring process had been effective in identifying the issue ahead of the refurbishment rather than after it. GOVCO had concluded the additional monies should be spent – amounting to a total cost of £25 million. This would bring the total cost of the entire refurbishment programme to £60 million.

[redacted]

Mr Bailie said the plan was to retrench into Head Office by 2003, but the paper raised the possibility that this might not be met. Mr Clementi said the Bank would be able to consolidate into Head Office as planned. Sir Neville Simms said he agreed with the proposals in relation to Bank Buildings. He felt it was unlikely there would be any collapse in local property prices over the duration of the delay.

Dr Julius said she found the papers disappointing. She asked why there was uncertainty about the Bank's demand for space which necessitated a delay in a sale of Bank Buildings. She said the risks about timing were not well handled in the paper and she asked what price movements would determine whether or not to proceed. She felt the property market was likely to be more favourable now than in, say, two years time. Dr Julius said she was content for the Bank to proceed with preparation for a sale but was concerned about the potential for delay.

The Governor said the Bank was preparing to make a decision to sell. Mr Clementi added that the Bank was not asking Court for a decision to sell today. If that were to happen, there would have to be precise dates for leasing back space. Additional needs for space were not firm at this time.

[redacted]

[redacted]

[redacted]

Dr Julius said the Leeds Cash Centre was a poor building and the site was not well used. She asked if relocation had been considered as a solution. Mr Clementi said it was easy to move the Agency but the Cash Centre was a more difficult matter. At the end of the current five-year horizon, the Bank would have to consider the future of the operation and whether it needed a cash centre in the north of England.

The Governor asked Court if it accepted the increase in the budget for the ground, mezzanine and first floor refurbishment. Mr Hall asked how the fifty per cent uplift in projected costs affected the investment appraisal undertaken in July last year, based on the original projected cost of £17 million. He also asked how those responsible had been made to account for the changes. Mr Clementi said there was, of course, an opportunity for the Bank to say no to the project and if there were cash constraints, that would be the case. But that was not the case and he considered the benefits worthwhile, not least to staff in terms of the improved quality of their working environment. Inevitably, this kind of return was difficult to quantify in terms of a rate of return calculation. It was a policy judgement rather than a profit-led decision. The motivation was partly to recruit and retain staff. And, of course, the refurbishment was being undertaken within an English Heritage framework.

The Governor asked Court for approval. Court ENDORSED the proposals set out in the three papers.

**Domestic Matters**
**(Messrs Bean, Clark and Plenderleith in attendance)**

The Governor advised Court that following the recent changes to Court's membership, it was appropriate to consider revisions to the membership of the Bank's Standing Committees and suggested the following revisions. The Governor said he had yet to contact all those concerned because of holidays and absences. He would do so shortly. He proposed:-

**Audit Committee** - Sir Neville Simms to become Chairman and Mrs Francis to join the remaining members.

**Remuneration Committee** – Mr Neill to become Chairman and Sir John Bond and Mr Hall to join the remaining members (pending discussion with Sir John Bond).

**Court Pension Scheme** – Sir Ian Gibson to become Chairman of the Trustees and Mr Bailie to join Mr Neill as a Trustee.

**Staff Pension Fund Trustee Company** – Mr Stretton to become Chairman of the Trustee Directors and Dr Julius to join the remaining Trustee Directors (pending discussion with Mr Stretton).

The Governor added that Sir David Cooksey was free to attend any of the committees in his capacity as chairman of NedCo.

Court APPROVED the revised memberships.

Court was up.

18 July 2001