

MEETING OF THE COURT OF DIRECTORS

Wednesday, 16 December 2015

Present:

Anthony Habgood, Chairman
The Governor
Mr Bailey, Deputy Governor – Prudential Regulation
Mr Broadbent, Deputy Governor – Monetary Policy
Sir Jon Cunliffe, Deputy Governor – Financial Stability
Mr Fried
Mr Frost
Baroness Harding
Mr Prentis
Mr Robert
Ms Thompson

Ms Hogg, Chief Operating Officer
Dame Minouche Shafik, Deputy Governor – Markets & Banking

Secretary:

Mr Footman

1. Minutes

The minutes of the meeting on 26 October were approved.

2. A Trusteeship

Court approved Minouche Shafik's appointment as a Trustee of the British Museum

3. Report from Audit and Risk Committee (ARCo)

Mr Fried said that ARCo's meeting on 3 December had covered a wide range of issues (balance sheet, cyber issues, compliance, physical and personnel security) but the significant recurrent theme had been the comprehensive focus on risk management. The Balance Sheet Remit and the Bank's Risk Tolerance Statement had been discussed in detail and amended in some respects – it was seen as a good starting point, which over time could be sharpened up as needed. (Court Agenda item 12(ii) below.) A new Quarterly Risk Report had been examined, along with the proposed financial risk dashboard and the scenario analyses that underpinned the report. There had been extensive discussion, which was a reflection of the very significant progress that the new Risk Team had made. Thirdly, ARCo had discussed a number of risks

relating to the Banking, Payments and Financial Resilience directorate, including the plan for a replacement of the RTGS hardware in 2016 (item 11 below).

4. Report from Remuneration Committee (REMCo)

Baroness Harding reported on Remco's meeting on 2 November to review the "flex" rates that determine the price at which staff can give up salary for pension accrual – and vice versa – under the flexible pension scheme introduced last year. The flex rates were intended to closely match the actuarial cost of providing pension, so as to be cost-neutral to the Bank, and Remco had agreed some adjustments to the mechanism to ensure that cost neutrality would be maintained.

5. Bank of England and Financial Services Bill

The Secretary noted that Government amendments to the Bill had passed at the Report Stage of the Bill in the House of Lords. These included provision for a Review of the Bank's performance to be commissioned by a majority of the non-executive members of the Court; a requirement that the Remuneration Committee should consist of at least 3 non-executives (at present it consisted of four); and new clauses specifying the five policy functions in respect of which the NAO would not conduct examinations of efficiency and effectiveness (the "policy carve-out"). There would be a requirement for the Bank and the NAO to agree an MoU concerning examinations, including specifying any functions of the Bank that the NAO would not "usually" examine, and setting out a procedure for the resolution of any disputes. The former provision that the Court should have the final say on whether an examination should proceed had been replaced by the explicit policy carve-out on the face of the Bill, which covered the Bank's policy objectives and the merits of policy decisions of the MPC, the FPC, the PRC, the Bank as resolution authority and the Bank as regulator and supervisor of FMIs; though in the case of a firm entering resolution the policy carve-out would cease to apply in relation to that firm.

Discussions between the Bank and the NAO on the possible text of an MoU were continuing, and Court would receive updates as these progressed.

6. Compliance - Attestations

(Sonya Branch, Virginia Eyre and Kathy McCarthy)

With reference to a Minute of 20 May, Ms Eyre said that the attestation process around the Bank's new Code of Conduct had been completed by all staff and a further process would cover contract workers. Staff had been asked to attest to their understanding and compliance with each aspect of the Code, and the process had surfaced some areas of misunderstanding about what had in the past been required to be disclosed and/or approved. None of these were of major significance and the process had created a good starting point for the new Compliance Division, and significantly improved staff understanding of what the Bank expected of them.

7. Update on Investigations

(Sonya Branch)

Ms Branch updated Court on current investigations.

8. De-redaction of Court Minutes from 1 April 2013

Court noted that since the requirement to publish its minutes came into force, in April 2013, it had, as permitted by the Bank of England Act, omitted a certain amount of information. The principal grounds for redaction were:

- Information subject to a statutory bar on disclosure – for example, data on regulated institutions and personal data
- Third-party commercial information that has not come into the public domain, except with the agreement of the party concerned
- Information relating to the security of the Bank and its staff
- Confidential policy deliberations especially with government
- Information intended for future publication by the Bank or others

There was no statutory requirement to keep these redactions under review, and absent a positive initiative by Court, the omitted material would be retained until normal archive release after 20 years. Court agreed that it was consistent with the spirit of the legislation to institute an annual review of the stock of redactions and to publish any that could no longer be justified. As a first step, Court reviewed the redacted material from 2013 and agreed that a number of passages should be released with the December 2015 minutes. Court also agreed that a Minute of the Oversight Committee relating to the (now public) IEO Forecast Review should be published.

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9. IEO – Progress, Future Work Programme and Terms of Reference

(Lea Paterson and Sarah Ashley)

Ms Paterson, the Independent Evaluation Director, said that the IEO had been in operation for a year, had concluded and published its first in-depth project (forecasting) and was nearing conclusion of its second (the PRA Competition Objective), which was likely to be published in the spring. Future work was likely to consist of a mixture of planned, in-depth evaluations – perhaps two per year - and one-off, more reactive pieces of work. The key objective was to support Court in overseeing the Bank’s performance, and Ms Paterson suggested a framework that emphasised (1) the statutory policy responsibilities; (2) areas of work incurring significant reputational or financial risk; and (3) workstreams that cut across several parts of the Bank, such as resolution, stress testing and operational resilience. Consistent with Court’s statutory oversight functions the IEO would never seek to second-guess current policy decisions, but rather focus on retrospective policy reviews or assessments of capability. The IEO programme would need to take account of the new role in the Bank of the NAO; and the NAO itself had indicated that its own plans would take account of the work programmes both of the IEO and of Internal Audit.

Court discussed the following as potential areas for substantive review: the Bank’s supervision of FMI entities; the Bank’s responsibilities as Resolution Authority; the stress testing programme; the effectiveness of the Funding for Lending Scheme (once the drawdown window had closed); the Bank’s operations under the Sterling Market Framework; Notes circulation policy; the outcomes of the Strategic Plan; and operational resilience. It was noted that some of these were potentially very broad areas and a review would need to be carefully scoped and also adequately resourced, in some cases probably from outside the Bank. One Director suggested that a short scoping review might be undertaken as a first step in some cases. Several Directors thought that the recent innovation of arranging “teach-ins” on some of the more technical and complex areas of the Bank’s work was a good way of identifying issues for subsequent review.

Provisionally, and subject to further discussion both of individual reviews and of the IEO’s terms of reference, Directors agreed the following as likely IEO reviews: FMI supervision; Operational Resilience; The Sterling Money Framework; Resolution; Stress Testing; and the FLS.

It was confirmed that the IEO had and would continue to have full access to the information it required in conducting reviews, and to the resources it needed to undertake them.

10. PRA Report

(Paul Fisher)

Mr Fisher summarised recent decisions taken at the PRA Board, and highlighted the following main developments:

Solvency II

All internal model decisions had been made ahead of the 1 January deadline – it had been announced on 5 December that 19 firms had models approved, with a number withdrawing so that there were no formal rejections. 160 firms had been reviewed for appropriateness of the standard formula for calculating capital requirements. The new Solvency II reporting system was working well, with over 250 annual and quarterly returns received over two separate reporting periods.

Mr Bailey added that there remained significant issues with the design of Solvency II. It had been intended to allow broad comparison of the capital positions of insurers across the EU but the concessions, particularly to life insurers in some jurisdictions, concealed the problems and made the comparisons misleading, a point he had made recently, with Mr Belsham, in evidence to the Treasury Committee. A full review of Solvency II was planned for 2018 but could now come earlier.

Stress Tests

The results of the 2015 stress tests had been announced on 1 December following a number of joint FPC/PRA meetings.

HBOS

The Report on HBOS, together with the enforcement report by Andrew Green QC, had been published on 19 November and hearings had already taken place in the Treasury Committee. Mr Bailey commented that a particular issue in the Committee had been the practice of not naming FSA supervisors below Director level: it had been judged, consistent with the

principles of the SMR, that responsibility lay at the higher levels; and maintaining this practice was an important issue for current staff in the PRA.

Structural Reform

The PRA was now receiving near-final plans from the banks affected by the ring-fencing legislation.

The Single Supervisory Mechanism (SSM)

The Bank was continuing to develop its relationship with the SSM, which as part of the ECB has supervisory authority over all euro-area banks and directly supervises the largest 130. The PRA benefited from engaging consistently with a single supervisory counterpart. A productive meeting had been held in Washington between the PRA, the Federal Reserve Board and the SSM.

11. Banking and Markets Report

Real-Time Gross settlement (RTGS)

Court approved a project to replace the hosting platform for the RTGS system; this will entail replacing the non-stop hardware running the system, which will no longer be supported after 2017. Total costs of £7.7mn would be recovered from users of the system, principally the CHAPS and CREST settlement banks; and the replacement would be managed so as to involve no interruption to the service. It would also provide a segregated development environment, which had been one of the recommendations of the Deloitte review following the 2014 RTGS outage.

Ms Shafik said that the Deloitte review had recommended the Bank define a future technical strategy for RTGS; and beyond that, rapid change in UK payments markets, reflecting the adoption of new technologies, and the creation of the Payment Systems Regulator, suggested the need for a more fundamental review, and it was proposed to announce that in January. RTGS was 20 years old – and, though remaining operationally robust on a day-to-day basis, its aging core architecture, and relatively complex codebase, pose material challenges in terms of future change capacity, support models and resilience. Moreover the current split of responsibilities between the scheme company (CHAPS Co) and the infrastructure (RTGS) was sub-optimal and presented risks to the Bank's supervisory objectives.

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The analytical phase of the review would run for 12 months and would be followed by an IT build phase. The analytical phase would consider the following key questions:

- What should the Bank's policy objectives be in the delivery of sterling central bank money settlement?
- How should the replacement to RTGS be designed?
- How and which participants should access the replacement to RTGS?
- What role should the Bank perform in the future provision of the RTGS replacement?

The review would be undertaken by a joint Banking/Technology project team, overseen by the RTGS Strategy Board but with close links to other relevant Bank workstreams and consulting externally.

FEMR Interim Update

Ms Shafik outlined progress over the past 6 months in meeting the FEMR recommendations, including:

- The measures included in the current Bank of England and Financial Services Bill to extend elements of the Senior Managers and Certification Regimes (SM&CR) to a wider range of regulated firms active in FICC markets.
- The joint FCA and PRA consultation in October containing proposals to require more detailed regulatory references to help prevent the 'recycling' of individuals with poor conduct records between firms, helping to solve the 'rolling bad apples' problem.
- The FICC Market Standards Board (FSMB) was operational with participation from a wide range of firms. The FMSB has also developed draft guidelines on the use of stop-loss orders, and hoped to finalise further guidelines in the next 6 months.
- Work was well underway in central banks to produce a single global FX code by May 2017, with an early release date of May 2016 for some sections.
- 'Neptune' - an initiative between 42 banks and asset managers to share information on dealer inventories in fixed income markets – had gone live. This was consistent with the FEMR recommendation to improve transparency where appropriate.
- The FCA recently intervened to halt the practice of 'payment for order flow' by brokers in the short-term interest rate derivatives market – an example of horizon scanning for conduct risks posed by emerging market structures and behaviours;

A number of recommendations required further legislation. These included widening the scope of criminal sanctions for market abuse for individuals and firms to a wider range of FICC instruments; and a new statutory civil and criminal market abuse regime for spot FX.

Finally, the IOSCO Board had approved the establishment of a Task Force to develop measures to promote, globally, proper conduct by market participants.

12. (i) Balance Sheet Remit and Financial Risk Standards

(Andrew Hauser, Chris Salmon and Nat Benjamin)

On a recommendation from the Audit and Risk Committee, Court approved the balance sheet remit, governing the objectives for management of the bank's balance sheet in both routine activities and in the event of contingences, and the associated standards for acceptance of credit, market and liquidity risk as amended in the light of the Financial Risk Management Review. The amendments to the remit and standards set out in particular the division between first and second-line risk management responsibilities, and escalation procedures.

(ii) Risk Tolerance Statement

(Ralph Coates, Andrew Hauser, Chris Salmon and Nat Benjamin)

On a recommendation from the Audit and Risk Committee, Court approved the Bank's Risk Tolerance Statement, setting out the extent of financial, operational and policy implementation risk that the Bank is willing to accept, as part of its Risk Management Framework.

13. MPC Report to Court

(Andy Haldane)

Mr Haldane noted that the ECB had cut its deposit rate and extended its Asset Purchase programme, while the FOMC was expected to tighten policy at its meeting the next day. UK short rates were little changed from the 15-day average on which the November Inflation Report had been conditioned. Measures announced in the Government's Autumn Statement meant a slightly lower pace of deficit reduction in 2016 than was previously planned, and there had been a number of measures related to housing, including extending the Help-to-Buy: Equity Loan scheme and increasing stamp duty on additional properties. Year-on-year CPI inflation had been -0.1% in October but was expected to start rising as the downward pressure

from food and energy prices dropped out of the annual comparison. However there were signs that nominal pay growth was levelling off, with recent indicators weaker than expected in the November Inflation Report.

14. FPC Report to Court

(Alex Brazier)

Mr Brazier reviewed current risks to stability and resilience, including from fragile market liquidity and housing and real estate lending. The recent stress test had modelled the impact of a severe global and domestic shock, including stressed misconduct costs of £40bn over five years, and while the impact on bank profits had been worse than in the financial crisis, all participating banks were able to maintain CET1 capital ratios above the hurdle rate.

The FPC had reached conclusions on the capital framework for banks and the strategy for setting the counter-cyclical capital buffer. Given the advent of resolution frameworks and non-equity loss absorbing capacity, and the potential for counter-cyclical add-ons, the FPC's view was that the baseline capital requirement by 2019 need be no more than 11% of risk weighted assets. The Countercyclical buffer would ensure that the banking system would withstand stress without restricting essential services to the real economy, being applied in gradual steps when the threat level appears to increase.

Finally the FPC had looked at market liquidity, and considered whether regulation might be encouraging dealers to hold liquidity but not to use it, making markets as a whole more vulnerable to correction.

Directors asked about the Committee's access to MI about non-bank intermediaries:

Mr Brazier said that it was not as good as it should be, and resources were being shifted into the capital markets area. Sir Jon Cunliffe added that the Bank did not itself supervise non-bank non-insurance firms, and the FCA's primary focus was not prudential. However the FSB was mandating the collection of more and better data, and the Bank would be shifting some resource into capital markets and focusing on open-ended investment funds.

15. Diversity Targets

(Jo Place and Maria Barriel)

With reference to a minute of 10 April Ms Place noted that the “stretching” targets set in July 2014 had been reviewed and while the aspiration remained, the target date had been moved to 2020, which was consistent with the succession planning exercise and the talent pipeline. The target for senior management females was now 35% and for other grades 50% by 2020. It was noted that there had been real progress, with female senior management representation up from 18% in 2013 to 27% now; there had been improvements in retention, and progress in recruitment. The Bank was attracting a higher proportion of BAME staff and retention here was improving as well; the talent pipeline was being reviewed and new targets for management grades were being considered. In response to questions from Directors, Ms Place added that the Bank was increasing the range of universities from which it recruited.

16. Counterfeits

(Victoria Cleland and Neil MacNab)

Ms Cleland said that the volume of counterfeits extracted from circulation had fallen significantly over the last couple of years, thanks to a large extent to police activity. But the threat remained, concentrated primarily on the £20, and with activity mostly attributable to a small number of well organised and professional gangs. The Bank’s strategy remained to issue high-quality banknotes with strong anti-counterfeiting features, education of the public and retailers in checking banknotes, promoting effective machine authentication, and working closely with law enforcement. Mr Broadbent added that the introduction of polymer would be a major advance. In response to a question from Mr Fried, it was explained that paper notes would still be in circulation during the transition.

17. £20 Polymer procurement – key contract terms

(Victoria Cleland and Andrew Baker)

Court approved the Bank’s proposed approach to tendering the polymer substrate contract for the next £20 note.

18. FCA/Bank IT agreement

(Dominic Whittle and Vincent Townsend)

Court approved the continuation of the Provision of Services Agreement between the FCA and the Bank, including the fixed cost element for IT services, and delegated authority to Mr Bailey to sign for the Bank.

The meeting of Court was closed.