

MEETING OF THE COURT OF DIRECTORS

Thursday, 11 February 2016

Present:

Anthony Habgood, Chairman

The Governor (for items 1-12)

Mr Bailey, Deputy Governor – Prudential Regulation (for items 1-10)

Mr Broadbent, Deputy Governor – Monetary Policy

Sir Jon Cunliffe, Deputy Governor – Financial Stability (for items 1-10)

Mr Fried

Mr Frost

Baroness Harding

Mr Prentis

Mr Robert

Ms Thompson

Ms Hogg, Chief Operating Officer

Dame Minouche Shafik, Deputy Governor – Markets & Banking

Secretaries:

Ms Reynolds/Mr Footman

The Chairman congratulated Mr Bailey on his appointment as the CEO of the Financial Conduct Authority and thanked him on behalf of the Bank for his invaluable contribution. The Governor added his thanks and expressed admiration for the public spirit and dedication shown by Mr Bailey in agreeing to accept the role.

1. **Minutes**

The minutes from 16 December 2015 were approved. Court noted that alongside the minutes of 16 December, the de-redacted sections from earlier meetings would be published, as agreed at the previous meeting.

2. **Matters Arising**

All remaining actions were scheduled either for the present Court meeting or a future one.

3. **Resolution Report**

(Andrew Gracie)

Mr Gracie presented the annual update to Court on the Bank's resolution capability. The majority of firms covered by the Bank's resolution powers would now be resolvable via a modified insolvency or special administration procedure. For some firms resolution would require use of the Bank's resolution tools. Many of these firms were either UK G-SIBs or subsidiaries of overseas G-SIBs. Progress in making these entities fully resolvable hinged on the refinancing of existing debt with instruments which could reliably be bailed-in.

In response to a question about the major findings from recent exercises, Mr Gracie noted that reliance on external advisors for transactional know-how presented the Bank with a structural difficulty over the point at which to engage with advisors, since engaging too early could be costly but engaging too late would increase the risks. In the context of the planned table top exercise on resolution decision-making, Mr Gracie emphasised the level of uncertainty that the decision-takers would be faced with when dealing with a resolution situation, noting that the valuation of the assets was likely to be partial and the liquidity position of the firm would be subject to the reaction of other market participants.

Addressing the issue of entities "too big to fail" was taking time in every jurisdiction but there had been real, tangible progress in the UK. Better tools were now in place and there was a growing understanding in the market of the options available to the Bank and HMT.

In relation to CCP resolution more work needed to be done to understand how losses in insolvency would currently fall to CCPs, clearing members and their users. Mr Gracie emphasised the importance of a globally consistent approach to CCP resolution. CCP resolvability was expected to be a top priority for the Financial Stability Board in the coming year.

4. **FMI Report**

(David Bailey)

Mr Bailey updated the Court on progress since his last update. The changes to the governance and organisation of the FMI Directorate highlighted in previous updates had now been implemented. The Directorate had received useful external perspectives on progress from a number of sources during the year, including two internal audit reports, an external review carried out by the Committee on Payments and Market Infrastructures and the IMF Financial Sector Assessment Programme review, which while broader, has encompassed consideration of FMI oversight.

In the past year, FMI Directorate had delivered a number of important changes including collaborating with colleagues from the Markets & Banking area on a number of changes including pre-funding of retail payment systems and establishment of cross-currency swap lines with the ECB in order to provide emergency backstop liquidity to CCPs.

Visa Europe had now been added to the Bank's list of recognised payment systems. Mr Bailey said that establishing oversight of a large and complex company of this type "in flight" presented significant challenges.

Changes in the FMI landscape would likely continue apace. 2016 would see the implementation of mandatory clearing rules in Europe and technological changes would present new challenges and opportunities for infrastructure firms.

5. **PRA Report**

Mr Bailey updated the Court on the nature and impact of recent financial market moves, which appeared to be driven by a combination of factors including: expectations about the macro outlook and future world growth; and a perception of regulatory uncertainty. The extent to which individual banks were impacted depended on the perceptions of the sustainability of their business model and any conduct issues yet to be addressed, plus their known or suspected exposure to particular geographical areas, sectors or asset types.

The Court noted the recent enforcement action taken against individuals formerly with Co-op bank and Millburn Insurance Company Ltd.

In response to a question about the potential impact on credit unions of the new rulebook, Mr Bailey said that there had been a wide consultation on the impact, a number of amendments had resulted and he had no expectation that it would reduce the number of credit unions operating in the UK.

6. Report from Audit and Risk Committee

Mr Fried reported on the meeting of the Audit and Risk Committee on 8 February. Amongst the items discussed by the Committee were consideration of a number of departmental risk drilldowns and a review of the 2016/17 Internal Audit work-plan. The Committee had welcomed changes to the regular risk reporting packs, which now delivered a more succinct and powerful update.

7. (a) Report from Remuneration Committee

Baroness Harding reported on the meeting of 26 January. The Committee had approved the 2016/17 pension “flex” rates used to determine the price at which staff can give up salary for pension accrual and considered the possible read across to the Bank from two current government consultations on civil service pay and conditions.

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.

Baroness Harding reported that the Remuneration Committee had been encouraged by the increased level of open, clear and honest feedback that they observed in the process for compiling the annual salary review for the Executive Directors.

(b) Staff Changes

Court approved the appointment Mr Nelson to the role of Deputy CEO of the PRA and Executive Director for Specialist Supervisory and Regulatory Operations, following

Mr Fisher's retirement later in the year; and of Mr Proudman to replace Mr Nelson as Executive Director for UK Deposit-takers.

(c) Report from Nominations Committee

The Chairman informed Court about discussions in Nominations Committee on the appointment process for the PRA CEO.

8. Senior Managers Regime

(Sonya Branch and Julia Rangasamy)

Ms Hogg noted the Governor's commitment at the Mansion House that the Bank would apply to itself the core principles of the Senior Managers Regime, which was to be implemented for banks and insurers by the PRA and the FCA on 7 March. Within the Bank this had involved mapping the senior management responsibilities, so far as they were appropriate to the Bank, onto the current organisation, taking account of the changes that would follow from the Bill currently before Parliament. From this a statement of responsibilities had been derived for each individual. Included among the Senior Managers were the Chairman, the SID, the Chair of ARCo and the Chair of Remco. The statement explained how the Bank's objectives were assigned to Court and to the policy committees, the latter having collective responsibility for their decisions.

The PRA was included in the statement but would also have its own statement, consistent with the FCA and reflecting a commitment made to the Chair of the Treasury Committee.

Directors thought that the template was good and the statements of responsibility improved the Bank's transparency. They welcomed the initiative and approved the publication.

9. IEO – Future Work Programme and Terms of Reference

(Lea Paterson and Sarah Ashley)

With reference to a minute of 16 December, Ms Paterson said that she had given further thought to the scheduling of the possible reviews discussed with Court, taking account of existing work going forward in the Bank. As requested, she had developed a framework for a review of FMI supervision, and thought there was a strong case for going ahead: since the

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Bank gained responsibility for this area there had been rapid change in the sector and a material increase in the quantity of risk. The IEO project would aim to give Court assurance that the Bank's approach was on course to deliver the step up in supervision that was intended and needed. Given the specialist nature an external expert with a background in FMIs would be appointed to act as a technical adviser.

She had also looked in more detail at a possible review of operational resilience activities across the Bank – both inward and outward facing. But a lot of work was already going on to design a Bankwide framework, and it was not clear what at this stage the IEO could usefully add.

Among other priorities, Resolution planning remained a strong candidate for review. And in relation to the PRA, two possibilities had emerged: one was the recently completed review of the Target Operating Model, and the other a review of the PRA's approach to its statutory insurance objective, in respect of policyholder protection.

Directors thought the logic for doing an evaluation of operational resilience at some point was very strong. Sir Jon Cunliffe agreed. The Bank was currently reviewing its objectives, risk tolerance and organisation of operational resilience across different business areas so it was probably most sensible for the IEO to review this area after any changes had been made and bedded down, probably in two years or so. He thought that it would be very desirable for the IEO to look at Resolution next year.

In relation to the PRA, Directors felt that the proposed review of the insurance objective would make sense: there could be much to learn in relation to it from the implementation of Solvency II and there were continuing issues around the design and impact of the Directive across Europe. It was also the case that insurance posed challenges that were less familiar to the Bank.

Court concluded that the IEO should focus in 2016 on FMI Supervision and the PRA Insurance Objective; with Resolution among the projects for 2017.

Court approved the Terms of Reference of the IEO, for publication on the Bank's website.

10. **Draft Competition Review**

(Lea Paterson, Sasha Mills, Alice Carr, Katharine Neiss and Paolo Siciliani)

Further to a minute of 26 October 2015, Ms Paterson presented the final version of the IEO report and the draft response from the Bank. She sought Court's approval to publish in March, subject to any final changes which would be circulated to Court nearer the time. The Bank response was positive, both in relation to the recommendations and in relation to the process. Mr Bailey confirmed that the process had been positive for the PRA and had helped to embed the Competition Objective in the organisation.

Court approved publication of the Review.

11. **Update on the Bill**

(John Footman)

Mr Footman noted progress of the Bill in Parliament. The Committee stage in the Commons would conclude on 23 February: thus far, Government amendments apart, the Bill was substantially the same as when brought from the Lords. Opposition amendments to change the names of the Bank and of Court had yet to be debated.

12. **Bank/NAO Memorandum of Understanding**

(John Footman, Ralph Coates and Lea Paterson)

Court reviewed the draft memorandum of understanding with the Comptroller and Auditor General. Mr Footman said that the memorandum met the requirements of the Bill to specify the Committees involved in taking policy decisions on FMI supervision and Resolution (those, along with decisions of the MPC, the FPC and the PRC being excluded from examinations by the Comptroller). The memorandum was also required to identify areas that the Comptroller would not "usually" examine. These were set out in Section 6 of the memorandum and included the Risk Tolerance Statements set by Court, and the decisions of the MPC and the FPC relating to the Sterling Monetary Framework and the provision of liquidity facilities. The Comptroller could of course examine the implementation of such high-level decisions. The memorandum also covered the arrangements for consulting Court about a prospective examination and the procedure for resolving disputes. It also provided that the Comptroller

would take account of the work programmes of the IEO and Internal Audit, with a view to avoiding unnecessary duplication. Copies of the draft memorandum had been provided to members of the Commons Committee examining the Bill.

Court was content with the memorandum as drafted.

13. **Banking & Markets Report**

(Chris Salmon)

Mr Salmon said that the Bank was publishing a consultation paper on making the Bank's deposit and liquidity insurance facilities available to banks operating on a Sharia basis.

Responses would be sought by 29 April.

14. **Update on Investigations**

(Sonya Branch)

Ms Branch updated Court on the progress of investigations.

15. **Bank Staff Indemnities**

(Sonya Branch and Karim Nath)

Court considered a proposal to adopt a standard Bank staff indemnity policy. This would remind staff of the common law protections and the statutory immunities relating to certain Bank functions; and also provide that in certain circumstances the Bank might, at its own discretion, provide a specific indemnity in relation to a particular project or role.

Directors supported the principle of a one-Bank standard approach; but several Directors were concerned about announcing a discretionary approach to granting specific indemnities.

Ms Branch said that it was important that no-one should think that the Bank was offering a blank cheque, and that the clarification of the Bank's approach might be in the staff handbook

Court also considered a standard form of indemnity for the Court and Policy Committee members; it was recognised that this would be essential for the PRC members (who currently benefit from the PRA Board indemnity) and desirable for the policy committee members. It

was also desirable to bring up to date the existing Court indemnity so that it applied to former as well as present members.

Court accordingly decided:

Governors' Indemnity

To resolve that the Governors and any former Governors be indemnified by the Bank against all costs, charges, losses, expenses and liabilities incurred by him or her in carrying out or purporting to carry out any of his or her functions, or otherwise in connection with or in relation to such functions, provided that he or she has acted honestly and in good faith and has not acted recklessly.

NED Indemnity

To resolve that the Non-Executive Directors and any former Non-Executive Directors be indemnified by the Bank against all costs, charges, losses, expenses and liabilities incurred by him or her in carrying out or purporting to carry out any of his or her functions, or otherwise in connection with or in relation to such functions, provided that he or she has acted honestly and in good faith and has not acted recklessly.

Policy Committee Indemnity.

To resolve that the [members of the Monetary Policy Committee, the Financial Policy Committee and the Prudential Regulation Committee] and any former members of those committees be indemnified by the Bank against all costs, charges, losses, expenses and liabilities incurred by him or her in carrying out or purporting to carry out any of his or her functions, or otherwise in connection with or in relation to such functions, provided that he or she has acted honestly and in good faith and has not acted recklessly.

16. **Strategic Plan Performance evaluation Report**

(Emma Murphy and Katie Hazell)

Court reviewed the latest metrics from the Strategic plan implementation. Directors asked for the ten most important KPIs to be elevated to the front; and also the ten biggest risks to achievement. Ms Hogg said that a particular concern had been finding the way forward on data; now that work had been taken forward on the data inventory it would be easier to plan the

data architecture. One Director commented that the Bank was now in the third year of a three year transformation plan; it would be necessary to draw a line and work what was achieved and what had to be rolled on into steady state.

17. The Bank's Finances 2015/16 expected outturn and 2016/17 Budget

(Ralph Coates)

Mr Coates said that the Bank's spending in 2015/16 would be slightly below budget, at £546mn, owing to delays in hiring staff offset by unexpected additional costs; for the forthcoming year the budget provided for spending of £582mn, most of the increase being caused by the switch to polymer notes and implementation of structural reform (ring-fencing). Excluding note production, spending growth was constrained to 1.5%. The PRA budget, at £253mn, remained within the limits set by the "counterfactual" (ie the PRA's share of the FSA's budget) plus allowance for new functions.

Court approved the budget proposed for the Bank and the PRA.

18. Interim Payment in lieu of dividend

(Ralph Coates)

Court agreed an interim payment to the Treasury, in lieu of dividend, of £51mn, this being half of the estimated full year dividend for 2015/16.

19. Pension Fund Trust Deed

(John Footman)

Court agreed a proposal to amend the Pension Fund Rules to clarify the treatment of GMP liabilities, and authorised the Chairman and the Secretary to approve a Deed of Amendment.

20. Inflation Report

(Andy Haldane; members of the policy committees joined the discussion)

Mr Haldane summarised recent market and policy developments since the previous Inflation Report: equity prices had fallen, volatility had increased, and high-yield corporate spreads had widened sharply. The ECB and the BoJ had eased policy further. The market-implied path for Bank Rate had declined further. Sterling had depreciated against a broad range of currencies.

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Among the questions this raised for the MPC were how to balance the drag on inflation from lower global prices, the risks to policy from low inflation having a more persistent effect on wage growth and the best way to interact with the FPC.

21. **Papers for Information**

Court noted:

- Annual Salary Review
- Business Continuity Annual Report
- Annual Insurance Update
- Health and Safety Annual Update

The meeting of Court was closed.