MEETING OF THE COURT OF DIRECTORS

Wednesday, 18 February 2015

Present:
Anthony Habgood, Chairman
The Governor
Mr Bailey, Deputy Governor – Prudential Regulation (withdrew for item 16)
Sir Jon Cunliffe, Deputy Governor – Financial Stability (withdrew for item 16)
Mr Cohrs
Mr Fried
Mr Frost
Baroness Harding
Mr Stewart (withdrew for items 7 and 8)
Ms Thompson

In attendance:
Ms Hogg, Chief Operating Officer (withdrew for item 16)
Dr Shafik, Deputy Governor – Markets & Banking (withdrew for item 16)

Apologies:
Mr Broadbent, Deputy Governor – Monetary Policy
Mr Prentis
Mr Robert

Secretary:
Mr Footman

Court noted with sadness the death on 11 February of Alastair Clark, formerly an Executive Director and Adviser to the Governor.

1. Minutes

The minutes of 10 December were approved.

2. Matters Arising

Court noted the recent evidence to the Treasury Committee given by Lord Grabiner, and subsequent correspondence between Lord Grabiner and the Committee. Mr Habgood and the Governor would be giving further evidence on 3 March.

3. Report from Audit and Risk Committee

Mr Fried commented on six issues recently discussed in ARCO:

i) Counterfeit Banknotes: The Committee had expressed the need for continuing vigilance with regard to counterfeiting rates, detection and prosecution, and contingencies.

ii) Cyber-risk Insurance: Over several meetings the Committee had explored the possibility of insuring the Bank's risk in this area. However it was clear that the insurable risk was hard to define, cover was uncertain and premia were high. Pool Re would not insure the risks. The matter had been referred back to the Executive: it might be worth exploring what regulated financial services firms who had taken such policies thought they were insuring against.

iii) The Committee had discussed the Bank's continuing review of Risk Governance.

iv) The Committee had supported proposals to increase the level of disclosure in the Bank's financial reporting (item 11 below).

v) The internal audit plan for 2015/16 had been reviewed and approved. The plan had been broken into mandatory audits (80% of total) and non-critical audits that could be deferred if necessary to make room for unplanned priority work.

vi) Finally, the Bank's physical security had been discussed.

4. Update on RTGS

Charlotte Hogg outlined the main conclusions of the Report on the RTGS intraday outage in October 2014. The impact of the incident had been that some housing transactions had completed late, with a few deferred to the next day which caused great inconvenience to individuals. The Bank's offer to compensate had resulted in payouts amounting to just over £4,000 in total. The causes lay with latent defects in the (new) Liquidity Saving Mechanism, and changes in the testing regime were recommended. In terms of handling on the day there was praise for the operational team, and support for the decision not to switch to the back-up system. Involvement of the senior leadership team on the day had been effective and the Report was broadly supportive of the media strategy adopted. There were recommendations about the governance of RTGS, and longer term about the system itself, which was old. Within the Bank, the crisis management framework needed to be reviewed: it was currently geared more to physical than to technical disruptions.

The Report was currently undergoing extensive fact-checking but it was agreed that it would be published in March following final review with the Chairman and Mr Fried. Advance copies of the Report and the Bank's response would be provided to other Court members and if necessary a teleconference could be arranged.

5. **Market Intelligence Review**

(Mr Salmon in attendance)

Court endorsed the Market Intelligence Review, the associated Market Intelligence Charter and the proposed response to Lord Grabiner's Report, all intended for publication on 26 February.

Ms Shafik said that the Review, announced in March 2014 as part of the Bank's Strategic Plan, had been comprehensive and far-reaching. Market Intelligence (MI) was a core input to determining and influencing policy, helping to ensure that policy decisions were made with a detailed understanding of the financial market context. But there needed to be a more robust framework within which staff could operate. The actions proposed were intended to reinforce the transparency and safeguards around the Bank's MI activities, to ensure that MI was focussed on the Bank's priorities and could adapt as they changed, and to promote the effective use of MI. Implementation would take place over the following six months.

Directors asked how the Bank's approach to MI compared with that of other central banks. It was suggested that the main comparator was the New York Federal Reserve, which undertook highly structured and centralised MI often based on standing consultative groups. The Bank's, by contrast, was a more distributed model; but the Bank was drawing on the Fed in its reforms, including in particular training. One Bank official was currently seconded to the Fed. Other central banks often drew on the Bank's MI. Across the Bank as a whole, including the PRA, there was scope to draw on intelligence about institutions as well as market movements.

One Director asked whether the MI function would draw more on the Bank's investment in data handling. Mr Salmon said that the aspiration was, as stated in the Review, that the MI Division should develop use of data and employ more innovative tools to process MI.

Directors asked about liaison with the FCA. Ms Shafik said that there had, since the start of the FX inquiry, been a substantial increase in referrals to the FCA. Some of these had been acted upon. Several Directors commented on the importance of embedding the change in culture that the MI Charter represented. The Governor said that, like the Fair and Effective Markets Review, this was essentially an orientation exercise. And Mr Bailey added that the change in culture embodied in both reviews should enable people to challenge more effectively practices that had been noticed but not acted upon in the past.

6. **Sterling Monetary Framework (SMF) Draft Annual Report**

(Mr Salmon and Ms Paterson in attendance)

In preparation for its consideration (in April) of the SMF Annual Report, Court reviewed the main developments of the past year. The discussion formed part of a strengthened process of Court oversight of the SMF Report, as proposed following the 2012 Winters Review of money market operations. Main developments of the past 12 months included the changes to governance (the relevant executive committee is now Govco), extension of membership to broker-dealers and CCPs, Sharia facilities and extension of collateral accepted to include invoice financing and auto loans. There had also been significant contingency planning ahead of the Scottish referendum.

Several Directors noted that a key issue for the next Report would be how the SMF managed risk.

7. PRA Competition Objective

(Ms Paterson in attendance)

Court endorsed a proposed assessment of the PRA's approach to its new competition objective, to be undertaken by the Independent Evaluation Office. The aim would be to facilitate Court oversight of the strategy adopted using appropriate metrics and monitoring tools.

It was noted that the statutory objective, which came into force in March 2014, required a more pro-active approach than the previous requirement to "have regard" to competition. But the objective was engaged only when the PRA was acting to discharge its primary objective: it was not in itself a reason to act and it did not make the PRA a competition regulator. Nor did it apply to individual supervisory decisions, unless these raised a broader issue of general application. The balance thus needed to be struck with some care.

Mr Bailey said that the PRA welcomed the evaluation which would be helpful for the PRA. There had been a focus already on smaller "challenger" banks, and the introduction of an effective resolution regime made it easier for the regulators to impose less exacting capital requirements on smaller institutions. Some Directors considered that a metric that focussed entirely on challenger banks would miss the point; others were concerned that individual decisions that affected a challenger institution might represent a tipping point for competition in the sector.

The Governor said that he would not see the objective in terms of making things better for challenger banks per se, but the mandate did require the PRA to reflect on competition when it was exercising its powers. Where there was a choice, the competition objective would be relevant.

Overall, Directors noted that, as the PRA now had a statutory secondary objective to facilitate competition, it would be valuable for the IEO to assess how this mandate was being discharged.

8. **PRA Report to Court**

(Mr Fisher in attendance)

Mr Fisher summarised recent issues discussed in the PRA Board. There had been progress in delivering new policies relating to governance – the Senior Managers Regimes for banks and insurers, the remuneration regime – and delivery of the first set of ring-fencing rules. There was currently a close focus on the prudential consequences of conduct risk, and heavy engagement with insurers ahead of the internal models approval process arising from the Solvency II directive. For the major banks, capital planning buffers had been reset in the light of the stress tests and other factors. The workload was substantial; though resourcing was now close to target for the first time since the PRA was formed.

9. **MPC Report to Court**

(Mr Haldane in attendance)

Mr Haldane summarised the Inflation Report and in particular the letter sent to the Chancellor explaining why inflation had fallen below its target range, when it might be expected to return to within the range, and what steps could be taken to manage downside risk. In particular, the letter had suggested that the current Bank Rate was no longer seen as the effective lower bound, a conclusion that had been reached with input from the PRA on the likely impact on the UK's banking system.

10. **Quarterly Update on the Strategic Plan**

(Ms Murphy in attendance)

Ms Hogg summarised the recent strategic milestones including the Transparency and Accountability initiative (December) and the completion of the performance management structure, which had been used to grade all staff in the Annual Salary Review. A conference on the new research model would be held later in the month.

The Chairman asked that the Talent Review be on the agenda for the April Court.

11. **Transparency of Financial Statement Reporting**
(Mr Coates in attendance)

Court discussed proposals (previously discussed in ARCO) to provide more details of the Bank's income in its Accounts. As permitted by Section 7(4) of the Bank of England Act 1998, the Bank had for many years withheld some of the elements of its income that might indicate unpublished assistance to financial institutions. A review in Finance had suggested that this risk was overstated and that in the interests of transparency the Bank should show net interest income, investment income split by available for sale securities and net income from financial instruments at fair value, and other income. Court agreed the proposals subject to further review by ARCO.

12. **2014/15 Outturn and 2015/16 Budget**
(Mr Coates in attendance)

Court discussed and approved the 2015/16 Budget for the Bank, including the PRA.

The proposed budget of £549mn was compared with the previous year's budget of £521mn, and expected outturn of circa £506mn. Key drivers of the year-on-year increase included increased spending on notes ahead of the introduction of polymer, and higher pension costs given lower gilt yields. Other incremental costs included spending on infrastructure and information security, and investment in the PRA regulatory agenda (including Solvency II, CRD IV, Structural Reform and Stress Testing).

Directors recognised the need to respond to the additional requirements on the Bank and to fund the strategic plan. But equally they noted that the increase was considerably more than the current public sector norm. Mr Coates said that the Governors had been mindful of that and the outline budgets for subsequent years started from a presumption of no real increase. The current year was deemed exceptional. Ms Hogg noted that a VFM exercise had been concluded successfully in 2014, but that a strategic Bank-wide review of the existing structures would be undertaken in due course. The Governor added that the PRA would be undertaking a review of its Target Operating Model (covering the PRA's risk appetite, risk oversight and mitigation plans).

13. **Interim Payment in Lieu of Dividend to HMT**
(Mr Coates in attendance)

Court approved an interim payment of £41mn based on estimated post tax profit for 2014/15 of £173mn. The final dividend would be based on the audited full-year accounts.

14. **Deed of Amendment - Bank Pension Scheme**

Court delegated to Mr Habgood and Mr Stewart authority to approve amendments to the Trust Deed and Rules of the Bank Pension Scheme, necessary for the implementation of the agreed pension reforms on 1 April.

15. **Report from Nominations Committee**

Court noted proposals from the Nominations Committee relating to future appointments to Court.

16. **Report from Remuneration Committee**

Court approved proposals from the Remuneration Committee relating to the pay and pension arrangements of Governors, the fees for the external members of the policy committees, and the pay and performance awards of Executive Directors.

17. **Items for Information**

Court noted a paper on the outcome of the Annual Salary Review for staff; a Report on the Bank's insurance policies; and a Report on Health and Safety

The meeting of Court was closed.