

MEETING OF THE COURT OF DIRECTORS

Wednesday, 16 April 2014

Present:

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

In attendance:

Ms Hogg, Chief Operating Officer
Mr Brazier

Apologies:

The Governor
Mr Fried

Secretary:

Mr Footman

1. Minutes

The minutes of 4 March and 14 March were approved.

2. Matters Arising

It was noted that the Chancellor had approved the appointments of Mr Dale to the Financial Policy Committee and Mr Haldane to the Monetary Policy Committee.

3. Chairman's business

The Chairman said that the Oversight Committee had met with Lord Grabiner and the legal team from Travers Smith to take stock of progress in the FX investigation thus far, and the planned next steps. Critical to that was the interaction with the FCA investigation. The Committee had received indications of the likely overall cost and had asked the legal team to identify specific blocks of work for budgeting purposes. Lord Grabiner had reported on a

“private” meeting with the Treasury Committee. The Chairman of the Treasury Committee had subsequently written to the Chairman seeking assurances as to the independence of the investigation and on co-operation with the FCA.

Lady Rice reported on the meeting of ARCO on 3 April. The Committee had noted the resourcing issues around the stress-testing programme, had reviewed haircut methodology in the context of the Bank’s facilities, and had noted the annual review of VAR limits. There had been a detailed review of risks in the FS area (including in relation to FMI supervision) and in the Communications area. The Committee was monitoring closely the Information Security Programme. The annual audit effectiveness survey had produced positive results though there might be a developing issue around resources in internal audit which had been static for some time. It had been noted that the dividing line between Internal Audit and the new Independent Evaluation Director would need to be made clear from the start. The Committee had also discussed the NAO’s published report on the regulators and had expressed disappointment that it did not reflect fully the baseline for PRA costs agreed on separation from the FSA, which had underpinned subsequent PRA budgets. The Chairman said that the Bank Annual Report would be clear on that point.

4. Court Committees

Court agreed that on the winding up of the Financial Systems Advisory Committee, those of its functions not delegated by statute to the Oversight Committee should be delegated to the Oversight Committee by Court. Accordingly:

Court RESOLVED that the Oversight Committee shall:

- (a) Keep under review the Bank’s exercise of its functions under: Part 5 of the Banking Act 2009 (oversight of recognised inter-bank payment system); Part 18 and Schedule 17A of the Financial Services and Markets Act 2000 (recognised investment exchanges and clearing houses); the Uncertificated Securities Regulations 2001 and the European Market Infrastructure Regulation (EMIR).
- (b) Keep under review the Bank’s exercise of its functions under Part 6 of the Banking Act 2009 (Scottish and Northern Ireland Banknotes).

- (c) Keep under review the Bank's capacity to exercise its powers under Part 1 of the Banking Act 2009 (Resolution).

In connection with (a) and (c) above, Sir Jon Cunliffe said that he would provide the Committee with papers taking stock of the work being undertaken in the FMI Board and in the Resolution Directorate.

Court also agreed that the Bank's Equality and Diversity Committee should become a Committee of Court, consistent with the emphasis in the new Strategic Plan.

Court accordingly RESOLVED to form an Equality and Diversity Committee with terms of reference as follows:

- (1) To oversee the Bank's diversity strategy to ensure progress is being made in achieving objectives, including:
 - o Reviewing and accepting the Bank's annual diversity strategy;
 - o Holding the Executive to account for achieving those strategic objectives, including setting performance indicators and targets, as appropriate;
 - o Monitoring the actions taken by the Bank in executing the diversity strategy, and reviewing progress against objectives and performance indicators;
- (2) To provide oversight of the Bank's Equality Duty under the Equality Act, including reviewing and commenting on the Bank's annual Equality Report.
- (3) To review and comment on the sections of the Bank's Annual Report relating to equality and diversity.

Initial membership would be Spencer Dale (chair), Mr Cohrs, Ms Hogg, Sir David Lees, Mr Prentis and Lady Rice.

5. Court Effectiveness Review

The Chairman summarised his review, based on interviews with all the non-executive directors and with Mr Bailey and Mr Bean, the only executives to have been on Court for the whole year.

The objectives set for Court in the previous year's review had been to make the Oversight Committee effective and to develop it as a vehicle for constructive challenge; to ensure an

effective handover to the next Governor and give backing to the new COO; to ensure implementation of the “Three Reviews”; to encourage a study of the cost effectiveness of the Bank’s operations, commencing with ISTD; and to monitor the PRA integration and ensure the effective provision by the Bank of the necessary support services. To a large extent these objectives had been achieved. Challenge was more effective and increasingly welcomed by the Executive.

For the coming year the Directors had endorsed the following objectives:

- (1) To ensure the effectiveness of the PRA as part of “One Bank”.
- (2) To establish more focus on succession planning and talent management with greater oversight from Court.
- (3) To monitor closely the delivery of the strategic plan and related organisational changes
- (4) Papers for Court to be more concise and focussed and all to be available in time for members to read them.
- (5) Given the 50% change in membership of Court between June 2013 and June 2014, much stress was laid on the importance of an effective handover to the new Chairman and effective induction programmes for all new members.

Sir Roger Carr, as Senior Independent Director, confirmed that he had spoken to the Directors and all were comfortable with the approach adopted and that the conclusions reflected their views.

6. Executive Report

Sir Jon Cunliffe said that the PRA Board and the FPC had held a joint meeting to agree on the UK variant scenario within the EBA 2014 stress tests, and the hurdle rate. The UK variant involved a severe housing market and consumption shock. The EBA scenario was not yet finalised but was expected on 1 May. The Bank would not publish the UK variant until then. Results for the UK would be announced after the mid-December FPC meeting: the EBA would publish in October.

Directors, noting concerns reported in the FPC survey (Agenda item 7) asked about the resource implications for the Bank. Sir Jon Cunliffe agreed that the stress testing programme would put pressure on the PRA Risk Specialists in particular and might divert resource from supervision. It was noted that both the Bank and the banks would want to comment on the results.

Sir Jon Cunliffe also reported on a short joint Bank/ECB paper published on 11th April as a pre-cursor to a longer joint discussion paper, to be published during May. The paper drew attention to a number of roadblocks to restarting securitisation markets, including unduly conservative regulatory capital charges in some areas of the market, inconsistencies across different regulatory initiatives (eg banks and insurers), and uncertainty about final regulatory treatment (eg in LCR rules). The paper had noted the possibility of 'high quality' securitisations, with appropriate treatment in regulation and eligibility for central bank facilities.

Mr Bean noted the Bank's announcement that UK Export Finance-guaranteed debt capital market notes issued under pro forma documentation and processes agreed between the Bank and UKEF would be eligible within the Sterling Market Framework (SMF). The Bank also expected to be able to agree processes with UKEF that will allow future UKEF-guaranteed loans to be made eligible in the SMF.

7. Review of FPC Procedures

(Ms Blowers and Mr Dale in attendance)

Ms Blowers noted that this was the first review of procedures since the FPC became a statutory committee in April 2013. The review had included a questionnaire circulated to members, and they had commented on an overall improvement during the year, with agendas and discussions more focussed, and stronger support from the secretariat. In response to the Chancellor's request in his 2013 Remit and Recommendations letter, the FPC had agreed and publicised three medium-term priorities: the medium-term capital framework for banks; ending 'too big to fail'; and ensuring diverse and resilient sources of market-based finance. This was seen as helpful, and for each of the priorities, FPC member 'sponsors' had been appointed.

In addition to the FPC's statutory responsibilities, the FPC had received a number of commissions from other bodies, including the Treasury (to conduct an annual assessment on the potential financial stability implications of the Help to Buy scheme) and the MPC (as part of 'forward' guidance, to alert them if the stance of UK monetary policy posed a significant threat to financial stability). In addition, the Chancellor asked the FPC in November 2013 to conduct a review into the role of the leverage ratio within the capital framework.

The FPC had worked increasingly closely with the MPC, in particular on developments in the housing market. This had included setting out publicly in the Inflation Report and the FSR how each committee has had regard to the other's policy stance. The FPC and PRA Board had also worked closely together on the stress testing framework for UK banks for 2014 and beyond, with a Discussion Paper published in October 2013. The Chairman however noted some concern among FPC members about the resources available for stress testing.

Ms Blowers said that apart from requesting greater focus in papers and policy options prepared for the Committee, a general theme from FPC members' comments had been to improve communication channels. In response to questions from Directors she said that regular meetings were now held with bank CROs; and briefings were offered to City economists and analysts. The Chairman said that communication issues had been a theme in his own discussions with FPC external members. Otherwise they had welcomed the opportunities during the year for more focussed and robust discussion.

8. MPC Procedures

(Mr Dale and Ms Blowers in attendance)

Mr Dale said that the annual survey of MPC members had shown a high level of satisfaction with the support provided by Bank staff – with many scores now at their highest level on record. Around 80% of scores were 'excellent' or 'very good', compared to around 70% in 2012. Staff inputs continue to be valued more highly than before the crisis.

Introduction of forward guidance had been the biggest single task. A group of economists had been assembled to work full time on this, with others contributing significant amounts of time and effort at various stages of the process. In addition to the specific processes supporting the

introduction of forward guidance, further changes were undertaken: to improve the forecasting of variables integral to the form of guidance the MPC implemented, such as unemployment and inflation at the 18-24 month 'knockout' horizon; to monitor better the impact of guidance on financial markets, and to commission and assess bespoke surveys to ascertain the extent to which forward guidance was understood by companies and households. During the February 2014 forecast round, the staff provided further briefing on ways in which the MPC might wish to update its forward guidance in light of the fact that unemployment looked likely to pass through the Committee's 7% threshold shortly thereafter.

Mr Dale suggested that the process improvements made following the Stockton review of forecast capabilities represented arguably the biggest improvement in transparency since the introduction of inflation targets. An 'MPC key judgements' table of projections was now included in the *Inflation Report*: the table in the February 2014 Report contained projections for 10 variables. And the Inflation Report now included scenario analysis illustrating the possible implications for the economy if it evolves differently than the judgments underpinning the central projection would suggest.

Challenge has been promoted through the introduction of a biennial MPC Challenges meeting, at which the staff had been given an explicit mandate to bring alternative perspectives on aspects of the Committee's forecast.

There had been significant improvements in interaction with FPC. In Autumn 2013, a joint Special Project Team (SPT) had been convened, comprising staff from across MA, FS and the PRA, to present to both committees on the housing market. More generally, management and staff across MA, FS and the PRA increasingly worked together to ensure that all of the Bank's policy committees received high-quality and coordinated briefing on macroeconomic, financial stability and prudential issues.

The MPC's perception of the quality of briefing it receives on financial markets was much improved on 2012. And the Bank's regional agents were thought to add useful colour, often suggesting themes for further analysis. Intelligence from the Agency network could provide real-world explanations for 'puzzles' (differences between other data / surveys and what the Agents themselves are hearing). The challenge was to maintain that direction and focus.

9. **Annual meetings with external members of Committees**

The Chairman reported on his annual meetings with the external members of the MPC, FPC and PRA Board. As regards MPC and FPC, the findings were largely consistent with the reviews of procedures referred to in the preceding minutes. As regards the PRA, the principal area of concern related to the resourcing issue. This was now regularly reviewed by the PRA Board and by Court.

10. **Monitoring the implementation of the strategy**

(Mr Proudman and Ms Murphy in attendance)

Mr Proudman introduced the first of a series of quarterly reports on the implementation of the Bank's strategy. Following a successful announcement in March expectations were heightened and the team had move swiftly into implementation mode. Filling the nine Director vacancies was an immediate priority. The jobs had been advertised internally and externally, and there were more than 200 applications. First round interviews by Executive Directors had taken place that week, and second round interviews would start shortly with a view to completing all processes before transition to the new structure on 1 June. There would be further consequential vacancies to fill at Head of Division level.

The reorganisation, and particularly the integration of teams, would involve more than 700 staff moving locations within and between the London offices.

Sponsors had been appointed to each of the 15 specific initiatives. There would shortly be announcements on revised responsibilities and objectives, all linked to the strategy, and the pay integration proposals (Agenda item 15).

11. **Sterling Monetary Framework (SMF) Annual Report**

(Messrs Fisher and Martin in attendance)

Court reviewed the draft annual report on the operation of the SMF: Mr Bean said that this was one of the products of the Winters Review, which had also provided the opportunity for the MPC and the FPC to have greater engagement in the SMF. Mr Fisher added that with the publication of the Report the Bank would take the opportunity to seek public comment on the

SMF. Court endorsed the report and made clear that it would wish to be associated with the initiative.

12. **Combined Quarterly Reports**

(Messrs Coates, Fisher, Nelson, Hunt and Ms Coffey in attendance)

(i) The Balance Sheet

Mr Fisher said that the balance sheet was stable. Pre-positioned collateral amounted to £400bn nominal, £230bn drawable. As at the end of February £41bn had been drawn from the (off-balance sheet) FLS.

(ii) QRR

Court noted the Quarterly Risk Report, which had previously been discussed by Audit Committee

(iii) QPR

Mr Coates said that the Bank was likely to record a profit before tax of £181mn in the year to February, slightly below budget mainly because of lower than expected FLS drawings. The estimated dividend to the Treasury was £81mn. An illustrative CET1 capital ratio for the Bank was 10.9%, or 16.7% excluding Government Bonds. It was noted that Court would have a full discussion of the Bank's level of capital, starting in May.

13. **Annual Turnbull Review**

(Ms Coffey in attendance)

Court noted the report from the Governors on the Bank's framework for risk management, and approved a statement for inclusion in the Annual Report.

14. **Draft Annual Report**

The Chairman asked for comments on the draft Annual Report text to be sent to the Secretary.

15. Remuneration and Grading Structure

(Mr Curtiss in attendance)

Subject to further review in May, Court approved an outline proposal for the new reward model, on the basis of which the Bank would consult staff.

16. Projects

(i) Collateral Operations Review

With reference to a minute of 11 December 2013, Court was content for the project to continue to completion, now planned for October 2014 at an estimated cost of £9.1mn.

(ii) Information & Infrastructure Security (IIS) Programme

(Messrs Semikin and Randell and Ms Kennedy in attendance)

Court APPROVED the IIS budget of £7.6m for 2014/15, part of a £21.4mn programme over the next four years. It was confirmed that the Audit Committee was keeping the programme under close surveillance.

(iii) £5 note design and production

(Ms Cleland in attendance)

Court APPROVED the £5 note project, with a budget of £7.3mn. This project will design, produce and launch the polymer £5 to be issued in 2016, also delivering infrastructure and printing press changes which are critical to print and process polymer notes, and which will benefit future denominations printed on polymer.

The meeting of Court was closed.