MEETING OF THE COURT OF DIRECTORS

Wednesday 10 April 2013

Present:
Sir David Lees, Chairman
The Governor
Mr Bailey, Deputy Governor – Prudential Regulation
Mr Bean, Deputy Governor – Monetary Policy
Mr Tucker, Deputy Governor – Financial Stability
Sir Roger Carr
Mr Cohrs
Mr Fried
Mr Frost
Mr Prentis
Lady Rice
Mr Stewart

1. **Minutes – 13 March 2013**

The minutes of the meeting of 13 March 2013 were approved.

2. **Matters Arising**

The Chairman noted that Matters Reserved to Court had been published on the Bank's website. The minutes of Court meetings, starting with the present meeting, would also be published on the website, following approval at the subsequent meeting.

The Chairman said that he had sent the financial stability strategy, as approved by Court, to the Chancellor. It would be included in the Annual Report in due course, along with the monetary policy strategy and the strategy for the Prudential Regulation Authority (PRA).

3. **Chairman's Business**

Lady Rice reported on the meeting of the Audit and Risk Committee on 2 April. The Committee had noted the successful conclusion of the PRA transition programme, and progress on the Business Transformation Programme. The programme director was arranging regular meetings with Lady Rice to report progress to ARCO, this now being one of the largest programmes in the Bank.

The Committee had reviewed the Bank's risk profile. It was noted that the Funding for Lending Scheme (FLS) was working broadly as the Bank had expected: the Bank was taking on some credit exposures to smaller institutions, though they were collateralised. The Committee had reviewed communications risks in detail with the Communications Director. They had also taken reports on Information Service and Technology Division from the Chief Information Officer, and separately reports of IT risk from KPMG, the Bank's auditors, as part of their annual audit. The major programme in IT was the move from Windows XP as an operating system, where there was a hard deadline of April 2014 because of withdrawal of vendor support. The Committee had reviewed the Bank's ethics and anti-bribery policies, which had been reviewed in the light of the PRA accession. A value for money study on security had been discussed and more analysis requested for the July meeting. Finally the Committee had approved the Internal Audit plan for the year.

Mr Tucker reported on the first meeting of the Financial System Advisory Committee, a non-statutory subcommittee of Court, which had taken over some of the functions of the Financial Stability Committee (which had been a statutory committee under the 2009 Banking Act). The terms of reference of the Committee would be brought to Court in due course. The Committee had also reviewed the terms of reference of the Financial Market Infrastructure (FMI) Board, the executive committee that would exercise the Bank's powers to regulate payment, clearing and settlement systems under the 2009 Banking Act and the Financial Services and Markets Act. The Committee had approved for publication the Annual Report on regulation, under the 2009 Banking Act, of the Scottish and Northern Ireland note issues.

4. PRA Appointments

Court APPROVED the appointments of Julian Adams and Paul Sharma as Executive Directors of the Bank, respectively for Insurance Regulation and Regulatory Policy in the PRA.

5. Court Effectiveness Review

Sir Roger Carr, as Senior Independent Director, had discussed the Chairman's review of Court Effectiveness with the Non-executive Directors as a group: all had endorsed his findings.

The Chairman said that he had two particular concerns: first, that the gender composition of Court with only one female Director was regrettable, and he had urged the Treasury to take account of that in their future appointments to Court; and second, that the prospective publication of the Court minutes should not result in any unnecessary truncation of the record.

6. **Appointments for PRA Board: Conflict of Interest Policy**

Mr Nicholson presented a draft policy. He drew Court's attention to the statutory provisions on conflicts, and suggested that there were three particular types of conflict that should concern Court in making appointments to the PRA Board: financial interests, Directorships of a PRA regulated entity or of a holding company or material affiliate of a PRA regulated entity, and an employment or consulting arrangement with such an entity. The Court would have to exercise judgment on the materiality of any such interest.

The Governor noted that materiality could be judged only ex ante, and the risk would remain that, ex post, what might have seemed a small conflict at the time of appointment might turn out to be significant. But to rule everyone out would have a cost. The solution lay in ensuring that Court held a full discussion in each case, setting out the risks very fully, and also Court's rationale for making the appointment, which should be minuted. Directors agreed, and added that one further consideration would be the seriousness with which the candidate took the conflict issue. Court agreed to adopt the policy and in due course to publish it as background to their decisions.

7. **Executive Report**

The Governor said that the PRA had made a good start with a successful move into the new building, which the Chancellor had opened on 2 April. By then the Board had already held two meetings (about Cyprus). He had been very encouraged by the way in which it had engaged with the big policy issues.

The Governor noted the new remit for the Monetary Policy Committee (MPC), which had reaffirmed the 2% inflation target and asked the Committee to report back in August on whether and how it might provide forward guidance on policy.

Mr Bean reported progress on the FLS. Contrary to external perceptions, progress had been broadly in line with the Bank's expectations. Initially the impact had been seen mainly in the mortgage market and that for larger companies, but so far there had been less impact on the SME segment. The reduction in SME loan costs had, however, been greater than it appeared as several lenders had also reduced their arrangement fees. There was a question as to whether some businesses were reluctant to apply for loans because they feared rejection. The Governor said that it was clear that across banking as a whole there was a supply element to the problem: it was clear that some banks were increasing lending and others deliberately cutting back: the latter group were those that were capital-constrained. Mr Tucker said that both the FPC and the MPC recognised that an adequate supply of credit required well-capitalised banks. Mr Bean noted that the Bank was considering possible extensions to the FLS.

Mr Bailey said that the PRA Board had started its response to the FPC recommendations on capital, looking at the position bank by bank. He also reported on the reorganisation of the Cyprus banks in London.

Mr Bailey also noted the Banking Standards Commission report on HBOS, which had made a number of recommendations on what the FSA/FCA report on the same subject should address. Mr Bailey said that as the FCA report was not being issued under Parliamentary privilege, it would need to go through a proper "Maxwellisation" process, and so would not be published until the autumn.

8. FPC Procedures

Mr Tucker summarised the development of Financial Policy Committee (FPC) processes since the start of the interim FPC, drawing on feedback from FPC members. He made two points. First, the FPC had focussed on bank capital given the risks in the current environment, but its mandate was wider. In particular, vulnerabilities, arising from the distribution of risk and from fault-lines in the structure of the financial system, were also part of the Remit and would be a focus going forward, taking account of the work underway internationally. Second, the Bank needed to develop – for both the FPC and the PRA - a permanent comprehensive stress-testing regime that would underpin its assessment of capital adequacy. The Bank executive was now working on that, drawing on lessons from overseas.

9. Accounting Profession and Provisioning

Court noted the paper, prepared following an earlier discussion of bank capital requirements, on the development of a new impairment model, for which there were different proposals from the IASB and the FASB. The Chairman pointed out that this important issue had been under discussion for some time, and that many of the FPC's recent recommendations on bank capital had their origins in a system that overstated the value of assets and understated liabilities.

10. Monetary Policy Strategy

Court agreed the monetary policy strategy, which would appear in the Annual Report, subject to a change to clarify the role, under the amendments to the Bank of England Act, of the Oversight Committee of Court.

11. Combined Quarterly Reports on Performance and Risk

(Mr Jones, Ms Brown and Mr Fisher in attendance)

Mr Jones drew Court's attention to the two high-profile projects that would shortly come to Court for approval – the PRA Business Transition (steady state) programme, which would complete the changes at the PRA and remove the continuing reliance on some FCA IT systems; and the Desktop Replacement Project, which was required to move the Bank away from Windows XP.

Reviewing the costs of the Bank's policy functions, Mr Jones said that expenditure during the year to 28 February had been slightly below budget, partly as a result of lower staff levels in the policy areas, offset by higher than expected IT costs. The latter was due to temporary reliance on contract staff to handle the pressures of the PRA transition. It would be important to reverse that as the transition programme wound down.

In response to a question from a Director, Catherine Brown confirmed that the talent management programme was progressing and that she was meeting with all potential Heads of Division.

Other Directors questioned Mr Fisher about the management of collateral associated with the wider range of FLS participants: Mr Fisher said that there had been a recent audit of the determination and implementation of haircuts on the collateral taken in the Bank's operations, which had found that the haircuts were determined and implemented appropriately and conservatively.

In relation to the Quarterly Risk Report, Mr Tucker expressed a concern that the individual Executive Directors (EDs) might not be fully involved in the sign-off process. It was noted that the report was backward looking, to the previous quarter, but Court agreed that EDs should nevertheless be encouraged to communicate current risks in their areas of responsibility.

12. **Balance Sheet Remit**
(Messrs Jones and Fisher in attendance)

Court endorsed the approval by the Governors of the Balance sheet remit, which governs the basis on which the executive manage the Bank's balance sheet.

It was agreed that a briefing on the Bank's balance sheet would be arranged for members of the Oversight Committee.

13. **Draft Annual Report**
(Mr Jones in attendance)

It was agreed that members would give drafting comments to Mr Jones. The Chairman requested that the Annual Report should include a glossary of terms and acronyms to make it more accessible to readers.

14. **Solvency II Project: Court Approval**
(Messrs Adams, Sarkar and Ainley in attendance)

Mr Stewart declared an interest in the Solvency II programme as Chairman of Legal and General.

Mr Bailey said that the programme was to implement the EU Solvency II directive. This had cost the industry upwards of £1bn but was running substantially behind schedule. The FSA had started a project aimed at the original target date, but it was recognised that this would not be met and implementation of an agreed directive was now, perhaps 3-4 years away. Accordingly, under the PRA, the project costs had been substantially scaled back. Mr Adams said that the aim now was to adapt the work done so far for use within the current framework; and the £2.9mn requested was intended (a) to continue policy work; (b) to develop the current framework and run trials at two firms; and (c) to prepare for interim guidelines from EIOPA. The funding had been in the PRA budget approved prior to transition.

The Chairman asked why the £2.9mn was presented as "non-recurrent" when the activities described seemed more like business as usual. Mr Adams said that much of the work was within the recurrent budget, but the activities covered by the request required a temporary increase in resources in his directorate and in policy which would be phased out when the project ended.

Court APPROVED the £2.9mn project spend.

15. **FPC Code of Conduct**

Court APPROVED the revised FPC Code of Conduct. This would be published on the Bank's website. The changes were designed only to reflect the coming into force of the legislation – the policy remained as for the interim FPC.

The meeting of Court was closed.