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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 16 JANUARY 2002

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 John Bond
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Mr Hall
Dr Julius
Dame Sheila McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Sir Neville Simms
Mr Stretton

Absent:

Ms O'Donovan

The Governor congratulated Dr Julius on being awarded the CBE in the recent honours announcement.

The Minutes of the Court of 19 December, having been circulated, were approved. Sir Neville Simms noted a qualification in relation to the discussion minuted on page 173 (Audit Committee Report – Banking and Market Services). [redacted]

MONETARY STABILITY ISSUES

The economic and monetary discussion, together with the monthly MPC Report to Court (Messrs Plenderleith, Clark, Bean, Allsopp, Ms Barker, Professor Nickell and Dr Wadhwani in attendance)

The Governor reminded Members of Court that the Minutes of the January meeting of the MPC were not due to be published until the following week.

In introducing the monthly MPC report to Court, Mr Bean noted that forecasts for the US economy tended to be revised up, reflecting positive signs from retail spending, business confidence and other indicators. Overall, the impact of 11 September was less negative than might have been expected at the time. He noted that the November *Inflation Report* assumed a gentle recovery in 2002. In contrast, Euro area forecasts tended to be revised down as industrial production fell. Japan had entered technical recession. In the UK, imbalances across sectors remained. Manufacturing output was now at 1996 levels. On the demand side, consumer spending remained strong – with indications of this continuing in December – and consumer confidence had recovered to its level prior to 11 September. But investment remained weak, particularly in manufacturing. Turning to inflation, goods prices inflation remained subdued and that looked likely to continue looking ahead. Retail price inflation overall was higher, reflecting rising services prices. Mr Bean said that looking at all the available evidence, the MPC had opted to leave the official interest rate unchanged in January.

Turning to the financial markets, Mr Plenderleith said that there were two main observations. The foreign exchange market had seen an easing in the value of sterling relative to the euro over the turn of the year. But this had proved to be a false dawn and sterling had since recovered. It has been related, in part, to EC rebate payments being made which had resulted in sales of sterling. There was also increased speculation about UK entry into EMU. The weakness of the yen had also been a recent feature. Although helpful to Japan, complaints from Japan's neighbours were likely and the fall had now levelled out. In the money markets, Mr Plenderleith commented that the steepening of the yield curve had abated a little, in response to recent news including Alan Greenspan's latest speech. It remained steep - implying higher future short-term interest rates – which seemed to reflect the markets' positive view of recovery prospects in 2002.

Dr Wadhwani said he was interested in the outlook for pay in the forthcoming round and whether reports of delays in corporate investment decisions were continuing or now beginning to unwind.

Mr Bailie noted that a shake-out was ongoing in the aerospace sector and there was a continued loss of capacity in the textile sector, which he viewed as inevitable. Consumer spending appeared buoyant in Northern Ireland over the December/January period. He said there was little evidence to date that the launch of the euro in the Republic of Ireland was spilling over into transactions in the north. Some Belfast stores were pricing in Euros as expected. Mr Bailie drew Court's attention to rising insurance premiums. He added that pay settlements were expected to be similar to the previous year. Little new investment was coming on-stream as most suppliers could easily meet demand with existing capacity. Investment decisions might now await the major spring trade exhibitions.

Mr Neill contrasted falling vehicles production with a record year for car sales in the UK. Data for the first 10 days of January suggested another strong month. Mr Neill also mentioned increasing insurance costs, in some instances they had risen by 700%. In relation to pay, he said there was increasing concern about the railways and the potential for contagion into other areas of the labour market. In general, there was little prospect of higher pay awards than last year.

Sir Neville Simms said that there was growing evidence that the construction sector was at, or approaching, a turning point. New orders were now flat though this would not feed into output for some time. Commercial and industrial orders were likely to fall in 2002. Infrastructural spending was an uncertainty as government spending required private finance to accompany it, which was an added risk. Repair and maintenance work was likely to increase but this was again uncertain. In the West Midlands, alongside the weakness of manufacturing, there was an excess capacity of office space in the financial sector that would depress future demand.

Mr Morris said the euro debate was dominating discussion. He felt that the issue of social integration and the need to balance the 'social cost equation' related to the wider debate on Europe, including issues like the Working Time Directive. He felt that if the UK joined EMU, its flexible labour market would come under challenge, particularly if capital migrated to the

UK relative to other European countries. Pay settlements were generally expected to fall within a 2-4% range, perhaps more where there were productivity elements. Mr Morris said he thought the Railtrack situation was overplayed. The situation partly reflected a lack of investment in training that had led to a shortage of drivers.

Mrs Francis said insurance prices were rising. Insurance was a cyclical market, exacerbated by the events of 11 September. This was leading to increased selectivity amongst re-insurers and the failure of Independent had reduced capacity in the market. She said domestic insurance premiums were expected to rise by around 7%, and for vehicle insurance around 8-10%. More generally, Mrs Francis said there were good levels of business reported in investment and savings markets. Prospects also appeared positive, reflecting strong consumer confidence though it would also be dependent on the equity market outlook.

Mr Hall referred to the labour market in Yorkshire and the Humber region. The unemployment rate had fallen 1% overall in 2001, to stand only 0.2pp above the national average. Mr Hall said prospects for direct wage costs needed to be considered alongside indirect costs, notably pension costs. Dame Sheila McKechnie said that she thought there were mixed messages about consumer debt, with some confusion about how the low inflation agenda interacted with issues concerning consumer borrowing. The Governor said the issue was whether rising borrowing should be restrained at this time, in which case there was a real risk of recession. The question was, in effect, whether the problem was so serious that that would be a price worth paying. He said there was no straight answer to the imbalances in the economy. Sir Howard Davies said the focus of the FSA was on pockets within the overall market, noting the issue of lending at very high income multiples.

Sir Ian Gibson said capacity was visibly being reduced in US automotive manufacturing. A decline in demand was forecast by US producers. Japanese producers in the US were more positive, reflecting their focus on smaller vehicles. This distinction was usually associated with oil price changes but this was not a factor at present. He said the depreciation of the yen was allowing rising margins in the US. Investment trends remained negative with earlier postponements being rolled-over in the new year. Consequently, some vehicle developments originally envisaged for September/October 2002 would now not happen given the necessary lead times.

Sir Brian Moffat reported that demand for engineering steel was holding up. Construction related demand was easing off in the UK and German demand was expected to fall again in 2002. The outlook was therefore a fairly rocky one. Sir Brian said he expected pay settlements to be between zero and 1%. He noted that despite pressures, settlements in Germany were still expected to be around 4%.

Sir David Cooksey reported that there had been some signs of an improvement in the telecoms sector. Destocking had seemingly ended and businesses in the early part of the supply chain – systems, fibre optics and components – were seeing some signs of new activity. Ms Blow commented that across the IT and service sectors redundancies had meant that utilisation rates for remaining staff were relatively high. Consequently, wage settlements might be higher than the previous year. Some managerial staff who had undertaken restructuring programmes might also have higher awards. On the investment side, although public sector investment was rising, the corporate picture was unchanged.

MPC PROCEDURES

- **Peer Review Comments on the Pre-MPC Process**
- **External Analysis of MPC procedures**
- **Provision of regional and sectoral information to the MPC**
- **Review of the Service Level Agreement with the ONS**

(Messrs Plenderleith, Clark, Bean, Jenkinson, Allsopp, Ms Barker, Professor Nickell and Dr Wadhwani in attendance)

In introducing a series of four papers relating to the MPC's procedures, Mr King reported that the first paper summarised the views of non-Bank visitors who had attended pre-MPC meetings. These views remained generally positive with some useful comments on format. The second paper drew together comments on views proffered by external parties relating to the procedures adopted by the MPC. The third paper provided a summary of the regional, sectoral and other information regularly supplied to the MPC. Mr King noted the recruitment of a PhD economist to undertake work in this area. The final paper considered the Bank's relationship with the ONS and the provision of statistical material to the Bank. Mr King reminded Court that Mr Len Cook and Mr John Kidgell had spoken to Directors in 2001. He drew attention to the overall judgement made by the Bank in relation to the service it received from the ONS.

This had been viewed as "acceptable" rather than "good" by the MPC; and there was an ongoing need for the ONS to upgrade and improve its IT systems. The Governor invited comments on the papers in turn.

Peer Review Comments on the Pre-MPC Process

Dr Julius said she agreed with the summary of the Peer Review paper. Mrs Francis commented on remarks concerning the balance between information and analysis presented at pre-MPC. She asked if there were other opportunities for the MPC to seek analytical advice. Mr Bean replied by saying that staff provided continual briefing through the month. The pre-MPC meeting brought everything together which did represent duplication but the collective presentation was very useful for the Committee. More detailed pieces of analysis on specific matters were produced by staff via notes to MPC members. Dr Wadhwani said that he would prefer more analysis at the pre-MPC meeting, and that he would welcome the thoughts of the non-executive Directors when they attended the meeting.

The Governor said the comments in the paper had to be judged against the fact that visitors only saw a part of the MPC process. The pre-MPC meeting was deliberately focussed on information. He found that very useful and vital for him as it brought all the data and information together. There was a great deal of analysis elsewhere in the process. Mr King said the balance of the pre-MPC meeting would be odd if it were the only meeting. Comments from peers typically requested integration of the data with the forecast, but they often acknowledged that this might happen in other meetings. He added that it was always tempting to think that more analysis would help the decision making. What was crucial in his view was that all the data and information were considered collectively. The MPC should not consider each piece of data in isolation on a day to day basis, a prominent characteristic of analysis in the markets and media.

Mr Bailie asked if pre-MPC observers were briefed on other elements of the process. Mr King replied that they were briefed. Mr Stretton said the key consideration was that the MPC were happy with the process. It was not a question of whether Non-Executive Directors were content with the pre-MPC meeting.

External Analysis of MPC procedures

Turning to the paper covering external analysis of MPC procedures, Professor Nickell referred to the points raised by the House of Lord's Committee. He said it remained difficult to obtain model simulations of alternative assumptions or judgements. In his view he felt this partly reflected the inefficiencies of the software employed for the model. This made it difficult to see the consequences of alternative specifications during the forecast round. He felt this was a matter of some urgency.

Sir David Cooksey suggested that the non-executive Directors' report on MPC procedures should include a review of progress since the Kohn Report. Mr King said the Kohn Report had not made any explicit recommendations but had encouraged the MPC to keep its forecast procedures under review. He said the MPC could provide a short report on progress since the Kohn Report to NedCo. There had been a number of changes to the forecast round. The Governor suggested that it would be helpful to recirculate to Court the Bank's published response to the Kohn Report.

Dr Julius said the point made by Professor Nickell was broader than the Bank's response to the Kohn Report. Mr Bean said generating alternative model simulations was partly constrained by access to data. The model software was being evaluated to improve accessibility. Dr Julius said it would be helpful to know when that improvement would be in place.

Provision of regional and sectoral information to the MPC

In discussing the third paper, Mrs Francis said the emphasis in the paper had been on regional information and she asked whether sectoral information available to the MPC was as well developed. Mr Bean said there was a great deal of sectoral data available from official sources. The Governor added that the Agents also provided sectoral intelligence. Professor Nickell noted that there was generally less data and information available for the service sector than the manufacturing sector. He said that was a longstanding constraint. The Governor said the enhancement of service sector data was one of the MPC's priorities for the ONS. Mr Stretton felt it would be useful for Court to hear directly from the new economist recruited to cover this area to ask for his assessment of the information available to the MPC. Dame Sheila McKechnie said that, relative to earlier years, this was an area where there had been considerable progress. She felt a great deal had been achieved in improving the amount and quality of regional and sectoral information available to the MPC.

Review of the Service Level Agreement with the ONS

Commenting on both the third and fourth papers, Ms Blow asked how accuracy of data was reviewed and whether this was an item in the Service Level Agreement with the ONS. Mr Bean said a major research project on data uncertainty was being undertaken within Monetary Analysis. This concerned not just the issue of revisions but also the definition and coverage of data used by policy-makers. He said one of the ONS's objectives was the avoidance of excessive revisions. He added that this might not be entirely optimal as economic indicators needed to be timely and therefore were necessarily partial. The ONS undertook a great deal of internal work on revisions. Mr Allsopp said revisions were part of the issue, but there were also difficult conceptual considerations about data measurement. The MPC had to live within the constraints of what was measurable.

Dr Julius agreed there had been improvements in the provision of regional information. But she felt sectoral information was not noticeably better. She said the index of services output, improvements to capital stock data and the retail prices index were all MPC priorities for the ONS but had not yet been delivered. She thought the MPC's rating of 'acceptable' for the ONS might not help the ONS obtain additional resources. In her view, a rating of 'poor' might be more honest and productive. The Governor said the rating reflected MPC opinion. Mr King said a lower rating would exaggerate ONS shortcomings. The ONS was clearly stretched, not least by work on the 2001 Census, and there were weaknesses in the management structure reflecting the way in which the organisation had been established. But, in areas such as the National Accounts, the ONS was not poor by any standards. In relation to the work on service sector data, many of the difficulties were conceptual rather than related to available resources. He said that, overall, the MPC could not claim that it had poor data. Mr Jenkinson explained that many ONS projects had long timeframes and so progress might not be evident outside. The RPI programme, for example, involved work over 3 years. Progress was being made on the index of services and corporate services prices indices.

Mr Hall said he would expect to see a business process map for the MPC, identifying the main inputs and outputs of the process, 'pinch' points and an improvement plan. Mr Allsopp said some areas of the process needed to be quicker such as the front-end of the forecast process. Mr King said the forecast process was the area where the MPC were least content. The policy process was reasonably straightforward. The main issue was the link between the forecast and policy, as had been identified in the Kohn Report. But this was not a business process question.

Sir Ian Gibson said all suppliers required demanding customers and asked if the Bank was helping to shape the future work of the ONS. He said it was not the Bank's job to understand the ONS's constraints too readily. Mr King said the Bank made it clear what it required of the ONS each year. Sir Ian said it was important that debate about progress was not just within the ONS itself.

The Governor said that it was a matter of seeking continuous improvement. He said no individual data series was absolutely necessary or essential for the MPC to undertake its task. He did not feel it would be necessarily productive to tell the ONS that its performance was poor.

Mr Bailie asked if 'acceptable' was good enough and should the Bank outline what would need to be done for performance to be judged good. Dr Wadhwani said the situation illustrated the dilemma of the ONS as a monopoly supplier. He said the error with the capital stock data was very worrying. He was personally not happy with the ONS's performance though as a label had accepted the term 'acceptable'. Mr King said that the Bank could deploy its own resources at the ONS if it felt the situation was critical to the MPC. He said there had been a long period of under-investment in IT and staff. He added that the errors with the capital stock data dated back to the 1960s. It was not about the past year. In his view, the ONS's performance was rightly described as 'acceptable'. It was neither good nor poor.

Sir John Bond asked if the Bank was comfortable with monthly MPC meetings. Mr King said that, with the benefit of experience, it might be useful to downplay meetings at certain times of the year but that would pose practical difficulties. A monthly rather than six-weekly meeting made sense because of the monthly cycle of data releases.

Dame Sheila McKechnie said it might be appropriate for the Non-Executive Directors to make criticisms of the ONS in their report on MPC resources and procedures. This might have a useful impact beyond internal correspondence between the ONS, Treasury and the Bank. Sir David Cooksey said he would prefer any comments in the Annual Report to come from Court as a whole. Sir Neville Simms said he felt the 'acceptable' judgement was right and did not see a need to go beyond the letter to the ONS as proposed.

FINANCIAL STABILITY ISSUES

Domestic developments and international issues
(Messrs Plenderleith, Clark and Bean in attendance)

Mr Clark commented that the Bank still did not believe that the Argentine problem posed a systemic threat despite the recent deterioration. This was partly because exposure in the UK was relatively small, partly because the issue had been around a long time and people had had a chance to position themselves against the possibility of default, and partly because, while contagion as measured by spreads had edged up a little, it was not by a significant amount. He noted recent political events, the economic measures proposed and introduced, the uncertainty remaining about the terms of these measures and the exposures of Spanish and some US, Canadian and European banks. There were attempts in progress to re-establish a worthwhile dialogue between Argentina and the IMF, although it was still not clear on what terms this might be achieved.

Sir John Bond said he agreed with the assessment. There was no systemic financial risk. But there may be a systemic behavioural risk in that other countries with international difficulties might decide that confiscation from banks was a way to pay for it. Countries such as Venezuela should be watched carefully. He noted what a tragedy the problems were for the people of Argentina.

FINANCIAL MARKET OPERATIONS ISSUES

Current issues
(Messrs Plenderleith, Clark and Bean in attendance)

Mr Plenderleith noted the increase in size of the issue of Bank of England euro bills from Euro 3.5 bn to Euro 3.6 bn, on the Bank's balance sheet.

He also noted that the tightening of the system of note distribution over the past year, and particularly the cut in stock, had posed no difficulties for the system over the Christmas peak period, and he was confident that the tightening still enabled the system to operate effectively.

Mr Plenderleith commented on the introduction of Euro notes and coins. The logistics had gone extremely smoothly and the ECB deserved a great deal of credit. The changeover was going even faster than expected and the period of confusion was short. The impact on the wholesale markets was negligible. Finally "Euro-creep" in the UK was extremely limited.

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

The Governor said the Bank proposed to present a Loyal Address to the Queen on 21 March to mark her Golden Jubilee later this year. In Court folders were copies of the proposed text which the Governor hoped Court would agree was both appropriate and acceptable. The next step would be to submit the text to the Lord Chamberlain's Office for approval before it was inscribed by hand on vellum, sealed and bound in leather. Unfortunately, the text had to be agreed before the February Court meeting, so if the Lord Chamberlain chose to make some small drafting changes to the text, the Governor hoped that Court would agree that the Governors could, together, approve the final version - apart from a major rewrite, in which case the Governor would contact Court members individually. Dame Sheila McKechnie made a drafting point on the use of the word "stability".

Secondly, as the document would carry the Bank's seal, the Governor asked whether Court was content for the seal to be used for this purpose.

Court was CONTENT on both points.

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Mr Clementi said that the management of the assets of Minories Finance had been dealt with in the Bank for some time, and there were very few assets left, amounting to a few million. The Directors had concluded, in part because of the retirement of an individual in the Bank, that it would be best to put Minories Finance into members' voluntary liquidation, which would not prejudice the collecting of the assets. In response to a question from Sir Neville Simms on whether this had ever been done before by the Bank, Mr Clementi said he would check. Sir Neville said that, with the Bank's reputation in mind, if the proposal went forward there should be no bounce-back on the Bank. The Governor said the decision was perfectly explicable and he was not too concerned about a reputational damage problem.

Court was CONTENT.

MANAGEMENT OF THE BANK

The Quarterly Financial Report
(Messrs Plenderleith, Clark, Bean and Midgley in attendance)

Mr Midgley said all he wished to say was contained in the report. Dr Julius said she would find it useful to see percentage deviations and also counterfactuals - for example, what the outcome would have been at the interest rates in the budget assumptions. The Governor said he was sure that could be done, although he would like absolute changes as well, because percentages could be misleading. In response to a question from Sir Howard Davies about the costs of BCCI, Mr Clementi said he recognised that the Bank would have to come to Court again, because the numbers were very high, and the current estimate for next year was £6mn - £9mn and then even higher the following year. He expected the case to come to Court in the Spring of 2003. The last overall number he had seen for the cost was around £20mn. Negotiations were taking place with Freshfields and Counsel about the costs. Sir Howard said the number was larger than he was expecting. In response to a question from Sir Brian Moffat about whether a liability for the costs would be provided in the Accounts, Mr Midgley said a discussion on the subject was planned at the Audit Committee.

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

Mr Footman introduced his paper on the pay review. In response to a question from Mr Bailie on presentational issues, Mr Footman said the real reason Bank pay per head was going up was that on average it had been losing lower paid staff and recruiting the higher paid. He also noted the distinctions between the criteria for bonuses and for pensionable pay increases. The Governor said the Bank would have to give some thought to how the year's pay awards were presented. Mr Neill said he was happy with the proposals and delighted to hear that the Bank did not negotiate merit and bonus awards with the Unions, but only across-the-board awards. Mr Hall also praised the proposals. The Governor said that the Bank would come back to the question of presentation in the discussions about the Annual Report.

Court was up.

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 20 FEBRUARY 2002

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir John Bond
Sir Howard Davies
Mrs Francis
Dr Julius
Dame Sheila McKechnie
Sir Brian Moffat
Mr Neill
Ms O'Donovan
Sir Neville Simms
Mr Stretton

Absent:

Mr King, Deputy Governor - Monetary Policy
Sir Ian Gibson
Mr Hall
Mr Morris

The Minutes of the Court of 16 January, having been circulated, were approved.

The Governor noted that Sir Neville Simms would be standing down as a Non-Executive Director at the end of May. Ms O'Donovan, Sir Ian Gibson and Ms Blow would be serving further terms. An advertisement would be placed in the press shortly requesting applications for a Non-Executive Director.

MONETARY STABILITY ISSUES

The Inflation Report and economic and monetary discussion, together with the monthly MPC Report to Court (Messrs Plenderleith, Clark and Bean in attendance)

Opening the economic discussion, Mr Bean said that the context of the February Inflation Report and recent policy decision was a severe synchronised downturn in the global economy in 2001 but, within this, the UK had performed relatively well. At the same time, the imbalances in the economy had become more marked – the differential between annual growth in manufacturing and service sector output was at its largest since 1981. On the demand side, consumer spending remained robust. The MPC expected consumption to slow but that remained an uncertainty, as was the extent of any slowdown. At the same time, investment remained weak. In the labour market, aside from movements in bonuses, underlying earnings growth was fairly steady. Commenting on the sharp rise in RPIX inflation in January, Mr Bean said a rise had been expected but the jump to 2.6% (from 1.9%) had been a surprise. An element appeared to reflect temporary factors – notably higher seasonal food prices – but a part of the increase was more widely dispersed which might indicate more lasting demand influences, for example lower discounting by retailers.

Mr Bean outlined the GDP and inflation projections contained in the Report, noting that the annual growth profile for GDP tended to exaggerate the implied extent of the slowdown and recovery – quarterly growth rates were more even over the horizon. The risks were on the downside. Inflation was expected to fall in the near term and then rise slightly over the two year period due, in part, to higher import prices as the world economy recovered. The risks to inflation were on the upside, largely reflecting the possibility of a fall in sterling.

Commenting on the financial markets, Mr Plenderleith mentioned three points: first, there had been little movement in foreign exchange markets over recent months with the exception of the yen; second, in the money market there were continued expectations of higher interest rates in 2002, though the up-slope of the curve had flattened a little; and third, there was increased market nervousness following the Enron collapse and associated concerns about the reliability of company reported results, and in relation to the Japanese financial system's position. These factors were reflected in weaker equity markets.

Mr Bailie noted the continued fall in advertising revenues – down by 10-15% in 2001 Q1 on a year earlier. He mentioned Mr Bean's visit to Northern Ireland the previous week and how the prospect of higher interest rates had not been a particular concern. Some companies had even suggested they could live with the current exchange rate. Business had made more comment about the growing burden of regulation and the higher cost of labour – previously an advantage over other parts of the UK. Retailing appeared less buoyant than in Britain. In the printing sector, wage negotiations were in the region of 2%, the lowest in recent years.

Mr Neill drew Court's attention to the imbalance between rising UK car sales – some 9% higher in January than a year earlier with a very strong pattern evident for February – and falling UK car output, down by around 9% overall in 2001 compared with 2000. A downturn in demand was evident in the US market. Sir Neville Simms said the Agents' Reports reflected the position of the construction sector. Output was now stable and surveyors – who are at the start of the order chain – were now seeing a downturn. There remained uncertainty about the flow of public sector work and, in this respect, he noted that civil engineering companies had not yet seen an upturn in work.

Sir John Bond said financial markets were 'skittish' at present with herd behaviour prevalent. Dr Julius said there had been a small rise in mortgage arrears but margins on lending were still rising. It was too early to say if there were any changes in trends.

FINANCIAL STABILITY ISSUES

Domestic developments and international issues
(Messrs Plenderleith, Clark and Bean in attendance)

In updating Court on financial stability matters, Mr Clark drew attention to the three themes of his note. First, he said that the position of Japan was being discussed by the Tripartite Committee. The recent news was poor and the removal of bank deposit guarantees meant further uncertainty ahead. Second, Argentina's fiscal proposals did not look realistic, based as they were on a reduction in government expenditure but no reduction in tax revenues assumed. Continued falls in output suggested tax revenues were unlikely to be stable. There remained little sign of contagion across the region – notably in Mexico and Brazil. There were problems in Venezuela but these was more directly related to domestic issues. Mr Clark added that a great deal of work was underway to extract the lessons of the Enron collapse for systemic stability, including accounting and insolvency regimes and the risks associated with dispersed treasury operations. Third, he drew Court's attention to the IMF's UK Financial Sector Assessment Programme (FSAP). The IMF team had been in the Bank for two weeks undertaking the first of its three planned missions.

In response to Dr Julius, Mr Clark explained that the FSAP was a relatively new IMF procedure. FSAPs had previously focussed on emerging market economies but there was a desire also to undertake assessments of major industrialised economies. Canada had already been reviewed, but the UK was the first major international financial centre to be examined. Undertaking the exercise was intended partly to encourage other countries – including Japan – to agree to the programme. At the same time, it would test the IMF's approach to the analysis of a major financial centre. Sir Howard Davies noted that the IMF did not have in-house experience in some areas, such as insurance regulation, and so was dependent on seconded expertise. He added that the US were not enthusiastic about the programmes. Mr Plenderleith commented that, from his perspective, the IMF team appeared to be undertaking a very thorough exercise.

Sir John Bond said liquidity in Argentina was 'hand to mouth'. He was surprised that, to date, there had not been a premium on Japanese lending. The Governor noted this was perhaps related to Government guarantees that would soon end.

FINANCIAL MARKET OPERATIONS ISSUES

Current issues
(Messrs Plenderleith, Clark and Bean in attendance)

Mr Plenderleith reported on two current issues in the Financial Market Operations area; a progress report on the Bank of England's C21 programme to modernise banking systems, and an update on the Bank's foreign exchange reserves management. He said that good progress was being made with the C21 project. The IT installation was taking longer than expected such that the initial June target date was not considered achievable. Business modelling of processes and software development was taking extra time so the Autumn was a more likely date. He stressed the change in dates had been a controlled and managed process, not a reaction to slippage. In relation to the Bank's foreign exchange reserves management, Mr Plenderleith said performance so far in 2001/2 was significantly above the benchmark return and the target set by HM Treasury. Discussions were underway with the Treasury regarding the remit for 2002/3.

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

Mr Clementi reported to Court on some new internal appointments following Clifford Smout's appointment as Finance Director. Paul Fisher would succeed Clifford Smout as Head of Foreign Exchange Division; Neal Hatch would succeed Paul Fisher as Private Secretary to the Governor and, David Rule would succeed Neal Hatch as Head of Gilt-Edged and Money Markets Division.

Mr Clementi also reported on the printing operations work at Debden commissioned at Court the previous November. He said that the Bank had announced to staff the plan to explore two main options for the printing operations – either to remain as at present under the ownership of the Bank or allow the work to be transferred into a private sector company, operating under contract to supply banknotes from the Debden site to the Bank. Mr Clementi said there had been press coverage but no particular follow-ups. The team was now working hard and he would report back to Court in March or April. A staff consultation was underway, involving the Debden unions and covering TUPE arrangements. Work was also underway on the potential nature of supply contracts.

Mr Neill said that it might be difficult to secure a contract that involved a private firm taking on the Bank's final salary pension scheme. Mr Clementi said that would need to be reflected in the contract price. There was no intention of changing the pension arrangements for staff. In response to Ms Blow, Mr Clementi said it was envisaged that the length of contract would be around 5-7 years but that was an area for discussion. There were also complicated issues concerning EU procurement policy which needed consideration. Sir Neville Simms said potential purchasers should be given room to make proposals before definite plans were put in place. Mr Clementi agreed but said he wanted to establish the broad position the Bank wanted before such detailed discussions.

MANAGEMENT OF THE BANK

The Bank's Budget for the year 2002/03
(Messrs Plenderleith, Clark, 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.

In relation to the Bank's income, only a small part could be predicted with certainty. A large part of the Bank's income was affected by fluctuations in short-term interest rates. On the expenditure side, the overall direction had been in place since 1997 and had included an expansion of analytical resources alongside savings from process efficiencies and reduced expenditure on overheads. There had been an increase in the headcount in the analytical areas (offset by reductions elsewhere) and a reduction in overhead expenditure in line with the planned reduction of £20 million, which would be fully achieved when retrenchment into Head Office was complete in 2003. The ability to reduce expenditure further was inevitably becoming more restricted. Overall, the changes in the budget for 2002/3 were relatively small compared to the previous year. Recurrent expenditure was lower. There were large expenditures relating to investment projects – such as C21 and Electronic Data Management – within the overall nominal totals. There was a question about whether the totals should be presented including or excluding expenditures relating to BCCI for the purposes of Objective 9 and the eventual publication of the budget and the Annual Report.

Mr Clementi said the current level of CRDs, at 0.15%, had been set in 1998 for five years. Interest rates since 1998 had fallen but the impact on the Bank's income had been cushioned by investments in long-term gilts. He said the framework continued to work well and the Bank was not proposing to seek a change in CRDs ahead of the planned five-year review in 2003.

Dr Julius asked how the current estimate for the Head Office refurbishment project compared with the original budget. Mr Clementi said the cost of the initial project covering floors 2-7 was broadly in line with budget estimates. The cost of the project covering lower floors had been revised in the light of quotes being received above the original budget. He reminded Court that he had reported the previous year (April and June) of the need to increase expenditure beyond the original budget.

Ms O' Donovan asked if the planned Health Centre was included in this year's expenditure. Mr Midgley said around £500,000 would fall in 2002/3 but the majority was in 2003/4. Mrs Francis asked if the Bank was comfortable that the increase in staff working within Monetary Analysis compared favourably with international comparisons, in addition to the internal justifications. Mr Bean noted that the totals for Monetary Analysis included staff in the Monetary and Financial Statistics Division. The increase in the number of economists since 1997 reflected operational independence and the work of the MPC. International comparisons were not straightforward because of different functions but he felt the current number of economists was a reasonably sensible complement.

Mr Bailie noted that capital expenditure at the Printing Works was significant but productivity gains were not apparent. He said there was a choice between introducing new equipment and refurbishment, particularly in the context of considering a private sector operator. Mr Clementi said that it was not the intention to re-equip the Printing Works ahead of considering proposals to contract out the printing operation, but neither was it sensible to spend nothing ie to run it down. A 'middle road' to investment would be pursued.

Mr Neill asked if expenditure and improvements in IT processes were being correlated with productivity gains. Mr Clementi said that much of the expenditure did not transfer to identifiable gains and savings – for example, the Head Office refurbishment created a better working environment; the EDM project would bring good practice and had delivered clear gains for MA who already had systems in place. But it was difficult to see the benefits in terms of budget measurables. Mr Neill agreed it was difficult and noted that he felt good progress had been made over recent years. But it was a good discipline to try to identify and measure expected gains. Mr Plenderleith said IT and other projects undertaken in the Market Operations area were considered against expected gains and savings.

Court APPROVED the Bank's Budget

Turning to the level of CRDs, the Governor asked if Court was content for the Bank to propose maintaining the existing level, ahead of the more in-depth review planned for the following year. Dr Julius said she supported the 5-year arrangement, so favoured the proposal.

Sir John Bond declared his interest in the level of CRDs.

In relation to the proposed letter to be written by the Governor to the Chancellor relaying Court's conclusion in relation to CRDs, the Governor asked whether expenditure including or excluding BCCI costs should be included. Mrs Francis said she was uneasy with the exclusion. Excluding a known contingency could be criticised. Sir David Cooksey agreed and suggested it might be helpful for the public to be aware of the expenditure. It would be transparent and in line with the practice of the receiver. Mr Bailie suggested it could be entered as an exceptional item.

Mr Clementi remarked that the issue was how it was treated within the control total, in view of the limited control over BCCI costs, rather than the Bank's Accounts at this stage. Sir Brian Moffat said there was some control link between the budget and Accounts. If there was a realistic chance the BCCI costs would be recovered it was reasonable to identify the item as a contingent liability but meet the costs on a 'pay-as-you-go' basis. However it was treated, he felt it should be disclosed and controlled where possible.

The Governor said it would be necessary to take legal advice on accounting treatment ahead of publication. Ms O' Donovan noted that if recovery of costs was included as an asset in the Accounts, recovery had to be certain. Sir David Cooksey supported a transparent approach. Sir Neville Simms noted that the Audit Committee had not discussed the treatment of BCCI costs but he felt the letter should include some reference. The Governor said there was a need for consistency with the wording proposed for Objective 9, but the sequencing was important and advice would have to be taken about disclosing charges. Mr Midgley said the letter to the Treasury could mention both expenditure totals. The choice for Objective 9 and the Annual Report would then depend on legal advice. Sir David Cooksey said referring to the totals separately would identify the £20 million reduction in costs which would otherwise be clouded by the BCCI costs.

Head Office Health Centre
(Messrs Plenderleith, Clark, Bean and Midgley in attendance)

In introducing the paper recommending that the Bank should build an occupational health facility, including a gymnasium, at Head Office, to improve staff morale and well-being, and to bring the Bank into line with other large City firms, Mr Clementi said that the project would incur some initial expenditure in 2002/3 but most would fall into 2003/4.

Mr Neill supported the concept and, in the light of his own experience, was happy to offer the Bank advice. He said the projected capital costs seemed high. To ensure good revenues over time required a good management team to maximise staff involvement. Additional facilities – such as various therapies – might be considered for only a small additional cost. Dr Julius said she was not convinced that other options had been considered and put to the staff, particularly options available in the City or local to where staff lived. There was a risk that an in-house facility might be initially popular but enthusiasm waned over time. She added that outsourcing the running of the facility needed consideration, with incentives linked to usage. The Governor said the staff survey had been clear about the desire to have an in-house facility. Mr Neill said if the objective of the project was that staff used the facility as opposed to simply offering another benefit, having the facility on site was crucial.

Sir Neville Simms agreed that the costs seemed very high though he understood the high cost of refurbishment in the Bank. However, he felt uncomfortable and wanted to understand more fully the costs and the choices for charging. Sir Howard Davies said the FSA's facility had a high utilisation rate on the basis of charging in the region of £18 per month. The Governor suggested the Bank bring a practical proposal back to Court.

A Report from the Trustees of the Court Pension Scheme
(Messrs Plenderleith, Clark and Bean in attendance)

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

Mr Neill reported that the Trustees of the Court Pension Scheme had considered a Report by the Actuary on his annual valuation of the Scheme as at 1 March 2001, together with a proposed Schedule of Contributions to the Scheme.

Court APPROVED the nil contributions Schedule.

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

Sir Neville Simms introduced the Report of the last meeting of the Audit Committee at which the main agenda items were a report from PriceWaterhouseCoopers on their Audit plan for the forthcoming year-end; a discussion on accounting and reporting issues for the forthcoming Report and Accounts and, an update on the work of the MANCO Operational Risk Sub-Committee.

Sir Neville said that Members could perhaps receive a copy of the paper by [redacted] on new accounting standards. The Governor agreed. Sir Neville said the approach in relation to FRS 17 was to follow rather than lead and to use the transitional arrangements. He said the issue could impact on the whole macroeconomic environment so the Bank might want to consider a public position regarding FRS 17. FRS 18 and 19 did not raise major issues for the Bank. Sir Neville said [redacted] had said there were no major forthcoming issues that the Bank needed to consider.

Mr Neill said many companies were having difficulties with their pension funds. Mr Stretton said the public debate had not focussed on resolving the different interests of companies and trustees, and how these might be reconciled. Mr Clark said that he did not concur with page 4 of the draft minutes of the Audit Committee meeting – that "the FS wing was broadly supportive of FRS17".

Sir David Cooksey said exiting final salary schemes would affect investment decisions as risks were transferred from employers to employees. He said pensions required a long term approach but FRS17 was forcing a short-term approach as companies adjusted, particularly those companies who had downsized over time.

Sealing Committee authorisations for inspection
(Messrs Plenderleith, Clark and Bean in attendance)

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.

David [illegible]

Peter Rodgers
20 March 2002

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 20 MARCH 2002

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 John Bond
Sir Howard Davies
Sir Ian Gibson
Mr Hall
Dr Julius
Dame Sheila McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Sir Neville Simms
Mr Stretton

Absent
Ms O'Donovan
Mrs Francis

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

MONETARY STABILITY ISSUES

The economic and monetary discussion, including international economic developments, together with the monthly MPC Report to Court
(Messrs Clark, Bean, Bailey and Allsopp together with Dr Wadhwani and Ms Barker in attendance)

In introducing the MPC Report to Court, Mr Bailey presented his International Economic Developments paper. He said private sector forecasts now pointed to a 'V' shaped pattern to economic recovery following the slowdown. This reflected expectations of stronger world demand. In the United States, consumer spending was being boosted by monetary and fiscal policy, as well as lower energy prices. There was also a positive boost from the inventory cycle, though this would be a one-off effect. The main question concerned the sustainability of any upturn. The latest FMOC statement had said that the sustained nature of the economic expansion was still uncertain. Mr Bailey said the profitability of the corporate sector and imbalances within the economy remained issues that might undermine recovery prospects.

In relation to the euro area, he said there were positive spillover effects evident from the US. Japan remained negative. The crisis in Argentina and the collapse of Enron did not appear to be having a wider impact on the global economy. He asked Court for any insights in relation to the imposition of US tariffs on imported steel. Mr Bailey also drew Court's attention to the discussion of the ICT sector in his paper.

Turning to the UK economy, Mr Bean discussed the recent GDP data for the fourth quarter of 2001. He noted that the weakness of construction output was at odds with other sources – such as DTI data – and he expected an upwards revision in due course. He said the improvement in confidence amongst businesses might suggest that the fourth quarter would be the low point in economic growth. On the demand side, Mr Bean said there was some evidence that consumer spending was slowing but not sharply. He said that the MPC would want to see a further easing as the rate of growth of the world economy increased. Investment had been weak. It was unclear whether that reflected a pause following 11 September or a capital overhang but a recent survey by the Agents had suggested a fairly positive outlook for investment this year.

Mr Bean summarised the latest labour market data, noting that unemployment continued to be lower than expected while underlying earnings growth had moderated slightly, after the impact of lower bonuses had been taken into account. The MPC meeting in March had considered the more positive news on the global economy which had reduced downside risks. However, the Committee felt is was too early to think recovery was firmly on track and so decided unanimously to leave the official rate unchanged.

In Mr Plenderleith's absence, Mr Bean described recent financial market developments. In the foreign exchange markets, he said the euro had strengthened slightly, associated mainly with merger and acquisition activity. In the money markets, there had been an increase in future interest rates though not in market expectations of the official interest rate – the 3 month inter-bank rate had been largely unchanged.

In response to Mr Hall, Mr Bean explained that interest rate expectations were derived from financial market prices, though care was needed in reading across to expectations of the MPC interest rate where term premia were present and not constant. Mr Bailie said a pick-up in economic activity was evident in Northern Ireland though the future of the Harland and Wolff shipyard remained very symbolic. He noted that there was weakness in the aerospace sector and amongst textile firms supplying the hotel sector. There was a great deal of spare capacity in the printing and packaging sector which meant investment remained weak. Growth in television advertising was not as much below last year as expected though it was too soon to talk of recovery. He added that there was some concern about the fall-out from the problems at Allied Irish Bank, in terms of the status of Irish banks. Tourism remained weak, particularly from the US. However, business confidence seemed higher overall.

Sir Neville Simms said construction output was growing year-on-year, borne out by the high levels of employment in the sector. New orders information did suggest that future growth would not be as strong but the impact of higher government spending was now becoming evident. This would offset the slowdown in industrial and commercial activity. Sir Neville said a large part of the growth in employment was self-employed labour. This may affect the nature of the impact of the slowdown on employment levels.

Sir Ian Gibson said the automotive sector was not optimistic. Investment programmes continued to be cancelled and large component suppliers were not profitable. Stocks were thought to be low enough but there was now nervousness about oil prices. Indications from the Geneva motor show suggested little improvement in trading prospects over the year ahead. Profitability was only being enjoyed by those producers benefiting from favourable exchange rates, principally German firms. Ms Blow said demand growth in IT and business services was split between positive public sector spending and subdued private sector spending. More suppliers were attempting to secure public sector work.

Sir Brian Moffat outlined to Court the nature of the situation concerning steel tariffs. He said the situation dated back to 1999 when the US market was flooded with new sources of supply from Asia, including Japan. There was a lack of competitiveness in the US industry with US prices around $50 a tonne above European prices. Accountancy changes relating to healthcare and pensions had put pressure on the balance sheets of US producers. He said too often bankruptcy did not remove capacity, which simply came back on stream with new owners. The situation was now a political tug-of-war with US consumers facing a 30% price increase.

Mr Hall noted that unemployment in Yorkshire and Humber was now slightly below the UK average. He said there were renewed difficulties in the steel and coal industries but some aerospace firms would benefit from orders for the Hawk training jet and there appeared to be positive indications that tourism in the rural economy was seeing an upturn in visitors.

Mr Morris said pay settlements appeared to be generally above inflation in both the public and private sectors. Mr Bean said the Bank's pay databank showed that while settlements had drifted upwards over last year, more recently the distribution of settlements had drifted downwards a little. He said that pay settlements at current levels of a little over 3% implied earnings around 4.5% which was broadly consistent with achieving the inflation target, given assumed productivity growth of 1.75-2%.

Mr Stretton said banking contacts had reported that higher investment intentions were not justified on profitability grounds, while high-technology companies reported that financiers were being more risk averse. Mr Stretton noted that the level of the exchange rate was not being mentioned as a concern. Mr Neill said the new car market had grown again in March. Car production had also increased – rising 20% on an annual basis in January. However, he noted that this output reflected model development decisions taken some 6-7 years ago so it was not a current indicator. He said suppliers were very nervous about UK production in view of the switch from UK to overseas sourcing.

Non policy meetings of the MPC

(Messrs Clark, Bean and Allsopp together with Dr Wadhwani and Ms Barker in attendance)

Mr King noted that the paper before Court listed three meetings held since October.

Agent's 'Issue of the month'
(Messrs Clark, Bean, Jenkinson, Iles and Pratt together with Ms Hyde in attendance)

Mr Iles, the Bank's Agent for the Central Southern Region, introduced the findings of the special survey conducted by the Agents in February addressing investment in the UK. The Governor said the survey had been a useful exercise and had informed thinking about investment in the forecast. Dr Julius asked if the survey had established whether the increase in investment intentions reflected a reversal of previously postponed plans or new replacement investment plans. Mr Iles said there was an element of catch-up envisaged this year but there was expected to be momentum carrying through into higher investment in 2003.

Mr Hall asked if there was a regional dimension to the survey and, given the survey's focus on private sector investment, how was intelligence gathered on public investment trends. Mr Iles said there was little differentiation in the survey by region. The picture on public investment was part of the Agents' monthly reporting.

Review of the work of the Agents
(Messrs Clark, Bean, Jenkinson, Iles and Pratt together Ms Hyde in attendance)

Mr Jenkinson, in commenting on his paper reviewing the activities of the Agents over the past year, drew attention to five headings; involvement in the monetary policy process, the value of economic reporting, intelligence gathering using the database of contacts, staffing and the establishment of working groups to improve business practices. He noted the substantial contribution the Agencies made to the MPC process and other areas of the Bank's work. Mr Bailie said the Agency for Northern Ireland was a very positive presence and the Agent, Nigel Falls, was doing an excellent job.

FINANCIAL STABILITY ISSUES

Domestic developments and international issues
(Messrs Clark and Bean in attendance)

Mr Clark updated Court on contingency planning where work in the public sector was continuing under the auspices of the Treasury, Bank and Financial Services Authority, through the Standing Committee. He noted that a website had been launched the previous week giving information about what was being done. The Bank had hosted a meeting of about 40 firms, trade associations and infrastructure providers to bring them up to date, and another meeting was planned in late June or July. Mr Clark also drew attention to the meeting of the Financial Stability Forum which was to take place the following week in Hong Kong.

In addition, he noted that the IMF/FSAP first mission had been completed, after the last Court; drew attention to the Competition Commission report on small firms making clear that it did not relate to the supply of finance to small firms, which was judged to be satisfactory, but to the availability and cost of other banking services; and said there was work in progress in the Bank on FRS 17, and also on wider issues relating to company pension schemes. The Governor said that this work would be brought to Court.

Sir John Bond said the Government appeared to believe that the banks made excess profits. But it was necessary to address the facts. The small business tariff in HSBC had been unchanged for 10 years. The return on equity in the FTSE averaged 25%, and the banks were 14th among 37 sectors. The winners from the Competition Commission report would be small business, and the losers would be those who received a lower return on their investments as a result, and employees of HSBC. To maintain profitability the bank probably needed fewer employees. In HSBC's experience, in the last 18 months, price regulation had only been an issue in Malaysia, Argentina and the United Kingdom!

The Governor said he had a great deal of sympathy for the banks' views. He was concerned that if the criterion were to be a very fragile calculation of excess profits, rather than identifiable collusion or obstruction of market pressures, he was not at all sure where that would lead. A reason for accepting the Competition Commission recommendations was that the Government had said that it was shortly to distance itself from the process, drawing an analogy with the Bank of England. To pursue the analogy, if Government were going to do that in the competition arena it would have to tell the commission what the target was. It seemed to be that the basis on which the proposals had been announced was an acceptance that it was possible to measure excess profits, and that that was a sufficient criterion.

Dame Sheila McKechnie noted that the Consumers Association owned a small business that specialised in recovering overcharging by banks. Although it was a small snap shot, there were very few cases where the firm did not find that the banks had been guilty of overcharging small business.

The Governor said that the Bank had held a seminar on small business for 10 years, with every representative small business organisation attending, and this was not a question that had been raised at the meetings. He was sure that in a business as wide as banking individuals would be found who could claim that they had not been charged the right tariff, or that it had been miscalculated. The Governor said he constantly saw references in the media which had influenced the process. But the Institute of Directors, for example which represented many small businesses, did not share that impression. The Governor said he would be interested to see the evidence the Consumers Association had acquired. Dame Sheila said the Bank was welcome to it at any time.

Sir John Bond noted that many people failed to differentiate between banks. 2% of complaints noted were against HSBC which had a market share of 16 – 20%. He personally responded to every complaint. In response to a question from Mr Hall, the Governor said that regulatory responsibility for individual lending institutions with regard to small business lay with Sir Howard Davies. Mr Neill drew parallels with the Government's move against the automotive industry, which was bottom of the profit league. But politicians saw it as a popular move. The Governor said that the Bank had been focusing over 10 years on financing of small businesses and this was part of the broader third core purpose work on the effectiveness on the financial system in supporting the wider UK economy. In response to a question from Mr Neill about whether the Bank would try an attitude survey, the Governor noted that many of these were already produced by representative bodies of small firms. All the evidence was being disregarded.

Sir Howard Davies said he wished to note two issues from the financial stability perspective. The Allied Irish Banks case was depressingly familiar, involving unexplained large dealings in a remote location that was not properly controlled. The FSA had studied the report on AIB. He noted that, since previous incidents in London, responsibility for risk management had been tracked up through institutions to the top. As far as the nature of the incident itself was concerned, this did not amount to an interesting or novel type of case.

Turning to small firms, he said it was hard to say that the sum involved in the latest move were material in terms of foregone profit, from a financial stability perspective. He had a lot of sympathy with Sir John's point about price controls, which were also applied, though in different circumstances, to ISAs and Stakeholder Pensions. There was a growth of a kind of price control which potentially could be quite serious from the perspective of overall investment in the UK financial system, and was potentially worrying. The FSA and the Bank would keep an eye on this. The Governor commented that he found it very difficult to see how the changes would be in the interest of small business. Sir John Bond noted that it was strange that the moves removed the competitive edge in the small business market of Halifax and Abbey National.

FINANCIAL MARKET OPERATIONS ISSUES

There were no issues to be reported.

EXECUTIVE REPORT
(Messrs Clark and Bean in attendance)

The Governor informed Court of the early retirement of Ian Plenderleith at the end of May when his renewal on the Monetary Policy committee came up. Mr Plenderleith had said that he would prefer to retire at that stage. He noted the appointment of Paul Tucker as Executive Director for Financial Market Operations and also to the MPC. He noted the retirement of John Townend whose functions will be taken over by Bill Allen, who would combine them with being Deputy Director in Financial Stability. He asked Court whether it was CONTENT for these changes to be implemented. Court was CONTENT. The Governor noted that the Bank proposed announcing them soon after Easter.

Mr Neil reported on a meeting of the Remuneration Committee which took place before Court. The Committee recommended that Mr Tucker should receive a salary [redacted] and be admitted to the Court Pension Scheme. It was agreed that Mr Plenderleith should be paid a further payment in line with previous practice for 3 months from the date of his retirement, and that his Court Pension Scheme be brought into payment. For Mr Townend it was recommended that his Court Pension Scheme should be brought into payment. Court was CONTENT with the Remuneration Committee's proposals.

The Governor proposed that Court constitute an informal sub committee to oversee the BCCI case comprising the Governor, the two Deputy Governors and Sir David Cooksey. Sir Neville Simms proposed that the Chairman of the Audit Committee should be added. Court was CONTENT with the proposal, including the addition of the Chairman of the Audit Committee. The Governor also agreed there should be a presentation by the Bank's lawyers to the Audit Committee in time for its next meeting.

With regard to the Printing Works, Mr Clementi noted the two current options of the status quo or privatisation with a contract to print Bank of England notes. Court in November had asked the Bank to work up a practical proposition and a steering group had been established to review this, chaired by himself. The advisers were Close Brothers and the Bank was also taking legal and property advice. There were three considerations: the quality and security of notes; the interests of staff, and the price to be paid. Mr Clementi said a detailed paper would be brought to Court in April. He expected it would propose, as part of the second option, that the contract should be for seven years, of which five years would be exclusive. This would give time for the Printing Works to adjust. It would be effected by TUPE transfer of staff to a subsidiary, which could then be sold. It was necessary to consult the unions about the options and this consultation had started on 6 February. The response from the unions was that their first preference was for Bank ownership with commercialisation. It had been explained to them that it was not part of the Bank's job to compete with the private sector. The unions' second preference was the status quo, which might have been influenced by the fact that a large number of the work force was coming up for retirement over the next eight years and was not concerned with where the Printing Works should be in ten years time, preferring to stay with the position they knew. The Bank would continue talking to the unions about the options.

In response to a question from Mr Neill, Mr Clementi said that pensions and redundancy were key issues. In response to a question from Mr Morris about whether the Bank had identified any potential partners, Mr Clementi said a number of interested parties had rung, and Close Brothers had noted their names. Mr Bailie said that it was important that the union side were not allowed to believe that they had the final decision, which was a management decision for Court. Mr Clementi said that it had been made clear that the decision was one of Court, but the three grounds on which Court would take the decision had been outlined.

Mr Clementi noted that six tribunal cases in which unfair dismissal had been claimed against the Bank would commence on 18 April, the day after the next Court Meeting. The Bank believed it had a strong defence.

Mr Clementi reminded Members that Mr Smout would be taking over as Finance Director from Mr Midgley with effect from 1 April and it would therefore be necessary to transfer Mr Midgley's ex-officio responsibilities relating to shareholdings and directorships in Bank subsidiaries to Mr Smout. As certain transfers required Court's consent, Mr Clementi drew Members' attention to the following Resolution:-

That consequent upon the retirement of Mr G MIDGLEY at the end of March 2002 and the appointment of Mr P A C SMOUT in his place, and with effect from 1 April 2002, the 925 shares representing 92.5% of the equity in The Securities Management Trust Ltd held jointly by Mr G MIDGLEY and Ms M V LOWTHER in a nominee capacity for the Governor and Company of the Bank of England be transferred to Mr P A C SMOUT and Ms M V LOWTHER as a joint holding, in the same nominee capacity.

That with effect from 1 April 2002 and pursuant to Section 375 of the Companies Act 1985, as appropriate, and until otherwise resolved by the Court of Directors:-

1 (i)Mr P A C SMOUT shall become a Director of The Securities Management Trust Ltd in place of Mr G MIDGLEY. The Board will then consist of Mr T A CLARK, Ms M V LOWTHER, Mr P A C SMOUT and Mr G P SPARKES.

(ii) Mr T A CLARK, or failing him, Ms M V LOWTHER, or failing her, Mr P A C SMOUT, or failing him, Mr G P SPARKES, be authorised to act a representative of the Governor and Company of the Bank of England at any meeting of The Securities Management Trust Ltd.

2 (i) Mr P A C SMOUT shall become a Director of Houblon Nominees in place of Mr G MIDGLEY. The Board will then consist of Mr M A KING, Mr P A C SMOUT and Mr P D RODGERS.

(ii) Mr M A KING, or failing him, Mr P A C SMOUT, or failing him, Mr P D RODGERS, be authorised to act as a representative of the Governor and Company of the Bank of England at any meeting of Houblon Nominees.

3 (i) Mr P A C SMOUT shall become a Director of B E Services Ltd in place of Mr G MIDGLEY. The Board will then consist of MS M V LOWTHER and Mr P A C SMOUT.

(ii) Ms M V LOWTHER, or failing her, Mr P A C SMOUT, be authorised to act as a representative of the Governor and Company of the Bank of England at any meeting of B E Services Ltd.

4 (i) Mr P A C SMOUT shall become a Director of B E Property Holdings Ltd in place of Mr G MIDGLEY. The Board will then consist of Mr D C CLEMENTI and Mr P A C SMOUT.

(ii) Mr D C CLEMENTI, or failing him, Mr P A C SMOUT, be authorised to act as a representative of the Governor and Company of the Bank of England at any meeting of B E Property Holdings Ltd.

5 (i) Mr P A C SMOUT shall become a Director of B E Museum Ltd in place of Mr G MIDGLEY. The Board will then consist of Mr P D RODGERS, Mr P A C SMOUT, and Mr J M KEYWORTH.

(ii) Mr P D RODGERS, or failing him, Mr P A C SMOUT, or failing him, Mr J M KEYWORTH, be authorised to act as a Representative of the Governor and Company of the Bank of England at any meeting of B E Museum Ltd.

6 (i) Mr P A C SMOUT shall become a Director of Minories Finance Ltd in place of Mr G MIDGLEY. The Board will then consist of Ms M V LOWTHER and Mr P A C SMOUT

(ii) Ms M V LOWTHER, or failing her, Mr P A C SMOUT, be authorised to act as a Representative of the Governor and Company of the Bank of England at any meeting of Minories Finance Ltd.

The Resolution was APPROVED

MANAGEMENT OF THE BANK

Payment to HMT in lieu of dividend
(Messrs Clark, Bean, Midgley and Smout 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 2002 would be £42mn, 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 that 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 £21mn be paid to HMT, in lieu of dividend, on Friday 5 April.

Annual Report:-

Review of the Bank's performance
Review of MPC Processes
Objectives and Strategy for 2002/03
(Messrs Clark, Bean, Footman, Midgley and Smout in attendance)

Mr Footman introduced drafts of Sections 4, 5 and 6 of the Annual Report. He said a re-draft would be brought to Court the following month but meanwhile he was looking for comments which could be incorporated in it. Court would also see the other sections including remuneration, in April. Dr Julius suggested two specific changes in chapter 4. The formulation of how closely the Bank met the inflation target was too casual, and the average RPIX over the years should be indicated rather than saying "a little below the target". The number, given for staff recruited was 211, but the report should also say the number who left, so that the turnover rate was apparent. Otherwise she thought the report was very well written. The Governor thanked Dr Julius for her suggestions. Mr Footman also agreed a glossary might be helpful. Sir Brian Moffat agreed with Mr Hall that the statement about the process appearing to work satisfactorily "at present" was not right and it would be better if the last two words were taken out. He also said that the words on the quality of sectoral information did not reflect the possibility that it could be better, which was a sentiment he took from Court, specifically in relation to the ONS. Sir David Cooksey noted that it would be best not to anticipate receiving a report by Adrian Pagan too soon, because in the light of a conversation with Mr Pagan he understood that he would wish to see the new model working first, which would not be until the Autumn, and the report might even be next year. Mr Bean said that Mr Pagan would be expected to give a verbal report rather than a written report at the interim stage. The Governor invited members of Court to give any other comments direct to Mr Footman.

The Governor extended his thanks to Mr Midgley. Measured by the change between the time Mr Midgley took over and the time he left his area, there had been an incredible step forward, and he wished to thank Mr Midgley for that, both personally and on behalf of all members of Court.

There being no other business court was up.

17 April 2002

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 17 APRIL 2002

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir John Bond
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Mr Hall
Dame Sheila McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Ms O'Donovan
Mr Stretton

Absent:

Mr King, Deputy Governor - Monetary Policy
Dr Julius
Sir Neville Simms

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

MONETARY STABILITY ISSUES

The economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Plenderleith, Clark, Bean and Allsopp together with Professor Nickell, Dr Wadhwani and Ms Barker in attendance)

In introducing the MPC Report to Court, Mr Bean noted that the world outlook was more comforting than previously expected and forecasters had revised up their predictions for the United States, though there were issues of sustainability there. The Euro area was still sluggish and had contracted in the fourth quarter, but there were now more positive signs, though not yet as strong as for the US. Japan remained weak. Oil prices had picked up but were still only at pre-11 September levels, though it was possible to paint scenarios involving a major Middle East confrontation and much higher oil prices. UK GDP had been revised to flat in the fourth quarter. Services growth was steady and manufacturing weak, and the gap in growth between them was the widest since the depth of the recession of the 1980s. Confidence had however picked up in the first quarter and manufacturing output rose in February. Both services and manufacturing appeared to be recovering somewhat.

Turning to demand, there was a question about whether retail sales had really been easing, given the strong growth in February and the British Retail Consortium March survey, which implied that year-on-year growth had picked up. Confidence was robust and house prices were strong, though the current account deficit had widened. Mr Bean noted that the MPC had not been briefed on the Budget ahead of its last meeting. This time the Budget was half way between meetings, and there was no particularly pressing need to brief, because there would be plenty of time to absorb the contents of the Budget during the forecast round. Turning to labour and prices, he noted that employment was still rising, but hours were down and earnings growth was weak. Commodity and input prices were up. He noted that RPIX inflation was 2.3% in March. The services component of the index was still at relatively high levels. In the context of the world economy starting to recover and possible signs of a slowing of consumption growth, the Committee had voted unanimously for no change in interest rates.

Turning to financial markets, Mr Plenderleith drew attention to the chart pack, and said that major markets had remained remarkably steady since the last Court meeting.

Dr Wadhwani said that he would be interested in Court Members' views of the degree of pass-through if oil prices should increase significantly. His view was that it would be limited, but was this too complacent?

Ms O'Donovan agreed that the pass-through would be limited. Mr Neill noted that there were many contracts where oil was a significant percentage of costs and there were arrangements to pass them through. Mr Bailie noted that tourism was still extremely sluggish for the first half and there had not been the recovery expected, but there was some optimism for the second half. He noted signs of more optimism in the advertising business. Sir David Cooksey said there was a flicker of positive news on the roll out of broadband from telecoms companies, though it was very early days. Commenting on employment in construction, Sir Brian Moffat said that orders up to two years out continued to fall at the beginning of the year, but there were huge discrepancies between sectors. In cars in particular, the huge demand at the retail end in the UK was not reflected anywhere else in Europe and there was a similar picture in construction. Mr Hall noted a decline in inward investment in the Yorkshire and Humber region in the current year from the high levels in the previous year. However, a £120mn investment in Goole was shortly to be announced. Mr Bean said he suspected the level of the euro was part of the story but it was also more than that. Rates of inward investment also reflected expectations of profitability in different parts of the world. Even producers in the euro zone were looking to relocate in Eastern Europe and so Britain was not alone in having to struggle to encourage inward investment. Mr Morris said he detected a greater sense of confidence about a wide range of business issues.

FINANCIAL STABILITY ISSUES

Domestic developments and international issues
(Messrs Plenderleith, Clark and Bean in attendance)

Mr Clark drew attention to the key points in his note related to Enron, the Financial Stability Forum, the International Monetary Fund and seminars given in the Bank. Sir David Cooksey said the seminar the previous week had helped very considerably in bringing out significant issues, particularly those the Government had to face up to. Turning to Enron, he said that he had been at a meeting on corporate governance in New York the previous week where the true independence of the Enron directors was severely in question. He hoped that the enquiry chaired by Derek Higgs would focus on the right issues. Enron was an extreme case. He also noted that in the private equities sector the insurance industry was withdrawing from the provision of professional indemnity insurance to limited partnerships. In his own case there had been a 20-fold increase in premium, and now he had been told it could not be placed at all. This could lead to a situation where the private equity industry stalled badly, because most investors insisted that such indemnities were taken out. There was potential for a real problem. In response to a question from Ms O'Donovan, Mr Clark said that the enquiry into rating agencies would include discussions with companies as well as banks and the agencies. In response to a question from Mr Morris, Mr Clark noted that the forthcoming report on small firms would include two special chapters on the two seminars in the Bank.

Mr Hall, commenting on University spin-off, said higher business survival rates were the key to success in the regions and higher levels of spin-off were crucial to that. The regional development agencies had raised this as a key issue with Ministers.

Sir John Bond commented that there was a huge opportunity for venture capital to relieve the funding of the NHS. There was much more substantial venture capital funding for US medical research. In the UK there was a need to break the mould. Sir John also said that he would be very happy to contribute to the rating agency debate, and would be very happy to be consulted. The Governor took note of those points.

Sir David Cooksey said that medical research was an area where the UK had the greatest success. The Welcome Trust put more money into medical research than the Government. It was the largest investor in technology-based venture capital in the country. A large number of the very best medical research based ventures were very well funded at the level of £20mn-£50mn. But there was a lack of debt finance, which in contrast was available in the US - indeed the US could be criticised for funding too many research based companies. He believed Sir John had overstated the position.

FINANCIAL MARKET OPERATIONS

Current Issues
(Messrs Plenderleith, Clark and Bean in attendance)

Mr Plenderleith noted that the date for the launch of the new £5 note would be 21 May. He also noted that the Bank had been using the Post Office and Marks & Spencer to circulate existing £5 notes because of the difficulties for the banks in distributing them via ATMs. He also said that the Bank had abolished the Sterling Lead Management Guidelines for the Capital Markets.

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

Mr Clementi informed Court of the sale and 20% leaseback of the Leeds premises. The leaseback was for the use of the Cash Centre. He also noted that an offer had been received in principle for the Bank's Gloucester premises and it was expected that contracts would be exchanged in June.

Mr Clementi said that the Employment Tribunal case against the Bank started the day after Court and was expected to last five weeks. There had been discussions with the unions about the possibility of a settlement, and a decision on a response had to be made within the next few hours.

The Governor said that a point of principle was involved. It was not just a question of the impact on staff, who would see those who refused to sign their contracts receiving more. An important consideration was that if an institution like the Bank of England, which believed that it had behaved reasonably in the circumstances, was prepared to go down the route of settling because the economic cost of that would be lower than pursuing the principle, it would encourage similar behaviour by staff in the future. It would also offer general encouragement to employees to go to tribunals. This would be a retrograde step for an institution like the Bank. Sir Ian Gibson said he thought it would be wrong to settle because an important principle was involved, and Court had been fully behind the introduction of BenefitSelect. Mr Morris said he was neutral on the matter but that this was finally a matter for the Bank Executive. Mr Bailie said he was against settling because that amounted to saying to anyone else to go to a tribunal in a dispute. Mr Neill said that the Bank had acted extremely reasonably over a long period of time and employees were not disadvantaged. He was against settling.

MANAGEMENT OF THE BANK

Quarterly Financial Report
(Messrs Plenderleith, Clark, Bean and Smout in attendance)

In introducing the Quarterly Financial Report, the Governor welcomed Mr Smout to Court, in his new capacity as Finance Director.

Mr Smout presented the Quarterly Financial Report. In response to a question from Mr Hall about the asset value of the Printing Works, Mr Clementi said that the kit was worth something in excess of £10mn.

The Bank's Annual Report – in draft, together with a Resolution to form a sub-committee of Court
(Messrs Plenderleith, Clark, Bean, Footman and Smout in attendance)

Mr Footman noted the changes in the draft and also the issue of disclosure of BCCI costs. A clarification on page 5 of chapter 4 was suggested by Sir David Cooksey and agreed. Mr Footman agreed to a suggestion by Sir John Bond that banks should take advice on the question of declaring paid leave for local council work as a political contribution. Dame Sheila McKechnie suggested changes in the comments on the Financial Law Panel, gold, the euro and the staff survey, all of which the Governor said would be looked into. Ms O'Donovan said that it was perhaps a little pejorative to refer to a "clear" decision on the euro, because it might imply that the Government might come out with an unclear decision. Sir Brian Moffat noted that in Chapter 7 it was not explained why the take-up on training was less than expected.

In response to a question from Ms Blow, the Governor said that it had been decided that transparency was good with respect to BCCI fees, and the Bank should disclose them in the Accounts. There was a question about whether they should be included in the budget for the year, because in a sense they were outside the Bank's control. Ms O'Donovan said she would prefer to see BCCI kept out of the table and put in a paragraph underneath which explained why it had been excluded from the table. She also thought it was rare to show what an organisation was budgeting for the costs of a high-profile legal action. Mr Clementi thought that the Bank should work to a control total that reflected its costs, including BCCI. Sir Brian Moffat agreed. The Governor said that if the Bank overshot its budget because of BCCI it should explain that. He was rather relaxed about the treatment.

The Governor drew Members' attention to a Resolution to approve the establishment of a sub-committee of Court to meet and approve the Annual Report and Accounts on a date after Court had met in May, should circumstances make that necessary. As a contingency for this year, a meeting had been booked on Friday 17 May. The Resolution read as follows:-

TO RESOLVE:

that pursuant to Schedule 1 paragraphs 10 and 11 of the Bank of England Act 1998:

(i) a sub-committee of Court be hereby created and constituted, having powers and duties set out in paragraph (ii) of this Resolution, and consisting of the Governor, the Director of the Bank designated under subsection (4) of Section 3 of the Act to chair the sub-committee of the Court of Directors [the Chairman of NedCo], the Deputy Governor with responsibility for overseeing the preparation of the Accounts and the Director appointed chairman of the Bank's Audit Committee;

(ii) once Court has reviewed the Bank's draft Annual Report and Accounts, the draft Letter of Representation to the Bank's Auditors and the final tranche of the proposed payment to HMT, in lieu of dividend, to be paid the following October, in accordance with Section 1 of the Bank of England Act 1946, as amended, the sub-committee be hereby empowered, if Court so determines, to agree any necessary further changes and give approval for:-
  (a) the Report and Accounts to be signed and printed,
  (b) the Letter of Representation to be signed, and
  (c) the above-mentioned payment to HMT, in lieu of dividend, to be made at the appropriate time;

(iii) the Governor, the Chairman of NedCo, or the Secretary of the Bank may, in writing or by telephone, summon a meeting of the sub-committee at any appropriate time on giving such notice as, in his/her judgement, the circumstances may require, and the proceedings of any meeting be regulated as follows:-
  (a) the quorum shall consist of not less than three members but a member who is not present at, but is in communication with, a meeting, is to be treated as present at it;
  (b) the Governor, or in his/her absence, the chairman of NedCo, shall take the chair;
  (c) each member present, or regarded as being present, at the meeting shall have one vote and all matters shall be decided on a simple majority vote. In the event of a tie, the Chairman shall have a second casting vote; and
  (d) the Secretary or his/her Deputy or Assistant shall be present and take minutes of the meeting which shall be recorded in a book to be kept for that purpose and such minutes shall be produced at the meeting of Court following the meeting of the sub-committee;

(iv) the powers and duties of the sub-committee be limited to the matters specified in paragraph (ii) of this Resolution;

(v) the sub-committee be known as 'The Annual Report and Accounts Committee'.

The Resolution was APPROVED.

The Printing Works
(Messrs Plenderleith, Clark, Bean, Thompson, Footman and Smout in attendance)

Mr Clementi summarised his paper on the future of the Printing Works. He also drew Court's attention to a letter and paper from Mr Dubbins, General Secretary of the GPMU, representing the Unions at Debden. Copies had been circulated to Court. Mr Dubbins proposed commercialisation of the Printing Works within the Bank of England.

Turning to the nature of the supplier contract, if it were decided to choose the option of a sale, Mr Clementi noted that Govco believed that a seven year contract would be reasonable, exclusive in the first five years. This would provide a fair balance between the interests of the customers and those of the supplier and its staff.

Mr Clementi invited Court to consider the proposal outlined in the paper and if so minded to approve, subject to further consultation with the trades unions on this and the other options, the preparation and issue of a sale memorandum for the printing operations.

He noted that Mr Dubbins had put him on notice that the unions wished formally to request a meeting with Court to put their case before Court.

In response to a question from Dame Sheila McKechnie, Mr Clementi noted that if Britain were to join the euro area there would be a very big peak of bank note production for the changeover, whether or not Option B were chosen. The issue to consider was not that peak load but the continuing annual contract for banknotes. Mr Stretton, commenting on pensions issues, said he believed that the Bank should not be prepared to subsidise other companies' employees by the generosity of what it was prepared to do. He believed it was important that the Bank should take great care to avoid giving guarantees to support decisions that might be made by a subsequent employer. Mr Footman said that the proposals in the annex were intended to avoid giving guarantees that someone else could call in an open-ended way. The Governor said that the Bank would look again at the points arising from the comments by Mr Stretton and Dame Sheila.

In response to a question from Mr Bailie, Mr Clementi said the taxpayer would benefit in terms of the costs of the notes if the Bank were able to drive a hard bargain on Option B. Mr Bailie said that he thought the proposals for the length of the contract under Option B were good. He did not however believe that it was necessary to create eleven new jobs within the Bank if Option B were chosen. Sir Ian Gibson agreed with Mr Bailie that he was uncomfortable in offering better than TUPE terms. He also agreed with Mr Bailie that the total of eleven new jobs was excessive. Turning to the suggestion by the unions that the Bank should own an operation competing with the private sector, Sir Ian said that there might well be opportunities but the Bank was not in a position to run a printing business competing with the private sector. The Governor noted that competition with the private sector had always been severely constrained, as it had also been with banking services. Mr Neill said that the Bank did not have a statement in its core purposes that it wanted to be a world class manufacturer of notes, so in his view the answer was that the unions' solution was not an option. He also believed that it was proper to protect pensions but the Bank should not go further than it needed to, because it would affect the proceeds of the sale.

Commenting on the request from the unions to make a presentation to Court, he said Court should be unambiguously clear that in no circumstances was that acceptable. This was a matter for executive management. After further comment from Members of Court the Governor noted that support for Mr Neill on this point was universal.

In response to a question from Mrs Francis, Mr Clementi said that it was very uncertain whether European procurement rules applied to central banks. No other central bank had followed them in respect of note printing contracts. Mr Clementi said that if Option B were to be chosen the Bank of England intended to follow the spirit of the rules with an open process and an auction which would be open to everybody. The Bank would be much closer to complying than other central banks. Mrs Francis noted that in the Annual Report no timescale was attached to the period of continuation of printing at Debden. Mr Clementi said that it would be made clear that the commitment would be for the period of the contract only. The Governor agreed that it was necessary to look at the Annual Report language to pick up Mrs Francis' point.

In response to a question from Ms O'Donovan about the Bank's response to Mr Dubbins, Mr Clementi said that the Bank had been consulting the unions and would consult further with the unions on the two options proposed in the paper. In addition he wanted to talk further with the Unions about the options set out in the paper for Tony Dubbins.

Sir Howard Davies said that, given the background of excess capacity in the banknote printing industry a sale under Option B to a financial buyer which might be a short term holder of the business would be sub-optimal. The Governor said the Bank would take note of that point.

Mr Plenderleith, responding to points made about the proposed increase in staff in the Bank if Option B were chosen, said that the Bank had been through this very carefully, and about half of the eleven would be in quality assurance. Mr Bailie said the cost to the Bank would be a saving to the Printing Works, and that should be in the price. The Governor said the Bank would look at that issue as it went forward, if Court approved the next stage of exploration. He asked Court, having considered the proposal, to approve, subject to further consultation with the trades unions on all the options, the preparation and issue of a sale memorandum for the printing operations.

Compliance with Turnbull
(Messrs Plenderleith, Clark, Bean, Footman, Butler, Thompson, Smout and Hitchins (PricewaterhouseCoopers in attendence)

In the absence of Sir Neville Simms, Mr Clementi noted the points made in Sir Neville's letter. They would be taken into account when the Bank looked at the way the Turnbull exercise was conducted the following year. Since the letter was written, Mr Clementi had decided to include examples of the 10 key risks. Mr Hitchins said there were some issues that the Auditors would take to the Audit Committee in terms of areas that could be improved upon, but they were not of a magnitude to affect the Report to Court. In response to a point made by Ms O'Donovan, Mr Hitchins said that the words "not inconsistent" in the PwC letter were chosen because the audit had not been finished, and would be changed to "consistent" when that had been done. Sir Ian Gibson commented that the Turnbull document was a good piece of work. Mr Hall said he was impressed by Annex 5, which showed where problems had appeared over the year. The Governor said his sense was that, on the basis of the report on Turnbull issues it had just discussed, Court would have no difficulties signing off the Annual Report.

Court was CONTENT.

There being no other business Court was up.

David Corker

Peter Rodgers
8 May 2002

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 8 MAY 2002

<u>Present</u>:

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
Mr Hall
Dr Julius
Mr Morris
Mr Neill
Ms O'Donovan
Sir Neville Simms
Mr Stretton

<u>Absent</u>:

Sir John Bond
Sir Ian Gibson
Dame Sheila McKechnie
Sir Brian Moffat

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

MONETARY STABILITY ISSUES

The economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Plenderleith and Bean, together with Ms Barker and Mr Allsopp in attendance)

The Governor expressed his appreciation and thanks on behalf of Court for the considerable contribution made by Dr Wadhwani (not present) to the work of the MPC.

In introducing the MPC Report to Court, Mr Bean said that the international economy continued to recover from the slowdown in 2001. The rebound in US GDP largely reflected the unwinding of previous destocking. Mr Bean said this was not something that would sustain recovery going forward and that the MPC continued to expect US growth looking ahead to be more moderate. There continued to be concerns about the extent of the capital overhang in the corporate sector and the level of household indebtedness, which were risks to a sustained recovery. In the euro area, recovery was progressing although consumer price inflation seemed entrenched towards the upper end of the ECB's target range. Some wage pressures could emerge if the current unrest in the labour market continued.

Turning to the UK, Mr Bean noted that growth in the first quarter was weak and the earlier pick-up in manufacturing activity had not been sustained in March. Survey information was more positive, in both the manufacturing and service sectors. On the demand side, the underlying trend in consumer spending remained quite strong and there had been a great deal of media commentary about the strength of house prices. The main domestic news over the past month had been the Budget. The increase in government spending amounted to around 1% of GDP rising to 2% in future years. The increase in taxes was partly predicated on an assumption of higher GDP growth driven by faster population growth, as well as the increase in National Insurance contributions (NICs). An issue for the MPC was the extent to which higher NICs might lead to increased wage claims by employees and price pressures from companies seeking to pass on the extra costs. Mr Bean added that, although the increased government expenditure and taxation were largely offsetting, there might be an impact on aggregate demand in view of the lower propensity to import from government spending relative to consumer spending. On the labour market, he said weak earnings growth continued to reflect bonus effects.

Turning to financial markets, Mr Plenderleith said that the main development over the past month had been the weakening of the US dollar. This had not been severe but was notable nonetheless. He said it appeared to reflect a number of factors – some shift in sentiment about near-term US recovery prospects; a reaction to a number of disappointing corporate results; a focus on the persistent imbalances in the US economy; and revisions to views about the medium term outlook for the US. The question was whether this was a readjustment to a more realistic level for the US dollar or a more jaundiced underlying view of US long term fundamentals.

Alongside this development, sterling had strengthened against the dollar but had weakened slightly against the euro, leaving the sterling effective exchange rate largely unchanged. This was a positive development in view of the UK's own economic imbalances. At the same time, there had been some easing in yield curves and equity markets were softer. This suggested financial markets were becoming more cautious about economic prospects, more in line with market economists who had previously been overly pessimistic.

Mr Allsopp said that it was difficult to assess the impact of NICs. He thought the effect would differ from sector to sector, so he was interested to hear comments from Court. He was also interested in any thoughts about current consumer behaviour.

Mr Bailie suggested that company responses to higher NICs would, in part, depend on capacity pressures across different sectors. He said large retailers were already seeking to offset increases by seeking cost savings from suppliers. In his view, few firms would be expecting to pass on increases to consumers but rather they would look at their own costs. Ms Blow said there was an expectation amongst some labour intensive services firms that around 50% of the cost increase might be passed on to customers, but there was no particular reasoning for this.

Mr Neill said most firms would try to squeeze suppliers but there would be long lags given existing contracts which would not have clauses anticipating such increases in costs. He said sectors such as banking, insurance and legal services were more likely to pass increases on to customers but elsewhere competitive conditions would not allow this. Mr Neill added that business opinion was sceptical that the extra resources for the health service would result in improvements. He said he had been struck by a chart shown at the recent pre-MPC meeting – which he had attended – showing no productivity growth in the public sector over a prolonged period.

Sir Neville Simms commented that construction activity remained strong with lengthening delivery times and rising costs evident. But the order book was weakening and public sector spending remained subject to delays. He said the imposition of the tax on aggregates was more significant for the sector than higher NICs.

Ms O'Donovan said firms producing industrial products were unlikely to pass on the cost of higher NICs. The Governor asked if higher NICs would impact on employment and Mr Clementi asked if it was likely to influence choices about where to increase and reduce capacity around the world. Ms O'Donovan said it might be a consideration in due course given that there had been no wage pressures over recent years and price contracts did not accommodate these kinds of cost increases. Ms Blow added that it would add to a continuing process of reducing employment via automation and in that sense it was more of the same.

Mr Hall said businesses would need to look at their total labour costs and seek offsetting savings. Sir David Cooksey suggested that some firms were planning to reduce staff numbers. He added that many businesses in the venture capital sector were claiming tax credits to the extent that he questioned how realistic the Inland Revenue's £400 million limit was likely to be.

Mrs Francis said there was some downward pressure on wages to offset higher NICs in the insurance sector. In relation to consumer demand, sales of pension and savings products remained buoyant. Insurance prices were levelling off though lack of capacity in the sector remained an upward pressure on prices. Mr Bean asked Mr Morris about the potential impact of higher NICs on wage claims. In reply, Mr Morris said there was little sense it would feed into wage demands. Workforces were more concerned about the prospects for recovery in the manufacturing sector.

FINANCIAL MARKET OPERATIONS

Current Issues
(Executive Directors in attendance)

Turning to current issues in the Financial Market Operations area, Mr Plenderleith drew Court's attention to the launch of the new £5 note on 21 May. He reported on progress with the C21 project. Having adjusted the timetable (previously reported to Court), good progress had been made and the team was on track to start trialling the new banking system shortly.

Mr Plenderleith also reported the publication on 16 May of a new booklet on the Bank's money market operations. This would update the existing publication and bring together material explaining the Bank's work in this area.

The Governor noted that this would be Mr Plenderleith's last appearance at Court. He said he had greatly appreciated Mr Plenderleith's service to the Bank over many years and expressed his many thanks on behalf of Court.

FINANCIAL STABILITY ISSUES

Domestic developments and international issues (Executive Directors in attendance)

Mr Clark drew attention to the key points in his note to Court. It covered the latest position on Argentina; progress in discussions about the international financial architecture – where he mentioned Mr Haldane's involvement with the IMF's recent work; the IMF's second mission to undertake the UK's Financial Sector Assessment Programme – which was mostly concerned with regulation and particularly the tripartite arrangements between the FSA, Bank and HMT. Mr Clark also summarised his note on the issue of FRS17 in the light of Court's interest in the subject at the April meeting.

In relation to FRS17, he said there was not unanimity of views about the impact of the new accounting standard. Further work was required in relation to the future provision of pensions and the impact on the corporate sector's financial position. He had talked to the Accounting Standards Board, and had stressed the issue of EU accounting standards overtaking national standards in due course and the need to ensure a smooth transition between regimes.

Dr Julius enquired about the relationship between FRS17 and the planned ending of the minimum funding requirement (MFR) and asked if they were offsetting pressures. Mr Clark explained that FSR17 was about disclosure rather than funding per se. It reflected a recognition about future asset yields and likely demographic changes alongside the size of future liabilities. In this sense it was a more fundamental issue than changes to funding arrangements.

Sir Howard Davies said the removal of the MFR had not been brought to a conclusion because it was linked to the discussion on the European Pensions Directive. This was now reaching a conclusion. He agreed that the issues surrounding FSR17 were more fundamental.

Sir Neville Simms said he felt some of the emphasis of the Bank's work should be on the impact on capital markets and how funds were likely to be allocated in response to these changes. Mr Clark said that, initially, the consideration had been to assess the potential for large company deficits in the short term but that did not appear to be a large issue on the whole. The Financial Stability area was now considering the demand effects in financial markets over the longer term.

Ms O'Donovan said the issue for companies was not with disclosure itself but rather the impact the new standard was having on the speed of change. She was concerned that it was inducing an overly rapid response to a long term funding issue. A steadier pace of adjustment was desirable. Sir David Cooksey said FRS17 was a catalyst for the private sector, but not the public sector. He also said little attention had been paid to the representation of the Accounting Standards Board. The credibility of the ASB would be questioned if it was not a broad representation. Sir David said he was concerned about the impact of FRS17 on the supply of higher risk equity finance, which had been an important motor of economic growth. There was some evidence that the supply was drying up. Mr Stretton said changes to current pension arrangements would have a long-term effect just as current pensions reflected what was done in the 1960s and 1970s. Although the move away from final salary schemes may be a rational response to expected future returns, the result would be a lower level of savings for pensions. But this would not impact on retirement incomes for some 20 or more years.

The Governor added to Mr Clark's remarks on recent progress in the debate about crisis prevention and resolution following the IMF/G7 meetings in Washington. He said he was encouraged by the outcomes given the earlier lack of progress. In particular the US position was now more favourable on issues such as presumptive lending limits for countries and how the private sector might respond when a country could not honour its borrowing commitments. The Governor said the Bank of England and the Bank of Canada had been influential in the debate, in particular in gaining the support of the ECB.

EXECUTIVE REPORT
(Executive Directors in attendance)

The Governor mentioned that he had recently chaired the AGM of the Bank's Sports Club and had been asked to convey to Court the Club's appreciation for the support it had given to the

Club. He also said that Members of Court should by now have received copies of the Club's latest Annual Report and Accounts. Also in connection with the Sports Club, he reminded Court that Governor's Day would be held on Sunday 21 July, invitations to attend had been posted and he hoped as many Members as possible would be able to join him.

The Governor noted the Report on gender equality by Opportunity Now and also the receipt of a Gold Performance Award for the first time. He asked that the Report be circulated to members of the Court.

Mr Clementi reported on the BenefitSelect Tribunal, noting that the charge of constructive dismissal had been dropped, but the hearing continued on unfair dismissal, claimed by six people, and on a technical issue related to consultations with the unions.

Mr Clementi noted that the Bank was continuing to work on the preparation of a sales memorandum for the Printing Works and was involved in lengthy consultations with the unions about the options.

Mr Clementi also noted that Mr Butler, the Auditor, was moving to a new job and it had been decided to look both internally and externally for a replacement. The post would be advertised.

Mr King noted that Mr Beverly was to retire at the end of the year as Agent for the South West, which gave an opportunity to think about the structure of that Agency. An office would be set up for the new Agent in Exeter, leaving the Deputy Agent in Bristol, and this would make it much easier to do a proper job serving Devon and Cornwall. Mr Butler was by far the best candidate for the Agent's job, and had been appointed. He had been the Birmingham Agent before becoming Auditor. The present Deputy Agent would continue in Bristol. Mr King noted that there might be a need in the future to discuss whether this or another Agency might need an extra Deputy Agent. Sir Neville Simms said that Mr Butler had done a first rate job as Auditor and had got his teeth into the issues he inherited 5 years ago. Mr Bailie said that the view of the business community in Northern Ireland was Mr Falls, who was also due to retire, had done a excellent job, and the Bank was held in very high regard. The Governor said he would pass both points on.

MANAGEMENT OF THE BANK

The Bank's Report & Accounts, together with a Report from the Chairman of the Audit Committee
(Executive Directors, Messrs Smout, Darbyshire, Butler, Glover and Hitchins (PwC) in attendance)

The Governor welcomed Mr Hitchins from PricewaterhouseCoopers to Court. He said that the draft Report and Accounts took on board comments made at Court the previous month. In Members' folders there were copies of 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 in response and a letter from Freshfields covering statements on BCCI.

Mr Clementi noted a number of changes in wording on pages 27, 30 and 35, inserted since Court last saw the Report.

Court was CONTENT.

Turning to the Accounts, he said that there were a small number of changes to the figures, and a schedule of these was in the folder, but none were important.

He turned to a number of key issues on which GOVCO and the Audit Committee had spent time, or which were related to formal opinions from members of Court. These included changes to the wording on responsibilities of Directors; the profit and loss account; the dividend; the balance sheet, including the effects of the increase in the Euro Note programme compared with the previous year; a cash flow statement, which he believed was meaningless for a bank; the adoption of FRS18; the increase in provision for Court Pension as a result of a change in the assumptions by the actuary; the explanation on page 67 of the application of FRS17; the FRS13 disclosures on pages 71 – 75; the valuations of the investments in the BIS and the ECB on page 80, which were deemed to be by members of Court; the statement by members of Court on non consolidation of very small subsidiaries, of which the main one was the holding in Minories Finance, set out on page 81; the disclosure that no Director had any significant interest or arrangement with the Bank on page 88, on which point he assumed that each Director had read the paragraph and satisfied himself or herself with it; and finally the statement on BCCI on page 89. He also noted the Letter of Representation to

PricewaterhouseCoopers, which went back to the issue of FRS18, and a comfort letter on the same subject received from PwC.

The Governor invited Sir Neville Simms to comment on behalf of the Audit Committee. Sir Neville noted that the Committee had spent more than 3 hours at its last meeting discussing the Accounts, including the balance sheet, the Auditors Report and programmes for the future. He said that the Report to the Audit Committee by Mr Ingram had been excellent, and the committee had had a long discussion with him and with the Auditor, and PricewaterhouseCoopers. The Committee felt that the whole subject of risk was now better understood and better managed. The Committee then took a detailed report from the Auditor and reviewed the plan for 2002/2003. It asked for certain additional reporting for the future. Although the Management response was not part of the Audit Committee's pack, he now had a copy. The Committee was broadly content. He wished to leave in Court's mind the high importance of the C21 project, which should move the Bank forward and greatly assist in the modernising of its systems.

Turning to the Accounts, he noted the importance of the BCCI issue. The Audit Committee had invited the Bank's barristers and solicitors to its meeting. The conclusion of quite a long discussion was that the Audit Committee was confident in the use of the phrase "the Bank had a strong defence." He agreed with Mr Clementi that the wording in the note to the Accounts was in fact less strong than the lawyers had put the point to Court. The Audit Committee had also considered whether a provision should be made, and its conclusion was that there was no need for one. Turning to the phraseology of the quantification of the claim against the Bank, which was in the words of the Claimants, his opinion was that it was correct, and reflected what they were saying. He noted the letter from Freshfields, saying they were content with the wording.

Sir Neville noted that Mr Darbyshire had led a discussion on FRS17. He also noted that the Audit Committee had been content with the provisions. The Governor offered his thanks to Sir Neville and to the other members of the Committee for their terrific work.

Mr Hitchins said that he had nothing to add. In response to a question from Mr Neill, Mr Clementi, Mr Plenderleith and Mr Smout noted reasons for the substantial changes in profits and cash between the current year and the previous one. The Governor agreed with

Mr Neill that he was right to draw attention to the need to give a coherent response in layman's terms to questions about these changes. The Bank should have a very clear explanation ready if asked. Mr Neill said he was content if the Bank handled it that way, rather than re-drafting the Report. Dr Julius agreed that it would be helpful to have a few sentences explaining the year - on year comparisons. The Governor agreed with Dr Julius that the Bank would check whether it would be necessary to refer in the Report to her employment as a member of the Monetary Policy Committee during the financial year as an arrangement or interest.

Mrs Francis asked whether the opinion on BCCI should refer to the fact that this was on the basis of advice received. Mr Clementi said it would be very surprising if Court had not taken legal advice and it would always be assumed that that was the case. He did not believe there was a good reason to change the wording. Mr Neill, Sir David Cooksey, Sir Neville Simms and Ms O'Donovan agreed. Mrs Francis said she was content to stand by the general view on the subject.

Mr Clementi agreed with a point made by Ms O'Donovan that Mr Goddard of Freshfields had been asked to address his letter to the Directors, and had not, and had instead sent it to the Bank.

Following a suggestion by Sir David Cooksey, the Governor agreed that the sentence on page 38 at the end of the paragraph headed "actual spending in 2001/2002" could be taken out. The sentence to be removed read " Lower interest rates reduced the cost to the Bank of pensioner Benefits." In response to a question from Mr Hall, the Governor said that the report would be published on 23 May. The Governor asked Court whether it was prepared to agree that, subject to resolving a number of small points outside the meeting, the Report and Accounts could be signed and printed, the Letter of Representation be signed and the final payment of £21,396,000 to HMT on 4 October, should be made in lieu of dividend. He noted that if anything arose ex post facto, it would be reviewed on 17 May at a sub committee of Court.

Court APPROVED the sign-off process.

Court Pension Scheme – annual adjustment
(Executive Directors 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, invited Mr Neill, in his capacity as a Trustee 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 Members of Court be increased, with effect from 1 July 2002, by the amount of the increase in the Retail Prices Index for the twelve months ended 31 May 2002.

b) similar increases be granted from 1 July 2002 to:

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

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

   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.

The Houblon-Norman Fund Report
(Executive Directors in attendance)

Mr Bean reported on the work of the Fellows. He noted that for the year 2002/2003 two senior Fellowships had been awarded; they were to Professor Francesco Giavazzi, Professor of Economics, Bocconi University, Milan, who would research the impact of structural reform in product and labour markets, and the conduct of macro economic policy in EMU. The second senior Fellowship was to Professor Kenneth West, Professor of Economics, University of Wisconsin researching exchange rates and monetary policy. A Fellowship had been awarded to Doctor Richard Roberts, reader in Business History, University of Sussex, researching the breakdown of the Bretton Woods system, 1971 – 1973. Mr King noted how well Mr Bean had done in encouraging good people to come to the Bank on fellowships. He also noted the difficulty of finding both older and younger stars in the profession in the United Kingdom because so many had left for the United States, attracted by the much higher academic salaries.

Report from the Chairman of the Remuneration Committee (Executive Directors in attendance)

The Governor noted his interest in his salary, which had been automatically increased in each year of his second term.

In his capacity as Chairman of the Remuneration Committee, Mr Neill said that he would like to make recommendations to Court on behalf of the Committee. He said that the Remuneration Committee was proposing that Dr Wadhwani be paid the equivalent of three months MPC remuneration for the three months purdah period. Although Dr Wadhwani had not accepted an appointment which could have commercial significance, it could be deemed that he had avoided taking up any offers due to the market sensitivity of his work on the MPC.

Turning to the appointment of Marian Bell, who had replaced Dr Wadhwani on the MPC, Mr Neill said that she would be working a three day week, and it was proposed to offer her the standard 3/5 contract of £82,788 p.a.

Mr Neill said that the Governors' salary was due for review on 1 July, and under the arrangements agreed at the start of his second term, it should be increased by 2.5% to £256,832.

Court APPROVED the recommendations.

Any other business

The Governor noted again that this would be the last attendance at Court for Sir Neville Simms and Mr Plenderleith. He thanked Sir Neville for his work as a Director and particularly for his great contribution to the Audit Committee. He reminded Members of Court that there would be another chance to thank them at the farewell dinner on Thursday 30 May.

Court was up.

19 June 2002

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 19 JUNE 2002

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
Mrs Francis
Sir Ian Gibson
Mr Hall
Dr Julius
Mr Morris
Mr Neill
Mrs Powers-Freeling
Mr Stretton

Absent:

Sir John Bond
Sir Howard Davies
Dame Sheila McKechnie
Sir Brian Moffat
Ms O'Donovan

The Governor extended a warm welcome to both Mrs Powers-Freeling and Ms Bell at their first meeting of Court.

The Governor explained that Mr Allen was unable to attend Court and so the report on Market Operations would be taken at a later date.

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

MONETARY STABILITY ISSUES

The economic and monetary discussion, incorporating the monthly MPC Report to Court and international economic developments
(Messrs Bean, Clark and Bailey together with Mr Allsopp, Ms Barker and Ms Bell in attendance)

In introducing the MPC Report to Court, Mr Bailey presented his paper on International Economic Developments. He said the world outlook had not changed much over recent months and the outlook for the US may have remained one of gradual recovery, as it did for the euro area. He outlined how recent developments in the US interacted with the exchange rate though he shared the MPC's view that causes of recent exchange rate movements were difficult to judge. In relation to the UK economy, Mr Bean outlined the main developments in the data over the past month. A number of data puzzles were present, notably the absence of growth in the first quarter, as measured by the ONS, alongside more upbeat business surveys, information from the Agents and employment data. He noted that there had been misleading media reports about house prices. He also said a fall in the annual rate of RPIX inflation in May had been expected but not by as much as the outturn (1.8%). The MPC would need to consider if there was any news in the data for the inflation outlook.

Turning to the financial markets, Mr Bean said exchange rate and equity price changes had been the main developments over the recent period. The sterling ERI had fallen by around 2% from its recent peak. The fall in the value of the dollar against the euro seemed to reflect both equity market developments and weaker US recovery prospects. Falls in equity prices in part reflected concerns about corporate accounts and governance in the US as well as concerns about the extent to which productivity growth would translate into profitability. In the UK, FRS17 had also been a factor.

Sir Ian Gibson reported that US car sales had fallen of late. Inventory levels had reached 60 days again and the outlook suggested they might reach 65 days – their level prior to the recent bout of destocking. European sales were likely to fall back this year, particularly in Germany. Car output would consequently be scaled back in the second half of the year. Japanese consumers continued to trade down to smaller models although Japanese production for the US market remained high.

Dr Julius said a continuing US equity market adjustment might imply a further fall in the value of the dollar. She asked if the Bank had undertaken work on equilibrium dollar exchange rates. She added that the puzzle between stagnant output and rising employment might be explained by higher public sector employment. Mr Bean said that was part of the story but he noted that average hours were also rising, including in the manufacturing sector. Mr Bailey agreed that the dollar might fall further with equities. He said measures of equilibrium exchange rates were hazardous and different concepts could be employed. A short-run equilibrium measure might suggest that the dollar was not overvalued in the light of recent productivity growth. But over the longer term that was unlikely to be sustainable in which case a long-run equilibrium measure might suggest the dollar was overvalued to a greater degree.

Mrs Powers-Freeling said retail demand had fallen in May compared with April, although 'home' sales had held up. Although sales to date in June had picked up, growth appeared to be on a different trajectory over the recent period compared with earlier in the year. On the consumer lending side, she noted a shift from personal loans to credit cards, perhaps reflecting some shift in confidence.

Ms Blow asked if there was a lack of confidence in ONS productivity estimates. Mr Bean said the data were odd but reflected higher employment alongside flat output. A Lloyds/TSB survey – based on CIPS survey measures – showed rising productivity. He did not, however, think the methodology used by the ONS was inferior to other countries. There were genuine difficulties involved in measuring service sector output, something the ONS was actively working to improve.

Mr Bailie said manufacturers' confidence had fallen since March, largely because of the impact of Budget proposals for National Insurance contributions. Service sector companies seemed more expectant that they would be able to pass increases on to customers. Manufacturers did expect positive growth ahead. Investment would remain weak though that was allowing debt levels to fall. Mr Bailie added that tourism demand in the UK was flat year-on-year. This contrasted with growth in national TV advertising, which was expected to record growth of 5% compared with a year earlier in July and August, based on forward bookings. An even stronger picture was emerging in the US (+16% anticipated in 2002 Q3) as multi-nationals started to increase spending. Mr Neill said UK car sales had been flat to date in June.

Mrs Francis said there were important questions relating to the longer term prospects for equity markets. The outlook was unlikely to be one of strong growth as in the past, yet lower growth would take place alongside increased calls for private pension provision. Mr Bean said there was a short term question about further falls in equities, particularly in the US. Over the longer term, the increased supply of funds to the market should boost share prices. At the same time, there might be a fall in the required rate of return which would be positive for companies though raised issues for pension provision.

Mr Morris said it was a concern that investment had not picked up at this point in the cycle. Mr Bean said the MPC hoped to see the recovery in exports leading to some increase in investment, alongside moderation in consumer demand. Mr Hall commented that it would be useful to look at regional development agency strategies when they are published in September. This would provide a view of how regional investment would be managed within the overall economic outlook. He said the Government was committed to aligning its policies with regional strategies for economic development.

FINANCIAL STABILITY ISSUES

FS Review together with domestic developments and international issues (Messrs Clark and Bean in attendance)

Mr Clark introduced his half-yearly review paper on FS's activity. First, he noted that the FS area had existed in its present form for around five years. Over that time, one objective had been to increase the research output of the area. In broad terms, he envisaged that 25% of the area's resources should be allocated to such work. The effort was being supported by a number of external academic consultants, including Professor Charles Goodhart. A second priority issue was to develop and reinforce the relationship with the FSA. The relationship operated at many different levels; but it was important that close contact between the two institutions became a habit of mind among staff generally.

In relation to the forthcoming publication of the FSR, Mr Clark said that a round-table meeting with market practitioners would take place immediately following publication. He noted that amongst current issues were high levels of corporate and household debt, fragility in equity markets and a deteriorating situation in several emerging markets. In relation to equity markets, there was a concern that regulatory rules should not exacerbate the position. Mr Clark said that the FSA was alert to the issue. He added that there were distinctions between the impact of equity prices over the near term and the longer term. In relation to the latter, the Bank had contributed to an FSA study on the effect of an ageing population. A Bank working paper would be published shortly.

Mrs Francis said that the life insurance sector was at the heart of equity market developments and was subject to stringent solvency rules. She said that the FSA's 'resilience test' was being applied flexibly. But she was concerned that addressing the problem of falling equity prices could itself add to the problem, given market sentiment. The Governor said that if the FSA relaxed the tests again, that would be the third occasion since September 2001. He said this raised a question about how sensible the process was. He was aware that the FSA was considering alternatives. Mr Clark said the resilience test was an example of a regulatory rule which made sense when applied to one institution in isolation but which could give rise to perverse results in aggregate.

Mr Stretton said a key question was how resilience tests should respond to events. Mr Clark said there was also a question about what constituted an 'excessive' market movement. Dr Julius asked if there were any lessons from the Japanese insurance sector, which seemed to have avoided systemic collapse. Mr Clementi said this largely reflected the presence of government guarantees. Mr Clark added that is also reflected an acute lack of transparency.

EXECUTIVE REPORT
(Messrs Bean, Clark and Footman in attendance)

Mr Clementi drew Court's attention to his paper on internal budget authorities for spending limits on projects and the new arrangements it proposed. Court noted the new arrangements as set out in the paper.

Mr Clementi said he had planned to tell Court about the BenefitSelect tribunal case but had now heard that it would be several more weeks before the Tribunal adjudicated, and he would report to Court when it had.

Mr Clementi described developments since April with respect to the Printing Works including detailed discussions with the unions on 9 May and 27 May. The second meeting took a paper prepared by the Bank which set out some of the concerns of Court on how far a company owned by the Bank of England could compete with the private sector. Another meeting with the unions was planned for the Friday after Court. It was important to continue with these meetings. He noted that the unions continued to have a strong preference for Option A. This was interesting since there was a recognition from the Union that the long term viability of the Printing Works (with one product and one customer) was in doubt. The Bank was working on the sales memorandum, which it expected to send out in the next few days to a small number of interested parties, to obtain feedback on the three criteria by which a decision would be made: the effect on quality and security of notes; the effect on staff; and the effect on prices of banknotes. No decision on option B could be taken until we had received this feedback. Responses were expected between August and October and it was anticipated bringing the matter back to Court for a final decision towards the end of the year.

In answer to a question from Mr Bailie, Mr Clementi said there were four or five serious expressions of interest and a small number of others, about which the Bank was doubtful. The Bank might not send the memorandum to the latter category, which comprised venture capital firms, because of insufficient confidence that they knew enough about printing, and the possibility that they would have difficulty meeting contingency planning requirements. Mr Neill said that, while not making a case for venture capital involvement, having some venture capital firms in the contest might help the Bank get better proceeds from any sale, if one went ahead. The Governor said the Bank would bear that in mind.

Mr King introduced the Bank's pamphlet on the benefits of low inflation, which was written for business people, and was the latest contribution to the programme to build a constituency for low inflation. The reception to the pamphlet would be monitored, there would be feedback from the Agents, and any feedback from Court would be extremely helpful. The pamphlet was an experiment, but if it succeeded the Bank might move on to thinking about what other pamphlets could be produced to get across the importance of low inflation. In response to comments by Mr Neill, Mr King said that in future more use might be made of questions and answers, perhaps in briefer material circulated for a limited time, to meet issues arising at particular points of the cycle.

MANAGEMENT OF THE BANK

Annual report on the Printing Works
(Messrs Bean, Clark, Thompson and Ms Lowther in attendance)

Mr Thompson introduced his paper on Debden Security Printing. There were no questions. Mr Thompson then introduced his report on the Printing Works. He noted the problem that had occurred with the ink used to number the new £5 note. He described proposals to fix the problem by changing the process, putting varnish over the numbers; he also explained why it had been decided to do it the other way round with the new note. Mr Thompson said he expected to be able to re-launch the £5 note towards the end of July or in August. Of the 200mn notes already produced, all would be salvageable, because they would dry with time. Initial trials indicated that the ink fully cures at a temperature of around 35 degrees centigrade for approximately a week. The worst case cost would be less than £200,000.

The Printing Works was still analysing the lessons. In the short term, extra controls were needed over the new process. In the longer term, more thought had to be given to making systems for the introduction of new products more rigorous. In answer to a question from the Governor, Mr Thompson agreed that without the varnish on the notes there would not have been a problem. It required a different ink for the varnish. In response to a question from Mr Hall, Mr Thompson said it was likely in practice that the cost would be considerably less than £200,000 and the Printing Works would expect to make that up.

Mr Neill noted that it was possible to rub the ink off Scottish notes with great ease. He also noted that one of the lessons learnt from Japan was that when problems arose they should be used as an opportunity to improve the business. In response to Mr Neill, Mr Thompson confirmed that the Printing Works was moving towards Six Sigma. Mr Bailie extended his professional sympathy as a printer. He was very aware of many of these problems. He believed this one could be sorted out. He noted that the public would try hard to rub off the number when the new notes were issued. That had to be dealt with from a public relations perspective. He agreed with Mr Thompson that putting the varnish on after printing the numbers was better. One option could be to switch to non-sequential numbering, so the Bank would record the numbers of the sheets that had been destroyed. In response to another question from Mr Bailie about the indestructible nature of the varnish, Mr Thompson said that the Bank shredded old notes. Ms Blow also commiserated, and noted the management challenge for the Printing Works, and the uncertainty hanging over the Printing Works. She asked what might go wrong if morale fell. Mr Thompson said that the £5 problem could not be blamed on such issues. Sir Ian Gibson, who also sympathised, said he was inclined to agree with Mr Thompson that Six Sigma should be introduced a bite at a time rather than too quickly. He noted that the UK had a worse record than Germany and Spain even among multinationals on new product launches. He suggested that the Printing Works should look at some of the work the DTI was doing through the Regional Development Agencies on the question of new product development. He also believed that it was important for the sake of the Printing Works that the Bank should reach a conclusion quickly about the future of banknote printing.

In response to a question from Mr Hall, Mr Thompson said that Printing Works health & safety standards were among the best he had ever come across and were getting better. Mrs Powers-Freeling noted that her organisation was initially a distributor of the new £5 note and she asked whether there were any distribution and supply issues arising. Mr Thompson said there should not be, because the relaunch would not take place unless it was clear these had been resolved. An issue that was being checked was third party machine vendors. Ms Lowther said there was a trade-off between getting the notes back out as soon as possible and being 100% safe. The Bank was working very closely with the main issuers to ensure they had a supply of existing notes and, at the moment, it was comfortable. In the timescale the Bank was talking about supply should be acceptable.

Dr Julius said she commiserated with her business hat on, but as a member of Court her reaction was that she was disappointed at the outcome and she also saw it as relating to the future of Debden. Quality would be a key consideration for Court to look at. The matter also related to the general reputation of the Bank. In other areas such as gold sales and the management of foreign exchange reserves, there was a contribution to the reputation of the Bank. This case was disappointing because it went in the other direction. Mr Stretton believed the Bank had got off comparatively lightly in the press. It looked to him as if it had been well handled. He assumed the Bank was looking at the lessons learned, with a post-mortem. The Governor noted that with respect to the media it was a game of two halves and the Bank was at half time.

The Chief Cashier's Report
(Messrs Bean, Clark and Ms Lowther in attendance)

Ms Lowther introduced her report, and drew particular attention to the scale of changes taking place in her area. The Governor invited questions and comments, and there were none.

The Bank's Insurances
(Messrs Bean, Clark, Smout and Evans in attendance)

Mr Smout introduced Mr Evans, who reviewed his paper. Mrs Francis said the Bank's experience of higher premiums for lower cover was not unusual. The situation on commercial insurance rates derived from a number of factors. The industry was very cyclical and competitive. It was not making a high rate of return. But if prices were rising excessively then there would eventually be undercutting, and that did not seem to be happening at the moment. This was probably the worst year, because of 11 September, and there may be some flattening out or reduction in premia going forwards. Mr Hall said there was a case for looking at self insurance particularly for directors and officers and vehicles. He also asked whether the rise in premia affected the case for offshore captive insurance vehicles. Mr Evans replied that the issue of captive insurers had been looked at before. He would look at it again, and also at whether cover was indeed necessary for small insurances such as directors and officers professional indemnity at DSP. Mr Neill said that if other industries faced such increases they would take costs out of their supply chain. Such huge increases in premia represented a very aggressive attitude to customers. Mrs Francis said that, as had been seen in the earlier discussion about house prices, there was a difference between rates of increase and actual levels. If levels were examined at the moment it could be argued that the premium of £123,000 in 2001/02 was very low. Mr Evans agreed, and suggested it might have been as a loss leader. In response to a question from Sir David Cooksey, Mr King said that household insurance showed up directly in RPIX, and other forms of insurance showed up indirectly through increased costs.

Domestic Matters
(Messrs Bean and Clark in attendance)

Turning to matters of a domestic nature, the Governor said that following the departure of Sir Neville Simms it was appropriate to consider revisions to the membership of the Bank's Standing Committees. He drew attention to a note in folders detailing proposed revisions to Court's Standing Committees together with a Recommendation relating to a proposed change of directorship for one of the Bank's subsidiaries, Bank of England Nominees Ltd, following the retirement of Mr Plenderleith.

On the Committees, he proposed that:-

Ms O'Donovan replaced Sir Neville Simms as Chairman of the Audit Committee and Mr Stretton moved across to Audit from the Remuneration Committee, and, to return the Remuneration Committee to full strength, Mr Bailie and Mrs Powers-Freeling joined that Committee.

The Governor also proposed that in his role as Chairman of NedCo, Sir David Cooksey should remain entitled to attend any of the meetings of the Audit and Remuneration Committees.

Turning to the vacant directorship on Bank of England Nominees Ltd, the Governor proposed Ms Lowther for that post.

Court APPROVED the changes.

Court also needed to appoint a new Trustee to the Houblon Norman Fund. Mr Clementi had written to Ms O'Donovan, who was absent, but she had not yet responded.

The Governor noted that details of all the directorships, appointments and business commitments of Members of Court were in folders. He reminded Directors to notify the Secretary, Mr Rodgers, at least seven working days before taking on any further directorships or any commitments which might affect their positions as a Member of Court.

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The Governor noted that his final Governor's Day at the Sports Club would be on 21 July and all Members of Court would be extremely welcome to come and watch.

There being no other business, Court was up.

David Cooksey

Peter Rodgers
17 July 2002

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 17 JULY 2002

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 John Bond
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Mr Hall
Dr Julius
Dame Sheila McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Mrs Powers-Freeling
Mr Stretton

Absent:

Ms O'Donovan

The Governor welcomed Mr Tucker to his first meeting of Court as an Executive Director.

The Minutes of the Court of 19 June, having been circulated, were approved.

MONETARY STABILITY ISSUES
The economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Bean, Tucker, Allsopp, Professor Nickell, Ms Barker and Ms Bell in attendance)

In introducing the MPC Report to Court, Mr Bean said that there was a contrast between the economic data relating to the recent past – which had been encouraging – and increased uncertainty about the economic outlook, centred on falling equity prices. Upward revisions to GDP data had brought the official data a little more in line with other information. He added that the fall in annual RPIX inflation in June, to 1.5%, was more than had been expected in-house but the causes were likely to be temporary influences. He expected inflation to rise back towards 2% over the course of the year.

Commenting on the financial markets, Mr Tucker said that the rise in the volatility of equity prices was accompanied by heightened uncertainty looking forward. Option prices suggested that the market was more likely to fall further rather than rise. Mr Tucker noted that insurance company shares had been hit badly and were still viewed as a risk. Alongside falling equity prices, triggered by corporate events in the US, the dollar had weakened by around 5% since the previous Court meeting. The sterling ERI was around 1% higher, reflecting gains against the dollar. At the same time, interest rate expectations had fallen, particularly at the short-end of the yield curve but also more generally. Mr Tucker added that corporate bond spreads had widened, particularly at sub-investment grades.

Dr Julius said she believed that the key issue was the extent to which falls in equity prices impacted on the consumer. Mr Hall asked about the impact on the MPC's assessment of the large increase in public spending announced in the Comprehensive Spending Review (CSR). Mr Bean said the CSR did not contain additional relevant information from that presented in the Budget. Of interest to the MPC would be the eventual way the money was spent by government departments, specifically the split between expenditure on goods and services versus wage costs. In relation to equity markets, he said it was a puzzle that falls in the UK had exceeded those in the US, given the US specific factors involved.

Mrs Francis said changes to the FSA's resilience test for insurance companies had made a difference and had reduced selling. However, if the market continued to fall the impact of the change (to a 3-month rolling average measure of prices) would not be sustained. In response to Mrs Francis's question about the impact on consumer spending and investment if the equity prices continued to fall, Mr Bean said that the traditional channels were household wealth and the cost of capital. He noted that the stock market falls of 1987 had only had a modest subsequent effect on the real economy. Mr Bean said, however, that the impact of uncertainty and falling confidence had been difficult to assess and was likely to be different in each cycle. The MPC would need to make qualitative judgements about these effects.

Mr Neill said car sales were rising by 5-7% on an annual basis in July to date. Car output continued to rise strongly, though he cautioned that current production reflected corporate decisions a number of years ago. Mr Neill asked how the Bank viewed the quality of UK corporate accounts. The Governor noted that there had not been disclosures in the UK similar to those in the US, and he took some comfort from that. Sir Howard Davies said he thought it was a difficult question to answer as there was no pro-active assessment of corporate accounts in the UK. It was entirely reactive, unlike the SEC in the US which did review compliance among a proportion of the top 500 companies. In the context of the debate on international accounting standards, a relevant question was how rigorous enforcement of standards should be. In relation to insurance companies, Sir Howard said it was not easy to disentangle the regulatory impact leading to the forced selling of shares (of which there was not a great deal of evidence) and a broader strategic view of the outlook for equities and their asset portfolios. Pension funds were similarly looking at the balance of assets and risk in their portfolios. Overall, the demand for equities was falling in response to some underlying factors. At the same time, price-earnings ratios were now below their ten year average in the UK so there was perhaps a greater prospect of a recovery compared with the US, where ratios remained above average.

Mrs Powers-Freeling said high street spending had been volatile over recent months, though remained ahead of retailers' expectations. She said discussions with consumer focus groups had revealed little understanding about financial market developments and an inclination to carry on as before in the absence of any material impact on their individual financial positions. Dame Sheila McKechnie agreed that consumers, in general, had very little comprehension of financial market developments. She felt employment and interest rates were key influences on consumer confidence given the lack of direct exposure to equity markets. But it would be interesting to see if consumers responded to information about falling capital values in guaranteed income bonds, which would become available towards the end of the year. She added that letters relating to endowment investments were not due for some time. Dame Sheila McKechnie said any event could trigger a consumer reaction, including the failure of an institution.

Mr Tucker commented that, although so far there had been no Enron-type case in the UK, the Elan case in Ireland perhaps raised questions for the UK and Europe about the ability of firms to flatter profitability.

FINANCIAL STABILITY ISSUES
Domestic developments and international issues
(Messrs Bean, Tucker and Allen in attendance)

In introducing his bullet point note, Mr Allen drew Court's attention to two issues. First, the IMF's UK Financial Sector Assessment Programme (FSAP), which was now complete. The draft conclusions were generally positive. The IMF had noted two particular concerns related to the Bank's responsibilities: the potential for contagion in the large unsecured inter-bank segment of the money market, although exposures had been reduced by changes to market structure and payment systems; and the need for a more formal statutory basis for the Bank's responsibilities in relation to critical payment systems. Second, Mr Allen discussed the situation in two emerging market economies, Brazil and Turkey.

Dr Julius asked if the IMF team had looked at corporate governance and, particularly, the role of audit committees. Mr Allen explained that the IMF team had considered standards and codes but the work covered the financial sector only and not corporate governance.

MARKET OPERATIONS ISSUES
Current Issues
(Messrs Bean and Tucker in attendance)

Mr Tucker reported that, in his first weeks, he had been looking at projects; risk management; training; and the area's market intelligence network. The projects involving markets were essentially directed at the development of straight-through processing, involving front, middle and back office operations; and the measurement of exposures and positions across the area. So far as he could tell, good structures seemed to be in place. The emphasis was on ensuring co-ordination across the Markets area, Banking and Market Services and FRPD. On risk management, he said the mechanisms for monitoring credit and market risk struck him as having improved over recent years. But manifestations of such risk were often via operational risks, and so for each division in the Markets area he had asked for a Risk Officer who would be responsible for ensuring that operational risks were tracked and managed.

On training, Mr Tucker said he intended to introduce individual training benchmarks for staff, similar to those employed by the Financial Stability area (5 days non-IT training; 3 days IT training). Finally, the area would review its network of contacts, both in the UK and in other principal financial centres world-wide.

EXECUTIVE REPORT
(Messrs Bean and Tucker in attendance)

The Governor reminded Members of Court that Governor's Day was on 21 July and he would be pleased to see as many of them there as were able to attend. He also drew Members' attention to a late start for Court on 21 August at 11.00am, because attendance would be relatively low and the agenda light, as usual for that month.

Mr Clementi noted that discussions with the Lawn Tennis Association about building a national tennis centre on part of the site of the Bank's Sports Club at Roehampton had come back to life a year after they had been dropped. The previous discussions had halted because of the unwillingness of the Association to give the Bank the final say on who the property might be sold to at a future date. The All-England Lawn Tennis Club at Wimbledon was involved in the renewed discussions. A meeting with the Club would take place the following day.
Mr Clementi said the Bank hoped to make progress in granting a long lease to a joint venture of the LTA and Wimbledon in return for a substantial capital sum.

Mr Clementi noted that the results of the BenefitSelect Tribunal had still not been announced.

Mr Clementi also noted that Ms O'Donovan had agreed to be the third Trustee of the Houblon-Norman Fund.

Turning to the £5 note, Mr Clementi noted that this was discussed at the last Court. The issue was that the Bank had chosen to print the number over the varnish and then not left enough time to allow the numbering ink to dry or cure into the varnish. The solution was to put the varnish on last, over the number, which was straight forward, although it had required a change to the production sequencing which was slightly complicated, which was the reason the Printing Works had not done this in the first place. He advised Court that there would be an announcement the following day that the Bank expected to start re-issuing £5 notes in the week beginning 19 August. Following extensive tests, the Bank was also satisfied that the existing stock of new Elizabeth Fry notes would be available for issue to the public. It believed the cost of treatment would be small, largely in the form of handling charges, and below £250,000.

MANAGEMENT OF THE BANK
Quarterly Financial Report
(Messrs Bean, Tucker and Mr Smout in attendance)

Mr Smout introduced the Quarterly Financial Report covering the first quarter of the financial year. He advised Court to be cautious about drawing too many conclusions from the report about expenditure over the year as a whole. There were no questions.

Update on IT
(Messrs Bean, Tucker and Brookes in attendance)

Mr Brookes introduced his paper on IT and expressed his gratitude to Members of Court for the advice and input they had given. He invited Members of Court to spend time with his Division and to meet some of his team.

Mr Stretton noted that a number of institutions had had difficulties introducing EDM and his organisation had concluded that there was less value in it than first thought. There might also be difficulties in getting people to accept the necessary level of change. Mr Brookes said that there was a third explanation with respect to the Bank which was probably too ambitious when it started. It tried to introduce a portal alongside document management and this did not work very well. Now the Bank was concentrating on document management. The Bank's approach included a central standards committee and local ownership of document management. He acknowledged that some behavioural change would be involved.

Sir David Cooksey noted that Court's involvement in IT arose from a feeling that Bank IT had slipped behind. He asked how the Bank benchmarked under the new plans to ensure that it was leading edge. Mr Brookes said there were a number of relevant matters including the infrastructure review and discussions with similar organisations outside. More was also being invested in external research. Responding to a question from Sir David on risk measurement, Mr Brookes said that measuring things that had not happened was difficult. But when a project was scoped, the benefits were examined closely. Some things could be measured in terms of risk reduction, for example in the error rate in statistics. But where there was not a well developed probability distribution it was quite difficult to measure risk reductions. The Bank had been looking at other organisations which were further ahead, and this encouraged the investment it was making. It was also very aware that with accounting projects the point of entry of the data was crucial, and this issue was discussed with PricewaterhouseCoopers and was one of the areas where risks were examined closely. Mr Clementi noted that there was a family of projects aimed at improving back office work among which C21 was the most important. Co-ordination was essential because of the interdependencies. These had been set out very explicitly by Mr Smout. They were reviewed in a quarterly meeting which Mr Clementi said he chaired. The Bank reported to Court, through the project review process, on how it was doing on these projects.

In response to a question from Ms Blow about how the Bank decided how much to spend on IT, the Governor said a generic problem for the Bank was that the measure of its output was not by numbers. Mr Clementi said there was a perception several years ago that the Bank was underspending, and Court had called for a review from the Bank's consultants.

Mr Neill said he was critical of IT in the Bank before Mr Brookes arrived but he and his team had impressed him with what they were doing and he noted that the staff survey painted a good picture of staff attitudes towards IT in the Bank. They were generally satisfied. This was difficult to achieve and he congratulated Mr Brookes. In response to a question from Mr Neill on Microsoft, Mr Brookes said that despite the issue of licensing fees the Bank would probably become more rather than less of an integrated Microsoft Office. In response to a question from Mr Hall he said that a number of IT services were out-sourced, including internet security services. The starting point with projects was that the Bank did not want to build software. For example it spent nine months looking for an outside supplier of a system for settling repos, but without success. The Governor thanked Mr Brookes and his team and said they had done well.

The Bank in the Community
(Messrs Bean and Tucker, [redacted] and [redacted] in attendance)

[redacted] introduced her paper including her description of the new Court Awards.

Mr Bailie said he was very impressed and he congratulated [redacted] on continuing with what she was doing and expanding into the Court scheme. In response to a question from Mr Bailie, [redacted] confirmed that the IASC was not a registered charity and also the cost of hosting Directors' charitable events was included in the overall count. The Governor agreed with Mr Bailie that where the Bank was involved in events it was worth asking one or two of [redacted] committee as guests of honour. Sir David Cooksey said it would be a good idea to get feedback on how successful events had been. He noted that the Lifeboats appeal raised £5mn in the 18 months after it had been launched successfully in the Bank. Dame Sheila McKechnie said she was impressed with what the Bank was doing in the business links programme. She noted the Bank worked extensively with schools – there were a lot of other charities in which it might be appropriate to be involved. [redacted] said there was a scheme where senior people in the Bank could act as mentors in a partnership role and the Bank also encouraged staff to be trustees of charities. Dr Julius said she was very impressed with what [redacted] and her small team had achieved. She said it would be helpful in future to have a little historical data in the paper for Court. She also asked whether the inclusion of the IASC donation was right in terms of the Bank's internal accounting for charitable work. She also made a similar point about the Target 2Point5 prizes for schools. [redacted] confirmed that donations to schools were included in the numbers. This was the prize money. Mr Neill said a terrific job was being done and that it was more important an ever that this work continues. He noted in the staff opinion survey that morale was low and that community involvement had a positive effect.

Sir David Cooksey said he was well aware of the caution of Bank Agents with regard to Regional Development Funds. But as Chairman of the Small Business Investment Task Force he noted that a problem was the lack of high grade people sitting on the boards of the organisations. He asked whether it would be possible to persuade some people to participate in a personal capacity which would be enormously helpful in establishing the credibility of these fund management organisations. The Governor said that was something that the Bank could explore. He was not sure it was inhibited in that respect. It was a management not a legal issue. The Bank could draw to the attention of Agents the fact that they should not be inhibited by Bank policy from acting in this way. The Governor thanked [redacted] and [redacted]

Report on the Staff Survey
(Messrs Bean, Tucker and Footman in attendance)

Mr Footman introduced his paper. He believed that the survey work was good and he was grateful to Mr Neill for recommending the firm that undertook it. The Governor said he was encouraged to think that by conducting a regular survey on this basis the Bank would get a real sense of the mood. Sir Ian Gibson said the Bank should consider doing the survey annually both for feedback and to reassure people that their views were being sought. There should not be too much concern about the detail because it was the trends that were important. He noted there were some very good numbers in the survey, for example faith in the performance of the appraisal system. The comment that senior management were less liked by staff than junior ones was the reverse of the attitudes he had seen in many other places. Mr Neill also noted the importance of feeding back the results, which the Bank had done; and the importance of being seen to do something about the surveys in areas where that was possible. Mrs Powers-Freeling said that Marks and Spencer did a very similar survey using BMRB every six months. It was absolutely transparent because the company wanted those involved to address the issues. The company incorporated into accountability targets for managers some improvement in scores in the survey if there appeared to be a problem. Dr Julius said she agreed with most of what was said. The divergence between managers and senior managers was the opposite at British Airways. She was not sure if the results were typical at the Bank but it was worth working on as Sir Ian had suggested. She did not agree with the conclusion in the cover note that the survey was a baseline for the future with no need for immediate action. One area she noted for possible action was the response on internal promotion and another was the question about strong capable management. She said that one possibility might be an external review of the process of selection of managers to see if there was a weakness that could be improved.
Mr Hall noted the usefulness of 360° appraisals and Mr Footman confirmed that the Bank was piloting these with 18 people. The Governor said the Bank would reflect on the comments made. The expectation was that another survey would be done in two years. Court Members had suggested that it would be better to do it more often and the Bank would look at that and also at whether there were cross-Bank action points it could pick up.

Head Office Health Centre
(Messrs Bean, Tucker and Footman in attendance)

The Governor noted that there were concerns expressed in Court in February about the cost and the Bank had looked at them again. Mr Clementi introduced the current proposal, noting that Mr Footman had become responsible for PSSD in April. Mr Footman described the paper, noted that the Bank had looked at whether it would be easier and cheaper to pay for staff to join a gym, which led to a tax liability, and also noted that 85% of the staff surveyed said they would use an in-house gym. The consultants had said that typically in other companies the number was 50% and at the FSA it was 40%. The assumption in the paper was 50% and that had been used for the calculations. He drew Court's attention to the importance of the 50% usage assumption and recommended on balance that the Bank should proceed with the investment but noted that the usage estimate was a leap of faith. He confirmed in response to a question by the Governor that all the numbers in the Court paper were in addition to the cost of moving the Dentist and the Medical Officer to the same area.

In response to a question from Mr Morris about the subsidy costs of Roehampton, Mr Footman said there were a number of ways of approaching this: staff paid £35 a year and commercial members were prepared to pay £800; alternatively the deficit at Roehampton made up by the Bank was £800,000 and this supported Bank employees and their families and pensioners' use of the facilities.

Mr Hall said that the Bank was a people business and he fully supported the proposals. In response to a question, Mr Footman said that the proposed investment was not currently in the Bank's investment plans but if it were approved today it could be finished in October 2003. He also confirmed that there was room for a sauna and steam room which were in the proposed budget but the Bank had not decided whether to incorporate those. Dr Julius said she supported the proposal. The cost was not excessive. She noted that the studio part of the facility was an odd shape for aerobics classes. Mr Footman confirmed that the Bank had been and would continue to consult users. Mr Bailie said the proposal was a good idea and very timely. Mr Neill said he strongly supported it. His company had been through the same process and had learned a lot. He advised not to make use of the facility free, even at the beginning, though perhaps a discount was appropriate initially. He also advised against paying by event. His company had achieved 80% usage. A board had been set up including the chairman of the company and that had helped the project to come alive. People were also allowed to use the facility at any time, which sent a message about trust. But he questioned the proportion of the cost allocated to consultancy fees and recommended a tough approach to consultants' charges. He also said that his organisation ran its gym for 1,000 people for half the annual running cost proposed by the Bank. He recommended that a further look was taken at that issue. His Company's experience was that it was better to buy rather than hire equipment. The Governor said the Bank would take account of the points made and Mr Footman would, he expected, want to talk to Mr Neill.

Matters Reserved to Court
(Messrs Bean and Tucker in attendance)

The Governor reminded Members that Matters Reserved to Court was an internal document which detailed topics brought to Court's attention. It was subject to annual review by Court, and this year, there were no revisions required.

Court APPROVED the proposal that no revisions be made.

A Report from the Chairman of the Remuneration Committee
(Messrs Bean and Tucker in attendance)

[redacted]

Court APPROVED both recommendations.

There being no other business Court was up.

21 August 2002

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 AUGUST 2002

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
Sir Ian Gibson
Dr Julius
Dame Sheila McKechnie
Mr Neill
Ms O'Donovan
Mrs Powers-Freeling
Mr Stretton

Absent:

Ms Blow
Sir John Bond
Sir Howard Davies
Mrs Francis
Mr Hall
Sir Brian Moffat
Mr Morris

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

MONETARY STABILITY ISSUES
The Inflation Report, together with the economic and monetary discussion, incorporating the monthly MPC Report to Court
(Messrs Bean and Clark in attendance)

Mr Bean introduced his MPC Report to Court, commenting on the international economic environment – where there had been some weakening – and in particular asset price developments, and sterling's recent volatility. He added that the output data would probably be revised down in the second quarter following the sharp fall in manufacturing output in June, though that was likely to have been the result of the Jubilee holiday. The outlook for demand, in part, depended on the relative strength of the impact of higher house prices on the one hand and lower equity prices on the other. Mr Bean said the influence of equity price falls was likely to be more lagged given their more indirect influence on current spending. The August *Inflation Report* projections reflected the impact of those falls in equity prices and showed a flatter profile for inflation next year. The tenor of the Committee's deliberations had, as a consequence, shifted from discussion about the appropriate timing of an interest rate increase to a more neutral tone.

Turning to the markets, in Mr Tucker's absence, Mr Bean said that the main exchange rate movements over the past month had involved sterling, especially against the euro. Yield curves had fallen at both the short and long end internationally as expectations of future monetary policy had changed. Credit spreads had generally widened, particularly for sub-investment grade bonds.

Mr Neill reported that the car market had been strong to date in August. Forecasts for 2002 as a whole suggested a record year. He said there had been a shift from used to new cars within the market such that a measure of total car sales might provide a better reflection of consumer confidence. Commenting on the issue of how higher National Insurance Contributions (NICs) might be accommodated by business, he said the situation was inconsistent with the Chancellor's objective of improving productivity. It would necessitate a reduction in headcount in the manufacturing sector to transfer resources to the public sector where productivity was lower. Firms would not be able to increase prices or pass the burden onto suppliers. Mr Neill asked if more could be done to measure sectoral productivity performance. Mr Bean said the ONS were looking at more sophisticated ways of measuring public sector productivity. He did not think the Bank had a comparative advantage in this area.

Mr Bailie said it was possible that the impact of higher NICs might start to become more apparent from October as firms started their budget planning for next year. He said packaging firms were being pressured by large retailers to reduce prices. Mr Bailie also reported that there had been a large fall in TV advertising in September, though that may reflect commercial positioning ahead of new contract negotiations in October.

Mr Stretton noted the fall in Scottish GDP in 2002 Q1, which had prompted some concern and uncertainty. Falling inward investment – to its lowest level since the early 1990s – particularly from the US, was adding to concerns. Commenting on oil prices, Dr Julius said the industry believed there was ample supply even without Iraqi output. She added that retail petrol sales in the US had been weak over the summer, a possible coincident indicator of demand.

Sir Ian Gibson agreed that manufacturing output in June had been distorted by extended holidays. Companies had taken the opportunity to bring forward holidays and also destock. He said confidence amongst US manufacturers had fallen quite noticeably. Within the automotive sector, there had been a marked fall in new design programmes and designers were being laid off.

Mrs Powers-Freeling said clothing and footwear retail sales growth had fallen back in August. Retailers were looking closely at all aspects of the wage bill, including staff benefits – partly in response to higher NICs. Dame Sheila McKechnie noted the contrast between consumers' confidence in the overall economy and that in their own financial position. This was obviously not sustainable. Mr Bean said unemployment prospects were probably central to confidence. Sir David Cooksey said he was concerned about prospects for manufacturing based on the experience of a range of smaller companies that he was involved with. He did not sense activity was likely to bounce back quickly. He added that there seemed to be little capital expenditure being committed and further inventory adjustment in some areas.

Ms O'Donovan said she also felt the situation was downbeat. Few new contracts were coming forward in the gas and power generation sectors, IT services were experiencing renewed weakness and US commercial building activity was also weakening. She said it was of concern that there were no signs of increased spending in 'early cycle' areas that might be expected to lead to a wider recovery. Ms O'Donovan added that productivity gains could be achieved in ways other than reducing numbers employed, for example through staff training and job respecification.

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

Mr Clark highlighted some recent issues, referring to his note to Court. First, the recovery in the equity market had relieved some of the pressures facing the insurance sector. A number of structural issues remained to be considered, including the design of regulatory tests for insurance companies, which the FSA was considering.

Second, the position in Brazil had deteriorated. Underlying the political situation, there was a deeper problem regarding the structure of Brazilian debt and its sensitivity to short-term exchange rate and interest rate movements. The IMF had agreed to further lending to Brazil, equivalent to about 900% of Brazil's IMF quota. Initially, the announcement had reduced Brazilian spreads but that proved short-lived. In terms of UK banks' exposures to Brazil, these were greater than those to Argentina but would not in themselves present a serious problem. US and Spanish banks were exposed to a larger degree.

Third, Mr Clark discussed the review being undertaken by Derek Higgs concerning corporate governance and the parallel exercises on accounting. He said an interim report from the Co-ordinating Group on Audit and Accounting Issues had been encouragingly measured, for example in its approach in relation to auditor independence and the role of audit committees.

Fourth, Mr Clark reported that the Continuous Link Settlement project – reported previously to Court – was now close to completion. It was likely to be launched in early or mid-September. The project aimed to improve the security of foreign exchange settlement by reducing intra-day exposures to counterparties – known as "Herstatt" risk.

Ms O'Donovan said she sensed that the panic over corporate accounting standards was subsiding. She felt there was a need to stress the differences between US and UK approaches to their 'generally agreed accounting practices' (GAAP). She also noted that plans to introduce FRS17 had been frozen. Ms O'Donovan also referred to the difficulties firms were facing when obtaining liability insurance. Premiums had risen dramatically. There were similar issues with insurance to cover performance bonds for contracts. She said she was also concerned about the impact rating agencies appeared to have on the financial system, given that there were only two major firms globally and there was little transparency about their activities and governance.

Sir David Cooksey said there was a need to emphasise nationally the positive attributes of UK accountancy practices yet the accountancy bodies were largely discredited. The destabilising effect on the market could continue without some check to the negative tones of the current debates. The Governor said he was confident that the differences between US and UK accounting and governance standards were beginning to be appreciated as people thought about the realities. In this sense, he felt the problem would provide its own solution. Ms O'Donovan said it was significant that the major corporate failures in the US were new companies involved in new ways of working and technologies but without equivalent accounting and governance frameworks.

MARKET OPERATIONS ISSUES
Current Issues
(Messrs Bean and Clark in attendance)

In Mr Tucker's absence, the Governor noted there were no issues to report this month.

EXECUTIVE REPORT
(Messrs Bean and Clark in attendance)

This being his last attendance at Court, Mr Clementi took the opportunity to briefly review the main management issues that would be handed over to his successor. First, the outcome of the BenefitSelect employment tribunal was still outstanding but was imminent. He believed the benefits system itself was now well anchored and accepted by Bank staff.

Second, the Bank's property portfolio had now been slimmed to consist largely of Head Office and Bank Buildings. The Head Office refurbishment project would be completed by Easter 2003. The Bank would need to consider options for Bank Buildings in the early part of next year. Third, Mr Clementi commented on the work to improve the Bank's risk and control systems. New checks and balances were in place and reporting systems had been improved. The Bank's management accounts were now compiled on the same basis as its financial accounts. He said work on risk assessment was continuing. Two ongoing projects linked to the Turnbull exercise needed progressing – work on business contingencies and precautions relating to the Bank's IT firewall. In addition, the work to develop straight-through processing in the Bank's banking and market services was ongoing. This would reduce operating risks. A great deal of progress had been made, though there was a great deal more to be done.

The fourth area highlighted by Mr Clementi was the Roehampton site. The strategic aim for the Bank had been to extract more value from the sports facility. Discussions with the LTA had been on and off over a prolonged period but more recently progress had been made following the involvement of the All England Club (Wimbledon). Mr Clementi said a price of £9 million had been agreed with the LTA for a part of the Roehampton site. The deal was finalised subject to two caveats. First, the LTA understandably wanted to ensure that planning permission to develop the site could be obtained. Second, dealing with the LTA was problematic, and the deal could be upset at this late stage.

Fifth, Mr Clementi outlined the position with the Registrar's Department in Gloucester. A working party led by HM Treasury was looking at how the gilts registration process could be re-engineered and what practically needed to be done. In the interim, this presented a difficult management issue given that staff were fully aware of developments. The Bank was considering a loyalty bonus scheme for staff in Gloucester. The sixth area was the Printing Works. Mr Clementi noted that the Bank was resuming the issuance of the new 'Elizabeth Fry' £5 note from today. Options for the Printing Works – previously discussed with Court – were under consideration. In the event of choosing to sell the operation, two or three quality bids were likely. Mr Clementi said it was not straightforward to compare options on a cost basis given the differing treatment of personnel costs in each scenario. In the meantime there was understandably a degree of uncertainty in the Debden workforce.

Finally, Mr Clementi noted that the BCCI trial had been rescheduled to October 2003. He said he expected the costs associated with the trial to be ongoing until this time. He was concerned about the added strain this delay would place on Bank witnesses. He added that it was remarkable that the legal issue of what misfeasance in public office amounted to had still not been adequately defined.

Mr Clementi ended by saying that he was very grateful for the support given by Court for the Bank's work on these management issues during his time as Deputy Governor.

Mr Stretton suggested that the issue of the Pension Fund's investment strategy might also be a subject that Mr Clementi's successor could be alerted to. The Trustees would welcome input. Mr Clementi said Mr Smout was preparing a paper on risks and tolerances for the Fund. This would be brought before Court, possibly in the Autumn.

On behalf of the non-executive Directors, Sir David Cooksey thanked Mr Clementi for his contribution. He said Mr Clementi had brought a refreshing management approach to the Bank alongside a respect for its culture and traditions.

The Governor expressed his thanks and gratitude on behalf of the whole of Court for Mr Clementi's work during the past five years.

The NEDs' dinner planned for early autumn had been postponed and a winter date was now being explored. He added that the question of succession was not resolved. Consequently, the Bank was considering plans to cover any period before a successor was able to take up the post, though those plans would depend on the length of the prospective gap.

MANAGEMENT OF THE BANK
CCBS Annual Report
(Messrs Bean and Clark and Professor Sinclair in attendance)

Professor Sinclair introduced his paper to Court. He outlined the Centre's various activities, both in London and abroad. He noted that the CCBS was increasing the number of advisors covering technical aspects of monetary policy decision-making, including econometrics and forecasting. He also noted the increase in the number of 'regional' events in different parts of the world, particularly East and South Asia and Latin America. Links with India had been greatly increased though the relationship with Russia required further development.

Ms O'Donovan asked if the CCBS was the only facility providing such services to other central banks. Professor Sinclair said a number of central banks had training centres. The Bundesbank had a large centre though its focus was particularly on supervisory issues. The Banque de France, Federal Reserve Bank of New York, IMF and the Financial Stability Institute (FSI) in Basel, among others, all provided training to other central banks. But it was the aim of the

CCBS to be the best provider of technical assistance, at the cutting edge of current developments.

Dame Sheila McKechnie asked about the cost of the CCBS. Professor Sinclair said total expenditure in 2001/2 was £1.3 million (£1.15 million net after income). Around £850,000 was devoted to staff expenditure. This did not include the cost of the time spent by other staff in the Bank who contributed extensively to the Centre's speaking programmes in London, nor the notional cost of space.

Dr Julius said the activities of the CCBS were beneficial and also provided spin-off benefits in terms of the development of Bank staff who contributed to CCBS courses. She said there was a question about the appropriate size of the CCBS relative to demand and what other central banks were offering. She asked if further expansion could be funded by the Department for International Development (DFID).

Professor Sinclair said there was excess demand for places on CCBS courses. This was managed in a variety of ways to ensure applicants were well suited to courses. Additionally, extra resources allocated to econometrics within CCBS would enable more demand to be met in this area of work. In relation to DFID, Professor Sinclair said more money had been allocated but was largely accounted for by new activities and programmes, in particular the FIRST initiative, which would tend to usurp existing monies. Indeed, the CCBS had just been told that some funding was to be withdrawn. CCBS would be giving further consideration as to how it might access DFID's resources. Professor Sinclair also said that it might be possible in the future to increase the amount of work undertaken with the FSA, notably on issues at the interface between supervisory and systemic issues.

The Governor noted that this would be the last occasion Professor Sinclair reported to Court whose contract ended in November. The Governor thanked him for his contribution, which had elevated the standard of the CCBS and focused it on high level assistance and instruction. The Governor added that the Bank was in negotiation with Professor Mario Blejer, a former Governor of the Central Bank of the Argentine Republic, to take over as Director of the CCBS.

Sealing Committee Authorisations for Inspection
(Messrs Bean and Clark in attendance)

The Governor reminded Members that under the terms of reference of the Sealing Committee, the authorisation of all orders, resolutions and transactions of the Committee were recorded in a book which was produced at Court twice-yearly for inspection. He invited interested parties to view the book, which Mr Wardlow had to hand.

There being no other business Court was up.

David Cooksey

Peter Rodgers
18 September 2002

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 18 SEPTEMBER 2002

Present:

The Rt.Hon Sir Edward George, Governor
Mr King, Deputy Governor - Monetary Policy
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir John Bond
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Mr Hall
Dr Julius
Sir Brian Moffat
Mr Neill
Ms O'Donovan
Mr Stretton

Absent:

Sir Andrew Large, Deputy Governor - Financial Stability
Dame Sheila McKechnie
Mr Morris
Mrs Powers-Freeling

The Governor noted that Sir Andrew Large had been appointed as successor to David Clementi. Even if the delay in the appointment had been regrettable the fact of it had been extremely well received, and he believed Sir Andrew would do an excellent job. He would join the Bank on 23 September, his confirmation hearing at the Treasury Committee would be on 25 September and he would attend the Washington Annual Meetings of the IMF and the World Bank over the following weekend. He would present in his office from 2 October.

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

MONETARY STABILITY ISSUES
The economic and monetary discussion, incorporating the monthly MPC Report to Court and including international economic developments.
(Messrs Clark and Bailey together with Ms Bell in attendance)

In introducing the MPC Report to Court, Mr King noted developments in RPIX inflation and also the fall in share prices which was the biggest development since the last Court meeting. He noted that the Monetary Policy Committee still expected a gradual recovery. A key development was that expectations of future short interest rates had fallen back sharply, by half a percent, since the Spring and there had been a monetary policy response to the change in the outlook. Not only had the forecast changed, but the interest rate paths the markets expected the Bank to follow had changed since the Spring. Falls in equity prices had brought the forecast more into line with the target. The potential rise in interest rates that had been implied was no longer seen to be necessary. Mr King noted that the MPC was starting to see mixed signals about the future pace of consumption growth, and a major question was the pace at which it would slow. He noted the first signs of a slowdown in the very rapid rate of house price inflation, and in due course he believed the 12 month rate would come down as well. Manufacturing output had rebounded in July, implying a switch of production from June, the month of the Jubilee celebrations. The MPC's view was that underlying manufacturing output had been broadly flat since the Spring, perhaps rising slightly. Mr King noted that the vote at the previous meeting had been unanimous, but there were clearly many uncertainties. He would value Court's advice on two matters in particular: the speed of any slowing of consumption and the question of the weakness of demand in the euro area.

Mr Bailey introduced his paper on international economic developments.

Sir Ian Gibson noted that in the US automotive industry the biggest increase had been at General Motors, which had been doing very well in volume terms, with very significant discounting. That was paying off in increased production, because the company was almost out of stock. General Motors claimed it was gaining incremental business but the industry believed it was the result of underpricing and was not a general growth. In Europe total sales were forecast to fall 4.7% but taking out the growth in the UK market the rest of western Europe could be down by as much as 6%. Some German manufacturers were talking about having reached the bottom and being able to stabilise production in the next quarter. Markets were declining in Italy and Spain. There was no optimism about next year. Mr Neill said that in August the UK market had the highest ever import penetration, with 80% of all cars sold imported, though it was not a big month for sales. The market was up 13%. Figures so far for September, a big sales month, were 15% down compared with last year and 21% down in the private sector. The industry thought the out-turn would be a fall of a couple percent. The feeling was that next year would not be as good as this, which had been better than expected. A couple of manufacturers were now thinking of reducing production capacity. There were starting to be signs of a slowing of confidence. In terms of overall business confidence, most people were worried, and the stock market situation was pretty depressing. UK price earnings ratios were well above historic averages, and companies that had had pension fund holidays were finding that they were over, and that was going to hit profits, at the same time as national insurance increases. There would be a lot of pressures on company costs.

Mr Hall noted that on a recent visit to China he had gained the impression that big companies were growing at a very rapid pace which supported suggestions that the Chinese economy was growing by at least 7% a year. He noted the range of opportunities available in China, including the mobile telephone business. He supported the first option in the consideration of China in Mr Bailey's paper. Mr Bailie agreed with Mr Neill on costs, particularly national insurance, and noted that it was now the time in which company budgets were being drawn up. Cost savings were going to be implemented, and the figures that would be coming out would not be particularly pleasant. In Northern Ireland, the consumer was still a good news story but there was also evidence of a slowdown. BT had said that the number of phone calls had fallen for the first time and energy consumption was down. He noted Mr King's visit the previous week to Northern Ireland.

Ms Blow noted her concerns about unemployment. In the IT market there was a buoyant public sector but a decline in the private sector. Service companies were beginning to bite the bullet and there would be more redundancies to come. Ms O'Donovan commented that there was no link between historic accounts and asset valuations and most equity analysts did not even read company reports and accounts ahead of their equity buying recommendations. She also added that it was wrong to add analysts' expectations of the growth of individual companies together, because each company had investors who believed that the company concerned would be able to grab additional market share. Averages were driven by people making bets on which companies would succeed in winning that extra share. Mrs Francis said that, if newspaper advertisements were a good indication of business confidence, they had been shrinking at broadsheets most of this year, but in the most recent weeks at the Financial Times and one or two others they had completely collapsed. Sir John Bond said that HSBC would have to add 9% to its salary bill in national insurance contributions and pension payments, quite apart from any pay rises. The counterpart was that someone's income would go down. He also commented that if acquisitions were stripped out from some well known large companies it would be found that far from out-performing they would be growing at the nominal rate of the economy as a whole. A sea change was required in investor expectations. This had not been priced in by the markets.

Sir David Cooksey noted that he had been shown data on the clothing retail trade in recent days. A huge overhang earlier in the year had been shifted by massive discounting. But new season sales were 15-20% down compared with last year. Reality was coming back into these markets and it was likely that consumer expenditure would drop. The buying earlier in the year was all to do with stockclearing, not new sales. Mr Neill noted the effect of interest rate changes on pension fund valuations, where deficits increased every time rates dropped. If interest rates rose some of these deficits would reduce. Mr King said that Sir John Bond had identified one of the MPC's major downside risks, which was equity values. In response to Ms Blow, Mr King said he had not referred in his own remarks to the labour market and unemployment because they had been unchanged month by month for most of this year. Unemployment was broadly flat while last Spring the MPC had expected an increase by now. But he noted that the labour markets statistics did conceal a switch from private to public sector employment which was likely to continue. An interesting number which would appear over the next month was the new census. This would take account of immigrants, and it might be that the numbers were different from those which had been expected. He noted that on his Northern Ireland visit he had spoken to two employers who had had difficulty in recruiting and both had found staff in Eastern Europe. The Bank would very much value Court's assessment of the labour market over the next three to four months as firms started to plan their responses to the increases in national insurance contributions.

FINANCIAL STABILITY ISSUES
Domestic developments and international issues
(Mr Clark in attendance)

Mr Clark reported on financial stability issues as set out in his bullet point note for Court. He also noted that the IMF annual meetings, in addition to tackling a number of the issues he had mentioned, would also look at access to IMF resources.

Sir John Bond asked whether Mr Clark could raise on his visit to Washington the issue of the Sarbanes-Oxley Act. All the top management of HSBC were having to go to other banks for their personal loans and these issues affected anyone with US listed securities. Most US banks insisted that their staff banked outside their own banks. HSBC took exactly the opposite view, which was that it wanted to know what its staff were doing with their money. Mr Clark noted that the issue had been discussed at the Financial Stability Forum. Sir Howard Davies said he recognised the concerns. The SEC's private line was apologetic about some of the issues involved. It claimed, slightly on the optimistic side, that there would be some exemptions in the Act for certain provisions related to overseas companies but these would not be in the gift of the SEC but of a public oversight board that would be set up. It was a little difficult to pursue negotiations on the issue because there wasn't anyone to pursue them with at this moment. The FSA would be taking it up at the IMF meetings. The Governor noted that reactive legislation had its dangers.

The Bank And The Euro
(Messrs Clark and Allen in attendance)

The Governor noted that the Bank would be bringing forward to a subsequent Court meeting the paper on the implications for the Bank of the euro, going forward. Mr Allen introduced his paper. In response to a question from Mrs Francis about how realistic the 24-30 months period was, Mr Allen said that the Bank did not have a view itself but was sponsoring a debate. It was not for the Bank to say what the Government position should be. In a sense, the first wave of countries had much longer to prepare because it was clear that their policy objective was to join the euro. However, it was the case that some were not certain that they were going to join until May 1998, shortly before the euro was introduced, which was quite short notice. The Governor noted that there was a sense that in some aspects of joining, particularly notes and coins, the UK could move more rapidly, based on experience within the eurozone. He noted that with regard to the timetable, the Bank had stood very firmly on its statement of minimum and maximum times. In response to a question from Mr Hall about managing the transition in the public sector, Mr Allen said that the Treasury was very concerned that a lot of the issues were within the public sector as well as within the private sector. In principle they had certainly covered these issues. Ms O'Donovan, noting that the five tests were the sole responsibility of the Treasury, asked whether other countries had involved their central banks. Mr Allen noted that the central banks of Sweden and Denmark had for a long time been in favour of entry but Mr King noted that other countries did not have the five tests. Mr Allen said that the Bank of England was not taking a position.

EXECUTIVE REPORT
(Messrs Clark, Footman and Smout in attendance)

The Governor noted that it was proposed to appoint Clare Brady as the new internal Auditor. Mr King and Ms O'Donovan as well as the Governor had spoken to her. She had had a very extensive background in commercial audit with First National Bank of Chicago, Republic National Bank of New York, a short period with HSBC and then a move to Barclays Capital where she was head of internal audit. The Governor believed that she would bring external input to the Bank audit which it had not had before. Ms O'Donovan said she had a perfect combination of style and character as well as a lifetime grounding in banking. Court was content.

Turning to the employment tribunal, Mr Footman noted that the Bank had won on all counts. He said that the Union claim that the Bank had failed to consult, when it had a plan involving more that 20 redundancies, had been rejected. The Tribunal decided that the Bank had never intended to dismiss more than 20 people and had only decided on dismissal when the numbers were down to 12. It had also decided that even if that particular provision of employment law had applied, the Bank had consulted adequately. Turning to the 31 "white form" claimants, Mr Footman said that the Tribunal had decided there was no repudiation of contracts and the Bank had not threatened dismissal. Turning to the seven former employees who had claimed unfair dismissal, Mr Footman noted that the Tribunal accepted that the Bank had a substantial reason for dismissal - the introduction of the new benefit scheme - which had business benefits, had been properly negotiated, and was accompanied by a very substantial information and consultation exercise. The Tribunal had also accepted the Bank's assertion that there were no clear losers from *BenefitSelect* which was simply providing the benefits in a different way with adequate compensation in the form of lump sums. He noted that there was in the 90 page document criticism of some of the Bank's communications effort and the suggestion that the Bank had not succeeded in persuading enough of the recalcitrant employees to sign up for *BenefitSelect*. These criticisms were mitigated by other parts of the report praising the Bank's efforts to communicate. There were also sharp criticisms in the Report of Unifi and of some of the Claimants. Mr Footman said that the Tribunal clearly took the view that the seven had not been prepared to listen and had formed a settled view right from the beginning, and that their minds were closed. The Governor noted the Unifi staff notice, which had got into the press. He said the Bank had been very careful not to react, and was taking the line that it was a sad event and a line should be drawn under it, and the Bank and its staff should move on. The Report of the Tribunal had been made available to staff, and a number had seen it. It was available to any Members of Court who would like to see it. Mr Neill said it vindicated the Bank's position, and it was right to take a firm decision and pursue it strongly. It was an excellent outcome and a credit to Mr Footman whom he congratulated. The Governor commented that it gave him a glimmer of optimism about the British legal system.

[redacted]

Turning to the Sports Club, Mr Smout noted that Court had heard last month of good progress in arranging a long term lease of part of the Roehampton site to the Lawn Tennis Association and the All England Lawn Tennis Ground Company for £9mn. Court had been alerted to two risks. The thrust was that the lease was subject to planning permission and there was a risk that such issues might be used to renegotiate the price later. Nevertheless, professional advice suggested we might do better if we started from a price of £9mn. The second risk was the approval procedure of the LTA, which had more than 100 Council members. They were meeting on 26 September. There must be a good chance that the proposals would be approved because they had been approved by the LTA Board. Nevertheless there might be some risk that some members of the Council, who came from all over the UK, would see a site so close to Wimbledon as not appropriate.

Mr Smout introduced his note on recent developments and next steps at the Printing Works. He noted that a provisional date of November had been set for the matter to come back to Court. Mr Neill asked whether the Bank had considered the issue of protection if the successful bidder failed as a corporation. Mr Smout said that the Bank's lawyers were giving quite a lot of thought to that sort of issue. There had been suggestions that in such an eventuality the business should be put back into Bank ownership, but that was not a particularly attractive option. The question would be looked at carefully. The difficulty was that the Bank had an interest in continued supply rather than, for instance, in taking collateral or receiving payment up front. The Governor said the Bank would come back to that question with a lot of others when there had been further exploration of the options. Sir Howard Davies said that the proposals were very sensible, and the two companies looked like the best bet for further negotiations. Sir Ian Gibson said that it was best to be transparent once the four had been reduced to a field of two, and tell the remaining two bidders that it was just them. He also commented that any commercial business should not expect a take or pay contract beyond year two, so the suggestion that there should be one for seven years did not merit consideration. Mr Bailie said only two bidders were needed for a competition. The Governor noted that while there was a possibility that one of the remaining two might drop out, so the Bank would be left with one bidder, option A also remained on the table.

The Governor noted that Ms Lowther had outlined a programme of productivity gains and increased automation and processing of customer services under the C21/Globus programme, but that had been delayed. The Bank had not been able sufficiently to test the processes up to now. It was to have gone live in October but he was not sure how much longer it would take to reach that point. The Bank would come back and report progress.

MANAGEMENT OF THE BANK
A Report from the Chairman of the Remuneration Committee
(Mr Clark in attendance)

Mr Neill introduced the report of the Remuneration Committee meeting which took place before Court. Noting that Mario Blejer had been recruited as Head of the Centre for Central Banking Studies, he said that normally payment would be on the Head of Division scale but given his experience and standing and the wider role he could play in the Bank, the position was more like that of an Adviser, and the Remuneration Committee recommended a salary of [redacted]

Court was CONTENT.

The Governor said he thought it would be a good appointment.

Before he, Mr King and Mr Clark withdrew for the second item, the Governor asked whether there was any other business. There was no other business.

The Governor, Mr King and Mr Clark left the meeting.

Mr Neill said that RemCo's recommendation for the salary of Sir Andrew Large was £211,382, the same as Mr Clementi had received and also the same as Mr King's current salary. RemCo also recommended that Sir Andrew Large be admitted to the Court scheme. There would be a pension cap at about £97,000. As with other Court members, the benefits the scheme would have provided on the full salary would be provided via an unfunded unapproved retirement scheme. Sir David Cooksey noted that Sir Andrew was over the age of 60 and contributions could be quite substantial. The Remuneration Committee did not know the numbers at this stage. He proposed that Court approve the salary with the understanding that Sir Andrew would be a member of the Court scheme, but that the Bank would come back and inform Court of the cost to the scheme of that membership.
Court AGREED.

Court was up

David Cooksey

Peter Rodgers
16 October 2002

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A COURT OF DIRECTORS AT THE TOWN HALL, LIVERPOOL.

WEDNESDAY 16 OCTOBER 2002

Present:

The Rt.Hon Sir Edward George, Governor
Mr King, Deputy Governor - Monetary Policy
Sir Andrew Large, Deputy Governor - Financial Stability
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir John Bond
Mrs Francis
Mr Hall
Dr Julius
Dame Sheila McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Mrs Powers-Freeling
Mr Stretton

Absent:

Sir Howard Davies
Sir Ian Gibson
Ms O'Donovan

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

MONETARY STABILITY ISSUES

The economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Clark, Bean, Tucker together with Ms Barker, Ms Bell, Mr Allsopp and Professor Nickell in attendance)

The Governor expressed his appreciation to all those present for coming up to Liverpool.

In introducing the MPC Report to Court, Mr Bean said that the recovery remained muted and the indicators were pretty mixed, and on the downside within the Euro area. US growth looked reasonably solid in the third quarter but this was largely due to continued strong consumer spending underpinned by high automotive sales. Consumer confidence was down in October, with the latest unemployment figure showing a small fall. US economic performance was much what would have been expected at the bottom of the business cycle and he hoped that, going forward, the recovery would gain momentum. But a lot depended on the continued confidence of the US consumer and that was one of the risks on the downside. Euro area GDP was up 0.3% in the second quarter but performance was disappointing, particularly in Germany, and business confidence was down. There were increasing concerns about the health of the German financial sector, and a possibility of adverse effects of that on corporate investment. There were tentative positive signs in Japan, including signs of political will to tackle non-performing loans in the banking sector. Other Asian economies were more buoyant than Japan. Mr Bean noted that equity prices fell another 10% between the September and October MPC meetings, though they were down by a smaller percentage between the two Court meetings. This was followed by a fairly strong recovery the day before Court. But the weakness of the last six months would depress demand going forward and probably retard a recovery. In the UK consumption was still strong though there was a statistical fog of special factors. Underlying retail sales growth was still growing reasonably steadily, and consumption was supported by rapid house price inflation, off-setting weak equity prices. The key drivers of consumption still seemed to be reasonably firm. Unemployment had remained steady and house prices were still growing quite robustly though there was a little evidence in some leading indicators that activity was beginning to slow. That would nevertheless leave activity still at a relatively high level. The Committee had been trying to keep consumption reasonably robust to make up for weak activity in the rest of the world. A key question for Court was whether Members had any indications to give of the strength of consumer demand over the next few months.

Turning to output, Mr Bean said this had been volatile in recent months because it had been strongly affected by the Jubilee. Manufacturing was unchanged in August despite large rises in motor vehicle production. Underlying output was flat. There had been a strong services bounce back since the Jubilee, and underlying growth in that sector was solid. Business confidence was steady.

Turning to labour and prices, he noted the new unemployment figures published that morning and said that the picture remained reasonably flat. The census had shown the population was a million lower than previously thought, with most of the reduction concentrated amongst prime age males. One explanation put forward by the ONS was that the extent of emigration from the UK had been underestimated. There was a lot of uncertainty about the immigration and emigration data and some questions about how the ONS was going to incorporate these estimates back into the past. He believed that as far as the MPC was concerned the revisions should not have any significant implications for monetary policy. Mr Bean noted that pay growth fell slightly in the three months to August and producer price pressures remained negligible. RPIX inflation rose to 2.1% in September.

Turning to Chart 1 of the markets charts, Mr Tucker noted that the main US, German and UK equity indices were back to where they were at the beginning of 1997, when there was "lift off" in the TMT sector. In the US it was quite difficult to identify reasons for the recent fall that were related to adverse macro economic news. In Europe and perhaps especially in Germany, equity falls had perhaps been more related to the adverse economic outlook. Mr Tucker noted that in the past couple of days shares had been rising sharply in the US, the UK and Germany. He noted the sensitivity of the markets to corporate news such as the one to one and a half percent fall in the US markets that morning as a result of the outlook published by Intel.

Notwithstanding the very high volatility, conditions had been fairly orderly. Price adjustments had been sharp, but the markets had not been disorderly.

Turning to Chart 3, he noted there had been a comment in the Financial Times that the Bank focused on equities at the expense of corporate bonds. In fact, they were followed carefully. The Chart showed a general rise in credit spreads since the last Court meeting. Turning to Charts 4, 5 and 6, he noted that money market yield curves had moved down sharply, though the movements had reduced since the last Court meeting. There were people in the sterling money markets looking for a cut, though that was not a widely held view.

Ms Barker noted that one of the features of the data was that business confidence in the Euro area had not pulled back much despite big falls in equity markets. She asked Court Members how they felt about the prospects for their businesses. Mr Neill said he tended to shut his eyes and forget about the equity markets in the hope they would get better, but he was concerned about the effect on Pension Funds. In the motor industry, September was 2% down and October so far was down 5%. The industry forecast for the month were between 175,000 and

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195,000, against 185,000 a year earlier. This implied that some were looking at real underlying demand and others were factoring in the incentive actions they knew they were going to take in the last few days of the month to push the numbers up. Very aggressive pricing was being seen. His view was that October sales would be about the same or slightly less than a year earlier, which had been a strong month. He asked for the MPC's view on where interest rates were in real terms and also on the issue of deflation. He said he was concerned to see a description in the Financial Times of the state of German banks, and suggestions that this was echoing Japanese banks, and he asked whether there were parallels. Were there implications for activity in corporate UK? Mr Bailie said it was a question of half empty against half full. Most people he spoke to did not anticipate that it would get much worse or indeed much better. There was a view that there was some form of equilibrium. He noted the issue of National Insurance and also of insurance costs. There was very little evidence that people believed an interest rate cut would make any difference. He noted a major review underway of local Government in Northern Ireland. Most of business in Northern Ireland felt too much was spent on local government, and the number of people going into it was to the detriment of the private sector. Ms Blow noted the importance for IT and support companies of having a good public sector customer base, because there was a problem for those dealing only with the corporate sector. She also commented that the market was not differentiating properly between businesses performing well and those that were depressed. Mrs Francis noted that the way the solvency regime produced a clear point at which there was a need to sell equities to buy bonds for stability. There was very much less clarity over when the reverse might happen, with purchases of equities again. Companies did not wish to pay transaction costs till they were sure the market had a clear upward trend. As and when that happened, the behaviour of institutions could drive the market up again quite rapidly, though that point had not yet been reached. A longer term question was whether institutions would feel that as a result of the last couple of years they should have a smaller percentage of equities in their holdings.

Dr Julius noted a possible structural change in the UK markets. Those companies at the small end of medium were finding it very difficult at this stage to raise money. The markets were not differentiating among companies as much as they normally do. This was exacerbated by firms such as Goldman Sachs and Merrill Lynch downsizing their analytical capability so they did not cover so many smaller companies. She noted that she had spent a month in the US and the view on the West Coast was that there was no sign in the corporate world of an improvement.

The view in Washington was different, indeed complacent. This was helped by the fact that the public sector was insulated. The New York view was much more pessimistic, and she noted the job losses in the financial sector there. In the Mid West she detected a feeling that everything was on hold until things got better. What worried her in the US was that there was no positive news on the horizon and confidence was fragile. The Governor agreed that there were different attitudes in different parts of the US. In Washington economic analysts dominated the view, New York was suffering its own particular difficulties but he thought that the West Coast views were more positive. It was inevitable with this uncertainty that different impressions were gained.

Mr Hall noted the improving performance of financial services in Yorkshire and the Humber. Mr Morris said that the picture in the labour market was fairly steady but he was not sure whether this was dealing with perception or reality. People were expecting the economy to perform a lot worse. Key opinion formers such as the CBI were making gloomy predictions and that was impacting on decisions to be taken. Confidence was beginning to be at the lower end of expectations. He did not believe these pessimistic judgements were being made on clear hard facts. The numbers did not indicate that economic performance was any worse. But there was a feeling that it was getting worse and may get a lot worse. At some point a more optimistic message needed to be given. Mrs Powers-Freeling noted that her organisation had a monthly set of focus groups. These showed scepticism about investment. They also indicated that people expected to spend more at Christmas, which was a surprise. This might be because people expected the outlook to be much worse next year. That implied that spending might go up because it was about to drop off. The Governor noted that that was what the MPC wished to see in the event that the global economy picked up. Sir David Cooksey said that in some areas of business there was a complete drought of investment even for equipment that was strongly productivity improving. Decisions were being delayed. That was seen particularly among the investment banks. He noted that there was an issue of whether the lack of confidence in the City and the impact on investment was related to the fact that City jobs were most at risk. Professor Nickell, responding to Mr Neill's question, noted that the last page of Mr Bean's handout was very informative in that it showed the prices of goods falling into negative territory but services inflation being the highest since 1993. Turning to real interest rates, he said the MPC had to look at the average, but in this respect services and manufacturing were moving further apart.

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Agent's 'Issue of the Month'
(Messrs Clark, Bean, Tucker, Ms Barker, Ms Bell, Mr Allsopp, Professor Nickell and Messrs Jenkinson and Strachan in attendance)

Mr Strachan presented the findings of a survey carried out recently by the Agents concerning prospects for the service industry. In response to a question from Mr Neill, Mr Strachan said one of the major contributors to the transport side of the survey covered airline passenger numbers and there was a general feeling that business was tough, due to competition rather than volumes. Mr Jenkinson noted that transport sector output had fallen 1.9% over the year against a rise of 1.9% in services and the sub-sector was clearly under pressure. Mr Morris noted a chronic shortage of drivers and engineers in the transport sector. In response to a question from Mr Hall about the size of the service sector, Mr Jenkinson said it was two-thirds of the whole economy. Mr Strachan noted that there was a higher response rate than usual to the survey and it was broadly representative of sub-sectors outside public services. The surveys by the Agents tried to capture start ups and young companies. In response to a question from Mrs Francis, Mr Strachan said that there would be companies in the survey whose business was influenced by public sector orders but which did not regard these as their principal source. Although the survey was primarily of private service it did support the point that activity was moving from the private to the public sector.

Non-Policy meetings of the MPC
(Messrs Clark, Bean, Tucker, Ms Barker, Ms Bell, Mr Allsopp and Professor Nickell in attendance)

Mr King noted that the paper before Court listed three meetings held since April.

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

Mr Clark introduced his bullet point note. Dr Julius agreed with Mr Clark that there was not much demand for loans in Japan and asked whether there was evidence in Germany that demand for loans had fallen off. Germany was the next country for which there were concerns

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about deflation. Mr Bean noted weaker investment in Germany as a result of the normal determinants of demand, but in addition there may have been a lack of supply of loans, further depressing investment. The ECB view was that part of the weakness of investment had to do with a credit crunch effect. The Governor said that this particularly affected the Mittelstand. Mr Stretton said that this went to the other Bank purpose of ensuring there was adequate infrastructure in the UK for supporting the provision of finance. The regulators had a clear mandate that they should be seen after the event to have acted in a way that made failure less likely. The fall in equities had an impact on the way businesses could raise money. Part of the Bank of England's job was to see how the whole structure fitted in with the third core purpose. He asked whether the Bank was doing work to see if the whole structure operated in a way that helped the economy, or was it hands off in that it was leaving the issue to the regulators to deal with? Mr Clark said this issue was regarded as part of the Bank's brief. On the insurance sector and the resilience test, the Bank had had extensive talks with the FSA. There were questions about whether regulatory requirements could be designed in a better way. It was important that in the long term there was no impediment to the availability of capital. With respect to the flow of savings from institutions to corporate borrowers, the Bank had an extensive exercise looking at how the situation had evolved. The Governor noted that in relation to banking regulation, there was bound to be an element of procyclicality. The issue had been visited in relation to the Basel Rules.

Dame Sheila McKechnie said that the retail financial sector was perceived to be extremely unstable. She noted the potential effect of one or two significant failures on consumer confidence. Mr Clark said such issues had been addressed by the Standing Committee throughout the period. It had had in mind the possibility that a significant upset would not just affect the company concerned but would also affect the attitude of savers to a whole class of institutions. Turning to contagion, he said it was conceivable that in extreme circumstances policy holders in an insurance company would cash in their policies and accept the penalties. There was an argument that with terminal bonuses down the cost of that penalty had also declined. But it was necessary to work hard to construct a scenario where that was rational.

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MARKET OPERATIONS ISSUES
Quarterly report on current developments
(Messrs Clark, Bean and Tucker in attendance)

Mr Tucker introduced his paper. The Governor asked Members of Court to raise any points they had directly with Mr Tucker and if they wished to bring any issues back to Court he would put them on the agenda for another meeting.

EXECUTIVE REPORT
(Messrs Clark, Bean and Tucker in attendance)

The Governor said that there were some domestic matters involving appointments to the boards of two Bank subsidiaries and one chairmanship which, in accordance with Matters Reserved to Court, required the consent of Court. These resulted from the change over of Deputy Governor for Financial Stability the previous month. He drew Members' attention to two resolutions in their folders – namely that consequent upon the appointment of SIR ANDREW LARGE to the position of Deputy Governor, Financial Stability and pursuant to Section 375 of the Companies Act 1985, as amended and extended by the Companies Act 1989, and until otherwise resolved by the Court of Directors:-

1 (a) SIR ANDREW LARGE should become a Director of Bank of England Nominees Ltd in place of MR D C CLEMENTI. The board would then consist of Sir Andrew Large, (Chairman) and Ms M V Lowther.

1 (b) SIR ANDREW LARGE, or failing him, MS M V LOWTHER, be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of Bank of England Nominees Ltd.

2 (a) SIR ANDREW LARGE should become a Director of BE Property Holdings Ltd in place of MR D C CLEMENTI. The board would then consist of Sir Andrew Large, (Chairman) and Mr P A C Smout.

2 (b) SIR ANDREW LARGE, or failing him, MR P A C SMOUT, be authorised to act as the representative of the Governor and Company of the Bank of England at any meeting of BE Property Holdings Ltd.

It was further recommended to Court that, pursuant to Clause 3 of the Trust Deed of the Houblon-Norman Fund, with immediate effect and until otherwise resolved by the Court of

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Directors, SIR ANDREW LARGE be appointed to succeed MR D C CLEMENTI as both a Trustee of the Fund and the Chairman of the Trustees.

Court APPROVED the recommendations.

Sir Andrew Large noted that UNIFI with regard to the BenefitSelect Tribunal result earlier in the year had decided to appeal in relation to the issue of proper consultation. The text of the appeal had not been seen yet but the lawyers felt that it was unlikely to succeed. However, there was likely to be quite a delay before finality.

The Governor suggested that in view of the shortage of time the Quarterly Financial Report be postponed.

Referring to the Parliamentary answer on Non-Executive Directors' appointments at the Bank, published the day before and circulated to Court Members, Sir Brian Moffat said that in a normal governance situation the Board usually had a view on Board performance and he hoped the Treasury, if it was considering introducing formal performance assessments of Non-Executive Directors of the Bank, would consult with that body. The Governor said he had made the point to the Treasury.

MANAGEMENT OF THE BANK
Mid-Year review of performance against objectives
(Messrs Clark, Bean, Tucker, Smout and Footman in attendance)

Mr Footman introduced the review. He drew attention to the red indicators and noted the higher level issues which would have to be commented on in the Annual Report. Dame Sheila McKechnie noted that in the reference to statistics everything was mentioned but the dependence on the Office for National Statistics, and that was a very big factor. In the light of developments with the census it would not be possible to go back to the Treasury Committee without commenting on the service from the ONS. Mr Footman said that would be for the MPC processes section of the Annual Report. Mr Bean said it was not clear to him that that issue belonged in Mr Footman's review which was about the Bank's rather than the ONS's performance.

Mr Neill, turning to Objective 4, asked to what extent the Bank felt it was responsible for measuring and creating understanding and trust in the wider financial system. He noted a reduction in public trust in financial institutions and company accounts. Mr Clark said the Bank did not measure it, but there were market measures of confidence in retail financial services and there were surveys of attitudes to financial sector companies. It was not exclusively the Bank's job to look at these issues but it was something that the Bank felt it should aim to contribute to. There were other public bodies such as the FSA and the Treasury which had a major contribution to make. The Governor said the Bank's remit was very much focussed on the stability of the financial system, not public confidence. If the system were unstable it was possible that public confidence would decay, with an impact on the functioning of the financial system. He warned against the Bank going outside the remit. Dame Sheila McKechnie said that the surveys were disturbing and she noted in particular the negative shift of attitudes on pensions.

Dr Julius asked whether one reason behind the delay on Globus was the management effort required to sort out printing issues. Mr Footman said that there had been a diversion of resources in the note issue area but this did not affect Globus at all. It had diverted attention from the note distribution scheme, not from Globus.

Sir Andrew Large said that with respect to Globus, Court should know that a significant exercise was underway to identify the nature of the problems and the implications and to try to minimise the knock-on effect on other projects. He would like to bring a report to Court as soon as possible.

Mrs Powers-Freeling asked whether Court could be given a method of interpreting the red boxes a little more informally by, indicating the implications for costs and for risk. The Governor said this was a helpful point and it could certainly be done.

There being no other business Court was up.

David Cooksey

Peter Rodgers
20 November 2002

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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 20 NOVEMBER 2002

Present:

The Rt.Hon Sir Edward George, Governor
Mr King, Deputy Governor - Monetary Policy
Sir Andrew Large, Deputy Governor - Financial Stability
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir John Bond
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Mr Hall
Dame Sheila McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Ms O'Donovan
Mrs Powers-Freeling

Absent:

Dr Julius
Mr Stretton

The Governor thanked Members of Court for their support in Liverpool in October which he believed was a very successful visit. He appreciated the presence of so many Directors. The Bank was thinking of holding Court in the East Midlands in October 2003. The Bank would be exploring that option and would report back to Court.

The Minutes of the Court of 16 October, having been circulated, were approved.

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MONETARY STABILITY ISSUES
Inflation Report and economic and monetary discussion, incorporating the monthly MPC Report to Court
(Messrs Bean, Tucker and Allsopp in attendance)

In introducing the MPC Report to Court, Mr Bean said that global recovery remained patchy and US consumer confidence fell sharply in October, with retail sales flat, though they were up 0.7% after excluding automobiles. That was not as bad as feared two to three weeks ago. Business confidence was muted in the US and euro areas. Japanese GDP rose 0.7% in the third quarter, which was a good sign. UK manufacturing output fell in September due to a sharp decline in motor vehicle output, but the underlying trend was flat. Services remained buoyant and business confidence was just about holding up.

Turning to demand, he said consumption remained robust and confidence was still strong with borrowing growth up again. He noted that annual house price inflation was in the 25 – 30% range and house price rises were more widely spread. The Halifax house price number was published the day after the last decision, but the MPC had a preview available for their policy meeting.

Turning to the labour market and prices, Mr Bean said unemployment was relatively flat, with pay growth steady, while oil prices had fallen back. There was a blip in producer prices due to the fall in oil prices last Autumn, and RPIX inflation rose to 2.3% in October, due to petrol prices and housing depreciation costs.

Turning to the Inflation Report projections, Mr Bean said that GDP growth was projected to rise above trend before dropping back, and inflation would also rise above target temporarily with the main driver of the near-term increase, being house prices. The major risks were from the world economy, from the consumer, and National Insurance contributions and pay growth. The overall risks to growth were all on the downside and the risks to inflation were on the upside. He noted that interest rates had been left unchanged at 4%. He also noted the MPC vote of 7 to 2 in favour of no change at its last meeting, as set out in the minutes released that morning.

Turning to the markets, Mr Tucker noted that expectations of an interest rate cut rose on the eve of the last meeting after the FOMC's 50 bp cut, but since then the market had concluded that a cut was not in prospect. He noted that dollar interest rates had shifted down as a result of the Fed cut but a more interesting movement was the shift downward in the curve of euro interest rates as a result of quite a strong expectation of a cut by the European Central Bank at its next meeting. Until about 9 October the probabilities of a movement either way in the S&P 500 index had shown that an increase was more likely than a decrease. Since then, the probabilities of up and down moves had become more equal and uncertainty about equity market levels had reduced. Mr Tucker also noted that US bond market borrowing conditions had remained difficult.

Mr Allsopp said he was particularly interested in the news from the eurozone as well as from the US. He noted that on several recent regional visits he had found the attitude to house price rises different from that in London. He asked for Court's comments on regional house prices.

Sir Howard Davies said that nervousness about financial prospects was great and he expected further news to worsen the picture in the short run. Investment banks had concluded that the upturn was further away and substantial job cuts might be seen in the City, which could have a confidence effect. In addition the financial pressure on the investment, insurance and pension fund industries remained strong, with continued uncomfortable news emerging for retail investors. This had not so far had an impact on spending, but it might at some point, as people saw that their wealth was declining.

Turning to Germany, Sir Howard said confidence was at a low ebb and banks were significantly worse capitalised than their UK counterparts; a fact which had been spotted by the markets. German insurance companies were also in considerable difficulty. The only way they could ease their position in the short term was by cost cutting, which implied significant job losses.

Sir Howard asked Mr Bean how he interpreted the move by the US Federal Reserve. Mr Bean said there was tension between the public explanation and what the MPC thought might have prompted the cut. The Fed Statement said it was designed to get the US economy through a soft patch, but most of the MPC saw it as a move to avoid any likelihood of deflation. Sir Ian Gibson noted continuing optimism among Spanish businesses, though it was difficult to determine why: there were deep concerns in Italian business arising from Fiat's difficulties: and

German manufacturers across the automotive industry were very gloomy, which was reinforced by the situation of their own banks.

Turning to regional house prices, Sir Ian noted that in the north people were very relaxed about increases, and took the view that they were overdue, not extreme and also a necessary adjustment relative to the south. There were no concerns.

Mrs Powers-Freeling noted that a survey by Marks & Spencer of what people owed and what they thought they owed showed that there was a gap of between 18 & 25% between the two. In response to a question from Mr Hall about the impact of charging full council tax on second homes, Mr Bean said that the Bank had not yet done any work on that, but staff would analyse it in due course. In response to a question from Sir Brian Moffat, Mr Bean said that job losses were continuing in manufacturing but were being offset by recruitment in the public sector. He would not expect the trends to continue indefinitely but the public sector would continue to recruit in the near term. Sir Brian noted that in Germany businesses complaining that the cost of shedding labour was prohibitive. Dame Sheila McKechnie noted a sharp increase in calls to the national debt line. The main problem was now credit cards. There were also signs from consumer advice bureaux of increasing financial distress. She asked how important it was to know when consumer confidence dropped off a cliff, and how good were the tools for measuring it. Mr Bean said that the real problem was that data was needed on individual households. The likelihood of serious problems depended on the distribution of debt across households. If debtors were likely to loose their jobs, that was something to worry about. But there were not many sources of data and those which were available came out with a lag.

Sir John Bond, in answer to a question from the Governor, said that no deterioration in household credit quality had been brought to his attention. The Governor said that was the same answer he had received from banks and building societies. Sir Howard Davies said there was not much sign in indicators such as mortgage arrears. The worst distress currently was in the informal credit sector, not the regulated sector. Ms O' Donovan asked whether age distribution had anything to do with the robustness of consumers. She also noted that large companies and advertising firms routinely sought detailed data on attitudes to spending.

Mr Bean said that the Bank had a project in Mr Bond's Division looking at the impact of ageing on consumer spending, but this was really a long term issue, not a quarter to quarter question for the MPC. But in considering movements in savings rates over periods as long as a decade, it was impossible to avoid getting into those sorts of issues. Mr Morris noted that a lot of 2 to 3 year pay agreements were being settled, and these gave some stability.

Productivity in the UK
(Messrs Bean, Tucker, Allsopp, Bond and Jenkinson in attendance)

Mr Bond introduced his paper. In response to a question from Mr Morris about companies' hurdle rates for investment, Mr Bond said that firm-level issues were a big part of the Department of Trade and Industry's productivity agenda. The DTI was looking closely at firm level comparisons. Hurdle rates of return were one aspect of this. Another was the role of entry to and exit from industries. In the US, a big driver, was the ease with which firms could be established and with which poorly performing firms could shut down. Mr Neill thanked Mr Bond for the paper, and commented that the most important factor driving productivity performance was competitive intensity, which applied to the private sector but not to the public sector.

Sir David Cooksey noted the attractions of China for the location of manufacturing investment, which he believed was a huge danger for manufacturing in Europe as a whole, including the UK. Turning to the public sector, Sir David asked whether Britain was lagging on public sector productivity or whether the issue was the problem of measuring it. He also noted that contracting out had largely stopped in the public sector since 1995, and he believed this would be an issue to revisit if the UK were to re-establish the productivity gains needed.
Sir John Bond noted the importance of productivity gains as well as cost savings in business decisions to establish operations in India. Mr Hall noted four key obstacles to growth as set out by the nine regional development agencies: transport, planning, skills and red tape. He asked whether there was any way the Bank could help by highlighting some of these issues.
Mrs Powers-Freeling noted that ICT did not necessarily change a firm's activities but it could provide more service for customers.

The implications of EMU entry for the Bank
(Messrs Bean, Tucker and Allen in attendance)

Following the paper addressing the impact of the introduction of the euro on the Bank, discussed in September, Mr Allen introduced his latest paper, which provided a broad outline of how the Bank would be affected were the UK to join the euro.

In response to a question from Sir Brian Moffat about minimum reserves, Mr Allen said there would be some effect on the Bank of the minimum reserve requirement, but it was not an interest free deposit. Sir David Cooksey noted that the paper said that Monetary Analysis would continue to advise the Governor in a different role after monetary union, but he wondered whether over time there would be a shift of that work towards the ECB. Mr Allen said that the Bank's approach would be to make the changes needed when it joined, but from then on to review the issue continually, adopting a softly approach. Mr Hall asked whether, in parallel, the Bank should carry out zero based budgeting to see what it would need to do to satisfy its functions within the Eurozone. The Governor said he believed the Bank would have quite enough to do on the "softly softly" basis. Other central banks had adopted the euro and then asked themselves where to go from there, rather than reinventing the central bank in order to go into the euro.

Sir John Bond said that the key to the successful cash changeover in the Eurozone was that there was one controlling entity in each country, and that should be the role of the Bank of England in the UK. The Governor said he found it very difficult to see that it could be any body other than the Bank because it was a Euro system issue. In response to a question from Mrs Francis, Mr Allen said that the Bank believed it could achieve what the ECB required in the time set out. If Globus was delivered in Spring 2003 that would meet the timetable.

In response to a question from Mrs Powers-Freeling about risk analysis, Mr Allen said the Bank believed it could do what was needed in the timetable set out in the report. There were project risks, but the Bank did not believe it was justified in spending money ahead of a Government decision. Sir Howard Davies said that financial stability responsibilities were a matter of debate within the European Union, and this was not made easier by the fact that no two countries were identical in how they divided responsibilities for financial stability and supervision. He wished to put down a marker that at the point of decision the Bank and the

Financial Services Authority would need to devise a clear strategy as to how they would operate in various committees of the ECB. He was not talking about any significant change of role. Financial stability was a responsibility the Bank should keep. But there was a spectrum of responsibilities, and so in certain decision forums of the Eurozone the FSA needed to be involved, and in others it did not.

MARKET OPERATIONS ISSUES
Current issues
(Messrs Bean and Tucker in attendance)

Mr Tucker introduced his bullet point note on current issues in the market area: money market instrument reform, the Euro note programme, and the six monthly meeting with the Treasury on the Exchange Equalisation Account. There were no questions.

EXECUTIVE REPORT
(Messrs Bean,Tucker and Ms Lowther in attendance)

1) The Governor said that due to time constraints at the meeting the previous month, Court had to postpone its discussion of the Quarterly Financial Report covering the period June to August. Court had been invited to contact Mr Smout with any issues requiring clarification, and some members had done so. He hoped Court was content that no further time needed to be set aside to discuss the report further. Court was content.

2) The Governor reminded Court that Mr Kemsley, the Bank's former Agent based in Liverpool, had been a director of the Merseyside Special Investment Fund (MSIF), which provided venture and loan capital to fill gaps in the funding of investment to small and medium-sized companies in the Merseyside region. Mr Kemsley had taken on that responsibility whilst working for the Bank. The view had been taken that to preserve communications between MSIF and the Bank, it was appropriate for a serving member of the Bank's staff to be the nominated member on MSIF's board. Mr Strachan, who succeeded Mr Kemsley as Agent for the North West, would now succeed him on MSIF's board.

3) The Governor reported that Lord Haslam a former Non-Executive Director, had died recently.

4) The Governor noted that in October Sir Andrew Large had reported that Unifi had decided to appeal in relation to the issue of whether there was proper consultation over the Benefit Select Tribunal. The Bank had now received the text of the appeal together with an order from the employment appeal tribunal setting up an ex parte hearing calling for submissions. The Governot said that it was difficult to understand why Unifi was pursuing the case. But perhaps it had become a matter of principle over the interpretation given by the Tribunal, which could have implications for the application of the industrial tribunal process in a broader way.

5) The Governor invited Sir Andrew Large and Ms Lowther to introduce the paper on the delay to the Globus project. Ms O'Donovan noted that Ms Lowther had been invited to the meeting of the Audit Committee that afternoon. She noted that the issue had implications for the control framework and raised questions about the management of the project itself. The Governor said he appreciated the fact that the Audit Committee would pursue some of the detailed reasons for the delay that afternoon. Mr Neill said that IT programme over-runs were an inevitable fact of life, and he recommended very detailed reports from the suppliers and the very fullest of customer testing. Ms Blow said it was a very honest report of a familiar story. She believed the Bank needed external help to get the project under control, and said there were firms used to picking up such situations. To have a second look on behalf of Court would be helpful. Sir Ian Gibson said he would go one step further than a report from the software supplier. It was necessary to sit down and go through the supplier's planning to ensure that it was right. The Bank needed external support for that. At the point the suppliers were sent off to implement the plan once it had been approved, the customers should be brought in. Mr Hall welcomed the report, saying it gave a lot of comfort. IT programmes did slip. Once Globus had been delivered there should be a paper on the lessons learnt. Mrs Powers-Freeling said it looked as if the project had lots of owners and lots of people who could have a say. She noted the importance of shutting down change during the implementation of a project. This one looked as if it ought to have had stronger single control. Sir David Cooksey noted that he had spent half a day with Mr Brookes and his team. The difference between the average load and the peak load in the

process was a factor of 100 and that was a problem for any IT system. He could well understand how the problem had emerged.

6) Mr King reported on the appointment on Mr Chilcott as Head of Risk Analysis and Monitoring Division following the change of responsibilities for Mr Ingram, who was to be appointed to a new post of project co-ordinator for the Process Coalition (Market, B&MS, and FRPD).

MANAGEMENT OF THE BANK
The Bank's Strategy and Objectives 2003/04
(Messrs Bean, Tucker, Footman and Smout in attendance)

Mr Footman introduced the Bank's strategy paper. In response to a question from Mr Bailie about Registrar's, Mr Footman noted that there was a problem in maintaining the commitment of staff when there were still two possible outcomes from the deliberations. One was to close the operation and offer a redundancy package, which would give people something to aim for. The other might be to transfer it to another operation, in which case TUPE would come into force, and there would not necessarily be redundancies. There was a further question about whether under TUPE a transfer to an employer at a different site would be acceptable. He noted that the Bank had been considering a long-term deal for staff including retention bonuses to keep them motivated during this final period. These issues were being discussed with the Chief Registrar.

Mrs Francis asked whether in the context of Cash Ratio Deposits the Treasury was expected to put a squeeze on at some point. Mr Smout said the Bank did not yet have clear indications from the Treasury as to its plans for the Bank over the coming five years. The review of CRDs would be a natural way to do that. The original agreement with the Treasury envisaged a review after five years. It was open to question whether it was sensible to have a fundamental review if within a number of months the position would be clouded by the possibility of Euro entry. The Bank had not yet been able to establish from the Treasury what attitude it took in the medium term. But he hoped the Treasury accepted that it was not sensible to have a fundamental review while the Euro outcomes were uncertain. He believed the Treasury would wish the Bank to aspire to increase productivity in the long term but he did not have an indication from them as to whether they wished to give that force by having numerical targets.

Court made a number of points about the drafting of the 10 Bank-wide objectives. Court agreed with a proposal from Mr King that objective 1 should be changed to read "maintain and where possible enhance the quality of information and economic briefing provided to the Monetary Policy Committee". The Governor suggested that the Bank come back to the next Court meeting with a revised version of the Bank-wide objectives.

The Printing Works
(Messrs Bean, Tucker, Smout, Footman, Thompson and Ms Lowther in attendance)

Sir Andrew Large and Mr Smout introduced the paper on the future of the Printing Works.

Mr Smout explained that the proposals had been examined against three criteria: the interests of the staff, the security and quality of note supply, and price. One proposal, under which the operations would be significantly expanded under Bank ownership, had been considered carefully but rejected.

As far as the staff were concerned, the Bank had consulted with unions and staff and it was clear that they preferred to remain as part of the Bank of England, even though they knew that would involve a significant number of redundancies. Oberthur's bid involved no planned redundancies, while a purchase by De La Rue might be more likely to lead to tensions. So far as quality and security of supply were concerned, all of the possibilities appeared satisfactory, although Oberthur were the weakest financially. On price comparison was complex; for instance Option A (current ownership) was not a firm price, and there were some upside risks to it. Finally, there was the question of timing, with the staff expecting an announcement soon, but where there was uncertainty linked to the possibility of euro entry.

The Governor said there were three questions: did Court agree that the sale of the operations was the best option? GovCo was persuaded that that was the case. A subordinate question was whether the Bank should go straight to De La Rue, since the price advantage was quite clear. But he noted that the interests of Oberthur and De La Rue in Debden were different, with the former's interest being more strategic in nature. So there was a case for going back to both and asking whether this was the best price they could offer, which would be done in a short space of time.

The third question was whether there was an argument for delaying until more was known about the Euro decision. The Bank and the bidders would then know what they were dealing with. The Governor said he was not sure whether that was an advantage or a disadvantage. If the Government were not to go ahead with the euro then the sale might perhaps be a less attractive proposition, since there would be less scope for printing the launch stock of euros, though the pricing would be more solidly based. The Governor said he would appreciate Court's advice.

Mr Neill asked how much would be paid for the printing operations. Mr Smout said that the operations would be sold for net asset value to whichever of the two bidders was successful. The advantage for the Bank would be a seven year supply contract at a lower overall cost than in-house printing. Mr Smout also noted that there would be credit risk over that period. The judgement between bidders would be made on the price of the notes.

In reply to a question from Sir David Cooksey, Mr Smout said that the benefits of releasing Bank capital tied up in printing operations would be relatively small. Sir Howard Davies said it was important to set out the basis on which these public sector assets were being sold (ie at net asset value) for the record. Sir Howard said that on the balance of advantage he was in favour of going ahead. A delay would create continued uncertainty for staff and a continued opportunity for canvassing of other solutions.

Mr Bailie said he found it strange that the gap between the price at which the Bank could produce notes in the initial years and the opening bids from De La Rue and Oberthur were so large. That needed debate. But otherwise the commercial arguments were sound, and he also noted the capital investment implications of continuing production within the Bank. Turning to the timing of a sale, he had concerns, as did Sir Howard Davies, over what message would be sent to staff if Court decided yes but not yet, which was the worst position to be in. Uncertainty over the euro was an issue for the buyer. Given that a delay could be as long as twelve months, there was a danger that the bidders could walk away. He questioned whether on the public relations side the Bank would be sending a signal of knowledge or influence over the euro decision if it went ahead now. It was a banknote contract with the possibility of specification changes built in, rather than a contract for notes of any particular currency, and that could be handled on a public relations basis. Mr Bailie said his view was that the decision should be made by Court that day.

Sir Brian Moffat said he understood the inclination to go back to the bidders but he did not understand what leverage the Bank would have on Oberthur, given the gap there was now on prices. The best approach must be to go to the favourite bidder and ask if they could sharpen their process a little, and say that if they did so they would get the contract, though without going further than that. He advised the Bank not to wait but to get on with it.

Sir Ian Gibson said it was wrong to contemplate postponing the sale until after the euro decision. That should not be on the agenda. In the automotive industry, a bid such as that from Oberthur would be ignored, and De La Rue would be approached with the message that the costs in years 1-3 were too high, and a request to the company to suggest what they might do in order to clinch the deal. They should be given only a week to think about it. Sir Ian advised compressing the timescale to deal with staff concerns as quickly as possible.

Mrs Francis said she supported going ahead. She asked whether the risk was that the Bank would have to pay De La Rue compensation if it went to someone else for euro notes.
Ms Lowther said that the contract committed the Bank to placing its regular euro stock with the supplier. The contract provided for change in the technical specification, including the switch to the euro, and it also provided that prices would be re-examined in agreeing the new technical specification. There was an inherent uncertainty about what that price would be. De La Rue had made all the right noises about the price for the euro notes but they had also made the point that there was over-capacity in the industry and a large number of public sector printers, which indicated that they had concerns about possible dumping. These were issues. But there was a mechanism in the contract for getting a fair price for the euro notes for regular stock. However with regard to the launch stock the contract made no promises, and the Bank had discussed with the two suppliers the options for dealing with that. The prices offered reflected no commitment on the part of the Bank to give an order for the launch stock. Ms Lowther and Mr Smout agreed with Mrs Francis that if it were found that buying from De La Rue was unnecessarily expensive the Bank would have an option under the contract to move after seven years.

Mr Morris said he understood the arguments about the euro, but did not see them as material to the decision. He was in favour of going to Oberthur because one of the criteria on which the proposals were being assessed was the interests of the staff. Oberthur offered greater certainty to them. He also noted the importance of explaining clearly the value of the business. A decision had to be defended. Subject to these considerations he did not think there was much value in delaying, apart from going back to seek to improve the price.

Mr King said that he believed the right way to go in the long term was to move printing into the commercial sector. But, for the record, he wished to note that he had serious reservations about signing before the announcement on the five tests. He noted that he was a minority of one in Govco on this subject. If the Bank knew it was going into the Euro area, the contract would be different, because Euro notes were very different. If the Bank knew it was going in, it might also take a view that Debden did not have a long term future and look for the cheapest printing option wherever it could find it. It would not have gone down this road of committing to a strategy for Debden. So there were serious difficulties in thinking about the contract until the Bank knew whether it was going into the Euro or not. It would also be difficult to explain why the Bank was paying compensation to a private sector company, if that arose, if it appeared that the compensation would not have been necessary as long as the Bank had waited a further two to three months for a Government decision. Furthermore, there was an uncertainty premium, given the different cost structures priced into the bid. As a matter of principle it made sense to wait till the decision had been made in order to be clearer about the contract. He did not believe that going ahead with De La Rue would guarantee the future of Debden for longer than the contract period.

Looking at the cost diagram in Mr Smout's paper, it did not seem that De La Rue was cheaper until year 4. More work should be done on the cost issue. Without the assurance of genuine cost advantages it would be better to delay. Over the lifetime of the contract the Bank might be paying more than it would have paid if it had gone to surplus producers in Europe. People might then say "if only you had waited". On the other hand, if the assessment of the five tests was that it was not yet time to go to a referendum, the contract would be easy to prepare and it would be simple to go forward.

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The Governor noted that compensation payments were triggered only if the Bank were unable to place an order with Debden for regular orders of euro notes.

Mr Hall said the Bank should outsource the printing of bank notes. It was then a matter of timing. The key to him was the people. The Bank-wide objectives included "building strong staff motivation and morale". Delaying would have a negative impact on that. He supported the option of moving now.

Mrs Powers-Freeling said she agreed with Mr King on the timing point. It was odd to go ahead with a decision when in a matter of months there could potentially be greater insight for the Bank. She noted that Oberthur was one of her company's suppliers. Her sense was that this was a strategic area for Oberthur and that it could be pushed harder but they would not move until there was a threat to walk away. She was in the camp that said that Court should not decide now. But if it did, she believed the Bank should go back to Oberthur as well.

In response to a question from the Governor about the argument for choosing De La Rue immediately, Sir Brian Moffat said that if the Bank went back to both bidders each of them would soon know that the other had been contacted. Sir Ian Gibson agreed. Sir David Cooksey noted the risks of disenchantment among the bidders if the public sector delayed and procrastinated about the sale of assets. If the Bank wanted the best deal it would get it now, not later.

Mr Neill said he sided strongly with Sir Ian Gibson on the question of going back only to De La Rue. He believed the Bank should go ahead. However, he did not believe that there would be a crisis of morale if the Bank delayed. He also advised the Bank to negotiate firmly with Close Brothers on fees and he would like Close Brothers to know that the fees would be reported to Court.

The Governor suggested that Court should take a decision to go ahead. The Bank had then to inform the Treasury that it was planning to go ahead. The Treasury may have a concern about the possible implications for the euro decision, and the Bank had to give the Treasury a chance to express that view.

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The Governor commented that he was puzzled by the commercial logic of going to one bidder but not the other. A consideration for the Governor, and one where he agreed with Mrs Powers-Freeling, was that for Oberthur this was a very important strategic matter because they wanted a new plant. So he could not see a disadvantage in going back to Oberthur as well. The key was that whoever the Bank went to, they should not be given very long. It was not a matter of reopening the negotiations but solely a question of discussing price.

Mr Bailie said that this particular aspect was a management decision. In response to a question from the Governor, Court was content to leave that aspect to the Bank. The Governor said that he took it from the discussion that Court was content to answer that there should be no delay unless the Treasury said it was concerned about announcing the decision in the period ahead of the decision on the five euro tests.

ANY OTHER BUSINESS

There being no other business Court was up.

David Cooksey

Peter Rodgers

18 December 2002

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 18 DECEMBER 2002

Present:

The Governor
Mr King
Sir Andrew Large
Mr Bailie
Ms Blow
Sir John Bond
Sir David Cooksey
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Mr Hall
Dr Julius
Dame Sheila McKechnie
Mr Neill
Ms O'Donovan
Mrs Powers-Freeling
Mr Stretton

Absent:

Sir Brian Moffat
Mr Morris

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

MONETARY STABILITY ISSUES
Economic and monetary discussion, including international economic developments, together with the monthly MPC Report to Court
(Messrs Clark, Bean, Tucker, Allsopp, Ms Barker, Ms Bell, Professor Nickell and Mr Bailey in attendance)

Mr A Bailey introduced his paper on international issues. Mr Bean introduced his charts summarising UK economic output, demand, household debt levels, labour and prices. He noted that GDP was up 0.8% in Q3 and services were robust while manufacturing growth had apparently bounced back. But the underlying level of manufacturing output had been flat since the start of the year once Jubilee distortions were allowed for. Confidence was a little lower. On the demand side consumption was up 0.8% in Q3 and retail sales were strong so far in Q4, with house prices up again and also a small increase in confidence. Investment was weak in Q3 but public spending strong, while the trade deficit widened.

Turning to household debt, Mr Bean drew attention to the charts showing debt levels were high and rising.

Income gearing was still relatively low, and those with high debts also had high incomes and assets suggesting households might not be unduly stretched. But those with high debts had few liquid assets suggesting a rather more precarious picture.

Turning to labour and prices, he noted that employment was up, largely due to the public sector, and wage growth was steady. Producer prices fell in November but RPIX inflation was up to 2.8%, driven by housing depreciation and energy.

Mr Tucker noted that there had been few developments in the month but he drew attention to the market chart number 2, which showed that expectations of sterling interest rates had barely changed over the last month, and rates were expected to be unchanged until mid-2003.

Mr Neill noted that in the first 10 days of the month, which included one extra day, the car market had shown a year-on-year drop, and the expectation was of a fall of 5% in December. The full year would still be an all time record. The industry was convinced that there would be a decline in 2003 and probably the year after. Mr Bailie said the reports he heard were of confidence weaker than at any time in the year and people were very concerned about the following year. Minds were focused on issues such as pensions, insurance, national insurance and the stock market at a time when businesses were completing 2003 budgets. There were very few opportunities to pass on cost increases. People had held on to labour in anticipation of an up-turn but some were now in the process of, or strongly considering, laying off people. Sir David Cooksey said that almost all of the companies in which his group invested in the business services area had reduced their labour forces considerably and all were intending to cut further. The data did not do justice to the pain felt in business investment.

Turning to house purchases, Mr Stretton said there appeared to be a local pattern. Around the country there were increases in unfashionable areas, which were catching up. Perhaps debt was being taken on in these places which was less dangerous. But he noted that optimism was lower for the housing market. In response to a question from Ms Bell about the consumer sector, Mrs Powers-Freeling said that there had been a dramatic upturn in the last two weeks although whether that was back to where her firm would like to see things was another story. People were buying for Christmas later than before and she also noted a strong uptake in internet purchasing for Christmas which was five times last year's level.

MPC Procedures: Resources for the MPC including IT and Personnel in MA (Executive Directors, external MPC members and Mr Jenkinson in attendance)

Mr Jenkinson introduced his paper. Dr Julius said she had two questions and a suggestion. First, a key procedural change had been to close some of the forecast meetings so they were attended by a smaller group. She wondered whether there was a down side for staff morale and wished to hear the views of the external members on whether the possible benefits outweighed that. Second, she asked whether the Bank could help Directors make a judgement on whether support for the external members of the MPC was adequate, given that only £1.6 million of the budget was devoted to them. Her suggestion was that one of the benefits of being over budget for economists in staffing terms was that they could spend more time on training, particularly the young ones. She was amazed how many said they had never been in a factory. It would be helpful if they could spend more time in the regions, perhaps being sent out with the Agents for a week.

Mr Bean said he believed he was speaking for all nine members of the MPC when he said that discussions at the tail end of the forecast process were very much better for being in a small group, though there was a cost in excluding staff from the process. To counteract this, before publication of the Inflation Report, the forecasters present at the closed sessions gave a presentation to MA staff (including the external MPC unit) on the final forecast and he himself gave an MPC perspective on the discussions. Mr Allsopp said that was a very fair summary. The meetings were better, but there was a cost. That needed to be watched.

Turning to the second question, Mr Bean said it was up to the externals to say whether the resources were sufficient. But Dr Julius 's comparison of the £1.6 million with £21million overall budget should be set against the fact that most of the MA budget went on producing regular briefing and conjunctaral analysis for all members of the MPC. A better comparison was probably with the fraction of the overall budget that went into research-like activities. On that basis the resources of the external unit were around half of the overall research man hours in Monetary Analysis. Professor Nickel said he was quite happy with the resources he had, and from that point of view the external members' situation was fine. Ms Barker agreed. Ms Bell said she had been very happy with the amount of resources, largely because of the accessibility and availability of Monetary Analysis staff in dealing with queries. If that were not the case there might be a need for more. Mr Tucker noted that he had a Private Secretary effectively working full time on monetary policy and it was the availability of MA staff that made the difference. The Governor said that the issue of resources had not been raised with him for some time, but MPC members knew that they were free to do so at any time.

Mrs Powers-Freeling asked whether there was a process to check whether some of the activities were no longer required. Mr Bean said that was a very good question and got to the nub of the issue of how big MA needed to be. A survey had been carried out six months ago to identify those MA activities and output that the MPC did and did not, find useful. Unfortunately nothing had been identified that could usefully be cut in order to save resources. But there might be more efficient ways of producing some of the outputs which were particularly time intensive. In answer to a question from Sir David Cooksey about whether there would be a tapering of resources after the introduction of the new model, Mr Bean said that resources had been taken from other activities and did not involve additional resources. Resources would be required in continuously developing and maintaining the model. That issue was flagged by Professor Pagan. But there might be an issue further down the road as to whether the size of MA could be reduced, given that this peak effort would by then be in the past.

Mr Neill said he agreed with Dr Julius's point about young economists getting experience in industry and he would be happy to organise a day in his company's factories and distribution centres. Perhaps a package could be organised with other Members of Court as an annual programme. The Governor said that was a very kind offer and the Bank would pick up on that. Mr Bean noted that about one third of Monetary Analysis economists had now been on industrial visits and Mr Jenkinson said that the plan was to send about 40 over the course of each year. This had been organised with the Agencies, which took three or four each. The feedback was that the economists were enjoying it and found it interesting and useful.

In response to a question from Mr Hall about whether MA staff had been asked about their expectations, Mr Jenkinson said one of the questions in the bankwide staff opinion survey was how happy people were with IT and general support. It was positive across the Bank as a whole but in MA it was 10% higher as an approval rating than in the Bank as a whole, at 76%.

Professor Pagan's Report on Modelling and Forecasting at the Bank of England (Executive Directors, external MPC members, and Professor Pagan in attendance)

Professor Pagan introduced his Report. He said that the Bank of England was now a leader in this area. The uniqueness of the monetary policy process in the UK meant that original methods had had to be evolved to deal with it. Procedures seemed to be well established. The current system was working well. Mr Stretton noted that on the one hand there was a view that a model produced scenarios for debate and at the other extreme what should happen to interest rates was determined and the model was retro-fitted. He asked where in this spectrum was the actual practice. Professor Pagan said that from his perspective a model was a way of organising facts and discussions and of analysing what was going on in the economy. The second view had some importance in that if a certain action was wanted and it was not possible to generate an outcome on a model there would be worries. But that was not the main concern. A model was not there to retrofit decisions that had been made. The Governor commented that a model was not an automatic process but a real input into the debate and the formulation of views on policy. Mr Stretton said he believed it was important to ensure that sufficient resources were used in order to remain at the cutting edge.

In response to a question from Sir Howard Davies about how single fan charts of both growth and inflation could be produced, Professor Pagan said that conceptually it was fairly straightforward but it could not be done very easily on the existing model. He expected it could be done with the new model. However, the fan chart was not a result of punching numbers out of a model but a question of MPC judgement on the risks, so the MPC would have to think carefully about the joint risks. It would require not so much a technical solution as getting used to a new way of doing it. Ultimately it was a question of whether the MPC felt it provided reliable information.

Dr Julius said she would have no objection to the release of the Report in full. She commented that the Bank was perhaps in a vulnerable situation over the next year or so because the old model was reaching the limit of its shelf life and the new one was a year behind its original schedule. It was important to make sure there was an adequate replacement for a crumbling process. This lent importance to the suggestion Professor Pagan made that it was better to have a smaller and more carefully chosen set of alternative models. It was also helpful if people outside the forecast team could test different approaches and they would need IT and economic resources for that. She would like to see the suggestions Professor Pagan had made listed, debated and brought back to Court.

The Governor said that the MPC would discuss its response and its comments on the Pagan Report would be brought back to Court in January. It was hoped to publish the response with the Report soon after the next Court. In response to a question from Mr Hall, Mr Bean said that the rest of Monetary Analysis had not seen the Report, apart from the Heads of Division. Professor Pagan was presenting it to staff at a seminar that afternoon.

Professor Pagan did not feel ready to judge the new model. Mr Bean said he had invited Professor Pagan to do his report before the new model was complete so that he could influence its development. He had tentatively thought of inviting him back to do a postcript when the new model was up and running, and Professor Pagan had indicated agreement. Mrs Francis said that was sensible.

She asked whether the balance between empirical and theoretical work was right in the model. Mr Bean said that, as Professor Pagan pointed out, there was a trade-off between empirical and theoretical coherence with all models. Given that an important function of the model was to help articulate MPC debates, the modellers' remit had been to come up with a model that was a theoretical improvement but was at least as coherent with the data as the existing model. If they came up with one that was worse empirically, in some sense they would not have met the remit. In response to a question from Dame Sheila McKechnie, Mr Bean confirmed that the new model would be published, as the old one had been, and it was also planned to have a conference on it about a year ahead.

Ms Barker said she looked with trepidation at the switch next year to the new model and would prefer Professor Pagan to visit sooner rather than later. The Governor said this was something that could be taken into consideration. Professor Nickell said that he had complained that it was difficult to play with the existing model although it seemed to have become easier. For that he was very grateful. He believed that the transition from the old model to the new was going to be very difficult for the Committee. Members had understood the old model's quirks and might flounder about with the new one until they saw how it related to the old. Mr Allsopp said that even if the model was not working particularly well it was a system that made one think about things, and as such was very useful. The new one was going to be enormously difficult to get used to. He asked Professor Pagan to explain the trade-off between theoretical sophistication and empirical usefulness. Professor Pagan said that the variables in the model were rarely measured in the data. The data was subject to a great deal of revision and in forecasting this was likely to be used in the model in unrevised form. A theoretical perspective steered modellers away from trying to fit every quirk of data. It was a matter of striking a balance. He also noted that when modelling started, computers were much less effective. Now it was possible to do very much more sophisticated things. The new model was trying to do something that had not been done before, but if it succeeded it would be a benchmark model.

The Governor thanked Professor Pagan for his time and wisdom and said he looked forward to seeing him again in the future on more than one occasion.

FINANCIAL STABILITY ISSUES
Domestic developments and international issues
(Executive Directors in attendance)

Mr Clark noted, in response to Sir David Cooksey's comments, the relatively limited number of cases of companies in debt difficulties being brought to the Bank, under the London approach. Mr Clark then introduced his note, which referred to the FSR and developments on Argentina.

Mr Neill asked whether it was within the remit of the Bank to research consumer attitudes since events in the financial services industry had shaken consumer trust and confidence in the financial sector recently. Mr Clark said that it was not and that the Bank did not do a survey; but it did take an interest to the extent that it could lead to different patterns of financial flows in aggregate investment. The tripartite committee had discussed this in the context of the insurance sector. Dame Sheila McKechnie noted an Economic and Social Sciences Research Council programme on consumer attitudes and said this could be useful to the Bank. Mr Clark pointed out that the FSA had an objective of maintaining confidence at an institutional and consumer level. So it was very much a joint interest. Sir Howard Davies said he agreed with Dame Sheila and noted a further factor. Data showed people had taken a knock to confidence in equity and pooled investments. The difficulty was disentangling that from falling prices. There had been three years of falls which had not happened for 70 years and on most models that was a perfectly adequate explanation of changes in behaviour.

Sir David Cooksey said that banks had become very much better at handling the run-up to potential insolvencies. Mr Clark agreed, saying that that was one of the reasons the Bank had had fewer approaches to resolve debt issues. Sir John Bond said there was a fair amount of generic research on the financial services industry but it did not differentiate between institutions. There was also a lot of in-house work in the banks. His bank was rewarding managers for good customer attitudes and had a big database on the subject. He also noted how closely UK and US house prices had tracked each other for five years and how big a gap had opened over the last 18 months. Mrs Francis said that there was a lot of effort going into structural and efficiency reform in the savings industry including insurance, but paradoxically a lot of attention was also being given to the shortcomings of the industry, as a result of the fact that they were in the process of addressing them. Partly because of the fall in the markets and the increased perception of risk after September 11 last year there was a clear swing away from savings and into life and health insurance in the US. There were some echoes of that in the UK.

MARKET OPERATIONS ISSUES
Current issues
(Executive Directors in attendance)

Mr Tucker introduced his note on open link, the markets' Quarterly Bulletin article, and the invacuation. There were no questions.

EXECUTIVE REPORT
(Executive Directors and Mr Smout in attendance)

Sir Andrew Large reported that the Bank had gone ahead with the Printing Works announcement the previous day. The press had been quite modest and so far there had not been a significant response from the unions. He noted that the Bank had been to both bidders to see if they would shave their prices and also to the Treasury to see if there was a view on the possible sensitivity in relation to the euro. Mr Smout said that the price shaving was of the order of 2-3%. The Bank had also looked again at the internal option which, if anything, was marginally more expensive. He noted that the printing operations staff at Debden had been briefed by the General Manager and the national union officers were contacted. There was not much reaction from the staff at Debden who had been expecting this development as a strong possibility since February and were perhaps pleased that a final decision had been made. The emphasis now was on detailed negotiations with De La Rue. The hiving down of the operations into Debden Security Printing was the next step. The shares in this company would be sold to De La Rue. The details of the supply contract were now to be negotiated and at the same time there would be detailed consultation with the three trades unions. The hive down would be late in January or early February.

It was aimed to exchange contracts in March while completion would depend on a number of factors including the state of the building work. Mr Smout said that the Office of Fair-Trading had indicated privately that it did not on the face of it see objections on competition grounds but there was a clearance procedure, which might take a number of weeks. An answer was likely in January but that could not be guaranteed. Mr Bailie said that the fact that the business was being sold at net assets value implied that there was a good residual value for the printing equipment. In answer to his question about why the starting point was higher than the Bank costs, falling only later, Mr Smout said that the first two years of the contract were the only ones with guaranteed values and it appeared to be a strategy based on that. It was clear that De La Rue was cheaper than the Bank over the life of the contract even though it remained expensive in the first year. In response to questions from Mr Neill, Mr Smout said the Bank would come back with precise figures on the fees to advisers. In response to a question from Mr Neill about whether the fees had been negotiated aggressively, Mr Smout said negotiations with the merchant bank had been handled aggressively by Mr Clementi. Mr Glover was trying to get commercial reality into the legal fees. The Governor said that the Bank would come back on that. Mr Hall complimented management on moving quickly after the last Court Meeting and said it was good news for everyone that the uncertainties had been taken away.

In accordance with Matters Reserved to Court, Sir Andrew Large reported that Mr Dobney had now been appointed as a Head of Division in Notes Division, Banking and Market Services.

MANAGEMENT OF THE BANK
The Bank's Ten Objectives 2003/04
(Executive Directors and Mr Footman in attendance)

Mr Footman introduced the objectives, which had been revised in the light of Court comments. Dr Julius said it would be helpful for Court to have factual information on the percentage of woman, ethnic and disabled staff by grade. She had in mind the kind of recommendation that came out of the Kingsmill review for the DTI, about having an external audit. She believed there should be baseline data. The Governor said he was happy to give data but if there was any implication that the Bank should set targets he would be adamantly opposed. The Bank had discussions with the CRC and other organisations, and it had the best qualified staff on an equal opportunities basis. Over time the numbers would change and had been changing given that the hiring emphasis was on economics and very few women studied it. The idea of setting targets was not acceptable. Dr Julius said she was not proposing setting targets, but it was possible to have incentives. Mrs Francis said she agreed that quotas or targets were not desirable, but would like to see the data including the baseline of the number of woman at entry level, and also promotion rates and any differences there might be on grounds of race or sex. The Governor agreed as long as these were not to be quasi-targets. Mrs Powers-Freeling said the most telling piece of data was how many women left any organisation at various levels. Mr Neill said equal opportunities were important and clear messages must be sent that there was an equal opportunities policy. But promotion should be based on merit.

Court APPROVED the revised list of objectives.

A Report from the Chairman of the Audit Committee
(Executive Directors in attendance)

Ms O'Donovan introduced the minutes of the Audit Committee meeting held after Court the previous month. She noted that much had happened in the five years since Mr Butler had taken over as Auditor. He had reported that a key area of work was still the learning of lessons from what had gone wrong on earlier projects, and C21 would be another example of that. She also noted how credit and markets had come to the fore in the last five years. On operational risks, the committee had looked at some of the issues and in many cases personnel was the key. She noted that credibility and public confidence were critical parts of the risk matrix. Sir Andrew Large had said there was to be a formal review of risk management standards and indicators, and also of appetites for risk in various departments of the Bank. A lot was going on, and there had been many improvements at the Bank over the years. She noted that the committee had looked at access security relating to e-mails, web browsing and payments systems. The committee felt very much more confident having had that information. Since there was still a dislocation of communications in certain areas and low awareness in certain departments of security issues, there was now an awareness programme and training. Ms O'Donovan also drew attention to Mr Tucker's report on operational risk to the Audit Committee and she said there was an element of cultural change in the way Mr Tucker was looking at that. The Audit Committee had looked at the development of corporate values and standards in the human resources area, which was on-going, and the Committee would be updated on that. Turning to the C21 project, she said this was a very ambitious change programme, both in IT and culturally. While other aspects had gone well the introduction of the core banking package was the last missing piece of the jigsaw. Globus, the name of the package, needed to be linked into a wide range of other systems in the Bank, and it impacted on other system development. This was problematic, and it had been postponed twice. Modelling by internal staff and by external consultants had seriously underestimated the time it would take, and the 3½ months had turned into 18 months. There was also a software issue with the suppliers. Trialling had started but that was also now delayed due to complex inter-dependencies of the system. These had also been underestimated and so trialling was a year late. The date had slipped from June to October 2002 to April 2003, and the Bank was probably now looking at June. She noted that Ms Lowther wished to name a new date on 11 January. She also noted that the committee had examined cost overruns. It had also found that the savings had risen. She congratulated Ms Lowther and her team for their very honest report. It was essential for the Bank that the project came back on track. The Audit Committee would follow up on C21 at its January meeting.

Sir Andrew Large said the Bank was hoping to get someone experienced in complex projects of this sort to help meet the deadlines the Bank would be setting itself. Mr Neill underlined the importance of end ~~user~~ to end testing. The Governor thanked Ms O'Donovan and the members of the Audit Committee.

There being no other business prior to the final agenda item, the Deputy Governors and Executive Directors withdrew. The Governor said he had been invited to stay by the chairman of NedCo.

MANAGEMENT OF THE BANK (Continued)
A Report from the Chairman of the Remuneration Committee

Mr Neill reported to Court on the recommendations of the Remuneration Committee which had met the previous month. Court was CONTENT with the new salaries proposed for Mr King, Sir Andrew Large, Messrs Bean, Clark, Tucker, Glover, Allsopp, Sir Peter Petrie, Professors Goodhart, Blejer and Nickell and Ms Barker and Ms Bell.

Court was up.

David Cooke

Peter Rodgers

15 January 2003