

MEETING OF THE COURT OF DIRECTORS

Monday, 26 October 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

Mr Prentis

Mr Robert

Mr Stewart

Ms Thompson

Ms Hogg, Chief Operating Officer

Dame Minouche Shafik, Deputy Governor – Markets & Banking

Apologies:

Baroness Harding

Secretary:

Mr Footman

1. Minutes

The minutes of 16 September 2015 were approved.

The Secretary confirmed that at its next meeting Court would review the outstanding stock of redactions from its minutes.

2. Matters Arising

It was noted that diversity targets would be discussed at Court's next meeting.

3. Report from ARCO

Mr Fried reported the October meeting of ARCO at which the following matters had been discussed:

- The implementation of the Loans Data System, which will reduce operational risk and allow improved modelling of haircuts. Haircuts are set so as to protect the Bank's

balance sheet and, early indications were that improved modelling would lead to an overall reduction in haircuts on residential mortgage collateral. This would result in potential improvements to the Bank's policy effectiveness without increasing its risk profile.

- The development of the Financial Risk and Resilience Division, which was now fully functioning as a well-structured second line of defence. Risk reporting was being reinforced and the level of executive challenge and governance through the Executive Risk Committee was going to plan.
- The proposed Codes of Conduct for the Policy Committees of the Bank, which were on Court's agenda that day.
- IT related risks, including the PRA's current reliance on FCA-outsourced systems, and the future of the data centres.

4. Conflicts Issues – MPC/FPC/PRC Codes of Conduct

(Mr Footman and Ms Branch)

Court noted that the Bank of England Bill would introduce identical statutory conflict of interest provisions for the three policy committees, and would require the Bank to issue separate codes to each committee. Court discussed and approved draft codes for the MPC, the FPC and the PRC, subject to changes to make clear that decisions by a Committee to approve a conflict would remain subject to the agreement of Court (although a Committee might take its own decisions in managing a conflict from meeting to meeting). The next stage would be to inform the Committee members, and then to share the Codes with the Treasury, which would, under the provisions of the Bill, have to be consulted.

5. (i) Bank of England and Financial Services Bill

(Mr Footman and Ms Branch)

Court noted updates on the Bill, which was to be debated in the House of Lords that evening. In response to a question, the Governor confirmed that he was planning to meet Sir Amyas Morse, to discuss how the Bank and the NAO could work together effectively while maintaining the Bank's policy independence.

Court members asked about the government's proposal, as part of the Bill, to replace the "presumption of responsibility" with a "duty of responsibility" on senior managers. Mr Bailey

noted that this was part of a substantial extension of the Senior Managers Regime, and the task of the regulator, in an enforcement case, would be to satisfy itself that an individual had taken reasonable steps to prevent a conduct failure, rather than requiring the individual to prove that he had done so.

(ii) Articles of Association

(Ms Branch)

Court was content with proposed changes to the PRA's articles designed to facilitate the use of written resolutions, and directed the Secretary to sign the resolution once received in its final form from the PRA. It was noted that the proposed changes were in line with provisions in the Bank of England and Financial Services Bill.

6. Update on Investigations

(Ms Branch)

Ms Branch provided an update on investigations and associated legal issues.

7. Forecast Evaluation Review

(Ms Paterson, Mr Ramsay and Ms Rutkowska)

Ms Paterson, the Independent Evaluation Director, summarised the main conclusions of the evaluation commissioned by Court of the Bank's forecasting performance. The report contained a statistical assessment of the Bank's forecasts of eleven macroeconomic variables, benchmarked to private sector forecasters and other central banks. It made a number of recommendations, including that the Bank should investigate more systematic use of a range of statistical models, undertake more systematic review of its own performance and report this to Court on a regular basis, and be more ready to challenge conventions. It was intended to publish this at the same time as the November Inflation Report, which would itself contain a response from the Bank. Mr Ramsay said that the response would welcome the Review and describe how the MPC was implementing the recommendations, alongside other initiatives already underway.

The Governor said that it was important to be clear about the horizons of the Bank forecasts that had been studied. He also asked that the IEO check that its results were robust to the latest

revisions to national income data. In response to questions from Directors, Mr Ramsay said that the Bank would be repeating the IEO's tests in the future.

Court approved publication of the IEO's Report.

8. IEO study of PRA Competition Objective

(Ms Paterson, Ms Carr and Mr Holman)

Ms Paterson updated Court on progress of the assessment requested by Court of the PRA's approach to its secondary competition objective (the "SCO"). This had been introduced by the Financial Services (Banking Reform) Act 2013, and required the PRA, when exercising its general functions to advance its primary objectives, to "facilitate effective competition" in the markets for services provided by PRA-authorised firms. It thus replaced a previous requirement to "have regard" to the need to minimise any adverse effect on competition.

Ms Paterson noted that the PRA had invested in its approach, with positive results both for new policies and the review of existing ones, building on the substantial reforms to reduce barriers to entry undertaken ahead of the SCO. Despite initial concerns that the SCO could conflict with the safety and soundness objective, practical experience of the SCO had been largely positive and the work undertaken by the PRA to address market and regulatory failures had generally advanced both safety and soundness and competition. The evaluation criteria had included whether the clarity of the statutory framework was reflected in the PRA's approach and processes; whether the effort devoted to competition issues was proportionate to their materiality; whether competition received consistent attention throughout the policymaking process; whether there were sufficient indications of the more proactive approach that legislators had sought; and whether decisions were being demonstrably influenced. The work drew on internal and external documentation; six case studies; and (experimentally) on linguistic analysis of material considered by the key decision taking committees.

Sir Jon Cunliffe said that in assessing interactions of the PRA with the FPC it was important to bear in mind that the FPC did not have a secondary competition objective: and its secondary objective – to support the economic policies of the government, was given shape by an annual remit from the Treasury. The Governor agreed, noting that the IEO assessment should remain focused on areas of the PRA's work where the SCO was engaged.

The Governor said that the assessment was important and timely. It was important that the recommendations to emerge from the IEO's work should be forward-looking. Mr Bailey agreed, and added that, to the extent that it found any residual mistrust of the SCO, it was important that the exercise should help the PRA to grasp the cultural nettle. He noted that the PRA had proposed new capital standards for small firms during the previous week: this was at least as big an advance as the earlier relaxation of new firm authorisation requirements. He noted that the EU banking authorities did not have a competition objective. Directors agreed that the work should proceed with a view to publication in due course; and in that connection it would be important to record what the PRA had done, as well as what it might do, and to be clear about the limits.

9. PRA Report

(Mr Fisher in attendance)

Mr Fisher commented on recent decisions of the PRA Board, and the PRA's report on the impact of climate change on the PRA's objectives¹, particularly for insurance, that had been issued alongside the Governor's speech at Lloyd's of London². In compiling the report the PRA had worked with regulated insurance firms, identifying three main risk factors: physical risks, transition risks (including the mispricing of carbon-intensive financial assets) and liability risks. The PRA's initiative had been followed closely by other central banks and insurance supervisors, and the framework adopted in the study had been adopted by others.

10. HBOS Review

Mr Bailey briefed Court on the long-running review of the HBOS failure, which had been commissioned in late 2012 and was inherited from the FSA. One objective was to review why HBOS had failed and the defects in its supervision: this was overseen by a committee drawn from the PRA and FCA boards. A separate part reviewed the FSA's enforcement decisions, and was being written by Andrew Green QC. Two Reviewers appointed by the Treasury Committee were writing a separate report on the conclusions. The HBOS Report, and the associated and lengthy Maxwellisation and consents processes, had now essentially been

¹ The impact of climate change on the UK insurance sector – September 2015

² Breaking the tragedy of the horizon: Climate change and Financial Stability – September 2015

completed, but decisions had to be taken on whether any enforcement action should be taken. Subject to that the Report should be published in November.

Mr Bailey added that future reports on regulatory failure were unlikely to be done internally.

11. FPC Report

(Messrs Brazier and Haldane)

Mr Brazier said that the FPC was preparing for its next Financial Stability Report, and had published its approach to stress testing during the previous week. The annual scenario would systematically link the severity of the test to the financial cycle, ensuring that in good times the stress was more severe and in bad times less. This approach was intended to ensure the resilience of the banking system to a downturn while not adding impetus to the downturn when it came.

The current cycle of stress tests was nearly complete with very good co-operation between macro and micro supervisors. In its fourth quarter meeting the FPC would be presented with analysis and policy options to support a decision on setting the counter-cyclical capital buffer. Staff were also working with the FCA on risks posed by mutual funds.

12. MPC Report

(Messrs Haldane and Brazier)

Mr Haldane noted further falls in market interest rates over the past month, following the FOMC decision to hold rates and concerns about global activity. The sterling forward curve had fallen by about 40bps since the August Inflation Report.

13. EU Membership and the Bank

Sir Jon Cunliffe commented on the Bank's publication on the ways in which EU membership affects the Bank of England's objectives, summarised in the Governor's speech in Oxford during the previous week. The paper had looked at three particular features of the EU.

First, through increased economic and financial openness, EU membership reinforced the dynamism of the UK economy, making it more resilient to shocks and able to grow more

rapidly without generating inflationary pressure or creating risks to financial stability. Second, and for the same reasons, the UK economy was more exposed to economic and financial shocks from overseas. Closer integration with the EU and, more recently, with the euro area, may have increased the challenges to UK economic and financial stability. Third, EU regulations, directives and rules define many of the Bank of England's policy instruments particularly in relation to financial stability. These must be sufficiently flexible and effective to manage the consequences for the United Kingdom of shocks originating in both the domestic and global economy and financial system. The arguments were carefully set out and would be the Bank's point of reference for the future.

14. Succession Planning

(Ms Place)

Court discussed the succession grids for senior appointments, and the measures adopted to develop potential leaders. Ms Place noted that the new assessment system was providing good data on performance and development needs for this group, which included in some cases gaining external experience, as well as directed moves within the Bank.

15. Quarterly Reports

(Mr Coates in attendance)

(i) Quarterly Financial Review

Mr Coates said that net earnings before tax were after three quarters running £13mn ahead of budget, mainly because of more banking income than expected. Head count, at 3,781 FTE, was slightly below budget.

(ii) Quarterly Risk Report

Court noted the risk report, which had previously been discussed in ARCO.

(iii) Quarterly Balance Sheet Report

Court noted the report, which had previously been discussed in ARCO.

16. Projects

- (i) Investment Portfolio Overview
(Mr Curtiss)

Court reviewed the Bank's project portfolio for the next three years. A substantial investment in technology simplification would make it possible to replace obsolescent systems and meet the demands for new systems to support policy areas and significant risk reduction within the existing budget envelope. Significant individual projects would continue to be brought to Court for approval and the investment budget for 2016/17 would be presented in February.

- (ii) Threadneedle Street Data Centre
(Mr Curtiss)

Court noted preliminary work on the relocation of the Threadneedle Street data centre in order to improve resilience and to reduce risk. Directors were supportive of the proposals.

- (iii) Structural Reform
(Messrs Fisher, Proudman, Norman and Ms Julien)

Court noted that estimates of the final cost of implementing the structural reform (ring-fencing) programme remained uncertain partly because of uncertainty over IT/data requirements and how that would be provided. In the meantime Court approved Tranche 2 funding of £3mn, and authorised the Investment Board to approve Trance 3 Funding of £6mn-£9mn.

17. Items for Information

The Court noted the following revised Memoranda of Understanding:

- between the Bank of England and FSCS
- between the Bank and ECB
- between the Bank, ECB and LCH
- between the Bank, ECB and ICEU

The Chairman thanked Mr Stewart, at the conclusion of his second term of office, for his long and dedicated service to the Court and the Bank.

The meeting of Court was closed.

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