MEETING OF THE COURT OF DIRECTORS

Wednesday, 25 September 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
Mr Cohrs
Mr Fried
Mr Frost
Mr Prentis
Lady Rice
Mr Stewart

In attendance:
Ms Hogg, Chief Operating Officer

Apologies:
Sir Roger Carr

Secretary:
Mr Footman

1. **Minutes – 17 July 2013**

The minutes of the meeting held on 17 July 2013 were approved.

2. **Matters Arising**

In relation to the "territorial army" (minute of 17 July 2013) to provide emergency support in a resolution, Mr Tucker confirmed that Ms Hogg had been leading an exercise on identifying candidates, and had reported to the FSAC that morning.

3. **Chairman's Business**

The Treasury were close to appointing head-hunters to identify a potential successor as Chairman (who would initially be appointed to the seat on Court vacated by Lord Turner). He asked members to reflect on possible names.

Lady Rice reported that ARCO had met on 12 September and reviewed a number of issues: progress on the anti-counterfeiting programme; a redesign of the risk reporting framework; cyber risks; the Information Assurance programme; and the PRA transformation programme. Risk issues that had been highlighted included data strategy fragmentation, future collateral realisation, and staff stretch. Mr Cornish had attended the Committee for the PRA.

4. **Conflicts of interest**

(Mr Nicholson in attendance)

The revised policy covering the PRA Independent Directors was AGREED, and would be published on the Bank's website.

5. **Matters Reserved to Court**

(Mr Nicholson in attendance)

The proposed amendments were agreed. However the Court decided that the MRC document should give significantly more prominence to the FMI Board which, although not a Court Committee, was exercising the Bank's statutory powers in a significant area. It was important that this Committee was visible to the outside world.

6. **Executive Report**

The Governor said that an important theme of the Bank's policy work was to look forward and develop the synergies between the MPC, the FPC and the PRA Board. An example was the housing market, which had received much attention and where all three policy boards were engaged. The market had been strengthening and the Government was about to launch the second element of the Help to Buy Scheme. The FPC statement – published that morning – made clear that the Bank was vigilant, intended to monitor the situation carefully and would take a graduated and proportionate approach. The FPC had tools available: sectoral capital requirements, and recommendations on affordability standards. The first step might be for the PRA, which might look at underwriting standards and supervisory intensity. Monetary policy was a final line of defence. This was a clear example of where the policy boards could work together. Court would be kept informed about developments in this area.

Mr Bean said that since the last Court the main monetary policy event had been the launch of forward guidance. The message had been simple: subject to the three “knockouts”, two of which were related to the risks to price stability and one to the risks to financial stability, the MPC would maintain the present policy stance at least until the unemployment rate had reached 7%. This seemed to have been properly understood by business and the wider public as a state-contingent commitment. But recent unexpectedly strong indicators had led market participants and commentators to suggest that the threshold would be reached sooner than the MPC had expected, and that the policy was therefore in some way “off track”. In recent speeches MPC members had stressed that the Bank would not withdraw stimulus until jobs and incomes were growing: the policy was not time-contingent.

Mr Tucker added that, for the FPC, the financial stability knockout was a tremendous advance, signalling the MPC’s belief that monetary policy could affect risk-taking behaviour. Beyond that, the Committee had at its latest meeting decided that it would pay very close attention to developments in the housing market and to banks’ underwriting standards in this area, and was looking at the range of tools that might be used to moderate the housing cycle if necessary to ensure the resilience of the financial system. The FPC had also discussed its work programme, as recommended by the Chancellor in his formal remit to the Committee, and had identified three priorities – completing the medium-term capital framework for banks; ending too-big-to-fail via resolution, and shadow banking/market-based finance.

The PRA Board and the FPC had met to sign off a joint Bank approach to stress testing, which would be published as a discussion paper.

Mr Bailey said that the PRA Board had also discussed the strategic options facing the RBS Board, and the possible decision to pursue a good bank/bad bank split.

Finally Mr Bailey informed Court that Paul Sharma, the Executive Director for Policy at the PRA, had resigned. This was a considerable loss to the Bank as he had a wide experience of regulation and a very close knowledge of legislation issues, especially in Europe.

The Governor said that progress on the three reviews (Plenderleith, Stockton and Winters) would be reported to Court in November. In the meantime he planned to announce in October some changes to the Bank's market operations in response to the Winters review. Court members would receive advanced copies of the detail, but the main point would be that the Bank was "open for business" and that the Bank's liquidity facilities were there to be used; and as part of that the Bank would cut the price of DWF access, expand the range of collateral accepted in auctions and make the crisis auctions a permanent (though contingent) part of the regime. Other questions raised by Winters, including whether the Bank should act as a market maker of last resort, and be willing to extend support to non-banks, would be addressed in the future.

The Governor added that on the Stockton review the focus would be on the transparency of the forecast process.

7. The Bank's Financial Stability Strategy

Mr Tucker reminded Court that the Bank was obliged to adopt a Financial Stability Strategy, consulting the FPC and the Chancellor, within six months of the coming into force of the 2012 Financial Services Act on 1 April. The Bank normally reviewed the FS Strategy as part of the budget planning round, and had done so in 2013, but the FPC had not been consulted as it did not then exist in statutory form. The FPC had been consulted at its September meeting – the first chaired by the new Governor – on a proposal to adopt the existing strategy, as published in the 2013 Annual Report, on an interim basis, pending a full review in the 2013/14 budget round that would also involve Sir Jon Cunliffe, the new Deputy Governor for Financial Stability. Only minor changes had therefore been made to the 2013 text to avoid obvious anachronisms and the introductory section had been rewritten to reflect the new legislation.

Court agreed to adopt the strategy as amended and to consult the Chancellor.

8. Terms of Reference for Strategic Plan

Ms Hogg advised Court that the executive were in the final stages of commissioning external advisers for the Strategic Plan and for the VFM review. The latter was likely to involve Deloitte and would be focussed initially on the Central Services area, which accounted for £180mn of the Bank's £500 mn budget.

9. **Inflation Report and MPC Report to Court**

(Mr Dale in attendance)

Mr Dale noted that while a record proportion of households now expected interest rates to remain unchanged over the next 12 months, and City economists had pushed out the expected date of the next rise in Bank Rate, forward market interest rates had risen since the announcement of Forward Guidance in August. The recent run of strong data had led external forecasters to revise down their forecasts of unemployment, so bringing forward the likelihood of the 7% threshold being passed. Some caution was required. The productivity puzzle meant that it was difficult to be certain about the impact of stronger activity on recorded unemployment. But growth in output was certainly strong at present. The other uncertainty was the housing market, on which the Bank was very closely focussed. The London effect was strong but some indices, and the Bank's Agents in particular, were reporting strength across the country.

Mr Frost asked about the Bank's handling of the media over this period. Mr Bean said that while the Forward Guidance announcement had generally been accurately reported and the threshold and the "knockouts" had been understood, subsequent commentary had tended to interpret the upward movement in yields as indicating that the guidance was not working. But the stronger data were of course good news - and international interest rates had also firmed over the period. Recent MPC speeches had been aimed at correcting this misapprehension. Mr Dale added that inflation, for the moment, was another good news story, and was likely to fall back towards target as external pressures eased. At this point, neither of the inflation knockouts seemed likely to be triggered.

10. **HR Strategy**

(Mr Curtiss in attendance)

Ms Hogg said that the main immediate challenge was the integration of PRA and Bank remuneration. The current models were fundamentally different, and the details on each side were not well understood by the other. There would therefore be a substantial exercise in education and consultation, whatever the integration model proposed. An immediate issue would arise in the annual salary reviews, where the FSA bonus had historically been much larger than the Bank's.

A second priority was talent management. The Bank's traditional "grow your own" model would remain important, but in the PRA there was a greater proportion of external recruits, with different career and pay expectations and a higher attrition rate. Both models had drawbacks, and the task was to find a way of accommodating both, consistent with creating a strong leadership cadre and pursuing the diversity programme.

Ms Hogg said she had been surprised to find that the Bank, unlike the PRA, did not have explicit performance ratings for staff. Mr Tucker said that the Bank had abandoned these in a review of the performance system in the late 1990s. He agreed they were useful.

HR itself would need to support both the VFM review of central functions and the pay integration exercise; it would need to have the organisational model to deliver both and the other key objectives. Court members noted that the list of HR objectives in Ms Hogg's note was daunting and it might need to be less ambitious. Directors also asked what (beyond remuneration policy) was being done to deliver cultural integration and common Bank values. Ms Hogg said that an exercise to define Bank values had been paused but would be addressed.

11. **Cyber Security**

(Messrs Randall and Finch in attendance)

Mr Randall outlined the main threats against which the Bank needed to be prepared. In the Bank's security model ISTD managed policies, infrastructure and protection of the Bank's assets, while Security, including the Cyber Intelligence Unit, monitored the threat landscape and network activity, and investigated incidents as necessary. The Bank worked closely with GCHQ, CESG, CPNI, industry groups and other central banks. Some 80% of the Bank's security technology had been updated or replaced in the past 18 months. The revised Information Assurance Programme would be reported to ARCO in November.

Immediate priorities were to establish an effective governance framework for managing and reporting information security risks; improving staff awareness; enhancing the response capability; developing a forensic capability and improving internal security controls.

The Chairman asked that when the proposals came to ARCO a time-frame should be put around these tasks.

The Governor noted that the FPC had asked HMT and the regulators for an update on progress with the financial sector's cyber resilience planning by Q2 2014. It might be helpful if the Bank had completed some additional penetration tests and had a view on the Bank's own position by then.

12. **Combined Quarterly Reports**

(Mr Fisher, Ms Place and Ms Coffey in attendance)

Court noted the reports on performance, finances and risk, including the PRA's report which had been seen by the PRA Board. On the latter, Directors discussed the Proactive Intervention Framework and its relevance to resolution planning in the SRU; Mr Bailey confirmed that as firms approached the higher PIF levels, the PRA interaction with the SRU increased.

Ms Coffey said that the risk report had been simplified, reflecting a more centralised approach to risk monitoring in the Bank. Area drill-downs would still be taken to ARCO.

Directors noted the importance assigned to data-handling in several reports and asked whether there were outstanding differences within the executive. Mr Bailey said that a common Bankwide approach had taken some time to emerge because the scale and scope of the demand had been unclear. With the recent joint FPC/PRA decision on stress testing and other initiatives it was possible to define the requirements. It had been right to delay up to that point.

Mr Cohrs suggested that, given what Court had heard, the Bank should register Bank/PRA pay integration as one of the top risks.

Mr Fisher, responding to questions about the risk of the LIBOR benchmark becoming unavailable, set out the actions that the FCA were taking to replace LIBOR and to plan for contingencies.

Ms Place noted that the PRA data pack had been reviewed by the PRA Board. They had asked for something much simpler, with less duplication, and focussed very clearly on their own objectives. They expected in future to sign off the report before it came to Court.

13. **Provision of FCA Services**

(Mr Whittle in attendance)

It was noted that the FCA agreement was working well with no issues.

The meeting of Court was closed.