

MEETING OF THE COURT OF DIRECTORS

Thursday, 28 April 2016

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 – Senior Independent Director
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 from the meeting held on 11 February were approved.

2. Report from ARCo

Mr Fried said that the Committee had reviewed the year-end financial results and nothing material or contentious had arisen. Both KPMG and the NAO had confirmed that there were no major issues arising from the audit.

The Committee had also reviewed the enhanced Quarterly Risk Review (QRR) report, as part of significantly more proactive approach to the assessment of non-financial risks, and this had prompted much discussion about the Bank's risk tolerance threshold. All of the NEDS on ARCO had been very encouraged by the progress made in this area, and the new format QRR would be discussed by Court later in the meeting.

The Committee reviewed reports about the recent Bank of Bangladesh hacking incident. The Committee had been assured that the Bank was working to understand any implications for its own operations.

Finally, Mr Fried noted that the new Bank of England Act established that the NAO could attend discussions in the Bank's Audit Committee that concerned the audit of the Bank's accounts. The Bank was unusual in that audit and risk matters were considered by the same committee (ARCO), and, to facilitate the NAO's involvement, agendas would in future be arranged so that audit items would be grouped together, and both the NAO and the Bank's internal and external auditors would attend for those items only. The approach proposed would make for increased clarity and would allow for ARCO to continue addressing risk factors appropriately and for the members to have an appropriate space to discuss those risks.

3. **Report from RemCo**

Baroness Harding provided a briefing from recent RemCo meetings, which had discussed issues in managing pay in the public sector and more recently Remco's Annual Report.

On the recommendation of RemCo, Court approved remuneration for Sam Woods on taking up his position as Deputy Governor for Prudential Regulation later in the year.

4. **Court Effectiveness**

(Kathy McCarthy)

Court discussed the main findings of the 2016 Court Effectiveness Survey, which had been based on a questionnaire circulated in December and a series of individual interviews conducted by the Chairman and the Senior Independent Director. The main survey findings were strong and on an improving trend, with meetings regarded as well-chaired and open. The subcommittees, particularly ARCO, were seen as very effective, though as in the previous year the desirability of splitting risk agendas from Audit had been raised. The institution of "Policy Lunches" on Court days, with members of all three policy committees invited, was welcomed, and the teach-ins on specific issues continued to be valued by the non-executives. There was very positive feedback on the work of the Independent Evaluation Office. Major issues identified for Court during the coming year were the relationship with the NAO and the creation of the PRC as a policy committee. In the latter context the Chairman said that the transition from the PRA Board to the PRC had been discussed between the Court NEDs and PRA NEDs the previous evening and that more work was needed to embed the concept of a policy committee.

5. **Bank of England Bill**

(John Footman and Sonya Branch)

Court noted the conclusion of the Bill's Commons stages and discussed the likely timing of its main provisions coming into force.

6. **Update on Investigations**

(Sonya Branch)

Ms Branch updated the Court on the progress of investigations, noting the good co-operation between the Bank and the SFO in relation to current prosecutions.

7. **EU Referendum**

Court discussed the EU referendum and the work underway across the Bank's policy committees in relation to this event. In line with its remit, the Bank is considering the effects on monetary and financial stability, as well as considering contingency planning as appropriate.

8. **IEO Evaluation – PRA approach to its insurance objective**

(Lea Paterson, Sarah Ashley and Anne Wetherilt)

Further to a discussion on 11 February Ms Paterson outline the proposed scope of the IEO's proposed evaluation of the PRA's approach to insurance regulation. The aim would be to give Court assurance that the PRA's framework was delivering what was intended in statute and that there was a consistent understanding of the "policyholder protection" objective, which (unlike for banks) supplemented the PRA's overarching safety and soundness objective. The focus would be on approach and process rather than individual supervisory decisions, so as to avoid duplication the work of the PRA's Supervisory Oversight Function. But it would encompass the interaction with the FCA.

As in previous reviews, the IEO would aim to draw on external advice. Some of this would come from the PRA's part-time senior advisers, others might be current senior practitioners. Court was content in principle that a small external group should be assembled as "critical friends" but these should not be just from the industry and should be involved as consultees with no direct involvement in the production of the assessment.

In relation to the proposed FMI study, Ms Paterson confirmed that Alexander Justham, formerly CEO of the London Stock Exchange and previously Director of Markets at the FSA, had been retained to work on the project.

9. **Support for Monetary Policy and MPC Effectiveness**

(Gareth Ramsay and Kathy McCarthy)

Mr Ramsay said that in the light of the IEO's study of the Bank's forecasting record, MA staff were developing a more systematic approach to analysing the MPC's forecast performance. Over the past year activity had been weaker but unemployment had fallen faster than expected. Inflation had been below expectations largely because of the sharp fall in oil prices during 2015.

The Bank's regular survey of MPC members was intended to help Court to fulfil its statutory responsibility to ensure adequate support for the Committee. In general, and as in previous years, responses were very positive for the quality of the draft minutes and Inflation Report, for conjunctural assessments and for the pre-MPC pack. Scores were less positive for the effectiveness of forecast processes, though this was also showing the biggest improvement relative to a year previously; and it was felt that more work was needed to get the best out of the joint meetings of the MPC and the FPC. Mr Ramsay commented that the move from twelve to eight MPC meetings a year would mean less concentration on the data "sausage machine" and enable an improvement in the quality of analytical input.

The Chairman noted that the MPC members seemed to rate the quality of inputs into some Inflation Report meetings more highly than the quality of the subsequent discussion in the Committee. Mr Broadbent and the Governor both thought that the move to fewer meetings would deepen the quality of the analysis and improve the quality of the discussion at MPC.

There was a brief discussion about the MPC's forecast as a "best collective judgement".

Mr Frost asked how this should be weighed against the individual accountability of MPC members. Mr Broadbent said he thought the interaction worked well and that, while they all sign up to the collective forecast, individual MPC members were free to take their own view of the risks to that forecast and to express that view publicly in explaining their vote.

Ms McCarthy said that the main additional issue to emerge from the Chairman's individual discussions with external MPC members had been a concern about maintaining the quality and motivation of their individual staff. Mr Ramsay said that he understood the issue and was committed to ensuring that people should regard a spell in the MPC unit as a positive and rewarding part of an economist's career in the Bank.

10. FPC Procedures

(Beth Blowers)

Ms Blowers presented the annual review of the FPC's based, like the MPC's, on a questionnaire completed by all FPC members. In general the responses had strengthened across the board, with staff support and analysis highly rated. There were three issues for further work. First, the process for drafting and approving the FPC record was being changed to bring in new authors and better co-ordination. Second members were concerned about the effectiveness of the Committee's communications. The *Financial Stability Report* had been reorganised during the year to differentiate more clearly between risk and resilience and had been given a pull-out executive summary. Third, on interaction with other bodies, collaboration with the PRA was seen as effective, but more thought should be given to joint meetings with the MPC. The Governors had agreed a new approach for how these should operate. There was also an appetite for more interaction with the FCA given the Committee's concerns about market risks.

Sir Jon Cunliffe said that the FPC was different in nature from the MPC: it covered a diverse set of topics, and each round of meetings brought a different set of issues that often needed a lot of preparation. The good progress that had been made during the year was a testament to the new management team in FSSR.

Mr Robert noted the comment from one FPC member that there was still too much focus on banking. Sir Jon Cunliffe argued that there had been a necessary focus on the regulatory framework for banks in recent years as the reform programme had been implemented – the 11% Tier 1 ratio, the Systemic Risk buffer, the MREL consultation and the risk-weight floors. But attention was shifting to risks over the credit cycle – the FPC had noted that risks from domestic credit expansion had risen - and to shifting risks within the financial system. Market-based

finance did not pose the same leverage risks as banking, but there were issues about market liquidity and how investment funds and asset managers would react in stressed markets.

11. **Six-Monthly Risk Update**

(Julia Rangasamy, Ralph Coates, Andrew Hauser and Nat Benjamin)

Julia Rangasamy introduced the new Quarterly Risk Report. This incorporated assessment of 73 specific non-financial risks against the Bank's risk tolerance threshold. In the dashboard presented to Court 13 of these risks were assessed as outside tolerance, half of these being in the technology/cyber area. The Executive Risk Committee would review these to ensure that where possible there were plans to reduce the risk or alternatively a process for accepting them. Court members found this presentation helpful as identifying the areas where the Bank was most exposed operationally, but suggested that that the reporting should place equal emphasis on plans to mitigate those risks and the likely timeframes.

Mr Benjamin described the evolution of the financial risk dashboard and plans to stress test the Bank's balance sheet.

12. **Report on Risk and Control Attestations**

(Julia Rangasamy and Ralph Coates)

Court was content for the normal statement concerning the effectiveness of the Bank's risk management and control systems to be included in the 2015/16 Annual Report.

13. **Annual Report and Accounts**

(Emma Murphy, Chris Peacock, Jenny Scott and Ralph Coates)

Directors reviewed the draft Annual Report text. A final draft would be brought for approval at the next Court.

14. **Report on Communications**

(Jenny Scott)

Ms Scott said that the year had seen several new departures, including the Open Forum which represented a completely new style of communication for the Bank. Use of social media was also increasing and required the Bank to adopt simpler and more accessible language.

The Bank had circulated guidance to the Committee members and staff concerning communication ahead of the Referendum on EU membership. The guidance followed closely that issued by the Cabinet Office to the civil service.

15. External Communications for Non-Executive Directors

(John Footman and Jenny Scott)

Revised guidance for non-executive directors was agreed.

16. Year-end Financials

(Ralph Coates)

Court reviewed the provisional outturn for the 2015/16 financial year. Net earnings before tax were £233mn, with the increase on the previous year mainly attributable to the Funding for Lending Scheme; costs were in line with budget. The Annual Accounts would be published in June.

17. ELA Report

(Andrew Hauser, Matthew Hunt and David Brighton)

Mr Hauser said that work had continued during the year to ensure the Bank's readiness to undertake Emergency Liquidity Assistance (ELA) if required to do so to a range of institutions including banks, building societies, CCPs and broker-dealers. This continued the work programme originally agreed following the Plenderleith Report (2012). ELA transactions were outside the Bank's normal operations and required the approval of Court; they were very rare, and consequently maintaining and periodically testing the capacity remained important. In principle such lending could be covert, though there remained issues around this not least because of the obligations on firms, and in some other jurisdictions covert lending was no longer possible. A recent IMF FSAP Report had described the Bank's ELA framework as "well organised, flexible and operationally sound".

18. Sterling Monetary Framework (SMF) Report

(Chris Salmon, Sarah John and Nick Butt)

Court reviewed and approved the publication of the annual report on the operation of the SMF, and reconfirmed the objectives of the SMF as being to implement the MPC's decisions in order to meet the inflation target and to reduce the cost of disruption to the critical financial services supplied by SMF participants to the UK economy by providing liquidity insurance.

Directors noted that the Bank was consulting on the provision of Shari'ah compliant liquidity facilities. It was noted that this was a part of extending the SMF facilities for smaller banks as recommended by the Winters Report of 2012. Mr Salmon said that there remained a long list of other potential improvements, including the market-maker of last resort (MMLR) facility, and improvements to collateral management.

19. Conflicts and Communications Codes for MPC/FPC/PRC

(John Footman)

Court approved revised Communications Guidance for members of the MPC and the FPC, and amended Codes on Conflicts of Interest for members of the MPC, FPC and PRC.

The meeting of Court was closed.