BANK OF ENGLAND

Annual Report 2015

The contents of this Report encompass the requirements of Section 4 of the Bank of England Act 1998, which include (1) a report by the Oversight Committee on the matters for which it is responsible (S4(2)(a)), including a review of the Bank's performance in relation to its objectives and strategy (S4(3)); (2) a report by the Court of Directors on the activities of the Financial Policy Committee of the Bank (S4(2)(aa)); (3) a statement of the Bank's objectives and strategy for the next year, as determined by the Court (S4(4)(b)); and (4) a statement of the rates at which Non-executive Directors of the Bank have been remunerated (S4(4)(a)).

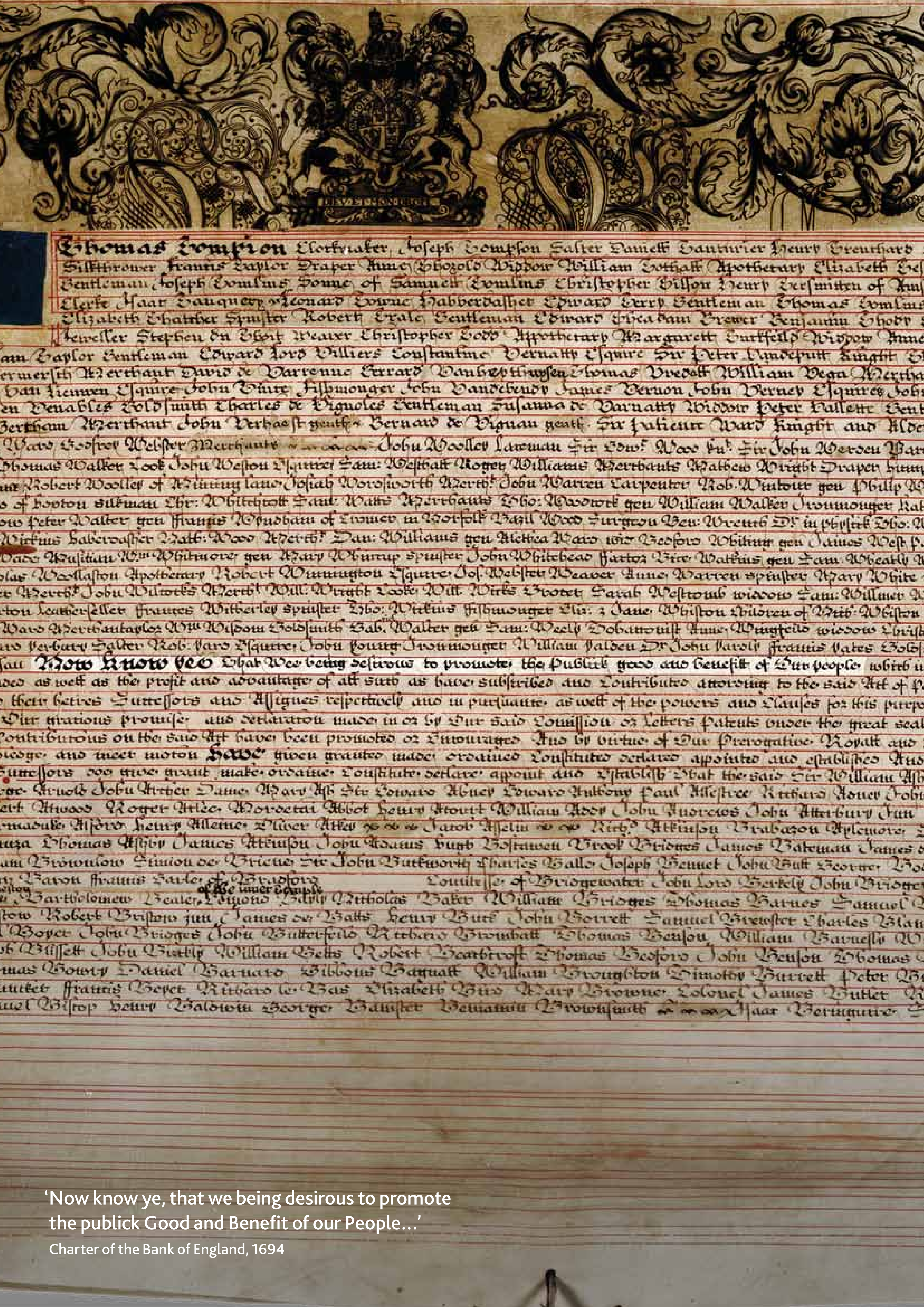
The Prudential Regulation Authority has published a separate report as required by Paragraph 19 of Schedule 1ZB of the Financial Services and Markets Act 2000, and in accordance with the requirements of the Companies Act 2006.

The Bank has also published a separate report, as required by section 203B of the Banking Act 2009 and paragraph 33 of Schedule 17A of the Financial Services and Markets Act 2000, on its supervision of financial market infrastructures.

Bank of England
Annual Report 2015

1 March 2014 to 28 February 2015

Presented to Parliament by the Chief Secretary to the Treasury
by Command of Her Majesty



'Now know ye, that we being desirous to promote the publick Good and Benefit of our People…'

Charter of the Bank of England, 1694

Contents

One Mission, One Bank

The Bank of England's mission is to promote the Good of the People of the United Kingdom by maintaining Monetary and Financial Stability.

Promoting the **Good** of the **People of the United Kingdom** by maintaining **Monetary** and **Financial** Stability

One Bank

Maximising our impact by working together

We attract and inspire the best people to public service, reflecting the diversity of the United Kingdom.

Diverse and Talented

Valuing diverse ideas and open debate, while developing and empowering people at all levels to take initiative and make things happen.

We are at the forefront of research and analysis as a necessary part of our policies and actions.

Analytic Excellence

Making creative use of the best analytical tools and data sources to tackle the most challenging and relevant issues.

Our decisions and actions have influence and impact, both at home and abroad.

Outstanding Execution

Co-ordinated, effective and inclusive policy decisions and reliable, expert execution in everything we do.

We are understood, credible and trusted, so that our policies are effective.

Open and Accountable

Transparent, independent and accountable to stakeholders, with efficient and economic delivery of our policies and actions.

Statement by the Chairman of Court

Anthony Habgood
Chairman of Court

The past year has been one of transition and change for the Bank as it seeks to be at the forefront of international best practice in all that it does.

With the Bank's Strategic Plan taking root, the organisation has seen considerable change. But we are very much at the beginning of a journey. The Bank aspires to the highest professional standards in ethics and management practices. And, as I approach my first anniversary as Chairman of Court (as the Bank's Board is known), it is a pleasure to be playing my part in helping the institution to realise these ambitions.

The role of Chairman

As Chairman, my job is to ensure that there is a robust, independent, well-functioning Board. Any successful Board requires a high level of mutual trust and respect between all the Directors. In part, that rests on a good relationship between the Chairman and the Chief Executive. In Mark Carney, the Bank is fortunate in having a high-calibre Governor (its Chief Executive) who is providing strong leadership right across the institution. I have very much enjoyed working alongside him and his colleagues. A successful board also maintains effective relationships with its shareholders. And I am grateful to HM Treasury for its continuing support of the work of the Bank and its mission.

Court as a unitary Board

Recently, Court has been through a series of reforms. Much has changed for the better – Court is smaller, more focused and clearer on its responsibilities. To all intents and purposes, it now acts as a unitary Board, with executives and non-executives working together for the long-term good of the business and its ultimate shareholders, the people of the United Kingdom.

But there is still more that could, and in my view should, be done. The Bank's December 2014 statement on transparency and accountability proposed a number of further reforms to Court that would, I believe, improve its effectiveness as a unitary Board.[1] Those included a further modest reduction in Court's size, as well as ending the distinction between Court and its statutory sub-committee of Non-executive Directors (known as the Oversight Committee).

Transparency and accountability

Since the middle of last year, the Bank has announced a series of transparency and accountability initiatives. Those have included wide-ranging reforms in monetary policy (page 20), as well as improvements in the transparency of Court. The archive procedures for Court's historical minutes have been brought in line with Whitehall best practice (page 51). And Court also decided to release the minutes of its meetings in the 2007–09 financial crisis period.

This *Annual Report* contains further changes in this regard, including, for the first time, reports from the Bank's Audit and Risk Committee (page 89) and on corporate social responsibility (page 68). The Bank is also providing more transparency about its financial statements (page 90).

Professionalising the Bank

Core to the Bank's mission is excellence not only in policy analysis and design, but also in policy execution and professional standards. Quite rightly, the institution's senior management have emphasised the need for the Bank, as a business, to professionalise its management practices and learn from the best elsewhere. There have been some encouraging developments, including the recent work on the Bank's approach and attitude to risk (report on risk management and business practices, page 62), and considerable progress in professionalising its approach to talent management and succession planning (page 45).

There is, however, still more to do, both in the areas mentioned above, and more generally in the realm of professional standards. For example, the independent review into the RTGS outage (page 36) pointed to the scope for strengthening

1 See www.bankofengland.co.uk/publications/Documents/news/2014/warshresponse.pdf

the Bank's crisis management framework. And the investigations of the past year have underscored the importance of the exemplary ethical standards that the Bank has laid down in its enhanced Code and of the new central compliance function.

Conduct and ethics

A key aspect of my job as Chairman is to set the right tone in terms of culture, standards and ethics. And one of the most important issues I have had to consider has been the potential implications for the Bank of the various misconduct investigations being carried out by the Financial Conduct Authority (FCA) and other regulatory bodies.

In November 2014, Lord Grabiner QC published an independent report into allegations that Bank staff had been aware of the potential for manipulation in the foreign exchange markets (page 38).[2] The report was thorough and comprehensive. It set out recommendations to improve processes at the Bank. And the Bank, rightly, undertook to implement all of Lord Grabiner's recommendations in full.

Early in this work, other records came to light relating to the Bank's liquidity auctions in 2007/08. On the recommendation of counsel, these were referred to the Serious Fraud Office. These developments have been distressing and uncomfortable. But rigorous and transparent follow-up is essential if the Bank is to maintain its integrity and to keep the trust of the public. Critical to this trust will also be the proper implementation of the enhanced Code and compliance function outlined in the Corporate Social Responsibility Report.

Court composition

Diversity of thought, experience and background are essential pre-requisites for a successful Board, and the Bank's Court has recently seen numerous changes in its composition.

Last summer, Sir David Lees stepped down as Chairman, Sir Charles Bean retired as Deputy Governor for Monetary Policy, and Lady Rice and Sir Roger Carr both came to the end of their terms as Non-executive Directors. On behalf of Court, I would like to thank them all for their dedicated service to the Bank.

I am delighted that Bradley Fried has stepped up to be Deputy Chairman of Court and Chairman of the Bank's Audit and Risk Committee and John Stewart has taken on the role of Chairman of the Remuneration Committee and senior independent director. We have also seen a number of new Court Directors – Ben Broadbent has replaced Charles Bean, while Dido Harding, Don Robert and Dorothy Thompson have joined as non-executives. Minouche Shafik, Deputy Governor for Markets and Banking, also attends Court meetings, and will become a full member of Court once the relevant legislation has been changed.

Court has become more diverse than ever before, a development that is most welcome. Once Minouche Shafik becomes a full member, three Court Directors will be female. In addition, Charlotte Hogg, as the Bank's Chief Operating Officer, attends all meetings. These recent appointments demonstrate the Bank's ongoing commitment to diversity at the highest level.

Outlook

The coming year will be another year of transition and change as the Bank continues the transformation set out in its Strategic Plan, the professionalisation of its management practices and, more generally, its drive to ensure that it is world-class in all that it does. Those ambitions have my whole-hearted support, and are integral to the institution's mission to promote the good of the people of the United Kingdom.

10 June 2015

2 See www.bankofengland.co.uk/publications/Documents/news/2014/grabiner.pdf

Report by the Governor

Mark Carney
Governor

In the first year of our Strategic Plan, we have made great progress towards our goal of building One Bank – an institution that fully exploits the synergies of having monetary policy, macroeconomic policy and microprudential regulation under the same aegis.

The 'One Bank' plan set out an ambitious three-year vision for discharging the enormous new responsibilities bestowed on us following the global financial crisis. The plan defined a unified, diverse and talented institution; one that delivers excellent analysis and outstanding execution; and that is transparent and accountable to Parliament and the public.

I am delighted to report that the initiatives put in place over the past year are already making a huge difference to the Bank's ability to deliver our mission of promoting the good of the people of the United Kingdom. These achievements would not have been possible without my colleagues, whose hard work and dedication make possible the reforms that are creating a Bank of England fit for the 21st Century. I want to take this opportunity to thank them for their extraordinary efforts to fulfil our policy remits while transforming this institution.

In 2014 we achieved a huge amount across each of the pillars of the 'One Bank' plan.

We have harmonised our staff terms and conditions across the Bank; implemented a new talent strategy; and embedded targets for diversity. These measures will help attract and retain talented individuals, and they will help colleagues build exciting careers across the organisation.

We have launched an integrated Bank-wide research function to improve our analysis of the most important issues facing the Bank, using our expertise to undertake cutting-edge research to inform our policy decisions.

We have taken a number of steps to professionalise the Bank – including establishing an Independent Evaluation Office to assess the delivery of our objectives; and setting out in a Charter how the Bank will collect and use market intelligence. We have responded to failures of our infrastructure and to troubling instances where our conduct has not met the high standards the public justifiably expect of the Bank. We have addressed the challenge, quickly dealt with comprehensive processes that draw on independent evaluations and advice, and we have learned lessons and taken swift and decisive actions to address shortcomings. As a consequence of these efforts we are overhauling how we conduct market intelligence, manage internal documents and information, and escalate concerns about market conduct.

We have delivered a revolution in the Bank's transparency. For the first time MPC minutes will be released alongside interest rate decisions, ending the drip-feed of information and allowing markets, businesses and the public to understand the MPC's decisions immediately after they are made. We also committed to publishing, with appropriate lags, the transcripts and the audiotapes of those MPC meetings. We are publishing past Court minutes, including those which cover the key years of the financial crisis. We have taken steps to include the public in the design of our banknotes. A panel of independent experts will consider suggestions made by the public to ensure the money in our pockets represents the preferences of the people.

We have established a new International Directorate to bring together the Bank's expertise, ensuring we act as one organisation to maximise our effectiveness on the global stage.

Throughout this period of considerable change within the Bank, the economic and financial backdrop has continued to pose many challenges.

UK output growth remained solid and unemployment has continued to fall. As we expected, the margin of slack in the economy has narrowed. The UK, like many countries, has experienced weak inflation in large part because of falls in global commodity prices. But with the UK economy expanding steadily, inflation is likely to pick up once these falls drop out of the annual comparison.

The MPC's actions have been consistently aimed at bringing inflation back to target within two years, and explaining that in order to achieve that goal, interest rates are likely to be raised in a more limited and gradual fashion than in the past.

The Bank has been at the forefront of international efforts to finish the job of fixing the fault lines that caused the last crisis. Through the Financial Stability Board we have helped the G20 countries achieve a watershed in ending 'too big to fail' so that future taxpayers will not face the burden of bank failure.

The PRA's work has continued apace, as the UK implements a new regime for holding individuals to account for their actions; to align more closely risk with reward; and as our insurance industry prepares for the advent of Solvency II in 2016. Following the FPC's review the Government legislated to grant the FPC powers of direction with regards to a leverage ratio framework for the UK.

As a forward-looking central bank we have remained vigilant to prospective risks to financial and price stability in the UK and beyond. Concern about developments in household indebtedness prompted the FPC to put in place measures to safeguard underwriting standards and limit increases in high loan-to-income lending, designed to prevent an erosion of standards that could pose broader macroeconomic risks.

The economic context means it has never been so important for the Bank to take a unified approach: using our policy tools in concert to respond to challenges across our objectives. The FPC measures helped ensure that monetary policy could concentrate on its primary responsibility of maintaining price stability. The stress tests undertaken by the FPC and PRA showed clearly the benefits of bringing together microprudential assessments of banks with a macro perspective on risks to which the sector must be resilient. The results demonstrated the improved strength of our banking system.

Building on these important steps in 2014, we will continue the process of strengthening and professionalising the Bank. My fellow governors and I are unwavering in our commitment to a central bank that serves the public with resilient infrastructure, transparent processes and unimpeachable integrity.

And having addressed the key fault lines that caused the crisis, we must now broaden our efforts to address new and evolving risks. In June we published the conclusions of the Fair and Effective Markets Review, which looks to restore trust in wholesale financial markets in the wake of a number of high profile abuses.

2014 was another important year for the Bank and this current year stands to be no different. As a forward-looking central bank our work is never finished, but our focus is constant: to promote the good of the people of the United Kingdom.

10 June 2015


1914 – 1918

Court, and the Bank's policy committees

The Bank's framework for governance and accountability is set by the Bank of England Act 1998. The Court of Directors acts as a unitary Board, with executive and non-executive members and an independent non-executive chairman.

It sets the Bank's strategy and budget and takes key decisions on resourcing and appointments; and, with the Oversight Committee,[3] keeps the Bank's performance and financial management under review. The Court meets at least seven times a year, and its minutes are published.[4]

Members of Court are appointed by the Crown, for periods of eight years in the case of the Governor, five years for the Deputy Governors, and up to four years for the Non-executive Directors. One of the latter is designated by the Chancellor of the Exchequer to chair Court.

Court delegates the day-to-day management of the Bank to the Governor and through him to other members of the executive. But it reserves to itself a number of key decisions, including:

- the Bank's strategy and objectives;
- the Bank's (including the PRA's) expenditure budget;
- major capital projects;
- the Bank's financial framework;
- the Bank's risk management policies;
- approval of the accounts and the appointment of auditors;
- the remit for managing the Bank's balance sheet;
- senior appointments within the Bank;
- major changes in staff remuneration and pension arrangements;
- the Bank's succession plan; and
- the establishment of sub-committees of Court, their terms of reference and membership.

Apart from the statutory Oversight Committee, the major subcommittees of Court are the Audit and Risk Committee, the Remuneration Committee and the Nominations Committee. Terms of reference of these and other Committees are published on the Bank's website.[5]

Members of Court have been indemnified by the Bank against personal civil liability arising out of the carrying out or purported carrying out of their functions, provided they have acted honestly and in good faith and have not acted recklessly. These indemnities were first granted in 2000 and approved by HM Treasury in accordance with the practice of the Government in relation to board members of Non-Departmental Public Bodies.

9

Court met nine times during the year Attendance at Court meetings is given on page 87

3 A Report from the Oversight Committee is at page 82.

4 www.bankofengland.co.uk/publications/minutes/Pages/court/default.aspx

5 www.bankofengland.co.uk/about/Documents/matters122014.pdf

The Court of Directors
as at 28 February 2015

Non-executive Directors

Anthony Habgood
Chairman of Court

Appointed
1 July 2014
Term expires on
30 June 2018

- Chairman, RELX Group plc
- Chairman, Preqin Holding Limited
- Chairman, Norwich Research Partners LLP
- Visiting Fellow, Oxford University

Michael Cohrs

Appointed
21 June 2011
Term expires on
31 May 2015

- Advisor, EQT
- Advisory Board, British Airways
- Fellow, Cambridge University
- Non-executive Director, SurfCast Inc

Bradley Fried

Appointed
1 June 2012
Term expires on
31 May 2019

- Managing Partner, Grovepoint Capital LLP
- Non-executive Director, Investec plc and Investec Limited
- CEO in Residence at Cambridge University's Judge Business School
- Fellow of Magdalene College, Cambridge

Tim Frost

Appointed
1 June 2012
Term expires on
31 May 2018

- Non-executive Director, Cairn Capital
- Member of Court and Council, London School of Economics
- Non-executive Director, LSE Enterprise
- Non-executive Director, Markit

Baroness (Dido) Harding of Winscombe

Appointed
1 August 2014
Term expires on
31 July 2018

- Chief Executive, TalkTalk Telecom Group plc
- Trustee of Go On UK, The Digital Skills Alliance
- Life Peer taking the Conservative Whip
- Member of the Jockey Club

Dave Prentis

Appointed
1 June 2012
Term expires on
31 May 2019

- General Secretary of UNISON
- Member of the Trades Union Congress Executive Council
- Member of the Labour Party Joint Policy Committee
- Vice-President of the European Public Services Union
- President of Public Services International
- Commissioner of UK Commission for Employment and Skills
- President of Unity Trust Bank

Don Robert

Appointed
1 August 2014
Term expires on
31 July 2018

- Chairman, Experian plc
- Chairman, Achilles Group Limited
- Non-executive Director, Compass Group plc
- Director and Trustee, National Education and Employer Partnership Taskforce
- Visiting Fellow, Oxford University

John Stewart

Appointed
1 December 2009
Term expires on
30 November 2015

- Chairman, Legal and General Group plc
- Chairman, The Guide Dogs for the Blind Association
- Chairman, Southern Cross Stud
- Non-executive Director, Board of the Financial Reporting Council

Dorothy Thompson

Appointed
1 August 2014
Term expires on
31 July 2018

- Chief Executive, Drax Group plc
- Chairman, Drax Power Limited
- Chairman, Haven Power Limited
- Non-executive Director, Johnson Matthey plc
- Chairman, The Sustainable Biomass Partnership Limited
- Non-executive Director, Energy UK

Governor/Deputy Governors

Mark Carney
Governor

- Chairman, Financial Stability Board
- First Vice-Chair, European Systemic Risk Board
- Member, Group of Thirty
- Member, Foundation Board, World Economic Forum

Ben Broadbent
Deputy Governor, Monetary Policy

- Alternate, ECB General Council
- Member, OECD Working Party No.3

Sir Jon Cunliffe
Deputy Governor, Financial Stability

- Member, G20 Financial Stability Board Steering Committee
- Member, European Systemic Risk Board
- Member, BIS Board

Andrew Bailey
Deputy Governor, Prudential Regulation

- Board Member, Financial Conduct Authority
- Management Board Member, European Banking Authority
- Board of Supervisors, European Banking Authority and European Insurance and Occupational Pensions Authority

Find out more online
www.bankofengland.co.uk

Policy committees

Monetary Policy Committee (MPC)

Members
Top row, left to right

Mark Carney
Governor

Ben Broadbent
Deputy Governor, Monetary Policy

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Minouche Shafik
Deputy Governor, Markets and Banking

Andy Haldane
Executive Director and Chief Economist

Bottom row, left to right

Kristin Forbes
External member
Term: 1 July 2014 – 30 June 2017

Ian McCafferty
External member
Term: 1 September 2012 – 31 August 2015

David Miles
External member
Term: 1 June 2009 – 31 August 2015

Martin Weale
External member
Term: 1 August 2010 – 31 July 2016

The Bank of England Act 1998 establishes the MPC as a committee of the Bank and sets a framework for its operations.

The Bank's monetary policy objectives under the Act are to:

- maintain price stability; and, subject to that,
- to support the Government's economic policies, including its objectives for growth and employment.

At least once a year, the Government specifies its price stability target and its growth and employment objectives. The MPC is responsible for achieving those objectives. In March 2015, the Chancellor the Exchequer re-confirmed the inflation target as '2 per cent as measured by the twelve-month increase in the Consumer Prices Index'. The economic policy objective of the Government was 'to achieve strong, sustainable and balanced growth shared more evenly across the country and between industries'.

The MPC has nine members. Five are Bank Governors and officials and four are external members appointed by the Chancellor. An HM Treasury observer attends its meetings. The Committee meets at least once a month to set policy. The MPC's decisions are announced after each meeting and the minutes are published two weeks later. The Bank's quarterly *Inflation Report* includes the MPC's projections for inflation and output.

To improve the transparency of MPC decision-taking, the arrangements for meetings and publication of minutes are currently undergoing revision following the Report by Governor Warsh.[6]

6 See 2014/15 Review, page 20 and www.bankofengland.co.uk/publications/Documents/news/2014/warshresponse.pdf

Financial Policy Committee (FPC)

Members
Top row, left to right

Mark Carney
Governor

Andrew Bailey
Deputy Governor, Prudential Regulation and Chief Executive of the PRA

Ben Broadbent
Deputy Governor, Monetary Policy

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Alex Brazier
Executive Director, Financial Stability Strategy and Risk

Bottom row, left to right

Dame Clara Furse
External member
Term: 1 April 2013 – 31 March 2016

Donald Kohn
External member
Term: 1 April 2013 – 31 March 2018

Richard Sharp
External member
Term: 1 April 2013 – 31 March 2016

Martin Taylor
External member
Term: 1 April 2013 – 31 March 2018

Martin Wheatley
Chief Executive, Financial Conduct Authority

The Bank has an overarching statutory Financial Stability Objective to 'protect and enhance the stability of the financial system of the United Kingdom'.

The FPC contributes to the achievement of this objective by:

- identifying, monitoring and taking action to reduce risks to the financial system; and, subject to that,
- supporting the Government's economic policies, including its objectives for growth and employment.

The FPC also advises Court on the Bank's Financial Stability Strategy.

At least once a year, the Government must make recommendations about the FPC's responsibilities for financial stability and also about its growth and employment objectives. The FPC must respond formally to these, and provide reasons if it proposes not to follow the recommendations.[7]

The FPC consists of eleven members. Five are Bank Governors and officials, and six are external members – the Chief Executive of the Financial Conduct Authority, four members appointed by the Chancellor and a non-voting member from HM Treasury. The Committee meets at least quarterly. It may give Directions to the PRA and the Financial Conduct Authority in relation to macroprudential measures prescribed by secondary legislation under the Bank of England Act 1998. The FPC also has powers to make Recommendations to any other body. It publishes a record of its formal policy meetings and is responsible for producing the twice-yearly *Financial Stability Report*.

The FPC is currently a Committee of Court. In December 2014, as part of its Transparency and Accountability initiative,[8] the Bank proposed that the FPC should become a Committee of the Bank, like the MPC, and that the Deputy Governor for Markets and Banking should become an ex-officio member, balanced by a further external member.

7 The 2015 remit is at www.bankofengland.co.uk/financialstability/Documents/fpc/letters/chancellorletterfpc180315.pdf
And the FPC's response is at www.bankofengland.co.uk/financialstability/Documents/fpc/letters/governorletter260315.pdf

8 www.bankofengland.co.uk/publications/Documents/news/2014/warshresponse.pdf

Find out more online
www.bankofengland.co.uk

Board of the Prudential Regulation Authority (PRA)

Members
Top row, left to right

Mark Carney
Governor

Andrew Bailey
Deputy Governor, Prudential Regulation and Chief Executive of the PRA

Sir Jon Cunliffe
Deputy Governor, Financial Stability

Minouche Shafik
Deputy Governor, Markets and Banking

Middle row, left to right

David Belsham
Independent member
Term: 1 May 2015 – 30 April 2018

Sandy Boss
Independent member
Term: 1 September 2014 – 31 August 2017

Iain Cornish
Independent member
Term: 20 February 2013
Resigned March 2015

Charles Randell
Independent member
Term: 20 February 2013 – 19 February 2017

Bottom row, left to right

Mark Yallop
Independent member
Term: 1 December 2014 – 30 November 2017

Martin Wheatley
Chief Executive, Financial Conduct Authority

The PRA is the UK's prudential regulator for banks, building societies and credit unions (collectively known as deposit-takers), insurers and major investment firms.

The PRA's objectives are set out in statute, principally the Financial Services and Markets Act 2000 (FSMA), and include:

- a general objective to promote the safety and soundness of the firms it regulates; and
- an objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for those who are or may become insurance policyholders.

A further, secondary objective was introduced by the Financial Services (Banking Reform) Act 2013. It requires that 'the PRA must so far as is reasonably possible act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.' This competition objective came into force on 1 March 2014.

The PRA is constituted as a subsidiary of the Bank,[9] and its most significant supervisory decisions are taken by the Board, which the Governor chairs. The PRA's strategy is set by its Board, consulting Court, and it publishes a separate *Annual Report* on the discharge of its functions.

The PRA Board consists of the Governor, the Deputy Governor for Financial Stability, the Deputy Governor for Prudential Regulation, the Deputy Governor for Markets and Banking and the Chief Executive of the Financial Conduct Authority. Further members are appointed by Court with HM Treasury's approval. A majority of the Board must be independent of the Bank.

9 The Bank has proposed that the PRA should cease to be a subsidiary and be fully integrated into the Bank, although the responsibilities of the Board in relation to the PRA's objectives would be unchanged; see page 51.

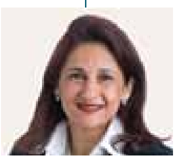

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Organisational structure

The organisation chart shows how responsibility for individual functions is delegated within the Bank. Membership of the MPC, FPC and PRA Board are also indicated.

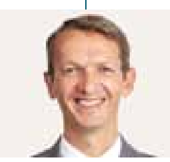
Mark Carney
Governor
(MPC, FPC, PRA Board)

Ben Broadbent
Deputy Governor, Monetary Policy (MPC, FPC)



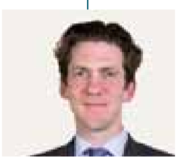
Minouche Shafik
Deputy Governor, Markets and Banking (MPC, PRA Board)

Sir Jon Cunliffe
Deputy Governor, Financial Stability (MPC, FPC, PRA Board)



Andy Haldane
Monetary Analysis and Chief Economist (MPC)

Chris Salmon
Markets



Andrew Hauser
Banking, Payments and Financial Resilience

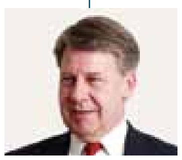
Andrew Gracie
Resolution

Alex Brazier
Financial Stability Strategy and Risk (FPC)

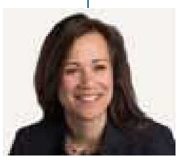
David Rule
Prudential Policy

Paul Fisher
Supervisory Risk Specialists and Regulatory Operations; Deputy Chief Executive, PRA

Sonya Branch
General Counsel



John Footman
Secretary of the Bank



Jenny Scott
Communications

Andrew Bailey
Deputy Governor, Prudential Regulation and Chief Executive of the PRA (FPC, PRA Board)

Charlotte Hogg
Chief Operating Officer

Audit and Risk Committee

Sam Woods
Insurance Supervision

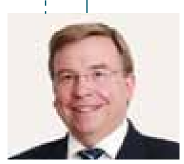
Megan Butler
International Banks Supervision

Lyndon Nelson
UK Deposit-takers Supervision

Joanna Place
Human Resources

Ralph Coates
Finance

John Finch
Chief Information Officer



Stephen Brown
Internal Audit

Find out more online
www.bankofengland.co.uk

Review of 2014/15

The Strategic Plan, adopted by Court in March 2014,[10] has proved the driving force behind the work of the Bank this year, and is changing the way that the institution approaches its tasks across the full range of its responsibilities.

One Bank

Initiatives

1. Open, transparent and agile culture
2. Forefront of joint policy decision-making

Diverse and Talented

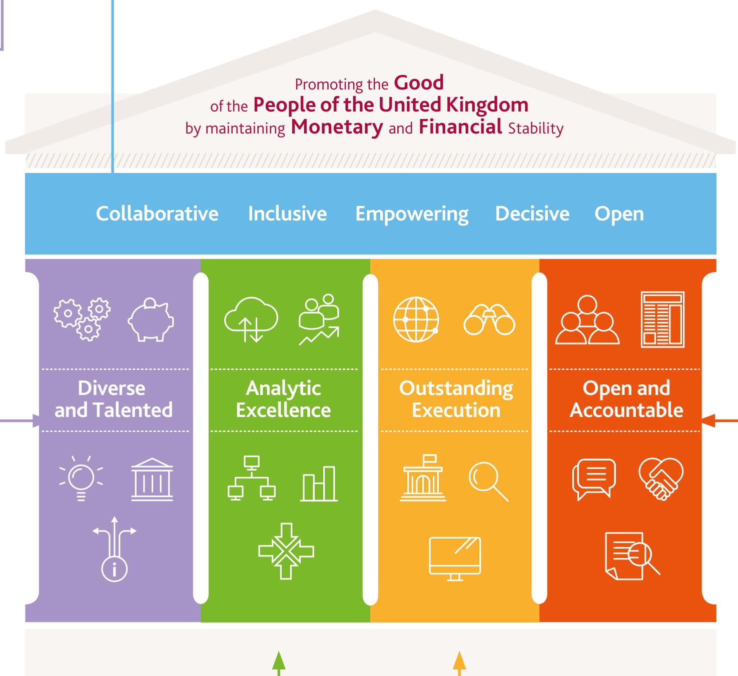
Initiatives

3. 'One Bank', Your Reward
4. Rewarding excellence and teamwork
5. Compelling talent strategy

Open and Accountable

Initiatives

13. Enhanced Central Bank transparency
14. Accountable
15. Engaged and approachable



Analytic Excellence

Initiatives

6. 'One Bank' research agenda
7. New approach to data and analysis
8. One Bank data architecture

Outstanding Execution

Initiatives

9. One credible voice in international policy
10. Delivering supervision as 'One Bank'
11. Execution in core markets
12. A safer Bank

10 The Strategic plan was summarised in the 2014 *Annual Report*, pages 14–17.

The Strategic Plan seeks to create a single, unified institution, working as 'One Bank' across all its functions, and with a single, timeless mission: 'promoting the good of the people of the United Kingdom by maintaining monetary and financial stability'. This requires a strong common culture, built from the best of all parts of the Bank, and bringing together the whole of the organisation to support every policy decision.

Central to the successful delivery of the Plan are fifteen initiatives identified in last year's *Annual Report* (page 15). Much has happened over the past twelve months – the Bank's new structure and management team has been put in place, and good progress has been made on many of these fifteen initiatives. But the Strategic Plan represents much more than a 'to do' list of major projects. It is leading to fundamental shifts in the Bank's culture and thinking, guiding not only the initiatives that were identified twelve months ago, but also the Bank's response to events during the year.

This Review details the progress made on the strategic initiatives identified in the 2014 *Annual Report*, as well as the work that has been done in the Bank on its policy objectives over the past twelve months. It covers the highlights of the work in monetary policy (page 19), financial policy (page 22), and regulatory policy (page 25); in all of these, the 'One Bank' strategy has seen policymakers share and develop analysis on a range of topical issues. The Review also sets out recent developments in the Markets and Banking and International areas, which support the delivery and execution of initiatives across the full breadth of the Bank's policy work.

The final section of the Review (page 43) covers the specific steps that the Bank has undertaken to strengthen the four pillars that underpin the Strategic Plan: Diverse and Talented; Analytical Excellence; Outstanding Execution; Open and Accountable. These steps include, but are not limited to, the fifteen strategic initiatives set out in last year's *Annual Report* (see box, page 18).

Highlights include: the material progress made in delivering an integrated 'One Bank' reward framework; the launch of a far-reaching package of accountability and transparency reforms; the establishment of a Research Hub and; the work that has been undertaken to improve the resilience of the Bank to cyber attack.

Overall, the Bank is broadly on track to meet the priorities set out at this time last year.

These initiatives illustrate the Bank's commitment not only to delivering the Strategic Plan, but also to ensuring that it meets exemplary professional standards across the full range of its work, essential for the fulfilment of the institution's mission to promote the good of the people of the United Kingdom.

The 'One Bank' strategy has seen policymakers share and develop analysis on a range of topical issues

Strategic initiatives

Open transparent and agile culture

New values launched	page 44
Our Code	page 68

Forefront of joint policy decision-making

New organisational structure in place	page 14
PRA/FPC stress tests	page 22
Joint FPC/PRA work on house prices	page 24

One Bank Your Reward

Integrated Reward Framework	page 43
New Bank-wide contract April 2015	page 43

Rewarding excellence and teamwork

New performance assessment system	page 44
360 degree feedback introduced for all managers	page 44

Compelling talent strategy

Launch of new talent strategy	page 45
Programme for PhD entrants	page 46
Aspirational targets for diversity	page 69

One Bank research agenda

Research Hub established	page 46
Research conferences	page 46

New approach to data and analysis

Research into digital currencies	page 42
Data lab opened	page 48

One Bank data architecture

Chief Data Officer appointed	page 48

One credible voice in international policy

Formation of International Directorate	page 29

Delivering Supervision as 'One Bank'

PRA and Resolution implementation of BRRD	page 28
Joint work on Recovery and Resolution Plans	page 28

Execution in core markets

Access to Sterling Monetary Framework	page 32
Improvements in ELA readiness	page 85
Market Intelligence charter	page 39
Polymer banknotes	page 40

A safer Bank

Revamp of risk management framework for the Bank	page 62
Launch of central compliance function	page 68
Chief Information Security Officer appointed	page 49
Cyber strategy agreed	page 49

Enhanced central bank transparency

Warsh Review	page 20
Banknote Character Advisory Committee	page 41
Transparency of Court documents	page 51

Accountable

Improvements in Court governance	page 50
Creation of Independent Evaluation Office	page 82
Grabiner Reviews	pages 38 and 84
RTGS Review	page 36

Engaged and approachable

Social media initiative	page 52

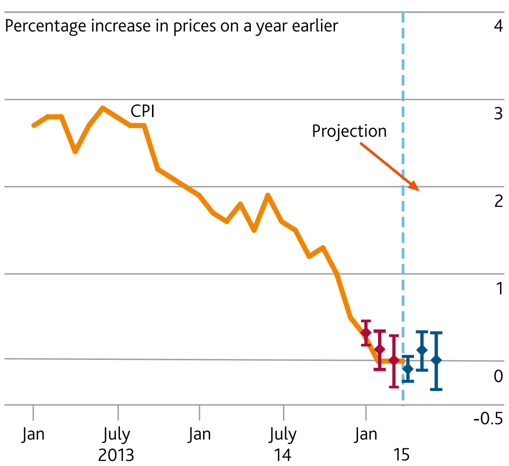
Monetary policy

Recent developments and the year ahead

Inflation has been below the MPC's 2% target, in large part reflecting the sharp drop in the global price of oil. In February and May 2015 – as required by the MPC's remit whenever inflation is more than one percentage point away from the 2% target – the Governor wrote an open letter to the Chancellor of the Exchequer. The letter set out recent developments in, and prospects for, inflation.

Since the beginning of 2015, CPI inflation has been close to 0% and it is anticipated that inflation will remain subdued for much of the year. Inflation is likely to rise notably around the turn of the year, however, as past falls in energy, food and other import prices drop out of the annual rate. The MPC judges that it is currently appropriate to set policy so that it is likely that inflation will return to 2% target within two years. Conditional on the Bank Rate following the path currently implied by market yields – such that it rises gradually over the MPC's forecast period – that is judged likely to be achieved.

Chart 1: Recent developments in inflation



The Bank's commitment to analytical excellence, and to harnessing the synergies from having monetary policy, macroprudential policy and microprudential supervision within a single institution, have underpinned the work of the MPC and the Monetary Analysis area over the past year. All members of the MPC, FPC and PRA Board have access to shared information and can, and do, attend each other's staff briefings. They also have joint meetings on topics of mutual concern.

Staff from across the Bank's policy areas worked together on a number of analytical issues over the year, including developments in the UK housing market; the possible effects on the supply of credit of any further downward adjustments in Bank Rate; and the potential macroeconomic and financial repercussions of the halving of the oil price seen in the second half of 2014. The analysis supporting the MPC, and the rationale for the MPC's decisions, are set out more fully in the *Minutes* of the Committee's policy meetings and its *Inflation Reports*.

In the coming year, the MPC will continue to evaluate the appropriate monetary stance in the light of evolving prospects for the economy, and will draw on expertise from across the Bank in doing this. Further joint meetings between the Bank's policy committees are planned. And as with the Bank's other policy areas, the MPC will benefit from the insights of the 'One Bank' Research Hub (page 46), as well as the Bank's investment in its data capabilities (page 48).

Forecasting is an important part of the MPC's processes. The Bank's Independent Evaluation Office was requested to put a work programme in train aimed at providing Court with a better basis for evaluating the Bank's forecasting performance (page 84).

2%

Inflation has been below the Monetary Policy Committee's 2% target

Note: The red diamonds show Bank staff's central projection for CPI inflation in January, February and March 2015 at the time of the February *Inflation Report*. The blue diamonds show the staff projection for April, May and June 2015. The bands on either side of the diamonds show uncertainty around these projections based on one root mean squared error of projections for CPI inflation one, two and three months ahead made since 2004.

Source: Bank of England *Inflation Report*, May 2015.

Monetary policy and transparency

The Bank was an early leader in the field of monetary policy transparency, and the Strategic Plan reiterated the institution's commitment to openness and accountability in all parts of its work, including policy communications. In April 2014, the Bank asked Governor Kevin Warsh, formerly of the US Federal Reserve Board of Governors, to conduct a wide-ranging review of the MPC's transparency practices. Following that Review, the MPC has announced a series of reforms aimed at putting the Bank at the forefront of international best practice in the realm of policy transparency.

The MPC has announced a series of reforms aimed at putting the Bank at the forefront of international best practice

The Warsh Review and the new MPC timetable

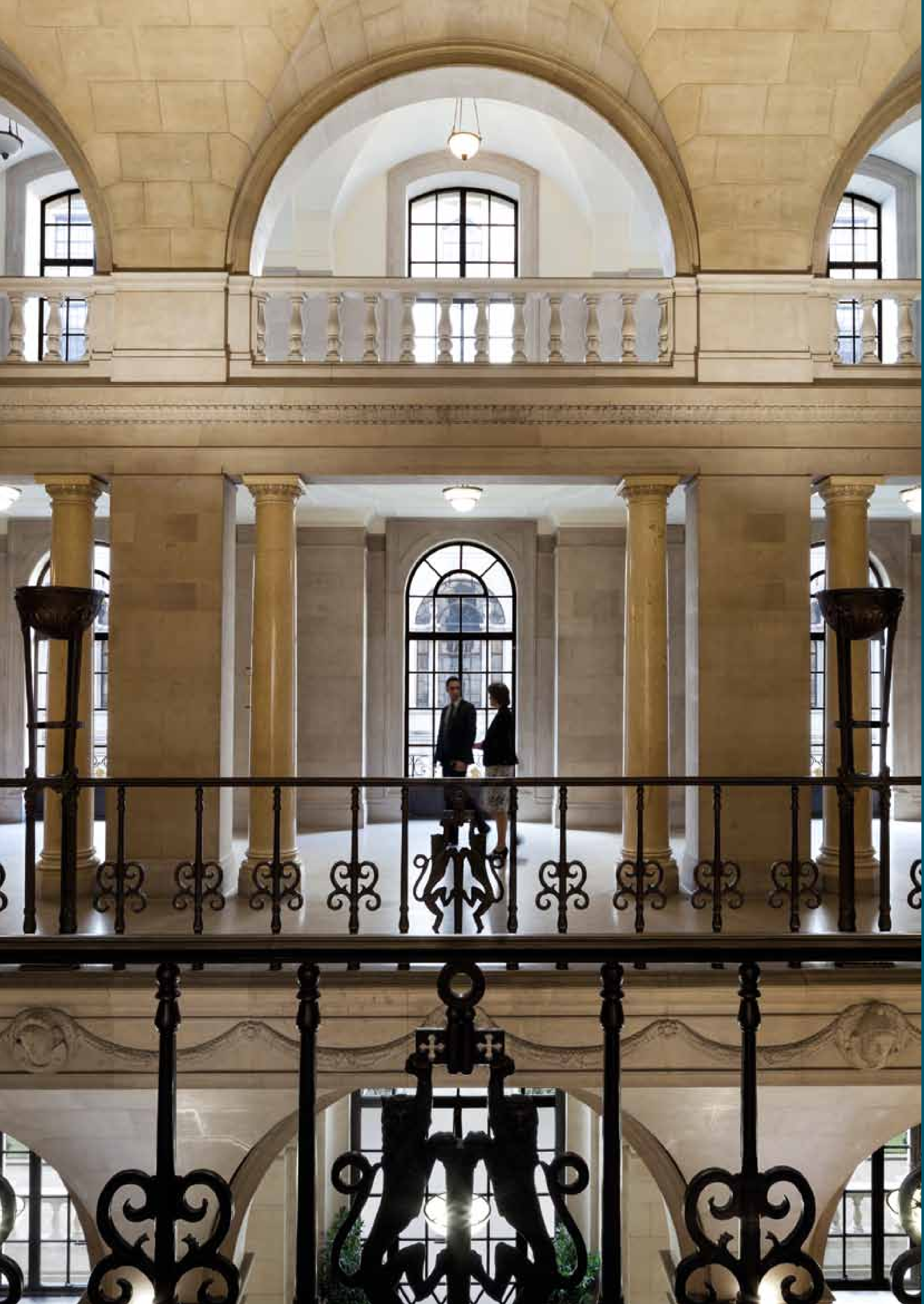
At the Bank's request, Governor Kevin Warsh, formerly of the US Federal Reserve Board of Governors, reviewed the MPC's transparency practices.

The Warsh Review was published in December 2014. The Review made a number of recommendations to improve effective transparency and genuine accountability. These included: providing more, and more timely, information about monetary policy decisions; releasing transcripts of that part of the MPC meeting where policy is decided with a deferral period of between five and ten years; releasing key staff briefing materials alongside the transcripts with the same deferral lag; and, strengthening archive arrangements.

The MPC agreed with the Warsh recommendations, and additionally identified scope to go further in promoting transparency in a number of areas.

So:

– from August 2015, the MPC will be releasing its policy announcement, its *Inflation Report* and the minutes of its policy meeting all on the same day – an initiative intended to deliver a material step forward in effective transparency;
– from 2016, four of the MPC's 12 regular briefing meetings will be joint with the FPC to allow discussion on topics of mutual interest. And while the MPC will continue to meet at least monthly, as required by statute, the new timetable will provide scope for a move to at least eight meetings a year in the event of legislative change; and
– the Bank began transcribing those parts of the MPC meetings at which policy is decided in March 2015. Those transcripts will be released, alongside key staff briefing materials, after an eight-year delay.



Financial policy

Over the past year, the Bank and the Financial Policy Committee (FPC) have continued to work to promote a more resilient financial system, to deliver the Financial Stability Strategy set out in last year's *Annual Report*[11] and thereby to contribute to the Bank's objective to protect and enhance the stability of the UK financial system.

UK banks are on a transition path towards greater resilience in advance of regulatory requirements. Over the past year, UK banks' leverage and reliance on wholesale funding have fallen.[12] Average capital ratios, adjusted for risk, for the largest UK banks are almost double their pre-crisis level.

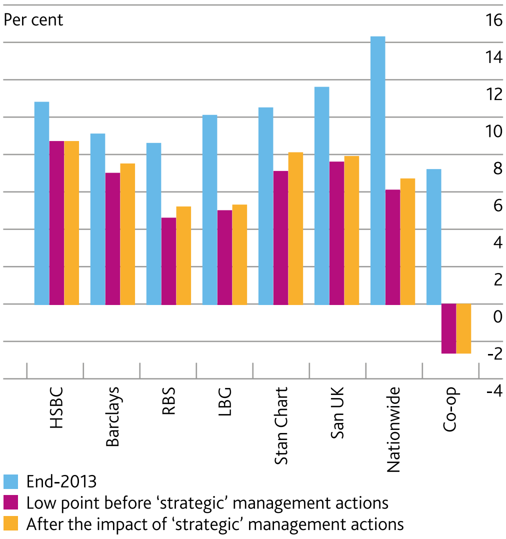
As summarised below, there have been material developments in the capital framework for banks in the UK, with the publication of the joint FPC/PRA stress tests (page 22) and the Leverage Ratio Review (page 23). There have also been a number of other policy developments, for example, in relation to the housing market.

Stress tests

In December 2014, the Bank announced the results of its first annual, concurrent stress test, conducted jointly by the FPC and PRA Board, of the UK banking system. The stress test provided a quantitative, forward-looking assessment of the capital adequacy of the UK banking system and individual institutions within it. It brought together expertise from across the Bank, including macroeconomists, financial stability experts and supervisors. And the stress test played a key role in the capital framework by informing judgements about the appropriate size of capital buffers for individual banks and building societies, and for the system as a whole.

Chart 2: Results of the 2014 FPC/PRA stress tests

Impact of 'strategic' management actions on low-point CET1 capital ratios



Sources: Participating banks' FDSF data submissions, Bank analysis and calculations.

The 2014 stress scenario was centred on a severe shock in the UK economy and housing market, including sharp interest rate increases, a deep recession, rising unemployment and a 35% fall in house prices. It was designed to be demanding but it was not a forecast – it was a coherent, tail-risk scenario. Following the stress testing exercise, the PRA Board judged that, as at end-2013, three of the eight participants needed to strengthen their capital position further. Given continuing improvements to banks' resilience over the course of 2014 and concrete plans to build capital further going forward, only one bank was required to submit a revised capital plan.

UK banks are on a transition path towards greater resilience in advance of regulatory requirements

11 Bank of England *Annual Report* 2014, page 38. See: www.bankofengland.co.uk/publications/Documents/annualreport/2014/boereport.pdf

12 December 2014 *Financial Stability Report*. See: www.bankofengland.co.uk/publications/Pages/fsr/2014/fsr36.aspx

Overall, the test results demonstrated that the core of the banking system had become significantly more resilient since the FPC's 2013 capital exercise. The results suggested that the system should be sufficiently capitalised to continue to serve households and businesses in the face of adverse shocks. Given this performance, the FPC judged that no system-wide macroprudential actions were required in response to the test.

Looking ahead, the 2015 stress test will explore risks arising from a deterioration in global economic conditions. The Bank has also announced its intention to publish an update of its medium-term vision for stress testing later in the year.

Leverage ratio

The leverage ratio is another important component of the UK capital framework. A minimum leverage ratio requirement guards against excessive balance sheet 'stretch' and the possibility that risk weights may not always be an accurate gauge of the true level of risk.

In November 2013, the Chancellor asked the FPC to conduct a review of the role of the leverage ratio within the capital framework, and to consider the case for the FPC being able to set requirements ahead of the international timetable or to set a higher ratio for UK banks.

In October 2014, the FPC published its review, which recommended that it should have the power to direct the PRA to set leverage ratio requirements and buffers for banks, building societies and PRA-regulated investment firms, including (a) a minimum leverage ratio (b) a supplementary leverage ratio buffer that would apply to Global Systemically Important Banks (G-SIBs) and other major UK domestic banks and building societies and (c) a countercyclical leverage buffer (CCLB) to be applied to all firms covered by the minimum leverage ratio requirement.

The FPC judged that the minimum leverage ratio management requirement should be set at 3%. This level is consistent with the Basel framework for risk-weighted capital, and is in line with emerging international standards on leverage.

The FPC also recommended a supplementary leverage ratio buffer for systemically important firms, and a countercyclical leverage buffer for all firms, to address risks that vary over the cycle. The FPC recommended that these buffers should be calibrated at 35% of those applied in the risk-weighted framework to achieve complimentarity and preserve the relationship between parts of the framework as conditions change.

On 6 April 2015, the FPC was formally awarded Direction powers over leverage ratio tools. The Committee stated in the leverage review that once it was granted Direction powers it would introduce the minimum level of the leverage ratio of 3% as soon as practicable. Supplementary leverage ratio buffers would be implemented in parallel with the corresponding risk-weighted systemic risk buffers from 2016 for G-SIBs, and from 2019 for other major UK banks and building societies. The CCLB would come into force on the same timescale as the minimum requirement and its level would be reviewed quarterly by the FPC alongside the risk – weighted countercyclical capital buffer.

3%

The FPC judged that the minimum leverage ratio should be set at 3%

Housing market

During the year, the FPC also took important steps to mitigate risks of excessive indebtedness, particularly in relation to the housing market. The recovery in the UK housing market was associated with a marked rise in the share of mortgages extended at high loan to income multiples. At higher levels of indebtedness, households are more likely to encounter payment difficulties in the face of shocks to income and interest rates. This could pose direct risks to the resilience of the UK banking system, and indirect risks via the impact on the economy of households cutting back expenditure when the unexpected happens.

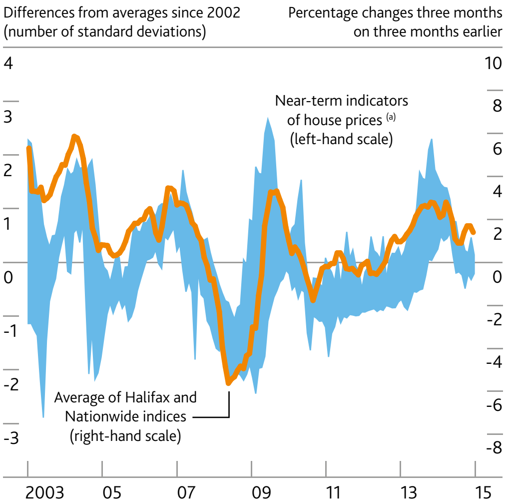
Against that backdrop, the FPC agreed that it would be prudent to take steps to limit the risks posed to financial and economic stability from an increase in the number of highly indebted households. The Committee made two Recommendations to help insure against this risk. One introduced an interest rate stress into the affordability test already in force since the Mortgage Market Review; the other a cap on the volume of high loan to income mortgages entered into by mortgage lenders. Following consultations, these were implemented by the FCA and the PRA respectively. The FPC acted early, taking graduated and proportionate steps to reduce the risk of more drastic action being required later.

The actions were carefully calibrated so as not to restrain current housing market activity – but to bite if sustained momentum in the housing market was accompanied by a further sharp rise in the number of highly indebted households. In that case, the FPC's actions would prevent a slide into riskier lending and higher indebtedness that could undermine economic and financial stability.

The policy will be kept under review and will be adjusted as appropriate as circumstances change.

In June 2014, the Chancellor invited the FPC to request additional powers to guard against financial stability risks in the housing market. In October, the FPC recommended it be given a Direction power that would enable it to require the PRA and the FCA to set limits on loan to value ratios and debt to income ratios for all residential mortgage lending. The Government consulted on the proposed powers in relation to owner-occupied mortgages and the FPC was formally given the new tools on 6 April 2015.

Chart 3: Recent developments in house prices



Sources: Halifax, Nationwide, Rightmove.co.uk, Royal Institution of Chartered Surveyors (RICS) and Bank calculations.

(a) Includes the RICS expected house prices three months ahead net balance, the RICS new buyer enquiries less instructions to sell net balances, the RICS sales to stock ratio and the three month on three months earlier growth rate of the Rightmove index of the average asking price trend. All series have been moved forward by three months. The Rightmove index has been seasonally adjusted by Bank staff.

The CCB rate for UK exposures is currently at 0%

Other financial policy developments

There were a number of other notable financial policy developments over the past year. As required by legislation, the FPC started to set the Countercyclical Capital Buffer (CCB) at its quarterly meetings – this is a macroprudential tool that requires banks and building societies to raise capital ratios as financial stability threats increase through the cycle. The CCB rate for UK exposures is currently at 0%.

The FPC also conducted a review of the regulatory perimeter, in particular of channels through which stress in selected parts of the non-bank financial system could affect wider UK financial stability. Based on its assessment and initiatives under way to improve understanding and manage some risks within these sectors, the FPC did not see a case for recommending changes to the regulatory framework but will return to the issue on an annual basis, or sooner, if risks are identified.

The work of the FPC over the past year is set out more fully in the FPC *Record* and the twice-yearly *Financial Stability Report*.

Regulatory policy

The Prudential Regulation Authority and microprudential regulation

The PRA is the prudential supervisor responsible for deposit-takers, insurers and major investment firms operating in the United Kingdom. It supervises around 1,700 firms and groups. This includes over 900 banks, building societies and credit unions and nearly 700 insurers of all sizes (general insurers, life insurers, friendly societies, mutuals). The United Kingdom is a major global hub for financial services and consequently the PRA is responsible for the prudential supervision of several global financial institutions.

The PRA's role is defined by three statutory objectives: i) to promote the safety and soundness of its firms; ii) specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders; and iii) a secondary objective to facilitate effective competition. The pursuit of these objectives is supported by the PRA's strategy to deliver a resilient financial sector by seeking: an appropriate quantity and quality of capital; effective risk management; robust business models; and sound governance, including clear accountability of firms' management.

The PRA does not seek to operate a zero failure regime. When failure does occur, this should be with limited disruption to the provision of core financial services and without spillovers to the wider financial sector.

The PRA's strategy will be achieved in close cooperation with other parts of the Bank, the Financial Conduct Authority and European and international counterparts. In delivering its strategy, the PRA will be judgement based and forward looking, proportionate in its actions, and efficient in its allocation of resources.

A 'One Bank' supervisory approach has improved the collaboration and interlinkages between PRA supervisors and other areas of the Bank

Over the past year, the largest single initiative for the PRA has been the finalisation and implementation of the EU Solvency II Directive, which encompasses a capital regime for insurers. This is a major change which will introduce a going concern, forward-looking, risk-based prudential regime for insurers that is consistent across the European Union.

For banks, the PRA has continued to work on the implementation of the EU Capital Requirements Directive which puts Basel III into place in Europe, on changes to Pillar 2 capital requirements, on depositor protection policy, and on the new liquidity ratios.

In the field of governance, there are major initiatives underway, following the work of the Parliamentary Commission on Banking Standards and the ensuing legislation; notably the introduction of the Senior Managers Regime for banks, and the Senior Insurance Managers Regime.[13]

The PRA's new secondary objective to facilitate competition came into force in March 2014. The Bank's Independent Evaluation Office is monitoring the PRA's approach to implementing this objective (page 85).

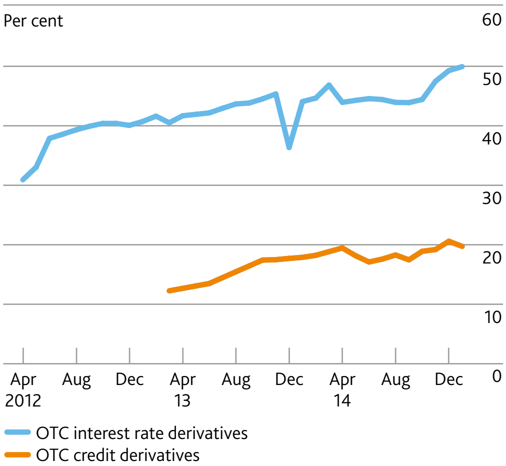
The PRA Board has made a full separate report on the delivery of its statutory objectives.[13]

Supervision of Financial Market Infrastructure (FMI)

As well as responsibility for the prudential regulation of individual firms, the Bank also has responsibility for supervising key elements of the United Kingdom's financial market infrastructure.

The Bank is responsible for the supervision of central counterparties (CCPs), securities settlement systems (SSSs) and systemically important payment systems. The Bank currently has statutory responsibility for ten systems – five payment systems, one securities settlement system and four UK CCPs, in addition to other responsibilities under FMI legislation. The delivery of this responsibility is discharged through the FMI Board, chaired by Sir Jon Cunliffe.

Chart 4: Percentage of gross notional outstanding globally in OTC interest rate and credit derivatives that are centrally-cleared



Sources: DTCC trade information warehouse reports and Bank calculations.

13 www.bankofengland.co.uk/publications/documents/annualreport/2015/prareport.pdf

The importance of FMIs is increasing given developments such as the G20 initiative to promote the mandatory clearing of standardised Over the Counter (OTC) derivatives. For example, around 50% of the global OTC interest rate derivatives market – the largest segment of the OTC derivatives market – is now centrally-cleared, compared to 16% in 2007. This will increase the concentration of risk in certain FMIs as well as the financial stability benefits that they deliver.

Recognising the increasing importance of FMIs, the Bank has intensified its focus on them. During the past year, as part of its Strategic Plan, the Bank has committed increased resources to its work on FMIs, establishing a new Directorate devoted to risk-based FMI supervision and to providing thought leadership on FMI policy and research.

The United Kingdom is home to some of the most significant FMIs operating in global financial markets, and the Bank is their lead regulator. Successful supervision of an FMI relies on effective cooperation with those who supervise the users of the FMI as well as the relevant authorities from the jurisdictions and currencies in which the FMI operates. The Bank attaches great importance to working closely with overseas authorities within and beyond the European Union, including by chairing and participating in supervisory colleges. The joint announcement, on 29 March 2015, by the European Central Bank (ECB) and the Bank of England of a series of measures aimed at enhancing stability in centrally-cleared markets within the EU is a good example of effective international co-operation in this important area (see box on page 27).

ECB and Bank of England agreement on CCP supervision

On 29 March 2015, the European Central Bank and the Bank of England announced a series of measures aimed at enhancing stability in centrally-cleared markets within the EU, specifically:

- enhanced arrangements for information exchange and co-operation regarding UK Central Counterparties (CCPs) with significant euro-denominated business; and
- extension of the standing swap line, should it be necessary and without pre-committing to the provision of liquidity, to facilitate the provision of multi-currency liquidity support by both central banks to CCPs established in the United Kingdom and euro area respectively.

CCP liquidity management remains first and foremost the responsibility of the CCPs themselves.

50%

Around 50% of the global OTC interest rate derivatives market is now centrally-cleared

Robust recovery plans and resolution powers are intended to ensure continuity of critical services at FMIs without recourse to public funds.

All UK FMIs supervised by the Bank have put in place recovery plans,[14] to ensure continuity of service in the event of financial distress. And UK CCPs have introduced loss-allocation rules both to allocate losses arising from a clearing member default that exceeded prefunded resources and to allocate solvency-threatening investment losses that arise. The UK CCP resolution regime came into effect on 1 August 2014.

Other developments include the establishment of a new payments regulator – the Payment Systems Regulator (PSR) – with a focus on competition, innovation and the interests of service-users. The PSR became fully operational in April 2015. The Bank, FCA, PRA and PSR have agreed a Memorandum of Understanding setting out the high-level framework that the authorities will use to co-operate with one another in relation to payment systems in the United Kingdom.

More detail on these and related matters are given in the Bank's Annual Report on its supervision of FMIs, published in March 2015.[15]

Resolution

The Banking Act 2009 created a special resolution regime, providing a permanent framework for dealing with failing UK banks and building societies. The implications of not having such a regime were made clear during the financial crisis, when it was necessary for the public authorities to intervene to limit the disruption, including by providing public funds to recapitalise some banks.

Subsequent amendments to the regime have introduced a bail-in tool – which was included in the FSB's international standard for effective resolution regimes – and have broadened its scope to include investment firms and central counterparties.

The Bank is the United Kingdom's resolution authority. In October 2014 the Bank set out its approach to resolving a failed bank, building society or investment firm.[16] Firms must be able to fail in an orderly way, that is, without excessive disruption to the financial system, without avoidable interruption to the critical functions that these firms provide, and without exposing the taxpayer to losses. The publication set out the Bank's toolkit, and provided detail about how it would be applied. It explained the purpose and objectives of the United Kingdom's resolution regime, its key features, the approach that the Bank would take to resolve a failed firm and the arrangements for safeguarding the rights of depositors, clients, counterparties and creditors.

The UK CCP resolution regime came into effect on 1 August 2014

14 With the exception of VISA Europe which was recognised by the Bank on 19 March 2015.

15 The FMI *Annual Report* is available at www.bankofengland.co.uk/publications/Documents/fmi/annualreport2015.pdf

16 The Bank has set out its approach to resolution at www.bankofengland.co.uk/financialstability/Documents/resolution/apr231014.pdf

Specifically, the approach document sets out three key stages of resolution which firms would go through. These are:

- stabilisation phase: Once a firm has entered resolution, the Bank must decide on the most appropriate method to stabilise the firm. This may be through transferring some of its business to a third party or through bail-in to recapitalise the failed firm;
- restructuring phase: Once the firm has been stabilised, it will need to be restructured to address the causes of failure and restore confidence; and
- exit from resolution: This is the end of the Bank's involvement as resolution authority – either the firm will cease to exist or it will be restructured.

The Bank Recovery and Resolution Directive (BRRD) came into force in January 2015. This creates some new responsibilities for the Bank as resolution authority, including setting loss-absorbing capacity for individual firms and the power to direct firms to remove barriers to resolution. The BRRD also changes the decision-making process for placing a firm in resolution.

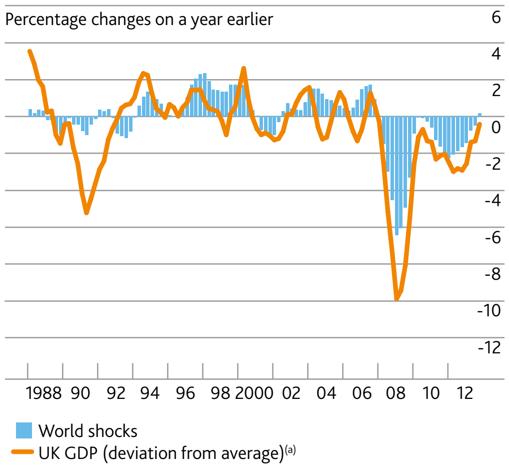
Although the BRRD allows for responsibility for resolution and for supervision to be within the same authority, it prescribes that the staff carrying out the different functions should be structurally separate. The Bank has therefore amended the current division of responsibilities and processes to be in compliance with the BRRD. Responsibility for those pre-resolution actions that must be undertaken by the resolution authority has moved to the Bank's Resolution Directorate, which will co-operate closely with the PRA in the preparation, planning and carrying out of resolutions, as set out in the BRRD.

International

The Bank's mission to promote the good of the people of the United Kingdom is not confined by national borders. Prospects for the UK economy depend heavily on developments worldwide.

Every year, the United Kingdom exports around 30% of its national output, and around half of all UK exports go to Europe. The UK economy is characterised by a large financial sector, with deep connections internationally. And developments in the rest of the world have therefore had, and will continue to have, major repercussions for prospects here in the United Kingdom.

Chart 5: Estimates of the historical impact of world shocks on UK GDP growth



Sources: Bloomberg, Bureau for Economic Policy Analysis, IMF, OECD, ONS, Thomson Reuters Datastream and Bank calculations.

(a) Line shows UK GDP growth relative to the average over the period 1988–2007, which is 3.1%.The contributions of world shocks are relative to model-consistent trend growth rates.

Firms must be able to fail in an orderly way without excessive disruption to the financial system

Reflecting the importance of the world economy – and global policy fora – to the successful delivery of the Bank's mission, the Strategic Plan led to the establishment of a new International Directorate, bringing together experts from all areas of the institution, and creating a team specifically dedicated to EU co-ordination and engagement within the Directorate.

The new Directorate is helping the different policy areas of the Bank to work together to understand the nature and impact of the global shocks hitting the UK economy, to design appropriate policy responses and to ensure that the Bank is playing a full role on the global stage. Consistent with the Bank's focus on analytical excellence, the Directorate is also expanding the Bank's international research effort, with the aim of positioning the institution at the forefront of understanding the interconnections between global developments and the UK economy and banking system.

Speaking with a single, credible voice on international policy is essential if the Bank is to operate effectively on a global stage. As a consequence, it is one of the key initiatives identified under the Bank's Outstanding Execution pillar. The Bank is an influential participant in numerous international and EU fora, and seeks to ensure that it uses its influence on the global and European stage to deliver on its mission to promote the national good.

The Bank has made a number of significant contributions to international and European policy debates this year, with support and co-ordination from the International Directorate. Following on from the European Commission's recent initiatives aimed at building a Capital Markets Union in Europe, the Bank published *A European Capital Markets Union: implications for growth and stability*.[17]

This work illustrates the Bank's commitment to have impact and influence abroad, grounded in sound economic analysis. Over the past year, there has been major progress towards making the global financial system safer, fairer and simpler, culminating in the summit of G20 leaders in Brisbane in November 2014.

Progress on 'too big to fail'

The G20 summit in Brisbane saw world leaders endorse landmark proposals on common international standards on the total loss absorbing capacity (TLAC) required for global systemically important banks (G-SIBs).

The proposals – developed by the G20 Financial Stability Board under the chairmanship of Governor Mark Carney – will establish a level playing field between banks, and ensure that those shareholders and creditors who benefit in the normal course of business also absorb losses when banks fail.

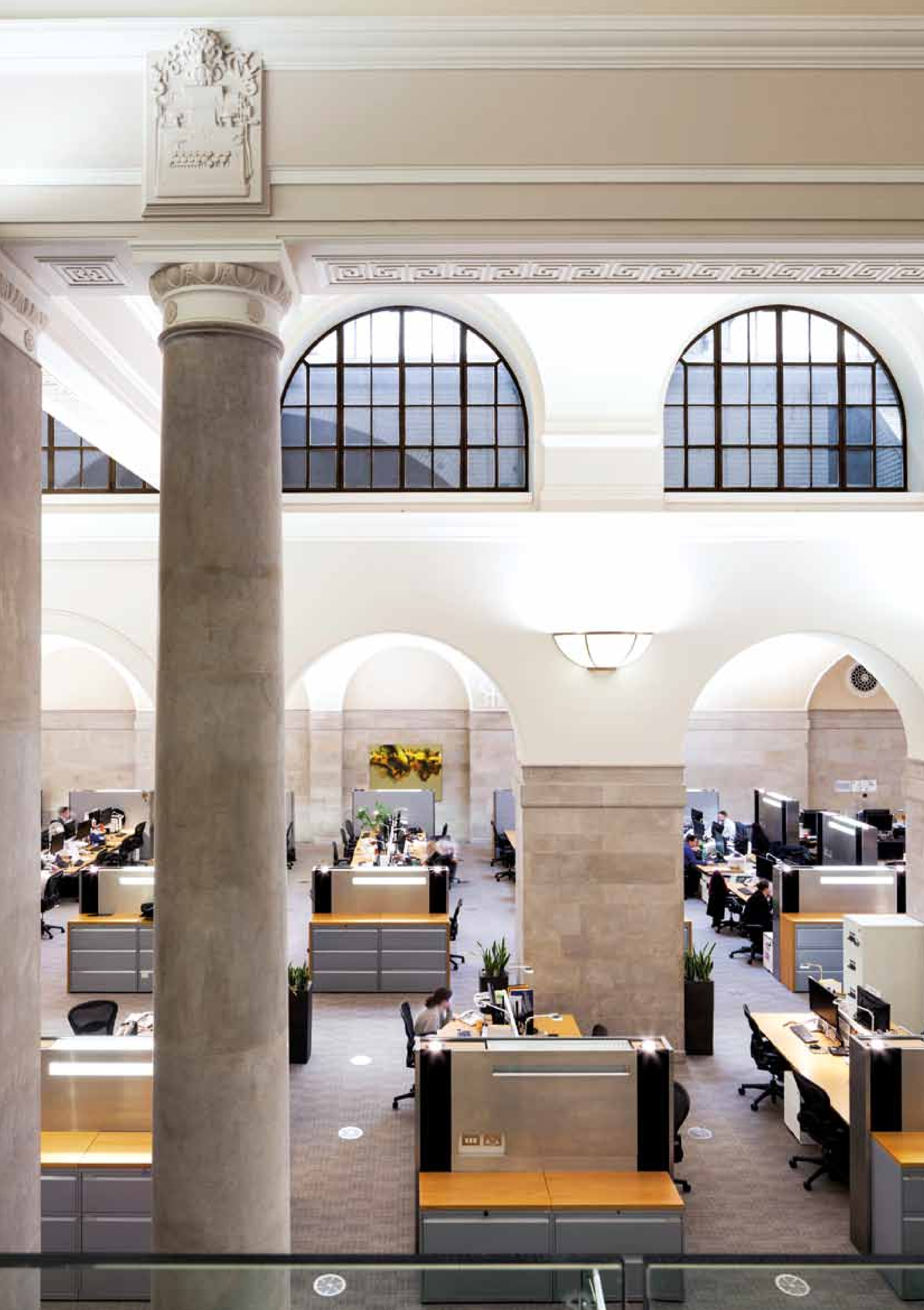
The new TLAC standards should provide home and host authorities with confidence that G-SIBs have sufficient capacity to absorb losses, both before and during resolution. And they should enable resolution authorities to implement a resolution strategy that minimises any impact on financial stability and ensures the continuity of critical economic functions, without exposing taxpayers to loss.

The TLAC proposals represent a watershed in the quest to end 'too big to fail' – the implicit taxpayer subsidy historically enjoyed by the world's biggest banks.

30%

Every year, the United Kingdom exports around 30% of its national output

17 www.bankofengland.co.uk/research/Documents/fspapers/fs_paper33.pdf



Banking and markets

Open for business

The Bank sits at the heart of the UK economy and works closely with firms and intermediaries to safeguard the effective functioning of sterling money markets, as well as to ensure the resilience and effectiveness of payment, clearing and settlement infrastructure.

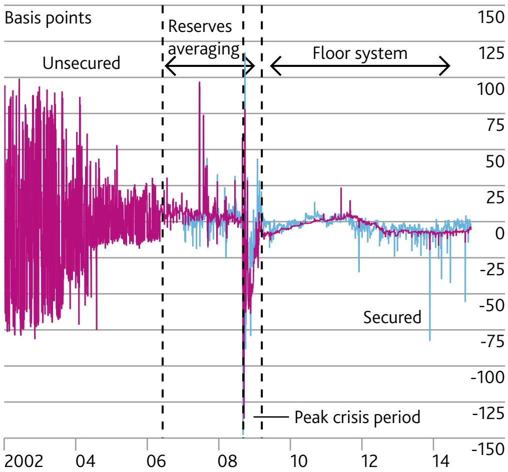
The Bank's operations in the sterling money markets have two objectives – to implement MPC decisions in order to meet the inflation target, and to reduce the cost of disruption to the liquidity and payment services supplied by banks to the UK economy. The Sterling Monetary Framework (SMF) is the Bank's published framework that it uses to meet these objectives.

Following the Winters Review,[18] the Bank committed to publishing each year an Annual Report on the operation of the SMF, designed to increase transparency about this important part of its operations. For the 2014/15 SMF Annual Report,[19] the Bank's Independent Evaluation Office assisted Court in fully engaging with the assessment of the effectiveness of the SMF. Its highlights are summarised below.

Monetary policy and the Sterling Monetary Framework

The Bank's current approach to implementing monetary policy is known as the 'floor' system and involves paying Bank Rate on the full balances held in reserves accounts. This approach remained successful in keeping sterling overnight market rates close to Bank Rate in 2014/15 (Chart 6). In the minutes of its August 2014 meeting, the MPC noted that the 'floor' system, introduced in March 2009 alongside the Bank's Asset Purchase Facility (which purchased gilts and small amounts of high-quality corporate debt), could continue to be used to implement the Committee's decisions on Bank Rate in the near term. Looking further ahead, the framework would be reviewed alongside decisions about the future of the Asset Purchase Facility.

Chart 6: Spreads of sterling overnight interest rates to Bank Rate[(a)]



Sources: Wholesale Markets Brokers' Association (WMBA) and Bank calculations.

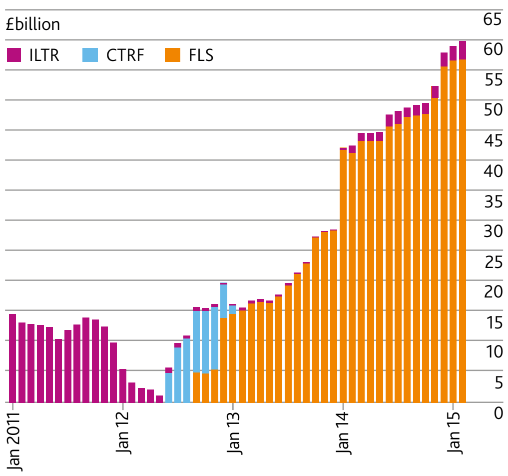
(a) In the brokered secured market, interest rates are represented by the repurchase overnight index average (RONIA), the daily weighted average interest rate of transactions secured against UK government debt, brokered by members of the WMBA. Interest rates in the brokered unsecured market are represented by the sterling overnight index average (SONIA), which is the daily weighted average interest rate of unsecured overnight transactions brokered by WMBA members. For further details on RONIA and SONIA, see www.wmba.org.uk.

The Bank sits at the heart of the UK economy and works closely with firms and intermediaries to safeguard the effective functioning of sterling money markets

18 www.bankofengland.co.uk/publications/Documents/news/2012/cr2winters.pdf

19 www.bankofengland.co.uk/markets/Documents/smf/news/annualreports.pdf

Chart 7: Outstanding amounts lent in SMF liquidity facilities and the FLS[(a)]



Source: Bank of England.

(a) Prior to January 2014, the CTRF was called the Extended Collateral Term Repo facility. The FLS (including the two FLS extensions) lies outside the SMF and is not a liquidity insurance facility, but has the result of providing liquidity to the banking sector. There has been no Discount Window Facility usage up to the most recent disclosure point (as specified in the Red Book).

Liquidity insurance and the Sterling Monetary Framework

In October 2013, the Bank announced a number of significant changes to the SMF aimed at increasing the availability and flexibility of liquidity insurance to the banking system. The Governor then described the Bank's revised Framework as: 'we are open for business'.

Over the past year, the Bank has extended membership of the SMF to broker-dealers and central counterparties (CCPs), the first major central bank to extend access to its facilities this way. As at the end of February 2015, 149 institutions were signed up to at least one of the facilities that form part of the SMF, up from 139 in February 2014. SMF member banks and building societies now account for 98% of total sterling deposits.

The liquidity insurance facilities provided by the Bank of England were used extensively during the financial crisis. But lending via these facilities has been lower in recent years, reflecting the improved financial positions of banks and building societies, the greater liquidity provided by the Bank through quantitative easing and, more recently, the Funding for Lending Scheme (FLS – page 34). As a result, the Bank's liquidity insurance facilities continued to see relatively modest use in 2014/15 (Chart 7).

The range of acceptable collateral in the SMF continues to expand, both in terms of the range of eligible loan assets and the number of securities deemed eligible. The market value of collateral delivered to the Bank for actual or potential use in its facilities (such as the FLS and those within the SMF) has increased substantially over recent years, and stood at £469bn by the end of February 2015. The Bank has also started work to ensure there are no technical obstacles to its ability to accept equities as collateral, should the need arise.

In October 2014, the Bank announced that it would assess the feasibility of establishing Shari'ah compliant facilities, which would further improve the flexibility of the Bank's ability to provide liquidity insurance.

£469bn

The market value of collateral delivered to the Bank for actual or potential use in its facilities stood at £469bn

Funding for Lending

The FLS was extended for a further year in December 2014. The FLS has contributed to a substantial fall in bank funding costs since its launch in mid-2012. That has fed through to improvements in credit conditions for households and businesses. Reflecting the significant improvements in household credit conditions, the incentives in the FLS were re-focused towards business lending in November 2013. The latest extension should continue to provide support where it is most needed, by focusing the incentives in the scheme towards lending to small and medium sized enterprises (SMEs) in 2015. At the end of 2014, £55.67bn of FLS drawings were outstanding, of which £15.65bn were drawings from the FLS Extension.

The FLS extension will complement various other longer-term initiatives to improve the availability of credit to SMEs as they take root. These include: the British Business Bank's various programmes to make markets work better for SMEs; the joint Bank of England-ECB initiative to improve the functioning of the securitisation markets, including securitisation of SME loans; the Government's Small Business, Enterprise and Employment Act 2015 that mandates a greater sharing of SME credit information and requires banks to share details of SMEs which have been declined finance; the Bank of England's consideration of widening access to credit data to support the provision of credit to SMEs through non-financial intermediary channels, such as trade credit; changes to the PRA's regulatory approach to make it easier to set up new banks; and a reduction in capital requirements for SME lending under EU legislation.

Banking

The Banking Directorate operates the UK's high value payments system (the Real Time Gross Settlement System, see page 36) and acts as the 'bank' within the Bank of England. It is responsible for the Bank's lender of last resort function, the provision of Emergency Liquidity Assistance (ELA), and the provision of bespoke banking services for financial stability reasons.

The Bank has implemented a range of improvements in its approach towards ELA following the independent report by Ian Plenderleith in 2012 of the provision of liquidity assistance during the financial crisis.[20] Bank staff have continued to embed these improvements into regular processes during the course of the year.

Important examples of this are the annual ELA test conducted by Bank staff and the improved co-operation and information-sharing between the ELA team and other parts of the Bank such as PRA supervisors. As recommended by the Plenderleith Review, Court has been updated on the readiness of the Bank to provide ELA (page 85).

In terms of customer banking, the Bank's strategy focuses on those banking activities that enable the Bank to fulfil its responsibilities as the central bank of the United Kingdom. That involves providing wholesale banking services to the UK Government, other central banks, and, where there are financial stability reasons to do so, certain other financial sector firms. As part of this strategy the Bank also provides custodial services for a range of customers. As of 28 February 2015, total assets held by the Bank as custodian were £514 billion (28 February 2014: £594 billion), of which £130 billion (28 February 2014: £140 billion) were holdings of gold.

£130bn

holdings of gold

20 The Plenderleith Review is available at www.bankofengland.co.uk/publications/Documents/news/2012/cr1plenderleith.pdf

Real Time Gross Settlement System

The Real Time Gross Settlement System (RTGS), operated by the Bank, settles payments in real time through the day. These include wholesale market transactions by financial institutions, but also 'real economy' high value time-critical payments including for house purchases. Given its significance to the real economy and the financial system, participants in the RTGS infrastructure – and most importantly, their customers – rightly expect it to meet extremely high standards of service, availability and resilience.

On 20 October 2014, the RTGS system suffered an unprecedented outage of approximately nine hours duration. This was resolved within the same day and all submitted CHAPS payments were settled within the day's operating hours. The Bank apologised to all those affected.

On the same day as the outage, the Governor announced that there would be an independent review of the causes and response to the outage. On 29 October, the Court of Directors set the terms of reference for the review and appointed Deloitte to conduct it. The RTGS Review was published on 25 March 2015, and the Bank is implementing its recommendations.

The RTGS outage was resolved within the same day and all submitted CHAPS payments were settled within the day's operating hours

RTGS and the Deloitte Review

On 20 October 2014, the RTGS system suffered an outage of approximately nine hours duration. The Deloitte review identified the cause of the outage as being the introduction of defects as part of functionality changes made to the RTGS system in April 2013 and May 2014.

The outage caused inconvenience to RTGS participants, and by consequence, to their customers – most notably a delay to some housing transactions. The Bank apologised to those who were affected, and implemented a compensation scheme to cover claims for costs incurred. The Bank has subsequently settled twelve claims totalling approximately £4,260.

Although RTGS participants and their customers were inconvenienced, substantive risks to financial stability, financial loss or long-term damage to the economy were avoided through the execution of a comprehensive plan to resolve fully the issue and enable submitted payments to be cleared by the end of the day. All submitted CHAPS payments (with a total value of £289.3 billion) were settled within the day's operating hours (which were extended until 20:00).

Among the lessons learned, the incident has highlighted the need for the Bank to consider further the contingency solutions for RTGS, as well as the future technical strategy. In addition, it has highlighted the need to strengthen the Bank's crisis management framework.

A series of actions taken by the Bank, in parallel to Deloitte's review, have already addressed several of the review's recommendations. The Bank has reconstituted its RTGS Board, now chaired by the Deputy Governor for Markets and Banking, as well as a delivery Board to further oversee the operation of the RTGS service. All of the remaining recommendations will be implemented as soon as possible.

Overview
Court, and the Bank's policy committees
Organisational structure
Review of 2014/15
Strategic initiatives
Monetary policy
Financial policy
Regulatory policy
International
Banking and markets
Protecting our banknotes
Diverse and Talented
Analytical Excellence
Outstanding Execution
Open and Accountable
Financial review 2014/15
Risk management and business practices
Corporate social responsibility
Report of the Remuneration Committee
Report of the Oversight Committee
Report of the Audit and Risk Committee (ARCo)
Statement of the responsibilities of the Court of Directors in relation to the financial statements
Financial statements
Contacting the Bank of England

'Open about our business'

The Bank is committed to ensuring not only that it is 'open for business', but also that it is 'open about our business', in line with the Open and Accountable pillar of the Strategic Plan.

The Bank recognises the importance of ensuring that its engagement with financial market participants represents best practice, and has taken a number of steps over the past year in this regard.

The Bank also continues to work with its domestic and international partners to put the necessary reforms in place to safeguard the integrity and effectiveness of core financial markets, including the wide-ranging Fair and Effective Markets Review (FEMR).

The Review, launched by the Chancellor in June 2014 and published in June 2015, provided a comprehensive and forward-looking assessment of the way fixed income, currency and commodity (FICC) markets operate.

Following the principles that individuals should be more accountable for their actions – and that firms collectively needed to take greater responsibility for developing and applying improved standards of behaviour – the Review set out a package of reforms aimed at restoring trust in these important markets in the wake of a number of recent high profile abuses. The Review also set out areas in which greater collaboration between international authorities could contribute to improved standards in these global markets.

The Bank is committed to ensuring not only that it is 'open for business', but also that it is 'open about our business'

Foreign exchange investigations

As set out on page 83, in March 2014 the Oversight Committee of Court appointed external counsel, Lord Grabiner QC, to lead an investigation into the conduct of Bank staff in the foreign exchange markets. This was in the in the context of investigations by the FCA and other regulators into the integrity of global foreign exchange (FX) markets, and an internal review by the Bank initiated in November 2013.

Lord Grabiner's report was published in November 2014. Its key findings were:

- There was no evidence that any Bank of England official was involved in any unlawful or improper behaviour in the FX market.
- Subject to the issues described below, there was no evidence that any official was aware or should have been aware of any unlawful or improper behaviour in the FX market.
- One Bank official was aware that bank traders were sharing aggregated information about client orders for the purpose of 'matching' – a practice that is not necessarily improper, but can increase the potential for improper conduct – and was uncomfortable with the practice in that it could involve collusive behaviour and lead to market participants being disadvantaged. Notwithstanding those concerns, the Bank official did not escalate the matter to an appropriate person. This constituted an error in judgement that deserved criticism, but such criticism should be limited in that the individual was not acting in bad faith, nor was the individual involved in any unlawful or improper behaviour, nor aware of specific instances of such behaviour.
- After careful consideration of whether his superiors should also be criticised, it was concluded that there was no evidence they were aware of the issue, nor that they should have been aware, as it was neither escalated to them nor raised in market intelligence (MI) reports.

Lord Grabiner made a number of recommendations relating to appropriate documentation of the Bank's interactions with financial market participants, education of its staff and clarity over its MI gathering functions. The Bank undertook to implement all of these recommendations, which were closely in line with the conclusions of the internal MI review that had been running in parallel.

Market Intelligence systems and controls

The process of gathering MI involves some risk. One is that those processing information intended for policymakers may not fully realise its significance to a conduct regulator; another is that potential issues are understood but neither escalated nor acted upon. More generally, there needs to be clarity about both the purpose of the Bank's MI programme, and the nature of relationships between MI staff and external contacts.

Against this backdrop, and given the Bank's desire to be open, accountable and ensure that all staff adhere to exemplary professional standards, there has been an internal review of the Bank's approach to gathering, recording and disseminating intelligence from its market contacts. The MI Review examined how internal records of discussions were synthesised and distributed within the Bank, and the box on page 39 summarises its main findings.

Policies on escalation and information sharing have been issued and updated over the past two years, and policies aimed at improving documentation standards have been introduced under the Bank's Records Management Review.[21] The Bank will introduce a formal policy consolidating all matters of relevance to MI and keep it under annual review. It will also improve compliance monitoring.

Policies on escalation and information sharing have been issued and updated over the past two years, and policies aimed at improving documentation standards have been introduced

21 www.bankofengland.co.uk/about/Documents/rmr111213.pdf

The Market Intelligence (MI) Review
For many years, the Bank has used its operational contacts to glean information about conditions and developments in financial markets that might be relevant to policymakers.

In 2004, a formal MI programme was established, using employees from the Markets Directorate and elsewhere in the Bank, to channel relevant reporting to policymakers. The purpose of the Bank's MI is to ensure that a good understanding of the financial market context contributes to policy decisions and that potential indicators of future instability are not missed.

In March 2014, as part of the Strategic Plan, the Governor commissioned a root-and-branch review of MI, to take account of the Bank's broader responsibilities as well as the need to be alert to the conduct issues described above.

The outcome of that review was announced in February 2015.[22] The Bank's Governors and Court of Directors endorsed all eleven recommendations stemming from the review, which will make the gathering and use of MI more transparent, robust and effective.

The recommendations include:

– an MI Charter which explains clearly the terms of the Bank's engagement with financial market participants, and its rationale for gathering MI;
– a strengthened set of policies that govern MI gathering, supported by expanded training for staff; and
– a new executive-level committee to oversee the MI programme, to ensure it retains the necessary flexibility, focus and relevance to the policy challenges of today and tomorrow.

The purpose of the Bank's MI is to ensure that a good understanding of the financial market context contributes to policy decisions and that potential indicators of future instability are not missed

22 www.bankofengland.co.uk/publications/Pages/news/2015/034.aspx

Protecting our banknotes

Maintaining public confidence in the currency is a key role of the Bank and one which is essential to the proper functioning of the economy. The Bank's commitment to outstanding execution, and to ensuring that its work reflects the diversity and talents of the whole of the United Kingdom, has underpinned a number of important initiatives in its work on banknotes over the past year.

Banknote printing contract and polymer

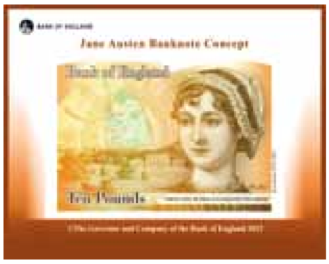
The Bank announced in late 2013 that the next £5 and £10 banknotes will be printed on polymer, rather than on the cotton paper used currently. That announcement followed a three-year research programme and a public consultation. New polymer notes will be cleaner, more secure and more durable. They are more environmentally friendly than the current cotton paper notes, and, because they last longer, will prove to be cheaper over time.

Over the past year, the Bank has been working closely with our banknote printer, De La Rue, and other key suppliers to run extensive production trials to ensure that the new polymer notes are ready for issuance. In addition, the Bank has engaged with key players in the cash industry, in particular machine manufacturers, financial institutions and retailers, who are undertaking their own preparations for the new notes.

This work will continue through 2015, and a full communication plan will be developed to enable a smooth transition for industry and for the public in 2016. The £5 banknote featuring Sir Winston Churchill will be issued in the second half of 2016, and the £10 banknote featuring Jane Austen a year later. Both of these new polymer notes will bear the signature of the Bank's new Chief Cashier, Victoria Cleland.

As well as preparing for the introduction of polymer, the Bank has also signed a new, long-term printing contract for Bank of England banknotes, thereby ensuring that the public can continue to depend upon the Bank to issue high-quality, secure notes into circulation. Following a formal public procurement process, which commenced in November 2012, the Bank announced, in autumn 2014, that it had entered into a new ten-year contract with De La Rue to print its banknotes at the Bank's facility in Debden, Essex.

On 3 March 2015, the Bank issued into circulation £10, £20 and £50 banknotes bearing Victoria Cleland's signature. These notes are the same design as those currently in circulation which bear the signature of Chris Salmon, the previous Chief Cashier, and of his predecessors Andrew Bailey and Merlyn Lowther. Cleland notes will circulate alongside the remaining Salmon, Bailey and Lowther notes, with the same status.



Design concepts for the £10 and £5 banknotes featuring Jane Austen and Sir Winston Churchill respectively.

Banknote characters

As part of its programme of issuing new banknotes, the Bank has the honour of celebrating a diverse range of individuals that have shaped British thought, innovation, leadership, values and society. In 2013, the Bank announced a new process for selecting the people that feature on Bank of England banknotes, to ensure that due consideration is given to important issues like diversity.

This new nomination process will be used for the first time for the next £20 banknote. As part of that process, the Bank announced, in January 2015, the membership of the new Banknote Character Advisory Committee (see box opposite).

In May 2015 the Governor announced that the next £20 note would celebrate Britain's achievements in the visual arts, and launched a public nomination period to seek people's views. The nomination period is open until 19 July 2015. Following this, the Committee will draw up a shortlist of characters from which the Governor will make the final choice.

The Banknote Character Advisory Committee

The new Banknote Character Advisory Committee will help to decide both the field, and the characters, for future Bank of England notes. Its inaugural members are:

- Ben Broadbent, Deputy Governor, Monetary Policy;
- Victoria Cleland, Chief Cashier and Director, Notes;
- Professor Sir David Cannadine, Princeton University, General Editor of the Oxford Dictionary of National Biography;
- Sandy Nairne, Director of the National Portrait Gallery (2002 – 2015); and
- Baroness Lola Young of Hornsey, independent member of the House of Lords, English Heritage Commissioner.

For the £20 character selection, three new independent members with expertise in the field of visual arts have joined the Committee:

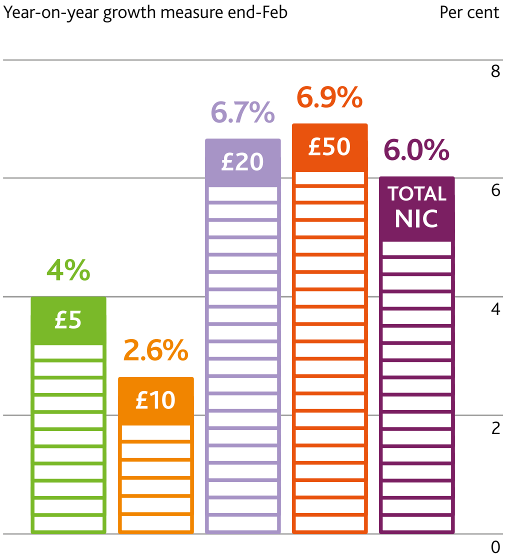
- Alice Rawsthorn, design critic and author;
- Andrew Graham-Dixon, leading art critic; and
- John Akomfrah, artist, writer, film director and screenwriter.

As part of its programme of issuing new banknotes, the Bank has the honour of celebrating a diverse range of individuals that have shaped British thought, innovation, leadership, values and society

Cash in circulation

Total notes in circulation (NIC) stood at £63.8bn at the end of February 2015, a year-on-year increase of 6.0%. Total NIC growth continues to be driven by the £20 note, the year-on-year growth rate of which has increased to 6.7%.

Chart 8: Growth in notes in circulation



The Bank continues to assess changes in demand for cash, and, during 2014, undertook research into digital currencies. While the work, published in the September 2014 Quarterly Bulletin,[23] concluded that digital currencies did not currently pose a material risk to monetary or financial stability, the Bank continues to undertake further research in this area. This work will be supported by the newly launched 'One Bank' research agenda (page 46).

Counterfeit banknotes

An effective anti-counterfeiting strategy is an essential part of the Bank's responsibilities to maintain a high degree of public trust in the currency. The number of counterfeit Bank of England banknotes identified and removed from circulation fell from 693,000 in calendar-year 2013 to 430,000 during 2014. The total value of counterfeit notes removed from circulation in 2014 was £8.05 million.[24]

While counterfeit notes remain a very small share of the total number of notes, it is important to keep it this way. A key element of this is the Banknote Education Strategy, providing training and materials – for example a new App – to encourage retailers and the public to identify genuine notes. The Bank continues to work closely with law enforcement agencies to detect and stop counterfeiting.

An effective anti-counterfeiting strategy is an essential part of the Bank's responsibilities to maintain a high degree of public trust in the currency

23 See www.bankofengland.co.uk/publications/Pages/quarterlybulletin/2014/qb14q3.aspx

24 See also www.bankofengland.co.uk/banknotes/pages/about/counterfeits.aspx

Diverse and Talented

Central to the Bank's mission is the attraction, development and retention of the best people into public service, building a talent base that reflects the diversity of the United Kingdom. Progress has been made on a number of fronts over the past year, including the delivery of an integrated 'One Bank' reward structure, the delivery of a new performance management framework and the launch of a new talent strategy.

The Bank continues to challenge itself to do more to ensure that its pool of talent reflects the diversity of the public that it serves.

Over the past year, the Bank has ensured that it pays all of its 3,868 staff at least the living wage. And all of the Bank's central London suppliers, providing catering, cleaning and other on-site services, have moved to the London living wage of £9.15 an hour.

Integrated reward structure

During the year, the Remuneration Committee monitored and approved, on behalf of Court, the development of the Bank's proposals for integrating the pay and pension arrangements of employees on legacy Bank and Financial Services Authority (FSA) contracts (see box below).

The review was carried out as the components of the compensation schemes differed significantly across the Bank. In developing revised terms and conditions, the Bank's aim was to develop a scheme that would attract and retain a mix of talent at all stages of their careers, be cost effective and provide value for the public purse. In doing so, the new scheme would create 'One Bank' in terms of remuneration, removing barriers to mobility across the institution.

The Bank continues to challenge itself to do more to ensure that its pool of talent reflects the diversity of the public that it serves

The new reward structure

The main elements of the new 'One Bank' reward structure, applicable to staff in all areas of the Bank from April 2015, are: a new set of pay scales; a fixed benefits allowance of 7%; and a flexible defined benefit pension scheme in which employees can choose, within limits, to exchange pension accrual for income and *vice versa*. All employees are now on a Career Average, rather than a Final Salary, pension scheme, in line with the rest of the public sector.

The Bank's Final Salary pension scheme, which had been closed to new entrants since 2007, was closed to new accrual from April 2015. Former members were placed into a reformed Career Average section of the Bank pension fund and at a accrual rate that ensured that their total remuneration remained broadly the same value. Former FSA employees, who had been members of a Defined Contribution (DC) section of the Bank Pension Fund, also joined the Career Average section of the Bank Pension Fund, but at a lower level of accrual again ensuring that their total remuneration remained broadly similar.

Following a consultation with employees the Remuneration Committee agreed the final terms of the Bank's offer in October 2014. These were accepted by 100% of employees in December and fully implemented in April 2015.

Performance management process

A key element of the HR agenda, driven by the Strategic Plan, was the overhaul of the performance management approach and delivering a consistent approach across the Bank. The aim was to create an environment where employees would know what was expected of them, would receive honest feedback on their performance and would have a clear view of the link between their performance and reward. Furthermore, behaviours would be a critical part of the review.

The extensive changes included the introduction of objective setting aligned to the Strategic Plan, mandatory 360 degree feedback for managers, a rating system that included what was achieved and how it was achieved, moderation meetings to ensure fairness and a direct link between overall performance rating and performance award.

The Bank's culture is at the heart of the success of the Strategic Plan

Bank values

The Bank's culture is at the heart of the success of the Strategic Plan. The Bank's leadership team have identified five core values that underpin the 'One Bank' culture. Evaluation of managers' performance against these values forms a central part of the Bank's new approach to performance management.

Value	Outcome
Collaborative	We are committed to working together to ensure our best possible contribution to the public good. We share information, skills and expertise freely.
Inclusive	We actively encourage challenge and divergent views, and create an environment where all staff can speak up, share their views and influence outcomes.
Empowering	We expect initiative-taking, creative thinking and rigorous analysis in all areas. To achieve this, we will clearly delegate suitable responsibility and accountability for analysis, recommendations and decisions.
Decisive	We support decisive action grounded in policy. We will create an environment that is agile, where all staff can respond swiftly to changing priorities, with a focus on delivery.
Open	We encourage open debate as the most constructive way to resolve conflicts. And we ensure that communication is open and transparent in discharging our duties in pursuit of our mission.

Diversity

The Bank of England values diverse ideas and talent. We believe that diversity is essential to our aim to make better decisions and more effectively fulfil our mission. An important part of this is to ensure that the Bank reflects the diversity of the UK public that it serves. The corporate social responsibility report sets out progress against the Bank's new targets for diversity (page 69), as well as other initiatives in this area over the past year.

Talent strategy

As part of the Strategic Plan, a new talent strategy for the Bank was launched in 2014. The strategy covers attraction and retention, performance management, succession planning, leadership development, career planning and diversity. Different career paths within the Bank, including technical and managerial paths, are being developed in order to help employees make informed career choices, and are supported by targeted training and development.

In 2015, the Bank launched a new three-year Research Programme for PhD entrants. The Programme is designed to offer significant scope to conduct policy-relevant research and opportunities to develop research skills further, together with a competitive salary and benefits package.

The Bank continues to support both outward and inward secondments to develop skills and expertise and to ensure decision-makers are exposed to a range of views. As part of a strategic review of learning resources, the Bank completed a comprehensive training needs analysis to inform a new learning and development proposition for 2015. Internal secondments and involvement in Community Relations activities continue to be encouraged as a way of stretching employees and supporting continuous development.

In 2015, the Bank launched a new three year Research Programme for PhD entrants

Analytical Excellence

A key objective of the Strategic Plan is to put the Bank at the forefront of research and analysis among central bankers, and the Plan contained a number of key initiatives aiming at bolstering the Bank's capability to deliver analytically excellent work.

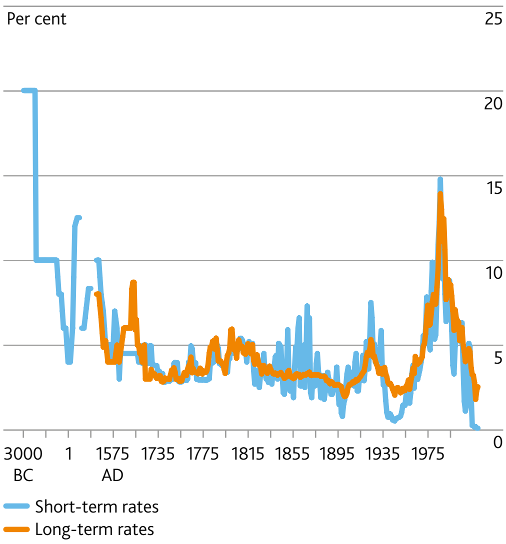
Research

The 'One Bank' strategy aims to create an integrated Bank-wide research agenda to improve the co-ordination and impact of its research, and to develop a research community drawn from all areas of the Bank. Over the past year, the Bank has established a 'One Bank' Research Hub to bring together staff and thinking from across the institution, creating a two-way flow between research and policy. Looking ahead, the Bank plans to expand research partnerships with academic institutions, to bring more outside academics into the Bank, and to invite external researchers to undertake joint projects with staff in the Research Hub and Advanced Analytics areas.

A new publications policy will provide more outlets for the work of economists and researchers, and more opportunities for publication will help the Bank compete in the market for top researchers. The Bank will have a stronger presence in the PhD recruitment market, offering a structured three-year Research Programme for new PhD entrants, dedicated to policy-oriented research. A technical career path for researchers will include new guidelines for managing performance, designed to ensure that high-quality research outputs are rewarded and recognised by management across the Bank.

A major research conference, held in February 2015, saw the publication of the five themes that will shape the 'One Bank' research agenda (page 47) and span all aspects of central banking. A 'One Bank' research agenda is now taking shape, building on extensive consultation with researchers and staff across the Bank and members of the wider academic community.

Chart 9: Historical interest rates



Source: Taken from Haldane 'Growing, Fast and Slow' by Andy Haldane, Speech on 17th February, 2015, and using in part the newly released Bank of England historical dataset. Other sources: Homer and Sylla (1991), Heim and Mirowski (1987), Weiller and Mirowski (1990), Hills, Thomas and Dimsdale (2015 forthcoming), Bank of England, Historical Statistics of the United States Millenial Edition, Volume 3 and Federal Reserve Economic Database.

The 'One Bank' research conference saw the Bank release a series of historical datasets, including three centuries' worth of data on key macroeconomic variables, another example of the Bank's renewed commitment to openness and accountability.[25]

At the conference, the Bank also launched two competitions to catalyse interest in its research agenda: the first on data visualisation, employing the Bank's newly-released data sets; the second on research into the interactions between macroprudential, microprudential and monetary policy.[26]

In June 2015, the Bank will host – alongside the Hong Kong Monetary Authority (HKMA) and the International Monetary Fund (IMF) – a major conference on the interaction between monetary and macroprudential policy.

A key objective of the Strategic Plan is to put the Bank at the forefront of research and analysis among central bankers

25 A copy of all the presentations made at the conference is available at www.bankofengland.co.uk/research/Pages/onebank/conference.aspx

26 See www.bankofengland.co.uk/research/Pages/onebank/competition.aspx for more details.

The 'One Bank' research agenda

Theme 1: Policy frameworks and interactions

– How do macroprudential, microprudential and monetary policy interact?

Theme 4: New data, metholodologies and approaches

– How can we harness computing power to exploit ever-increasing amounts of data, and to improve our understanding of the economy and the financial system?

Theme 2: Evaluating regulation, resolution and market structures

– What is the interplay between the post-crisis reform of regulatory policy and the changing nature of financial intermediation? How might market structures evolve, and what does policy need to do to keep up?

Theme 5: Response to fundamental changes

– What will be the long-term implications for central banks of technological and structural changes such as changing demography, increasing longevity, inequality, climate change, the increasing importance of emerging economies and the development of digital currencies?

Theme 3: Policy operationalisation and implementation

– How is the transmission of policy affected by its implementation and communication? What more could be done to enhance effective transparency in all areas of policy?

Data

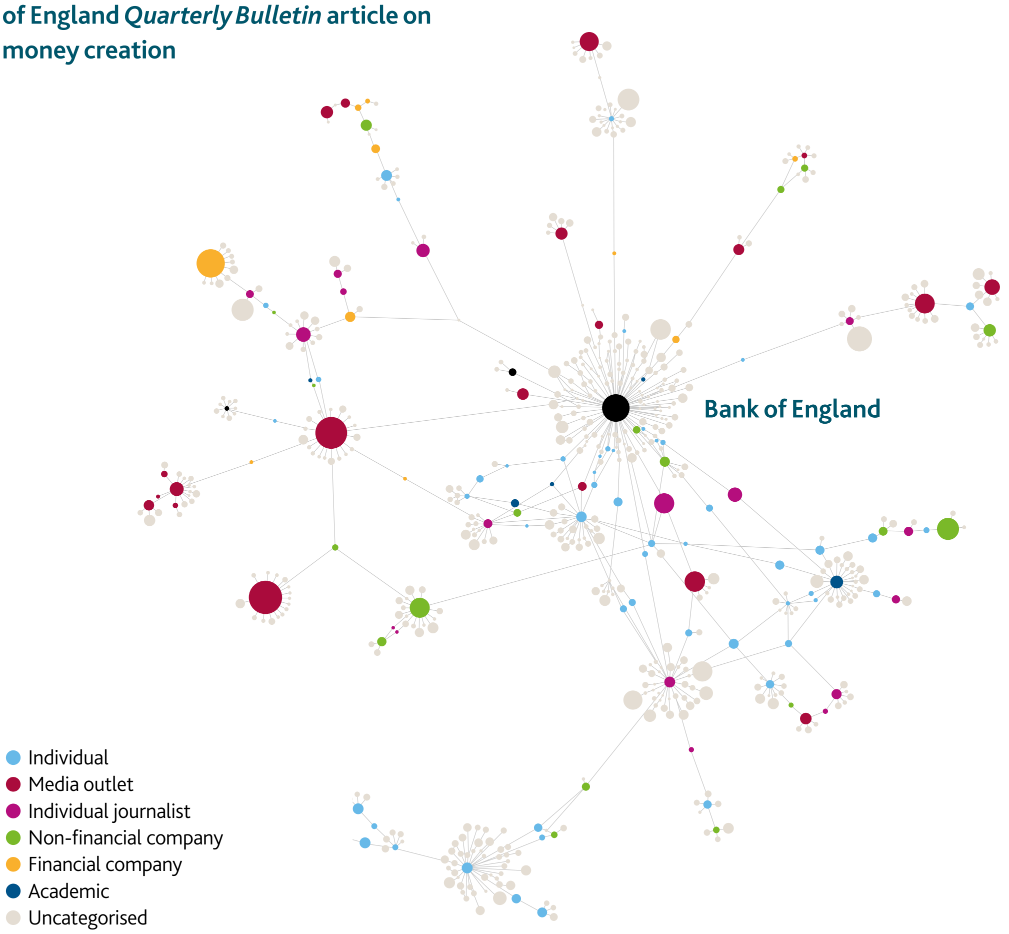
Increasing amounts of data are available on almost every aspect of the economy and the financial system. The Bank recognises the importance to its policymaking of exploiting developments in advanced analytics of large data sets. As such, non-traditional data sources – such as information scraped from search engines or social media sites – are increasingly being used by the Bank to supplement its analysis of more traditional data and statistics.

As set out in the Strategic Plan, the Bank is investing in its advanced analytical capabilities to help it deliver excellence in this area. Over the past twelve months, the Bank has opened a new data lab, and has begun to partner PhD mathematicians and statisticians with analytical staff across the full range of its work.

New and ever-increasing amounts of data bring with them new demands on data architecture and governance. The Bank's data strategy seeks to rise to this challenge. The Bank has recruited a Chief Data Officer (CDO) with broad data and industry expertise who reports to the Bank's Chief Information Officer. The CDO leads a new Data Division which is bringing together all of the institution's data capture, validation and storage expertise. The Bank has also put in clear governance so that all data investments are considered together, helping ensure that data procurement processes are efficient as possible.

The Bank recognises the importance to its policymaking of exploiting developments in advanced analytics of large data sets

Who tweets? Tweets and retweets of Bank of England *Quarterly Bulletin* article on money creation



Note: Chart shows global tweets and retweets of the Bank of England Quarterly Bulletin article *Money in the modern economy: an introduction 2014 Q1* www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q101.pdf

Size of node corresponds to Twitter influence, as measured by their Klout score (see https://klout.com/corp/score). Source: DataSift, Twitter, Bank of England calculations.

Outstanding Execution

The Bank recognises that it is only as effective as its actions. No matter how good its analysis, its decisions and actions need to have influence and impact, both at home and abroad. To achieve the Bank's mission, it needs co-ordinated, effective and inclusive policy decisions, and reliable, expert execution in everything we do. The past year has seen numerous initiatives in this area, including in the International Directorate (page 29), the implementation of recommendations from the RTGS Review (page 36), and in the Bank's Notes Directorate (page 40).

Over the past twelve months, the Bank has also taken significant steps to improve the resilience both of its own systems, and that of the financial system more broadly.

Cyber and information security – a safer Bank

The Bank itself has launched a multi-year work programme to strengthen its own protection against cyber attack. The aims of the work programme are:

- to create multiple layers of defence around the Bank, and strengthen the protection around the most critical assets, reducing both the likelihood and potential impact of a successful cyber attack;
- to ensure that the Bank's defences can withstand the most commonly experienced attacks, and that the Bank has both the processes and tools in place to quickly and effectively detect and respond to attacks as required;
- to ensure that senior management are fully aware of information security strengths and weaknesses so that investment and resources can be efficiently directed to ensure the continued safety of the organisation; and
- to ensure that security-conscious staff play an active role in the defence of the organisation.

Enterprise-wide Threat and Risk Assessments are carried out annually to determine the Bank's level of maturity with respect to cyber security.

Over the past year, the Bank has appointed a Chief Information Security Officer (CISO) who reports directly to the Chief Operating Officer. The CISO helps to develop all policy regarding information security and to deliver this policy across the Bank. All staff undergo mandatory information security training annually; the Bank has recruited specialists in information security and associated technology and will be doubling this capability in the next 18 months.

Financial sector's cyber resilience

In June 2013, the FPC recommended that: 'HM Treasury, working with the relevant government agencies, the PRA, the Bank and the FCA should work with the core UK financial system and its infrastructure to put in place a programme of work to improve and test resilience to cyber attack'.

In response, HM Treasury has co-ordinated a work programme across the financial authorities, with support from GCHQ and the Centre for the Protection of National Infrastructure. It involves understanding the threat, and strengthening assessment, testing and information sharing, with a particular focus on threats that might affect financial stability rather than low-level crime or fraud.

The Bank, through its Sector Resilience Team and with support from the Information Security Division, has been closely involved. A sector-wide exercise to rehearse the response of the wholesale banks sector to a cyber attack was completed in November 2013, followed by a questionnaire-based self-assessment programme pertaining to firms' cyber resilience, completed in 2014. These initiatives have been reinforced by an independent, intelligence-led vulnerability testing framework – CBEST – developed by the Bank and launched in June 2014. CBEST has provided a means of joining private sector expertise in penetration testing of firms' systems with intelligence about evolving threats. The framework replicates behaviours of threat actors, assessed by Government and commercial intelligence providers as posing a genuine threat to systemically important financial institutions. Prudential supervisors in the PRA are also involved, to oversee development of action plans formulated by firms in response to this diagnostic work.

Open and Accountable

An open, transparent and accountable central bank is essential not only for effective policy, but also for democratic legitimacy. In December 2014, the Bank announced a major package of reforms aimed at improving its transparency and accountability, including reforms to MPC transparency (page 20), to the institution's governance structure and to the accountability of Court (see below). The Bank has also adopted a more transparent approach to its own financial reporting practices (page 90). And it has continued to build public trust in its work through its communications and public liaison strategies, as well as through its twelve-strong Agency network operating throughout the United Kingdom.

Court of Directors and governance of the Bank of England

The Financial Services Act 2012 made fundamental changes to the role of the Bank, giving it responsibility for oversight of the UK financial system as a whole and overhauling the institution's governance. In its December 2014 statement on *Transparency and Accountability at the Bank of England*,[27] the Bank sought to build on this by setting out a series of proposals aimed at further strengthening and simplifying the Bank's governance structures. These included a further slight reduction in the size of Court (the institution's Board of Directors), consistent with best practice in the private sector. The Bank additionally recommended that the statutory separation of Court and its Oversight Committee should be ended and their powers be vested in a single unitary Board, retaining an independent Chair and a majority of non-executives.

An open, transparent and accountable central bank is essential not only for effective policy, but also for democratic legitimacy

27 www.bankofengland.co.uk/publications/Documents/news/2014/warshresponse.pdf

The Bank's December 2014 statement on transparency and accountability also recommended changes in the structure of its three policy committees. At present, these are all constituted on a different basis. The MPC is a Committee of the Bank, operating under objectives set in legislation and to an annual remit set by the Chancellor. The FPC, by contrast, is a sub-committee of Court, while the PRA is a subsidiary of the Bank, with a Board that is responsible both for delivering the PRA's objectives and for the direction of the subsidiary company. Of these models, the MPC's is the clearest and most straightforward, and the Bank has proposed that the status of the FPC and PRA Board be aligned with that of the MPC's. Specifically, that would mean:

- changing the FPC's status from a sub-committee of Court to an independent Committee of the Bank, establishing a clear separation of policy responsibility (FPC) from management and oversight responsibility (Court); and
- making the PRA a full part of the Bank of England and not a subsidiary, with the PRA Board solely focused on the delivery of the PRA's statutory objectives. Court would remain responsible for providing adequate resources, accounting and risk control to allow the PRA and the other committees to discharge their functions.

The Bank places the utmost importance on both its accountability through the Treasury Committee to Parliament, and its accountability more broadly to the citizens of the United Kingdom. Reflecting this, the Bank's December 2014 statement on transparency and accountability additionally contained a number of initiatives aimed at improving the transparency of its historical records and documents (see box opposite).

Release of historical Court minutes

Since April 2013, following amendments to the Bank of England Act 1998, the Court has published minutes of its meetings, typically with a six week delay.[28] Prior to April 2013, the Court minutes were not published, but instead transferred to the Bank's Archive, to be opened to the public after a delay of 100 years.

In late 2014, as part of its review of the Bank's governance and accountability, Court decided to bring the release of the minutes of its historical meetings in line with the standard for other material in the Bank's Archive and the National Archives more generally. As such, the minutes of its meetings (and those of a former inner group of Court known as the Committee of Treasury) from 1914 to 1987 were released during the early months of 2015. In total, the Bank's Archive has released 104 volumes (totalling 25,000 pages) of historical Court minutes over the past year.

Alongside the release of the first instalment of the historical Court minutes, the Bank decided to make a special release, in appropriately redacted form, of the minutes of Court and some of its subcommittees during the financial crisis period of 2007–09. That release followed requests by the Treasury Committee to understand better Court's role in the crisis.

More generally, the Court recognises that it has a responsibility to meet, as openly as possible, reasonable requests for information from Parliament through the Treasury Committee, and oversees processes that ensure that as much as possible is put into the public domain or shared with the Treasury Committee or its Chairman on a confidential basis.

The Bank places the utmost importance on its accountability

28 Since April 2013, the Bank has published Court minutes six weeks after the meeting to which they relate, or, if there is no further meeting within that period, then two weeks after the date of the next Court meeting.

Communications and public liaison

The global financial crisis exposed the Bank to greater scrutiny. And expansion of the Bank's powers and responsibilities has also increased the need for a proactive and professional communications policy that promotes openness and transparency about the Bank's activities.

The Bank's new Stakeholder Relations Group – among the initiatives identified in the Strategic Plan – will develop and deliver the Bank's strategy for engaging external technical experts and professional observers in the Bank's analysis, actions and communications.

More generally, under initiative fifteen of the Strategic Plan ('Engaged and Approachable'), the Bank has started a new approach to promoting trust and understanding among the public. Recent work has focused on identifying where we can make the most progress in improving understanding, and therefore trust, in the Bank. Although the Bank has always aimed to promote better understanding of what it does, this has traditionally been achieved mainly via the mainstream national and regional press, along with input into school curriculums. But digital and social media, in particular, offer new opportunities to connect with the public in more direct and imaginative ways, and the Bank is actively exploring how best to use these newer channels of communication in building understanding and trust in its work.

The Bank offers a wide range of resources and services to build awareness and understanding of its role and functions, and of central banking more generally. These include the work of its Museum, as well as its educational resources, as discussed in its corporate social responsibility report (page 69).

The Bank's Centre for Central Banking Studies (CCBS) brings together experts from central banks from all over the world to share experiences and learning. In 2014/15, the focus of the CCBS's work was the study of interactions between monetary, macroprudential and microprudential policy. The CCBS held 53 seminars (34 in London and 19 overseas) involving almost 1,400 delegates. In total, experts from 132 central banks and 30 regulatory authorities participated in CCBS seminars.

External engagement of the MPC, FPC and PRA Board

Policymakers from all three policy committees – the MPC, FPC and the PRA Board – have engaged fully with external stakeholders over the past year as part of the Bank's broader commitment to be open and accountable about its actions. Over 2014/15, policymakers have:

- appeared in front of Parliament on more than 18 occasions;
- given 79 public speeches with text;
- given more than 170 interviews to media outlets; and
- carried out 54 regional visits to all parts of the United Kingdom.

Digital and social media offer new opportunities to connect with the public in more direct and imaginative ways

Agency network

Liaison with the business community happens in many ways at the Bank, although a principal channel is through the Bank's Agency network. The Agency network acts as the eyes and ears of the Bank in all parts of the United Kingdom.

The Bank has twelve Agencies that feed intelligence gathered from their network of contacts into the work of all the Bank's policy areas, and regularly present their work to policymakers in London. Over the past year, the Agencies have been refocusing their efforts to ensure that they are effectively serving the needs of all of the Bank, including the financial policy areas and supervision.[29]

During 2014/15, the Agencies have:

– visited some 5,200 companies for in-depth discussions with senior executives, drawn from all sectors of the economy, and all parts of the United Kingdom;

– supplemented those company visits with panel discussions with some 3,700 businesses;

– hosted 54 visits across the country from members of the MPC, FPC and PRA Board; and

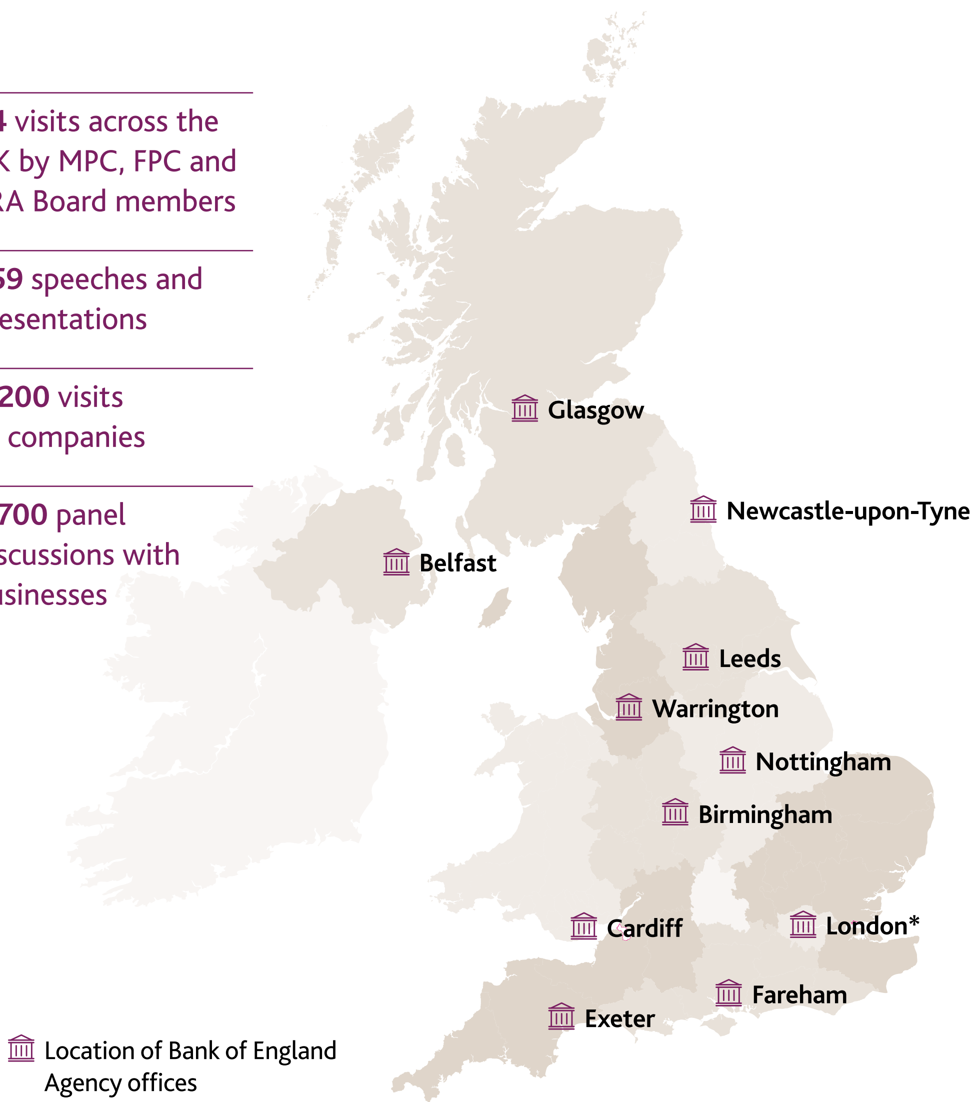
– given 559 speeches and presentations to external audiences explaining the work of the Bank and its policy committees.

54 visits across the UK by MPC, FPC and PRA Board members

559 speeches and presentations

5,200 visits to companies

3,700 panel discussions with businesses



29 For more detail on the work of the Agencies, see www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q104.pdf

* Covers two areas: Greater London and the South East and East Anglia.

Financial review 2014/15

Financial statements highlights

The table below presents highlights of the combined 2015 financial statements.
Further explanation and commentary is provided below.

Financial statement highlights

	2015 £m	2014 £m
Banking Department total balance sheet size	402,573	399,341
Banking Department profit before tax	198	180
Cash Ratio Deposits	4,098	4,078
Funding for Lending Scheme drawdowns	56,836	41,405
Funding for Lending Scheme fees	132	89
Notes in circulation	63,789	60,198
Net seigniorage income	506	443
Combined cost base	510	469
PRA cost base[30]	236	202
Payment to HM Treasury in lieu of dividend[31]	93	80

Financial framework

The Bank operates as 'One Bank', a single unified institution, and the financial review is presented in a way that is consistent with this operating principle.

The PRA is a separate legal entity, operating under the Financial Services and Markets Act 2000. The disclosures presented in this review for the PRA are recognised separately in the PRA's Annual Report and Accounts. Additionally, under the 1844 Bank Charter Act, the Bank was divided for accounting purposes into the Issue Department, covering banknote issuance activity, and the Banking Department, which encompasses all other activities.

Under the Bank of England Act 1998 the financial statements are prepared on a non-consolidated basis. The 'combined' income statement and balance sheet data represents the aggregation of the Banking Department, Issue Department and PRA, and is presented for information purposes only.

30 2015 is the first twelve-month operating period for the PRA. 2014 represents an eleven month operating period.

31 Includes 50% of Banking Department post-tax profit and Special Liquidity Scheme (SLS) compensation payment of £8m received by the Bank relating to the reduction in SLS fees received due to manipulation of submissions to the British Bankers' Association GBP repo rates by Lloyds Bank and Bank of Scotland. The Bank believes this payment fully compensates it for all losses it may have suffered.

The key elements of the financial framework of each component of the Bank are detailed below.

For the Banking Department, the Bank compiles its medium-term spending plans within a financial framework which has three main tenets:

- First, that policy functions of the Bank (monetary policy and financial stability) are financed by the Cash Ratio Deposit (CRD) scheme. Under the CRD regime, banks and building societies are required to place an interest-free deposit at the Bank which is a set percentage of their deposit base. The Bank then invests those deposits in interest-yielding assets, generating income to fund its policy functions. The CRD requirements are set by HM Treasury through a Statutory Instrument every five years.[32]
- Second, that the remunerated activities of the Bank – banking and lending operations for the Bank's own account – will be expected to break even over the medium term. In these areas the focus will be on net spending, although the Bank will remain committed to providing value for money, without running undue risks. Any gains or losses from these activities will not flow back to CRD payers, but instead be recognised in the Bank's capital. The Funding for Lending Scheme (FLS) is considered a remunerated activity.
- Third, that if spending on policy functions is in line with CRD income and other functions break even, the profit of the Bank should be broadly equivalent to the return on the assets in which its capital and reserves are invested – largely gilts. Under the Bank of England Act 1998, the Bank's post-tax profit is shared 50:50 with HM Treasury unless otherwise agreed.

The Issue Department is funded by buying interest yielding assets to back the notes in circulation. The interest earned on these assets is used to fund the costs of note production and supply. The net profits/losses of the Issue Department are referred to as seigniorage, and paid/claimed directly to/from HM Treasury via the National Loans Fund.

The PRA, operating under the Financial Services and Markets Act 2000, may levy regulated firms to recover all costs incurred in the performance of the PRA's functions under the Act. The PRA's budget is subject to the approval of Court.

Court considers the operation of the Bank's financial framework in fulfilling its responsibilities under the Bank of England Act 1998.

32 The current requirements were agreed in May 2013; see www.bankofengland.co.uk/boe-ar2014/links for the 2013 Cash Ratio Deposit legislation.

Combined income statement

The combined income statement reflects a profit before tax of £198m (2014: £180m). This is effectively equal to the Banking Department profit before tax as the PRA operates a cost recovery model, and Issue Department profits are payable in full to HM Treasury.

Year-on-year growth in profit before tax was driven primarily by increases in Funding for Lending Scheme income and growth in sterling bond portfolio income, partly offset by mark-to-market losses on foreign currency deposits and reserves, and increased salary and post-retirement costs.

Summary combined income statement[30,33]

	2015 £m	2014 £m
Income	**708**	**649**
Banking Department	569	506
Issue Department	576	513
PRA	236	202
less internal income recoveries and seigniorage income		
Banking Department corporate service management fee to the PRA[34]	(97)	(59)
Issue Department income transferred under seigniorage arrangements[35]	(576)	(513)
Expenses	**(510)**	**(469)**
Banking Department	(371)	(326)
Issue Department	(70)	(70)
PRA	(236)	(202)
less internal cost recoveries and seigniorage expenses		
Issue Department costs under seigniorage arrangements[35]	70	70
PRA corporate services management charge from the Banking Department[34]	97	59
Combined profit before tax	**198**	**180**
Taxation	(19)	(20)
Payment in lieu of dividend	(93)	(80)
Profit after tax and dividend for year ended 28 February 2015	**86**	**80**

33 The separation of the Banking and Issue Department for accounting purposes is required by statute. A summary 'combined' income statement and balance sheet as at 28 February 2015, aggregating the Banking Department, Issue Department and the PRA, is provided in this financial review. It is provided for information purposes only.

34 The Bank provides certain central and support services to the PRA, for which it charges a corporate services fee. During the year, the Bank changed its methodology for recognition and subsequent recharging of these expenses. As a result, costs which had previously been recognised directly in the PRA were initially incurred in the Bank, and subsequently recharged, thereby driving an increase in the fee charged, with corresponding direct cost decreases in the PRA. On a comparable basis, and assuming a full twelve-month operating period (2014: eleven months), the 2014 charge of £59m would have been approximately £84m. The year-on-year increase is attributable, inter alia, to additional IT investment and legal expenditure.

35 Net seigniorage income of £506m (2014: £443m) is paid to HM Treasury via the National Loans Fund.

Expenditure by function

Total expenditure for 2015 of £510m was £11m below the 2015 budget of £521m.[36] The variance to budget was predominantly attributable to lower investment expenditure and staff vacancy levels throughout the year.

The 2016 cost budget has been set at £549m (of which the PRA is £255m). The increase is partly driven by increases in bank note production expenditure (the first polymer note will be issued in 2016), higher accounting costs on the defined benefit pension scheme, and by conscious decisions to strengthen the organisation given its challenging supervision, regulatory and policy agenda.

Combined expenditure by function[37]

	2015 Actual £m	2014 Actual £m
Policy functions		
Monetary policy	69	64
Financial stability	63	67
Expenditure on policy functions	**132**	**131**
Remunerated functions		
Notes issue costs recharged to the Issue Department	72	72
Government agency services	9	8
Payment and settlement	12	13
Banking services	33	27
Other functions	16	16
Expenditure on remunerated functions	**142**	**136**
Corporate service costs recharged to the PRA[34]	97	59
Expenditure on other functions	**97**	**59**
Total Banking Department	**371**	**326**
Issue Department	**70**	**70**
Operational expenditure	229	182
Special project and Solvency II costs	7	11
Transition costs	–	9
Prudential Regulation Authority	**236**	**202**
Issue Department costs settled under seigniorage arrangements	(70)	(70)
PRA corporate services management charge from the Banking Department[34]	(97)	(59)
Internal charges and settlements under seigniorage arrangements	**(167)**	**(129)**
Total combined expenditure	**510**	**469**

36 The budget of £521m presented in the 2014 *Annual Report*.

37 Combined expenditure by function represents the aggregation of the Banking Department, Issue Department and the PRA, adjusted for internal charges and eliminations under seigniorage arrangements.

Policy functions

Expenditure on policy functions was £132m, consistent with prior year expenditure of £131m.

Remunerated functions

The increase in expenditure to £142m for remunerated functions was primarily driven by additional IT investment on strategic initiatives.

The Bank's remunerated functions (operating on a full and fair cost recovery basis) continue to make a surplus as a consequence of Funding for Lending Scheme income of £132m (2014: £89m).

Prudential Regulation Authority

Operating costs for 2015 of £236m (2014: £202m) were slightly below budgeted costs of £238m, reflecting higher than expected staff vacancy levels. The increase from 2014 is primarily attributable to a full year of operations (2014: eleven-month period), closure of prior year resourcing gaps and expansion of the PRA's regulatory remit.

Issue Department

Expenditure of £70m on the Issue Department is consistent with the prior year. Lower new note production costs were broadly offset by preparatory spend in anticipation of the switch to polymer notes in 2015/16.

Combined balance sheet

The combined balance sheet grew by £4.0bn in 2015. The largest movement in assets was an increase in 'loans and advances' of £3.2bn. This was mainly attributable to an increase of £1.8bn in Indexed Long Term Repo (ILTR) balances across the Banking and Issue Departments, and £1.2bn in other reverse repurchase agreements in the Banking Department.

The upward trend in 'notes in circulation' continued in 2015, bringing the liability to £63.8bn (2014: £60.2bn).

The Funding for Lending Scheme (FLS) grew by £15bn in the year as banks and building societies utilised the scheme to boost their lending to UK households and businesses. In December 2014, the Bank and HM Treasury announced a further one-year extension to the FLS; the FLS Extension drawdown window will now remain open until 29 January 2016, with incentives of the scheme focused towards lending to small and medium sized enterprises in 2015.

The FLS is a fully collateralised scheme, classified as off balance sheet under a collateral swap arrangement, which allows participants to borrow UK Treasury bills in exchange for eligible collateral.

The fee paid by participants on their drawings from the first part of the scheme (which ended in January 2014) was determined by their net lending performance, with the majority of participants paying a fee of 0.25%. The fee for all drawings in the second part of the scheme (the FLS Extension, which commenced in February 2014) is 0.25%.

Summary combined balance sheet

	2015 £m	2014 £m
Assets		
Loans and advances	389,330	386,175
Securities held at fair value through profit or loss	5,160	6,090
Available for sale securities	11,075	10,566
Other assets	2,927	1,604
Total assets	**408,492**	**404,435**
Equity and liabilities		
Deposits	336,714	336,565
Notes in circulation	63,789	60,198
Foreign currency bonds in issue	3,898	3,599
Other liabilities	692	1,026
Capital and reserves	3,399	3,047
Total equity and liabilities	**408,492**	**404,435**
Off balance sheet – Funding for Lending Scheme		
Funding for Lending drawdowns	**56,836**	**41,405**

Financial review of Banking and Issue Departments

Banking Department

The Banking Department's financial statements for the year ended 28 February 2015 are shown on pages 96 to 150 and reflect a profit before tax of £198m (2014: £180m) and tax charge of £19m (2014: £20m). The Bank and HM Treasury normally share the Banking Department's post-tax profits equally. However, £7.76m compensation was received by the Bank in the year relating to the now closed Special Liquidity Scheme, £7.75m of which is payable to HM Treasury net of costs. Profit transferred to reserves therefore amounts to £86m (2014: £80m), being 50% of post-tax profit excluding this compensation, and the amount payable to HM Treasury in lieu of dividend accounts for £93m (2014: £80m).

The statement of comprehensive income reflects a net income for the year of £445m (2014: £225m loss), comprising post-tax operating profits of £179m (2014: £160m) and 'other comprehensive income' totalling £266m (2014: £385m loss). 'Other comprehensive income' includes a net increase in the fair value of available for sale assets of £95m (2014: decrease of £245m), positive retirement benefit remeasurement income of £130m (2014: £154m negative) and property revaluation gains of £41m (2014: £14m).

The total balance sheet of the Banking Department increased slightly during the year, from £399.3bn at 28 February 2014 to £402.6bn as at 28 February 2015.

The main change in the Banking Department's assets was an increase in 'loans and advances to banks and other financial institutions' of £1.8bn, primarily due to increases in reverse repurchase agreements.

'Capital and reserves' increased to £3.4bn (2014: £3.0bn), largely due to changes in market valuations of available for sale assets and retirement benefit remeasurements. The Bank's retained earnings, together with Cash Ratio Deposits, are predominantly invested in gilts and supranational sterling bonds. The Banking Department's holdings of gilt securities and other supranational bonds were £6.7bn at 28 February 2015 (2014: £5.9bn).

At 28 February 2015, the Banking Department's balance sheet contained £3.9bn of liabilities associated with the management of the Bank's foreign exchange reserves (2014: £3.6bn).

The main movement in Banking Department liabilities was an increase of £2.3bn in 'other deposits', primarily due to an increase in the Issue Department deposit resulting from increased notes in circulation partly offset by a decrease in public deposits held with the Bank.

Issue Department

The statements of account for the Issue Department (which is provided on pages 151 to 155) reflects net profits from note issue of £506m (2014: £443m), payable in full to HM Treasury. In 2015, gilt revaluations contributed £81m to income; there were no such revaluation gains in 2014.

'Notes in circulation' continued to increase year on year, and totalled £63.8bn at 28 February 2015 (2014: £60.2bn). Gilt purchases to back banknote issuance, introduced in January 2008, remained on hold during the year while Bank of England Asset Purchase Facility Fund Limited undertook gilt purchase operations. The market valuation of gilts on Issue Department was £4.1bn at 28 February 2015 (2014: £4.2bn). The 'Ways and Means advance' to HM Treasury remained at £370m as at 28 February 2015.

Risk management and business practices

Court is responsible for the risk management and internal control systems in the Bank and its subsidiaries. The responsibility for day-to-day operations is delegated to the Executive Directors, and monitored by the Audit and Risk Committee (ARCo).

The risk management and internal control systems are based on what Court considers to be appropriate for the Bank's activities, to the materiality of the financial and other risks inherent in those activities and to the relative costs and benefits of implementing specific controls. The systems are designed to manage rather than eliminate the risk of failure to achieve the Bank's mission and, as such, provide reasonable, but not absolute, assurance against material misstatement or loss. In accordance with the Financial Reporting Council's Revised Guidance for Directors on the UK Corporate Governance Code, Court has reviewed the effectiveness of the risk management and internal control systems. Court confirms that an ongoing process of identifying, evaluating and managing the Bank's risks has operated throughout the year covered in this *Annual Report* and up to the date of its approval. To facilitate Court's review and confirmation, the Executive Directors and Directors have certified compliance with the Bank's risk management and internal control requirements by the areas for which they are responsible. This attestation included a review of the risk and control issues identified and reported during the year.

The Bank's risk governance arrangements are being reviewed and an Executive Risk Committee is being established which will be responsible for the operation of the risk governance framework including monitoring the overall risk profile. A risk tolerance statement is being developed to provide clearer articulation of the levels of risk exposure appropriate to the various activities undertaken by the Bank, together with a framework for managing the risks within agreed tolerance levels.

The Bank's risk management framework

In order to deliver its objectives effectively and efficiently, the Bank is required to identify, assess and manage a wide range of risks. The Bank's risks are managed through an overarching risk management framework in order to apply consistency and transparency of risk management across the organisation. The framework identifies the roles and responsibilities of key parties in the risk management process, the policies for how risks are managed, the tools and processes used, and the reporting outputs that are generated. The Bank is establishing a framework of tolerances which sets the extent of the risk it is not comfortable exceeding, and within which risks are managed.

Risk management processes are embedded into the operations of the Bank. The Bank's risk management framework assists the Bank in identifying, assessing and monitoring both the material risks to the Bank's mission, and the actions taken to mitigate them.

Risk governance

The Court of Directors

Court's overall responsibilities include determining the Bank's objectives and strategy, and ensuring the effective discharge of the Bank's functions and the most efficient use of the Bank's resources. Within this, Court takes responsibility for the overall governance framework of the Bank, including the Bank's risk management and internal control systems.

The Audit and Risk Committee (ARCo)

ARCo assists Court in meeting its responsibilities for an effective system of financial reporting, internal control and risk management. It has responsibility for reviewing the findings of internal and external auditors and monitoring outstanding actions for timely completion. It is supported by the Bank's Internal Audit function. The Committee receives reports on the Bank's risk profile, the operation of the risk framework and the risk management processes and systems in place in the Bank.

The Governors

The Governors receive a quarterly high-level report on financial risk from the Executive Director for Markets, as well as reports on Bank-wide risks.

Executive Directors:

Executive Directors are responsible for managing the risks within their Directorates. Each Bank Directorate has staff who are given responsibility for co-ordinating risk management activities for that business area. In the case of Markets and Banking, there are dedicated organisational units set up to deliver the risk management framework locally.

The PRA Board

The PRA participates in the Bank-wide risk management framework, and the Board has established reporting systems and controls to ensure that it is able to monitor and manage risks that are specific to the PRA's objectives.

Risk assessments produced through this process are approved by the Board and shared with ARCo, which Board members attend. Through ARCo, Board members share in monitoring operational risks arising in the Bank's common services.

The Board's appetite for risk is ultimately determined by the statutory objectives of the PRA and is set out in the PRA's strategy and approach documents. The Board is supported by a Supervisory Oversight Function, the aim of which is to provide assurance to senior management on the quality and effectiveness of supervision. The Supervisory Oversight Function reports directly to the Board.

The Assets and Liabilities Advisory Committee (ALCo)

ALCo supports and advises the Executive Director for Markets on the management of the Bank's balance sheet under the terms of the annual Balance Sheet Remit from the Governor. In the context of the Remit and risk management framework, it monitors the financial performance and risk profile of the Bank's main financial activities, and of the balance sheet as a whole.

Internal Audit

Internal Audit assists Court and the Bank's Executive Directors in protecting the Bank, and its reputation, by independently and objectively evaluating the effectiveness of internal controls, risk management and governance processes.

Internal Audit's charter is published on the Bank's website.

Principal risks

The principal risks to achievement of the Bank's mission are risks to its credibility or reputation, its financial soundness and its operational capability. Risks are assessed with respect to the likelihood and potential scale of damage to the Bank's mission. Financial risks to the Bank's balance sheet arise from credit, market and liquidity risks; with operational risks resulting from weaknesses in business processes, systems or through staff or third-party activities, which may have an impact on the delivery of the key business functions or on the Bank's reputation.

The Monetary Policy Committee, Financial Policy Committee and Board of the Prudential Regulation Authority are responsible for making critical policy decisions, which the Bank implements. Policy implementation gives rise to financial and operational risks which are described below.

The Bank aspires to be at the forefront of research and analysis, and to deliver innovative and effective operations through the three year Strategic Plan, which is monitored by Court throughout the year.

Financial risk

The Bank is exposed to financial risk in the market operations it conducts to implement monetary and financial stability policies. Most of the assets on its balance sheet arise from this implementation; the main types of financial risk to which it is exposed are credit, market and liquidity risk.

Financial risk is managed through the Balance Sheet Remit from the Governor to the Executive Directors and Directors (principally the Executive Director, Markets), which governs the management of the Bank's balance sheet for both routine balance sheet activities and known/understood contingencies. It sets out the high-level purposes, responsibilities, constraints and associated delegated authorities with respect to those activities.

The Bank has a financial risk control framework which includes financial risk standards, a limits structure, and a suite of tools to manage the risks, including credit assessments, collateral eligibility assessments, haircuts, stress testing and liquidity criteria.

People and conduct risks

The Bank is committed to attracting and retaining people of the highest calibre and relevant experience, and aims to be fully and appropriately resourced. It seeks to mitigate the risk of the loss of key skills and experience through talent management, training, and motivating and developing staff to fulfil their potential.

The Bank holds its staff to the highest standards of ethics and conduct. Over the past year, the policies and rules that underpin these standards have been brought together in an enhanced Code (page 68). All employees will be required to attest on an annual basis to their familiarity with our Code, and their observance of it. To support this initiative, the Bank is establishing a central compliance function.

Operational risks

Operational risks include process and systems risks, as well as those arising from external events that would have an operational impact.

Information management and security risks

The Bank aims to have a highly secure environment which protects its people, data and systems and other assets from the impact of physical and cyber threats, with physical security, robust technology solutions, and security policies and incident management processes in place. The Bank has established processes in place for data integrity and compliance with legal requirements.

Process risks

The Bank has in place business processes to support development and delivery of policy. Processes are managed through control frameworks and independent review.

Crisis management and business continuity risks

The Bank aims to maintain the capability both to respond effectively to incidents that could affect its people, operations or credibility, and to rapidly invoke trained teams to handle such incidents. It gives priority to providing stable, high-availability systems to support its business-critical activities, in particular the provision of payment and settlement services, and critical banking services. Following the publication of the Independent Review into the RTGS outage on 20 October 2014 (page 36), the Bank is considering the contingency solutions and future technical strategy RTGS, and the need to strengthen the Bank's crisis management framework.

Systems availability is monitored and risks are mitigated through clear maintenance and change management processes. Crisis and business continuity management are focused on maintaining critical business activities and the systems which support them, and managed through defined maximum recovery times for key systems and established business continuity plans.

Outsourcing and procurement risks

The Bank uses third parties in some areas to assist delivery of its mission; this exposes it to risk from the poor performance or failure of those parties, and risk to its reputation through association should such a third party act in a way that is inconsistent with its standards. Risk management is a key consideration when engaging in outsourcing and procurement. For example, in delivering on the objective to meet demand for banknotes, the Bank outsources note printing and uses third parties to store, process and redistribute banknotes. There is a control framework to manage the integrity and availability of notes: third parties used are carefully vetted, and closely monitored through contractual arrangements and a rigorous compliance regime.

Exchange Equalisation Account

The Bank acts as agent for HM Treasury in managing the UK's foreign currency assets and gold reserves, and its foreign currency liabilities. These funds are not held on the Bank's balance sheet, but in HM Government's Exchange Equalisation Account (EEA).

The risks incurred in conducting this business are similar to those in relation to the Bank's own business, namely credit, market, liquidity and operational risk and the controls are applied and monitored alongside those applied in respect of Bank business. The management of the EEA is conducted within a framework agreed annually with HM Treasury, which is described in the EEA Report and Accounts published by HM Treasury. The Executive Director for Markets reports quarterly to HM Treasury on major risks, incidents and control issues on the EEA.

Corporate social responsibility

The Bank exists to promote the public good, as expressed in its Charter and governing legislation. Any profits it makes accrue to the public exchequer. But as a corporation it commands substantial resources, manages property in London and Essex, and has responsibility now for 3,868 staff from a wide range of backgrounds, as well as a multitude of suppliers and contractors. And within the Bank, decisions are taken that have a significant impact on the economy and the financial system. To maintain public support and trust, the Bank must be sensitive to the concerns and interests of its many stakeholders; must be representative of the community it serves, and must hold itself and all its staff to the very highest ethical standards. This section of the *Annual Report* describes how we endeavour to meet these responsibilities.

Ethical standards and 'Our Code'

Over the past year, partly in response to Lord Grabiner's Review (page 38), the policies and rules that underpin the Bank's standards on ethics and conduct have been brought together in an enhanced Code. 'Our Code' seeks to capture the essence of what it means to be in public service at the Bank. It applies to all employees and will be published on the Bank's website. 'Our Code' provides a statement about the behaviours our colleagues, counterparties, stakeholders and the public should expect from us. All employees will be required to attest on annual basis to their familiarity with our Code, and their observance of it.

'Our Code' and its associated policies are grouped by principle. These are drawn from the Nolan principles of public life, the values we established in the Strategic Plan, and the principles we require of others under the Senior Managers Regime.

They are:

1. Acting with integrity. Integrity underpins all that we do at the Bank. We want to ensure that the Bank is a place where people always do the right thing for the institution and our mission.
2. Creating an inclusive working environment. The Bank is an environment where difference is celebrated and discrimination or harassment never tolerated. It is a place where we all collaborate and support each other in working for the public good
3. Demonstrating impartiality. At the Bank, we act with impartiality. We want to be objective in our decision-making and decisive in our actions.
4. Being open and accountable. As unelected public servants, we recognise that democratic legitimacy is key to all that we do. And that requires us to be open and accountable for our actions and the resources we use.
5. Feeling empowered. We should feel empowered to hold each other to account. We believe that in all of our interactions with each other, with external stakeholders and with Parliament, we have an opportunity to enhance public trust in what we do and set the tone for the financial services industry we regulate. The Bank's 'Speak Up' policy allows our employees to raise any concerns that they may have.

To support this initiative, the Bank is establishing a central compliance function, which will work with management to embed the approach in terms of both understanding of, and compliance with, our Code. This function will sit within the Legal Directorate and will report to the General Counsel and independently to the Audit and Risk Committee, and through them to Court.

Top: Fine dexterity test used in the 1980s for recruiting banknote sorters at the Bank's Birmingham Branch.

Bottom: King George V and Queen Mary printing the first nomination war bond in what was then called the Printing Department, 18 December 1917.

Building understanding of the Bank's work

The Bank offers a wide range of resources and services to build awareness and understanding of its role and functions, and of central banking more generally. These include the work of its Museum, as well as its educational resources.

The Museum, which received more than 100,000 visitors over the course of the year, explains the Bank's history since its foundation in 1694 and its work today at the centre of the economy. The Museum held two temporary exhibitions in 2014, the first featuring some of the more unusual items from the Bank's extensive collection ('Curiosities from the vaults: a Bank miscellany'), and the second marking the centenary of WW1 ('The First World War and the Bank of England).

Educational resources on the role and functions of the Bank are available for all age groups. For young people, there is introductory material on money, prices and the economy. For older students there are more in depth resources, and the annual competition for secondary schools, Target 2.0, which is now in its fifteenth year. In 2014/15, 288 schools took part in Target 2.0. The competition continues to attract new schools and produce new finalists and winners.

Diversity

The Bank is committed to fostering an environment that promotes teamwork, fairness and trust. In particular, the Bank values diverse ideas and talent.[38] Diversity leads to better decisions. And an important part of this is making sure that the Bank reflects the diversity of the public that it serves.

Ten years ago 7% of the Bank's senior management were female; the proportion now is 26%. Targets have been set for both gender and ethnicity – for senior management the aim is to reach 35% female and 9% BAME (Black, Asian and minority ethnic). For management levels and below, the Bank aims for a 50:50 gender split and 15% BAME. The lower target at the senior management level reflects the starting point; an important part of the Bank's commitment to diversity involves developing the pipeline for future senior positions.

Since 2014, the representation of female employees and BAME employees has remained constant at 43% and 15% of the Bank's population respectively. However, there have been increases in representation at Director level and above (females increasing from 13% to 27% at end-February 2015); and BAME at senior manager and above have increased from 3% to 5% (with senior managers at 7%).

Representation on the graduate programme has also risen. For the 2014 graduate cohort, the proportion of female graduates rose just over nine percentage points to 37%, while BAME representation rose six percentage points, to 23%.

The Bank is committed to fostering an environment that promotes teamwork, fairness and trust

38 Diversity statistics in this section are based on a headcount number exclusive of Non-executive Directors and contingent workers.

The representation of staff with a declared disability is 1.9% (compared with 1.3% last year).

Flexible working is encouraged and the Bank's working practices include many different working patterns at all levels of the organisation. Currently the number of staff working part time is 11%.

The percentage of staff who declare as Lesbian, Gay, Bisexual and/or Transgender (LGBT) is disclosed as 2.0% (compared with 1.7% last year). Those declaring their religion or beliefs is currently 21% (up from 19% last year). The Bank is working to encourage disclosure of these protected characteristics.

The Bank's employee networks are widely supported.[39] Membership numbers have increased, as has participation in network speaker events and development events. The Women In the Bank and Bank of England Ethnic Minority networks have mentoring schemes open to all staff that have provided guidance on areas such as confidence building and career management. Among the inspirational speakers hosted by our employee networks, the Bank has been delighted to welcome Muhammad Yunus, past winner of the Nobel Peace Prize, the leading headteacher, Sir William Atkinson, and Dame Fiona Woolf, Mayor of the City of London 2013–14. These events are open to all employees of the Bank.

The BEEM network is sponsoring the launch of a pilot scholarship programme for three African/Afro Caribbean students starting university in 2015. The scholarship aims to reduce financial barriers to higher education, encourage higher levels of achievement at university, and encourage greater diversity within the Bank. The scholarships cover living expenses, and include paid internships at the Bank during the summer as well as mentoring from Bank staff. The successful students were selected in April 2015, following a competitive selection process for which over 3,700 applications were received.

In addition to the three scholars, two students have been offered bursaries and a further seven have been offered a Summer internship

The Bank has partnerships with many diversity-focused organisations, including: Business in the Community, which encompasses Race for Opportunity and Opportunity Now; Stonewall; The Employers' Network for Equality and Inclusion; the Business Disability Forum and Working Families. These memberships allow the Bank to ensure policies and procedures take account of best practice, and the Bank benchmarks to industry standards on a regular basis. This year the Bank has added membership to OUTstanding, a not-for-profit professional network for LGBT executives.

Health and safety

The Bank manages health, safety and risk as a priority. Through its safety management system the Bank delivers a safe working environment and promotes and maintains a positive health and safety culture. Health and safety issues and incidents are monitored by the Bank's Safety, Health and Environment (SHE) Committee which reports annually to Court.

The environment

In addition to health and safety, the SHE Committee monitors the impact of the Bank's operations on the environment. By managing waste production/disposal and reducing energy usage through better power efficiency, the Bank is able to minimise its impact on the environment.

The Carbon Reduction Commitment (CRC) is a mandatory scheme aimed at improving energy efficiency and cutting emissions in large public and private sector organisations. The scheme features a range of reputational and financial drivers to encourage organisations to develop energy management strategies. The Bank is required to declare carbon emissions and to purchase allowances equivalent to those emissions.

39 Women in the Bank (WIB); Bank of England Ethnic Minorities (BEEM); Mental Health Network (MHN); Disability network; Lesbian, Gay, Bisexual and Transgender network (LGBT); Muslim network; Jewish network and Christian Union.

The Bank submits an annual report to the Environment Agency which administers the scheme, stating its usage figures for both gas and electricity in KWH. Utilising conversion factors supplied by the CRC, the readings for both gas and electricity are converted into Carbon Dioxide emissions in tonnes (tCO_2). The CRC levies a charge against a participant based on the number of tonnes produced.

Figures for CO_2 emissions declared via the CRC scheme for 2013/14 were 23,425 tCO_2, 300 tonnes less than the previous year, a further reduction of 784 tCO_2 was realised in 2014/15 following a number of energy saving initiatives. The continued reduction in energy consumption also saw a further reduction in the displayed energy certificate rating.

More than 98%, or 1,285 tonnes, of waste generated by the Bank is recycled or reused. Over a third of this waste is utilised in the production of power through the burning of the waste material at an award winning 'Energy from Waste' facility. The Bank's main publications, including this *Annual Report*, are available online: to the extent that they are printed, the paper contains 75% post-consumer recycled fibre and 25% virgin fibre sourced from well-managed, responsible, Forestry Stewardship Council® (FSC) certified forests, and is certified as a FSC® mixed sources product.

Suppliers and contractors

The Bank's supply chain is key to achieving its mission. The Bank works closely with suppliers to ensure the its values are embedded within the supply chain. All the Bank's Central London suppliers, providing catering, cleaning and other onsite services, have moved to the London Living Wage and the Bank expects to become accredited by end of 2015. The Bank uses corporate social responsibility within its pre-qualification process to ensure that it is integral to its requirements where appropriate. The Bank challenges its supply chain in our tenders on how they dispose and recycle their waste streams and their assessment of their carbon footprint.

The Bank follows the Public Procurement Regulations to drive value and ensure that its spend is subject to competition. Through the tendering portal the Bank is fully accountable and auditable for the decisions and selections made. The Bank has engaged well with small and medium enterprises (SMEs) and prides itself on taking time to provide feedback, especially to SMEs. Recent comment from the Bank's largest tender (the replacement banknote contract) showed all participants respected the rigour and discipline shown by the Bank throughout the long and detailed process.

The procurement team has received strong feedback, even from losing participants, on the quality of the engagement.

The Bank is an approved signatory to the Prompt Payment Code. Standard payment terms are 30 days, but the Bank aims to pay invoices as quickly as possible. Measured in terms of the number of working days between receipt of an invoice and payment by the Bank, average trade creditor payments days were estimated to be 12.89 in 2014/15 (2013/14: 12.94). The average number of invoices processed per month in 2014/15 was 1,742 (2013/14: 1,815)

More than 98%, or 1,285 tonnes, of waste generated by the Bank is recycled or reused

Political and charitable donations; and Community Affairs

No donation was made for any political purpose in 2014/15 (2013/14: nil). No paid leave was granted to staff for political purposes in 2014/15 (2013/14: nil).

During 2014/15, the Bank continued to play an active role in the community. Bank staff responded positively to opportunities for taking part in community projects. During this period, the Bank had a very high level of Bank staff taking part in some form of community activity. These ranged from a variety of fundraising initiatives to staff holding trusteeships, becoming school/college governors, scout and guide leaders, mentors, and undertaking commitments such as being a Samaritan or a Special Constable. Bank staff chose Guide Dogs for the Blind and the Refuge as their charities of the year raising over £59,000 through various fundraising activities from quiz nights to auctions. Staff also hosted work experience placements for 126 students, and over 600 students from various state schools attended employability workshops.

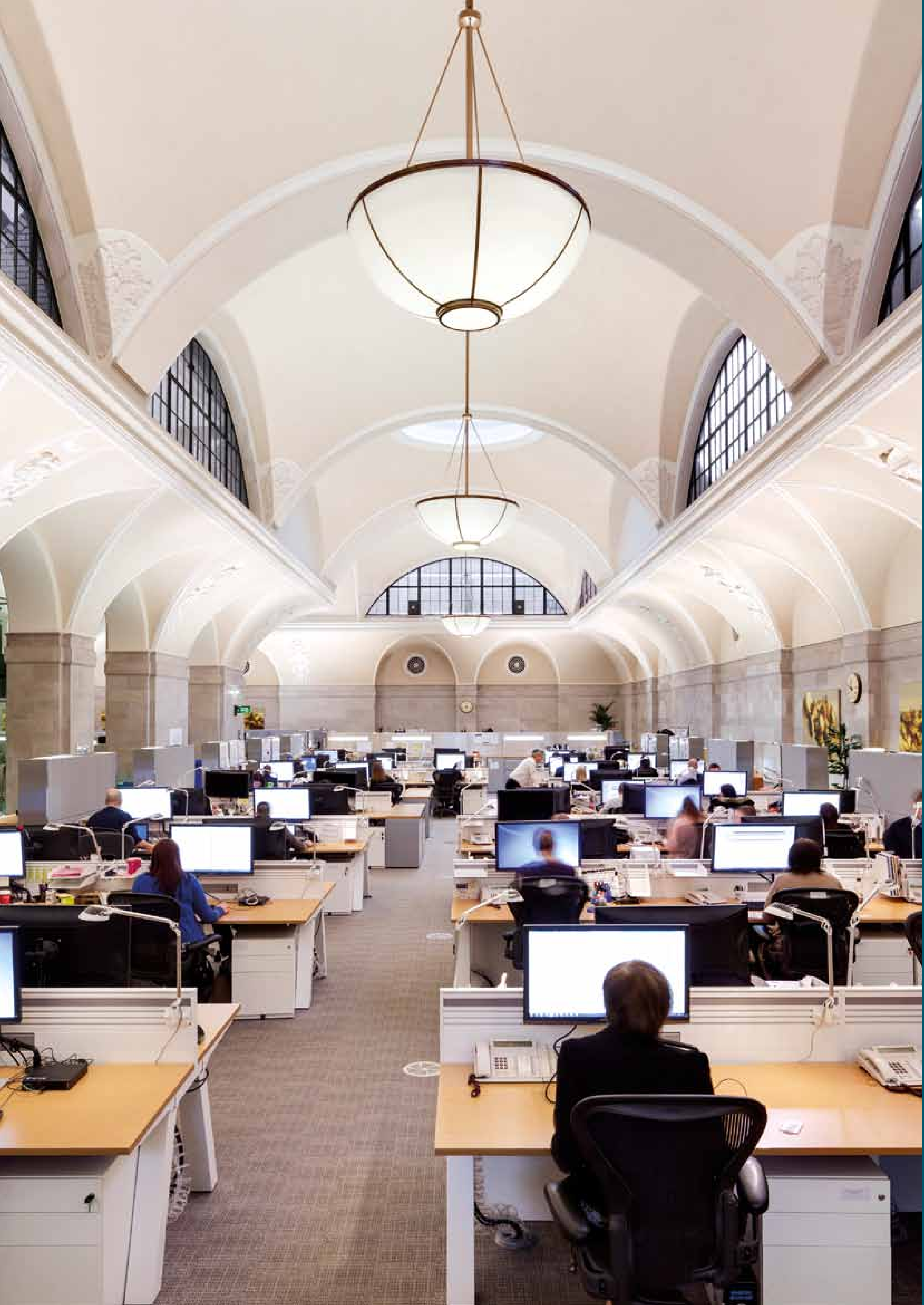
During 2014/15, the Bank contributed an estimated total of £832,000 in support of its community programme (2013/14: £824,000).

Cash donations totalled £489,000 (2013/14: £485,000), including:

- £120,000 to community organisations via the Staff Volunteering Award Scheme;
- £60,000 to charities supported by the Bank's regional Agencies;
- £35,000 to match record staff fundraising for the staff charities of the year;
- £40,000 matched funding under the Payroll Giving Scheme;
- £15,000 via the Bank of England Court Awards through which donations are made to community organisations in recognition of outstanding volunteering contributions by members of staff;
- £94,000 made to partner charitable organisations and membership subscriptions;
- £10,000 for the David Sharp School Governor Awards; and
- £115,000 in donations to support academic research (2013/14: £112,000).

The Bank may grant staff paid leave to perform voluntary duties in the community, or to undertake public and civic duties. The Bank estimates the total value of non-cash community contribution, including time spent by staff on community involvement, travel costs for volunteers and the costs of hosting charitable events at the Bank, to be £343,000 in 2014/15 (2013/14: £339,000), of which £139,000 was for staff time involved in volunteering and taking civic duties and volunteering leave.

During 2014/15 the Bank contributed an estimated total of £832,000 in support of its community programme



Report of the Remuneration Committee

The Remuneration Committee (RemCo) advises Court and its Oversight Committee on the remuneration of the Governors, other senior executives and the external members of the MPC, the FPC and the PRA Board.

The Committee also advises on major changes to remuneration structures within the Bank, including pension schemes.

Remuneration policy

The Committee's policy is to set pay, benefits and other conditions of service that are appropriate to the Bank's needs. The Committee takes account of external salary comparisons insofar as these might affect the availability of good candidates for senior roles in the Bank, while bearing in mind the Bank's position within the public sector.

Where relevant, the Committee makes use of external advisers to benchmark individual roles and pay across the Bank as a whole.

The Governor is appointed by the Crown for a non-renewable term of eight years,[40] and Deputy Governors are each appointed by the Crown for five-year terms, which may be renewed once. The Governors have no termination provisions, although RemCo has discretion to impose a period of restricted duties, of up to six months before individuals can accept roles outside the Bank. The policy is in line with changes recently agreed for Executive Directors.

Under the Bank of England Act 1998, Governors and Deputy Governors are required to provide remunerated services only to the Bank. With Court's approval other directorships relevant to the Bank's work may be accepted, but any fees must be surrendered to the Bank. The only such directorships held during the past year have been the appointment to the Financial Conduct Authority Board held by Mr Bailey, and the membership of the Board of the Bank for International Settlements held by Mr Carney.

Since 2007, any new Governor or Deputy Governor has been enrolled into the Career Average section of the Bank Pension Fund, but when relevant tax limits are reached they may opt out and receive a salary supplement of 30% in lieu. Sir Charles Bean, who retired as Deputy Governor in June 2014, was a member of the Court section of the pension scheme, which allowed members to achieve a maximum pension of two thirds of salary at a normal pension age of 60 after 20 years of service. A part of this was provided in Mr Bean's case by an unfunded scheme, set up for executives who were subject to the pension earnings cap introduced in the Finance Act 1989. Provision for these unfunded benefits is made in the Bank's financial statements. The Court section is now closed and Court decided in 2005 to make no further unfunded commitments to members.

Governors and Deputy Governors receive no bonuses or other performance-related pay. It is the Bank's policy to provide for relocation support as necessary to those appointed to senior positions. Such support was provided to Mr Carney in 2013,[41] and to Kristin Forbes, who joined the MPC in 2014.

40 The present Governor has indicated that he would serve five years.

41 *2014 Annual Report*, page 50.

Remuneration levels

The salaries of the Governor and the Deputy Governors are reviewed each year.

The remuneration arrangements for the present Governor were agreed and announced in January 2013, and were set out in the *Annual Report* 2013. The Governor's salary was set at £480,000p.a., with membership of the Bank's career average pension scheme or 30% of salary in lieu. The Governor declined pay increases of 2% in 2014 and 1.5% in 2015.

The salaries of the Deputy Governors, which had been frozen from 2010 to 2013, were increased by 2% in March 2014, and by 1.5% in March 2015. Sir Jon Cunliffe and Mr Bailey both receive 30% of salary in lieu of pension accrual; Mr Carney and Mr Broadbent are both members of the Career Average section. Ms Minouche Shafik (Deputy Governor Markets and Banking) and Ms Charlotte Hogg (Chief Operating Officer), although not members of Court, are paid at the same rates as the Deputy Governors appointed under statute. Both are members of the Career Average section.

Taxable benefits

The Remuneration Committee also keeps under review other benefits available to the Governors. Mr Carney receives, as was announced on his appointment, an annual accommodation allowance of £250,000p.a., to reflect the additional cost of living in London rather than in Ottawa. Medical insurances and health checks were the principal other non-salary benefits received by Governors during the year to 28 February 2015.

£	Mr M J Carney 2014/15	Mr M J Carney 2013/14	Lord King 2014/15	Lord King 2013/14	Mr A J Bailey 2014/15	Mr A J Bailey 2013/14	Sir Charles Bean 2014/15	Sir Charles Bean 2013/14
Base salary	480,000	320,000	–	178,131	263,986	253,127	153,992	258,809
Fees	–	–	–	–	–	–	–	–
Salary and fees	**480,000**	**320,000**	**–**	**178,131**	**263,986**	**253,127**	**153,992**	**258,809**
Taxable benefits	**251,633**	**167,680**	**–**	**36,890**	**2,791**	**11,356**	**1,250**	**1,670**
Pension benefits	148,140	98,330	–	–	–	–	–	116,630
Payment in lieu of pension	–	–	–	–	79,196	75,938	–	–
Pension benefits	**148,140**	**98,330**	**–**	**–**	**79,196**	**75,938**	**–**	**116,630**
Total remuneration	**879,773**	**586,010**	**–**	**215,021**	**345,973**	**340,421**	**155,242**	**377,109**

£	Sir Jon Cunliffe 2014/15	Sir Jon Cunliffe 2013/14	Sir Paul Tucker 2014/15	Sir Paul Tucker 2013/14	Mr B Broadbent 2014/15	Mr B Broadbent 2013/14	Ms N Shafik 2014/15	Ms N Shafik 2013/14
Base salary	263,986	86,270	–	228,615	175,991	–	153,992	–
Fees	–	–	–	–	–	–	–	–
Salary and fees	**263,986**	**86,270**	**–**	**228,615**	**175,991**	**–**	**153,992**	**–**
Taxable benefits	**1,320**	**584**	**–**	**5,616**	**709**	**–**	**709**	**–**
Pension benefits	–	–	–	–	54,080	–	47,180	–
Payment in lieu of pension	79,196	25,681	–	–	–	–	–	–
Pension benefits	**79,196**	**25,681**	**–**	**–**	**54,080**	**–**	**47,180**	**–**
Total remuneration	**344,502**	**112,535**	**–**	**234,231**	**230,780**	**–**	**201,881**	**–**

£	Ms C Hogg 2014/15	Ms C Hogg 2013/14	Non-executive Directors 2014/15	Non-executive Directors 2013/14
Base salary	263,986	162,585	–	–
Fees	–	–	162,833	150,000
Salary and fees	**263,986**	**162,585**	**162,833**	**150,000**
Taxable benefits	**179**	**–**	**13,655**	**31,967***
Pension benefits	74,330	–	–	–
Payment in lieu of pension	6,600	51,762	–	–
Pension benefits	**80,930**	**51,762**	**–**	**–**
Total remuneration	**345,095**	**214,347**	**176,488**	**181,967**

* During the year it was identified that certain taxable expenses had been classified as business expenses, and therefore not disclosed in the Remuneration table. This has required restatement of prior year Non-executive Directors expenses from £15,458 to £31,967, which are stated gross of relevant tax liabilities.

	Accrued pension as at 28 Feb 15 £p.a.	Accrued pension as at 28 Feb 14 £p.a.	Increase in accrued pension £p.a.	Pensionable age
Mr M J Carney	12,500	4,900	7,600	65
Sir C Bean	122,300	119,200	3,100	60
Mr B Broadbent	2,700	–	2,700	65
Ms N Shafik	2,400	–	2,400	65
Ms C Hogg	3,700	–	3,700	65

Remuneration of Non-executive Directors

The Bank of England Act 1998 provides for the remuneration of the Non-executive Directors to be determined by the Bank with the approval of the Chancellor of the Exchequer. With effect from 1 June 2009, these rates were set at £15,000p.a. for Directors, £20,000p.a. for Committee Chairmen, and £25,000p.a. for the Senior Independent Director and Deputy Chairman. The Chairman of Court is paid £48,000p.a. Non-executive Directors do not receive any post-retirement or medical benefits from the Bank, or any additional fees for serving on Committees. The Bank meets appropriate travel and subsistence expenses.

External members of the FPC, the MPC, and the PRA Board

The terms and conditions of service of the external members of the FPC and the MPC appointed by the Chancellor of the Exchequer, and of the PRA Board members appointed by Court, are determined by the Oversight Committee. All are appointed for terms of three years on a part-time basis, and must not during their term of office retain or accept other appointments or interests that would create a conflict with their responsibilities at the Bank.

In 2014/15, the external members of the FPC were each paid at a rate of £90,968p.a.; the rate for the MPC external members was £135,751p.a. and for the independent members of the PRA Board was £102,326p.a. The differences reflect the time commitments involved for the members of each of these committees, which the Remuneration Committee keeps under review. For 2015/16, these fees were increased by 1.5%.

On leaving the Bank, members of the three policy committees are paid their fee for a further period of three months, during which time the Bank has the right to veto any employment that would conflict with their former FPC, MPC or PRA responsibilities, and to require continued adherence to the relevant Committee's code of conduct.

Integration of Bank/FSA remuneration schemes

During the year RemCo monitored, on behalf of Court, the development of the Bank's proposals for integrating the pay and pension arrangements of staff on Bank and FSA contracts: the arrangements and the components of the compensation scheme differed significantly across the Bank. The main elements were a new set of pay bands, a fixed benefits allowance of 7% for all; and a flexible defined benefit pension scheme in which staff could choose, within limits, to exchange pension accrual for income and *vice versa*. The new arrangements covered Executive Directors and below, but not the Governors or the external Committee members. The objective was a scheme that would attract and retain a mix of talent at all career stages, be cost effective and provide value for money, and would reinforce the 'One Bank' culture. In the reforms, the Bank Final Salary scheme, which had been closed to new entrants since 2007, was closed to future accrual; former members were placed at the highest level of the reformed Career Average section. Former FSA staff, who were members of a DC scheme, also joined the Career Average section. Following a consultation with staff and the Union, the Committee agreed the final terms of the Bank's offer in October, and these were accepted by 100% of staff in December 2014.

Executive Directors' salaries and benefits

The table below shows, for Executive Directors serving at the end of 2014/15, the total remuneration for the year including pension and benefit allowances.

£ Year to 28 February 2015	Salary	Pension	Payment in lieu of pension	Benefits	Total
Megan Butler*	207,150	29,287	–	20,400	256,837
Ralph Coates	198,900	45,771	14,918	14,813	274,402
John Finch	207,060	32,611	30,318	15,399	285,388
Paul Fisher	180,285	–	49,578	13,476	243,339
John Footman	187,295	–	–	13,980	201,275
Andrew Gracie	171,360	52,338	–	12,836	236,534
Andy Haldane	180,285	21,866	–	13,476	215,627
Lyndon Nelson*	212,250	–	25,470	20,591	258,311
Graham Nicholson	184,792	–	55,438	13,799	254,029
Joanna Place	162,180	16,680	–	12,177	191,037
David Rule*	207,150	29,527	–	20,400	257,077
Chris Salmon	180,285	–	49,578	13,476	243,339
Jenny Scott#	124,240	30,802	–	8,329	163,371

* Denotes EDs remaining on FSA terms until 1 April 2015. Staff on FSA terms received performance awards from a pool equal to 15% of salary (against 6% for those on Bank terms); and a contribution to a DC pension scheme. Staff on Bank terms were entitled to a defined benefit pension; the value of the Bank contribution is calculated as the real increase in pension at retirement age times 20. Where pension contribution is declined for tax reasons, a 30% payment in lieu is made (12% for FSA terms). From 1 April 2015, all staff will have had a flexible defined benefit pension, and performance awards will be paid from a 10% pool.

Jenny Scott works part time.

Other Senior Executives' salaries and benefits

The following table shows remuneration ranges for the year to February 2015 for all staff below Executive Director level with remuneration in excess of £80,000p.a. on a full-time equivalent basis, excluding employer pension contributions and performance awards.

Remuneration range £	Number of staff
240,000–249,999	1
230,000–239,999	1
220,000–229,999	–
210,000–219,999	1
200,000–209,999	3
190,000–199,999	4
180,000–189,999	12
170,000–179,999	11
160,000–169,999	22
150,000–159,999	22
140,000–149,999	43
130,000–139,999	43
120,000–129,999	45
110,000–119,999	71
100,000–109,999	94
90,000–99,999	150
80,000–89,999	185
Total	**708**

John Stewart
Chairman of Remuneration Committee

Report of the Oversight Committee

The Oversight Committee consists of the Bank's Non-executive Directors. Under Section 3A of the Bank of England Act 1998, the Committee is responsible for monitoring the Bank's performance against its objectives – that is, the statutory objectives for monetary policy and financial stability (including the responsibilities of the FPC), and objectives set by Court itself.

It also keeps under review the achievement of the Bank's financial management objectives, the Bank's internal controls, and the procedures of the MPC and the FPC. It is required to make this Report, on the matters for which it is responsible. The review of 2014/15 (page 16), the financial review (page 54), the report on risk management and business practices (page 62), the corporate social responsibility report (page 68), the report of the Remuneration Committee (page 74) and the report of the Audit and Risk Committee (page 89) should, insofar as they relate to the Committee's responsibilities, be regarded as part of the Committee's Report.

Members of the Oversight Committee may attend meetings of the MPC, the PRA Board and the FPC, and have access to their briefing papers. The Committee may commission external reviews to inform its work, though these must be retrospective and not related to current policy. Subject to any confidentiality restrictions, they must be published. The Committee also monitors on behalf of Court the performance of the PRA.

So far as possible the Committee conducts its business in Court meetings with the executive members normally present (though they withdraw when appropriate). The non-executive members meet separately, as a matter of practice, after each Court meeting.

Independent Evaluation Office

The Independent Evaluation Office (IEO), which formally came into being in September 2014, supports the Oversight Committee in discharging its statutory obligations to keep the performance of the Bank under review. The IEO, created as part of the Bank's 2014 Strategic Plan, aims to build public trust in the Bank and to embed the institution's culture of learning. It operates at arm's length from the business areas and is staffed by a small, permanent secretariat. The Independent Evaluation Director, Lea Paterson, reports directly to the Chairman of Court.

The IEO undertakes one-off assessments as well as regular reporting to Court on the performance of the Bank's policy areas and strategy. In its analysis, the IEO focuses on the inputs, infrastructure and outputs of the Bank's three policy committees (the Monetary Policy Committee, Financial Policy Committee and Prudential Regulation Authority Board). It assists Court in overseeing other key aspects of the Bank's performance. And it also supports, where appropriate, external reviews of the Bank, for example, the Warsh Review of transparency and monetary policy (page 20).

The Oversight Committee is responsible for monitoring the Bank's performance against its objectives

MPC and FPC procedures and accountability

During the year, the MPC's processes and transparency were reviewed by Governor Warsh. Governor Warsh's Report, and the Bank's response, are summarised on pages 20 and 51.

As in previous years, the Oversight Committee reviewed the MPC's processes and the Chairman interviewed all MPC members individually. In general, the MPC's assessment of staff support was very positive, though satisfaction with the quarterly forecast round had fallen a little relative to last year. Staff were taking forward a number of initiatives to address this, such as improved interaction with MPC members ahead of each forecast round.

A similar review of the FPC's processes was also conducted. As part of that, the Oversight Committee reviewed the FPC Code of Conduct. The Committee approved proposals to amend the communications section of the FPC Code of Conduct to make clear that the requirement to reach decisions by consensus wherever possible stemmed from legislation and not the Code; and to set out what was expected of FPC members in each of the range of possible decision-making outcomes.

Foreign exchange market review

As noted in last year's Report, against the background of the Financial Conduct Authority's investigation of the foreign exchange market and a preliminary review of Bank records, the Committee appointed Lord Grabiner QC to lead an investigation to determine whether any Bank official had been involved in, had colluded in, was aware of, or was aware of the potential for, manipulation of the foreign exchange market, the sharing of confidential client information, or any other unlawful or improper behaviour or practice. Lord Grabiner's report was published in November 2014.

The key findings of Lord Grabiner's report were:

– There was no evidence that any Bank of England official was involved in any unlawful or improper behaviour in the foreign exchange market.
– Subject to the issues described below, there was no evidence that any official was aware or should have been aware of any unlawful or improper behaviour in the foreign exchange market.
– One Bank official was aware that bank traders were sharing aggregated information about client orders for the purpose of 'matching' – a practice that is not necessarily improper, but can increase the potential for improper conduct – and was uncomfortable with the practice in that it could involve collusive behaviour and lead to market participants being disadvantaged. Notwithstanding those concerns, the Bank official did not escalate the matter to an appropriate person. This constituted an error in judgement that deserved criticism, but such criticism should be limited in that the individual was not acting in bad faith, nor was the individual involved in any unlawful or improper behaviour, nor aware of specific instances of such behaviour.
– After careful consideration of whether his supervisors should also be criticised, it was concluded that there was no evidence that they were aware of the issue nor that they should have been aware as it was neither escalated to them nor raised in market intelligence reports.

Lord Grabiner was asked by the Oversight Committee to put forward any recommendations that he felt necessary to improve processes and procedures at the Bank.

He made three recommendations:

- Documentation: It was recommended that the Bank reviews whether the steps it has taken through changes to its record management policy will ensure that sufficient minutes will be taken and distributed of meetings, such as those of the Chief Dealers' subgroup.
- Education: It was recommended that any Bank official working in connection with the foreign exchange market should receive continuing training in the non-investment products (NIPs) code – a voluntary code of conduct for principals and broking firms in the wholesale markets, or if the Government decides to regulate the foreign exchange market, the relevant regulations.
- Clarity over systems and controls around the Bank's market intelligence role: The Bank should more clearly explain to market participants its market intelligence role and how it uses intelligence gathered from the market; should set out a formal written policy clearly stating that market intelligence cannot be used for trading purposes, and should also provide staff with regular training on that policy; should review its controls around market intelligence being, intentionally or not, passed to other market participants; should regularly review its escalation policy; and should ensure that Bank officials with market intelligence roles are given training about improper conduct.

The Bank's response to these recommendations was discussed in Court and published in February 2015, and the changes being made are summarised on page 38 of this Report. The Oversight Committee supports these initiatives and will continue to monitor their implementation.

Liquidity auctions review

Lord Grabiner undertook a further review for the Committee, into the conduct of some of the Bank's liquidity auctions during the financial crisis of 2007–08. He reported in November 2014, and on his recommendation the matter was referred to the Serious Fraud Office.

RTGS review

Following the RTGS outage in October 2014, Court appointed Deloitte to undertake a review of the causes of the incident, to evaluate the robustness of the system, and its governance, and to assess the effectiveness of the Bank's response and of its incident management and back-up arrangements. Deloitte's report was published in March and the Bank's response, also published, was agreed with Court (see page 36).

Evaluation of forecasting performance

At the request of the Oversight Committee, the Bank's IEO has put a work programme in train aimed at providing Court with a better basis for evaluating the Bank's forecasting performance. This work programme will provide benchmarks for both MPC and FPC relevant forecast variables, including tests for bias, as well as comparisons with the forecast performance of other institutions.

Lord Grabiner was asked by the Oversight Committee to put forward any recommendations that he felt necessary to improve processes and procedures at the Bank

Evaluation of the PRA's approach to competition

The Financial Services (Banking Reform) Act 2013 gave the PRA a secondary objective to facilitate effective competition in the markets in which PRA-regulated firms operate. This objective, recommended by the Parliamentary Commission on Banking Standards (PCBS), came into force on 1 March 2014. It is defined as follows: 'When discharging its general functions in a way that advances its objectives, the PRA must so far as is reasonably possible act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities'.[42]

At the request of the Committee, the Bank's IEO will be monitoring the PRA's approach to this new objective. In particular, the IEO has been asked to facilitate Court oversight of the strategy adopted by the PRA.

Sterling Monetary Framework

Court has responsibility for approving the objectives of the Sterling Monetary Framework (SMF), which is the Bank's framework both for implementing monetary policy, and for providing liquidity insurance to financial institutions. It also is responsible for approving any amendment to that framework that raises the risk exposure of the Bank.

The governance of the SMF was substantially reformed following the Winters Review in 2012,[43] and the performance of the SMF is now reviewed annually by Court. The governance of the SMF has been further enhanced over the past year: key decisions around SMF strategy are now discussed among the Governors in the first instance, and Court's oversight of the annual review process has been strengthened through the involvement of the IEO.

Court discussed and approved the 2014/15 SMF Annual Report (page 32) and the 2015/16 SMF objectives at its April Court meeting.

Readiness to provide Emergency Liquidity Assistance

As well as overseeing the Bank's regular liquidity operations, Court also has oversight of its readiness to provide Emergency Liquidity Assistance (ELA) to institutions which are not eligible to receive liquidity support through the SMF. Following the 2012 Plenderleith Review,[44] Court reviews the Bank's readiness to provide ELA on an annual basis (page 34).

At its April 2015 meeting, Court discussed and endorsed the improvements to the Bank's capability to extend ELA that were implemented during the year. The discussion covered both the Bank's response to live contingency situations and its business as usual activities, including testing, to ensure that the Bank's ELA capability remained high. Court noted the progress that had been made over the past twelve months in building effective working relationships between the Markets and Banking Directorate, the Resolution Directorate and the PRA supervisors.

42 The 'objectives' referred to here are the PRA's general objective to promote the safety and soundness of its regulated firms, and its insurance objective to protect policyholders.

43 www.bankofengland.co.uk/publications/Documents/news/2012/cr2winters.pdf

44 www.bankofengland.co.uk/publications/Documents/news/2012/cr1plenderleith.pdf

Finance and Value for Money

The Value for Money initiative undertaken in late 2013 and early 2014 has delivered to plan, providing savings of £12 million in 2014/15 and an anticipated £19 million per annum thereafter, but for a reduced investment cost of £7 million (previously estimated at £18 million). As intended, savings have been reinvested into key strategic initiatives, including the Research Hub, the data initiative and much needed enhancements to information and infrastructure security.

Court effectiveness

The Chairman of Court undertook a review of the effectiveness of Court and its sub-committees during the year. The review was based on targeted questionnaires and individual meetings with Court members, and was discussed at April 2015 Court. Court and its sub-committees were generally seen to be working well. Three main areas were identified for improvement: talent management and succession planning; the measurement of the Bank's performance against objectives; and risk management practices.

The Bank has already made progress in these areas in the recent past, for example in its approach to risk management (page 62) and in talent management and succession planning (page 45), which are now regularly discussed in Court agenda. Measurement of performance against objectives is progressing with the continued implementation of the Strategic Plan.

£12m

The Value for Money initiative has provided savings of £12 million in 2014/15

Attendance	Court (9)	Oversight (10)	Audit and Risk (7)	Remuneration (9)	Nominations (3)
Mr Habgood (appointed 1.7.14)	5 of 5	5 of 5 (observed additional 3)	4 of 4 (attends as an observer)	4 of 5	2 of 2
Sir David Lees (resigned 30.6.14)	4 of 4	5 of 5	3 of 3	4 of 4	1 of 1
Sir Roger Carr (resigned 31.5.14)	2 of 4	2 of 4	–	4 of 4	1 of 1
Lady Rice (resigned 31.5.14)	4 of 4	4 of 4	3 of 3	–	1 of 1
Mr Stewart	8	9	5	6	2 of 2
Mr Cohrs	9	10	–	8	–
Mr Fried	8	9	7	–	1
Mr Frost	9	10	7	–	–
Mr Prentis	6	8	–	5	–
Baroness Harding (appointed 1.8.14)	4 of 4	4 of 4	–	2 of 3	–
Mr Robert (appointed 1.8.14)	2 of 4	2 of 4	2 of 3	–	–
Ms Thompson (appointed 1.8.14)	4 of 4	4 of 4	–	–	–
Mr Carney (appointed 1.7.13)	8	–	–	–	1
Mr Bean (resigned 30.6.14)	4 of 4	–	–	–	–
Mr Bailey	8	–	–	–	–
Sir Jon Cunliffe	8	–	–	–	–
Mr Broadbent (appointed 1.7.14)	4 of 5	–	–	–	–

Report of the Audit and Risk Committee (ARCo)

Court monitors the Bank's risks and controls, mainly through the Audit and Risk Committee (ARCo). ARCo consists of four non-executive members of Court, with wide experience of company board practice and risk control, and the Chairman of Court normally also attends by invitation.

It met six times during the year, and in addition to its scheduled meetings, held private meetings with the Governor and Deputy Governors, the Chief Operating Officer, and internal and external auditors. Non-executive members of the PRA Board have joined ARCo so that the Committee's coverage extends to the entire Bank.

Risk Management Framework

During the year, ARCo oversaw the first phase of a review of the Bank's risk management arrangements, in particular relating to financial risks. The review benefited from an independent benchmarking of the Bank's risk management practices compared with those in commercial and other central banks, undertaken by consultants.

As a result of this work, the Bank is establishing an Executive Risk Committee (ERC), responsible for the operation of its risk governance framework including monitoring its overall risk profile; it will be supported by an enhanced central risk function, reporting to the Finance Director, and providing regular reports to ARCo. The management of the Bank's financial risks specifically, risk management responsibilities within the Markets and Banking area will be reorganised and the structure of the committees that support risk management in the Bank's market operations will be reformed.

Risk and control processes

In addition to its review of the Bank's risk management arrangements and as part of its oversight of the Bank's risk and control processes, the Committee also:

– received and discussed regular updates and reports from the Bank's Chief Operating Officer summarising major operational issues and control-related and risk issues relating to strategic and other key Bank initiatives. Areas of focus in 2014/15 included: the Value for Money savings programme; the transfer of staff to the new organisational structure; changes to the Bank's cost structure; the standardisation of pay and remuneration for different groups of Bank staff; and proposals for setting up a compliance function for key policies;

– reviewed Quarterly Risk Reports from the Finance Director covering the main strategic, operational and financial risks to the Bank (including the PRA), including a forward-looking consideration of risks. During 2014/15 the Committee discussed risks including those relating to PRA resourcing and the implementation of PRA regulatory change projects such as Solvency II. ARCo also considered the actions being taken by management to bring risks within tolerance.

– received and considered regular reports from the Executive Director, Markets on developments relating to the Bank's balance sheet, including a financial risk review, and sought assurance that the financial risks to the Bank's balance sheet were being managed effectively;

– reviewed with responsible executives risks in individual Directorates, including within the PRA Directorates, and provided feedback to the Directors;

– received regular reports on the management of current significant projects and related controls. In 2014/15 these included the bank-note procurement and design projects; major collateral projects; and the Information Security programme;

- received regular updates from the Executive Director for IT and from Information Security on work-streams and projects relating to information technology, and systems resilience and security;
- assessed reports from the internal and external auditors to ensure that necessary standards of risk management were being applied and that appropriate action was being taken in relation to significant incidents. This included the Deloitte's review following the RTGS outage; and
- reviewed aspects of business practice risk, including the counterfeit threat to the Bank's note issue; implementing the recommendations from the records management review; the Bank's insurance arrangements; business continuity; Freedom of Information (FoI) requests received by the Bank; Health and Safety; and pension administration and payroll outsourcing arrangements.

Transparency of Financial Statements

ARCo keeps under review the Bank's accounting practices. During the year the Committee considered the justification for limiting the detail shown in the Bank's published accounts. The Bank of England Act 1998 permits the Bank, in drawing up its published accounts, to disregard a requirement corresponding to the relevant Companies Act requirement to the extent that it considers it necessary to do so, having regard to its financial stability objective; and this has enabled the Bank to avoid disclosing financial assistance given to institutions, in part by limiting the amount of detail given in the income statement. The Committee noted that the benefits of this approach were limited, and the Bank stood out among central banks in the brevity of its reporting. Accordingly a more detailed presentation was agreed and subsequently endorsed by Court.

Integrity of financial reporting

In terms of discharging its responsibilities in relation to the Bank's financial statements, ARCo:

- reviewed the accounting policies and practices adopted in the preparation of the Bank's annual financial statements;
- reviewed the annual financial statements for the Bank and PRA before their submission to Court at its May 2015 meeting. Supporting these, the Annual Risk Control attestations were also provided to the Committee; and
- reviewed reports from the Finance Director, including regular accounting updates, an annual report on taxation and a review of Bank cost allocations.

External auditors

In relation to the external auditors, ARCo:

- received and discussed regular updates from KPMG, the Bank's external auditors, and from the NAO, the PRA's external auditors. These included the nature and scope of the external audit plans for the Bank and PRA and a review of the findings of the audits;
- reviewed the external auditors' Management Letters for the Bank and for the PRA;
- assessed the extent to which non-audit services were provided by KPMG to the Bank and the associated fees; and
- agreed KPMG's change of audit entity.

Internal auditor

In relation to the internal auditor, the Committee:

- considered and approved the remit, resources and budget for the internal audit function and confirmed that it was satisfied that the internal audit function had appropriate resources;
- reviewed and approved the internal audit plan and monitored its execution, including progress in respect of recommendations made; and
- considered major findings arising from internal audit's work, and reviewed and monitored management's responsiveness to the internal auditor's findings and recommendations.

Terms of reference and effectiveness

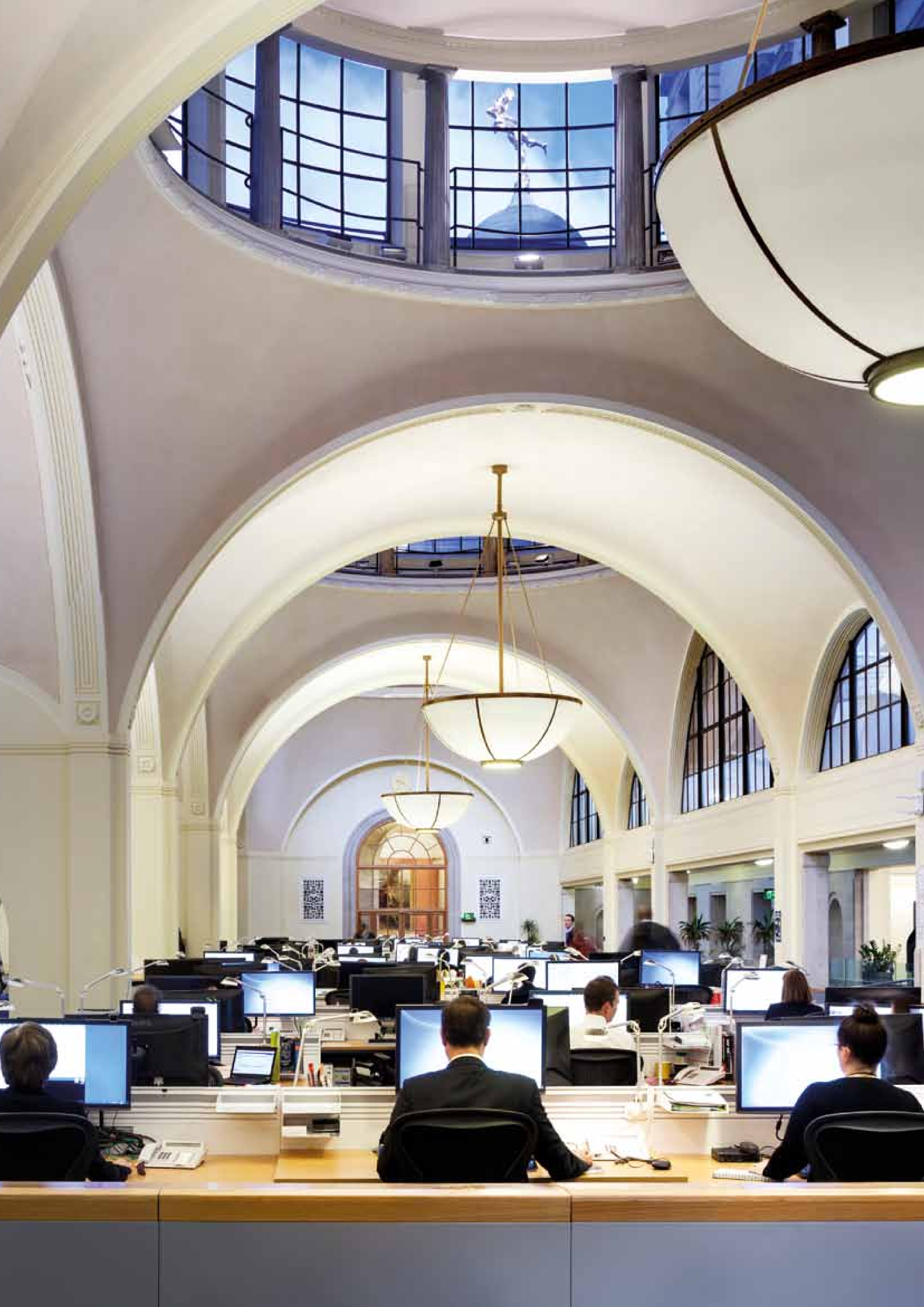
Under the direction of the Chair of the Committee, some changes were made to ARCo membership during the year, including a reduction in the number of standing members.

The Committee undertook its annual review of ARCo's terms of reference, as part of which the terms of reference were streamlined and brought more in line with those for other Court Committees.

The effectiveness of ARCo was reviewed as part of the 2014/15 Court evaluation.

Other responsibilities

The Committee reviewed a summary of the annual expenses of the members of Court.



Statement of the responsibilities of the Court of Directors in relation to the financial statements

The Court of Directors is responsible for ensuring that the financial statements of the Banking Department are properly prepared on the basis set out therein, as at 28 February 2015 and for the year to that date.

The statements of account of the Issue Department are prepared in accordance with provisions agreed between the Bank and HM Treasury to implement the requirements of the Currency and Bank Notes Acts 1928 and 1954, the National Loans Act 1968 and the Currency Act 1983. The Court of Directors is responsible for ensuring that the statements of account are prepared in accordance with these requirements as at 28 February 2015 and for the year to that date.

The Court of Directors is responsible for ensuring proper accounting records are kept, which disclose at any time the financial position of the Bank and enable Court to ensure that the financial statements comply with the requirements set out in note 2 of the Accounts. The Court of Directors is also responsible for safeguarding the assets of the Bank and its subsidiaries, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Court of Directors confirms that suitable accounting policies, consistently applied and supported by reasonable and prudent judgement and estimates, have been used in the preparation of the financial statements of the Banking Department. The accounting framework adopted is set out on pages 101 to 109.

The Directors who held office at the date of approval of this *Annual Report* confirm that, so far as they are aware, there is no relevant audit information of which the Bank's auditors are unaware; and each Director has taken all steps that they ought to have taken as a Director to make themselves aware of any relevant information and to establish that the Bank's auditors are aware of that information.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Bank's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Report of the Independent Auditor

Independent Auditor's Report to the Governor and Company of the Bank of England and its Shareholder

We have audited the financial statements of the Banking Department ('financial statements') for the year ended 28 February 2015, set out on pages 96 to 150, and the statements of account of the Issue Department ('statements of account') for the year ended 28 February 2015, set out on pages 151 to 155. The financial reporting framework that has been applied in their preparation is applicable law and the accounting policies set out therein.

This report is made solely to the Governor and Company of the Bank of England and its Shareholder in accordance with Section 7 of the Bank of England Act 1998. Our audit work has been undertaken so that we might state to the Governor and Company of the Bank of England and its Shareholder those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Governor and Company of the Bank of England and its Shareholder for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of Members of Court and auditor

As explained more fully in the Statement of the Responsibilities of the Court of Directors set out on page 93, the Members of Court are responsible for the preparation of the financial statements and statements of account in accordance with applicable law and the bases of preparation set out in note 1 on page 101 and note 2 on pages 101 to 108 respectively.

Our responsibility is to audit, and express an opinion on, the financial statements and statements of account in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements and statements of account

An audit involves obtaining evidence about the amounts and disclosures in the financial statements and statements of account sufficient to give reasonable assurance that the financial statements and statements of account are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Members of Court; and the overall presentation of the financial statements and statements of account. In addition, we read all the financial and non-financial information in the *Annual Report* to identify material inconsistencies with the audited financial statements and statements of account and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements and statements of account

In our opinion:

- the financial statements of the Banking Department on pages 96 to 150 for the year ended 28 February 2015 have been properly prepared, in all material respects, in accordance with the bases of preparation set out in note 2 on pages 101 to 108.
- the statements of account of the Issue Department on pages 151 to 155 for the year ended 28 February 2015 have been properly prepared, in all material respects, in accordance with the bases of preparation set out in note 1 on page 153.

Opinion on other matter

In our opinion the information given in the Report of the Remuneration Committee, the Financial Review, the Risk Management and Business Practices, and the Report of the Oversight Committee for the financial year for which the financial statements and statements of account are prepared is consistent with the financial statements and statements of account.

David Todd (Senior Statutory Auditor)
for and on behalf of KPMG LLP

Chartered Accountants
15 Canada Square
Canary Wharf
London E14 5GL

10 June 2015

Banking Department statement of income
for the year to 28 February 2015

	Note	2015 £m	2014 £m
Net interest income		12	16
Fee income	4	155	113
Trading income	4	192	196
Management fees	4	181	140
Other income	4	29	41
Net operating income		**569**	**506**
Staff costs	5	(208)	(196)
Infrastructure costs	4	(82)	(51)
Administration and general costs	4	(81)	(79)
Operating expenses		**(371)**	**(326)**
Profit before tax		**198**	**180**
Taxation	7	(19)	(20)
Profit after tax		**179**	**160**

The notes on pages 101 to 150 are an integral part of these financial statements.

Banking Department statement of comprehensive income for the year to 28 February 2015

	2015 £m	2014 £m
Profit for the year attributable to shareholder	**179**	**160**
Other comprehensive income/(loss) that may be recycled to profit or loss:		
Available for sale reserve		
Net gains/(losses) from changes in fair value	119	(326)
Current and Deferred tax	(24)	81
Property revaluation reserve		
Net gains from changes in fair value	51	17
Deferred tax	(10)	(3)
Total other comprehensive income/(loss) that may be recycled to profit or loss	**136**	**(231)**
Other comprehensive income/(loss) not recycled to profit or loss:		
Retirement benefit remeasurements	162	(202)
Deferred tax	(32)	48
Total other comprehensive income/(loss) not recycled to profit or loss	**130**	**(154)**
Total comprehensive income/(loss) for the year	**445**	**(225)**

The notes on pages 101 to 150 are an integral part of these financial statements.

Banking Department statement of financial position
as at 28 February 2015

	Note	2015 £m	2014 £m
Assets			
Cash and balances with other central banks	9	1,005	584
Loans and advances to banks and other financial institutions	10	11,662	9,899
Other loans and advances	11	375,198	375,197
Securities held at fair value through profit or loss	12	5,160	6,090
Derivative financial instruments	13	1,251	179
Available for sale securities	14	6,994	6,342
Investments in subsidiaries	15	–	–
Property, plant and equipment	16	341	262
Intangible assets	17	12	11
Retirement benefit assets	18	540	312
Other assets	19	410	465
Total assets		**402,573**	**399,341**
Liabilities			
Deposits from central banks	20	15,601	14,854
Deposits from banks and other financial institutions	21	318,576	318,735
Other deposits	22	60,432	58,103
Foreign currency bonds in issue	23	3,898	3,599
Derivative financial instruments	13	46	465
Current tax liabilities		10	–
Deferred tax liabilities	24	128	60
Retirement benefit liabilities	18	208	197
Other liabilities	25	275	281
Total liabilities		**399,174**	**396,294**
Equity			
Capital	26	15	15
Retained earnings		2,607	2,391
Other reserves		777	641
Total equity attributable to shareholder		**3,399**	**3,047**
Total liabilities and equity attributable to shareholder		**402,573**	**399,341**

On behalf of the Governor and Company of the Bank of England:

Mr M Carney Governor
Mr B Broadbent Deputy Governor
Mr A Habgood Chairman of Court
Mr R Coates Finance Director

Banking Department statement of changes in equity
for the year to 28 February 2015

		Attributable to equity shareholder				
	Note	Share capital £m	Available for sale reserve £m	Property revaluation reserve £m	Retained earnings £m	Total £m
Balance at 1 March 2013		**15**	**727**	**145**	**2,465**	**3,352**
Post-tax comprehensive income/ (loss) for the period		–	(245)	14	6	(225)
Payable to HM Treasury in lieu of dividend	8	–	–	–	(80)	(80)
Balance at 28 February 2014		**15**	**482**	**159**	**2,391**	**3,047**
Post-tax comprehensive income/ (loss) for the period		–	95	41	309	445
Payable to HM Treasury in lieu of dividend	8	–	–	–	(93)	(93)
Balance at 28 February 2015		**15**	**577**	**200**	**2,607**	**3,399**

The notes on pages 101 to 150 are an integral part of these financial statements.

Banking Department statement of cash flows
for the year to 28 February 2015

	Note	2015 £m	2014 £m
Cash flows from operating activities			
Profit before taxation		**198**	**180**
Adjustments for:			
Amortisation of intangibles	17	2	2
Depreciation of property, plant and equipment	16	17	14
Profit on sale of available for sale securities	14	–	–
Dividends received	4	(9)	(17)
Net movement in accrued interest and provisions, including pensions		924	59
Changes in operating assets and liabilities:			
Increase in loan advanced to the Bank of England Asset Purchase Facility Fund Ltd	11	–	–
Net (increase)/decrease in other advances		(1,714)	2,463
Net increase/(decrease) in securities held at fair value through profit and loss		521	(3,011)
Net increase in deposits		2,917	2,134
Net increase/(decrease) in foreign currency bonds in issue		4	(3)
Net (increase)/decrease in financial derivatives	13	(1,491)	391
Net decrease in other accounts		28	2
Corporation tax (paid)/received		(6)	12
Net cash inflow from operating activities		**1,391**	**2,226**
Cash flows from investing activities			
Purchase of available for sale securities	14	(940)	(1,768)
Proceeds from redemption of available for sale securities	14	315	242
Dividends received	4	9	17
Purchase of intangible assets	17	(3)	(2)
Purchase of property, plant and equipment	16	(40)	(24)
Net cash outflow from investing activities		**(659)**	**(1,535)**
Cash flows from financing activities			
Payment to HM Treasury under Section 1 (4) of the Bank of England Act 1946		(80)	(55)
Net cash outflow from financing activities		**(80)**	**(55)**
Net increase in cash and cash equivalents		**652**	**636**
Cash and cash equivalents at 1 March	27	4,776	4,140
Cash and cash equivalents at 28 February	**27**	**5,428**	**4,776**

Notes to the Banking Department financial statements

1 General information

The Bank of England is the central bank of the UK and is incorporated under a Royal Charter of 1694. Legislation covering its operations includes the Bank Charter Acts of 1694 and 1844, the Bank of England Acts 1946 and 1998, the Banking Act 2009 and the Financial Services Act 2012.

The Bank Charter Act 1844 requires that the Bank's note issue function be separated from its other activities. Accordingly, for accounting purposes, the Bank is divided into Issue Department and Banking Department, which are accounting designations and reporting entities. Neither is an organisational unit of the Bank. The Issue Department is solely concerned with the note issue and the assets backing the issue. The statements of account of the Issue Department are given on pages 151 to 155, and show the note issue, the assets backing the issue, the income generated by those assets and the costs incurred in the production, issue, custody and payment of notes. The net income of the Issue Department is paid over to National Loans Fund. Securities held by the Issue Department are revalued quarterly at their clean market price. If a revaluation of securities shows a net gain this is included in income. A deficit is not taken against income but is settled by a transfer from the National Loans Fund. The Banking Department comprises all other activities of the Bank. The post-tax profits of the Banking Department are effectively shared equally with HM Treasury unless the Bank and HM Treasury agree otherwise (see note 8).

2 Bases of preparation

The principal accounting policies applied in the preparation of the financial statements of the Banking Department are set out below. These policies have been applied consistently to all of the years presented, unless otherwise stated.

a Form of presentation of the financial statements

The financial statements of the Banking Department comprise the statement of income, the statement of comprehensive income, the statement of financial position, the statement of changes in equity, the statement of cash flows and related notes.

Under the Bank of England Act 1998, the Bank, in preparing the financial statements of the Banking Department, is subject to requirements corresponding to the Companies Act requirements relating to a banking company. The Bank may, however, disregard a requirement to the extent that it considers it appropriate to do so having regard to its financial stability objective.

The financial statements of the Banking Department have been prepared in accordance with the measurement and recognition requirements of the International Financial Reporting Standards (IFRS) and International Financial Reporting Interpretations Committee (IFRICs) as adopted by the EU (together, 'adopted IFRS').

The financial statements have been prepared on the historical cost basis of accounting, modified to include the revaluation of land and buildings, financial assets that are available for sale and all financial assets and financial liabilities (including derivatives) that are held at fair value through profit or loss.

Adopted IFRS and the Companies Act have been used as a model for the presentation and disclosure framework to provide additional information and analysis of key items in the financial statements except insofar as the Bank considers disclosures inappropriate to its financial stability objective.

In exceptional circumstances, as part of its central banking functions, the Bank may act as 'lender of last resort' to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. In some cases, confidence can best be sustained if the Bank's support is disclosed only when conditions giving rise to potentially systemic disturbance have improved. Accordingly, although the financial effects of such operations will be included in the Banking Department's financial statements in the year in which they occur, these financial statements may not explicitly identify the existence of such support. However, the existence of such support will be reported in the Annual Report when the need for secrecy or confidentiality has ceased.

Notes to the Banking Department financial statements continued

2 Bases of preparation continued

As a result, the financial statements of the Banking Department disclose less detail of certain elements than would be required under either adopted IFRS or the Companies Act. Disclosure limitations include:

– Presentation of the statement of income disclosures

– Operating segments.

– Contingent liabilities and guarantees.

– Information on credit and liquidity risk.

– Fair value of collateral pledged and held.

– Related party disclosure.

– Off balance sheet arrangements.

b New and amended accounting standards

The Bank has considered the potential effect of forthcoming EU endorsed standards which have not been adopted in the financial statements; none of these is expected to materially impact the Bank. The Bank has specifically considered the impact of IAS 32 'Offsetting Financial Assets and Financial Liabilities' and has determined that no further disclosures are required as a result of the implementation of this standard.

c Consolidation

The financial statements of Bank's subsidiaries, including the Bank of England Asset Purchase Facility Fund Limited and the Prudential Regulation Authority, have not been consolidated. Under the Bank of England Act 1998 the financial statements are prepared on a non-consolidated basis. Investments in subsidiaries are stated in the balance sheet at cost, less any provision for impairment in value. Dividends from subsidiaries are recognised in the income statement when declared.

d Foreign currency translation

i Functional and presentation currency

The financial statements of the Banking Department are presented in sterling, which is also the Bank's functional currency.

ii Transactions and balances

Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Where a gain or loss on a non-monetary item is recognised directly in other comprehensive income, such as equity investments classified as financial assets that are available for sale, the related exchange gain or loss is also recognised in other comprehensive income.

e Financial instruments: assets

i Classification of financial assets

The Bank classifies its financial assets in the following categories: loans and advances; financial assets at fair value through profit or loss; and financial assets that are available for sale. The Bank determines the classification at initial recognition.

Loans and advances measured at amortised cost

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money or services directly to a counterparty with no intention of trading the receivable. Assets in this category exclude those reverse repurchase agreements which are designated at fair value through profit or loss.

Financial assets at fair value through profit or loss

A financial asset is classified in this category if it is acquired principally for the purpose of selling in the short term or if so designated by management.

Derivatives must be held at fair value through profit or loss. The Bank does not currently hold any financial assets for trading but designates the following at fair value through profit or loss at inception:

- Securities and reverse repurchase agreements matching the Bank's issued foreign currency securities; and
- Securities and reverse repurchase agreements matching the fixed-term deposits placed at the Bank by other central banks

This designation is to eliminate, or significantly reduce, inconsistencies that would otherwise arise from measuring assets and liabilities on different bases. The relevant assets and liabilities (including derivatives) are managed together and internal reporting is evaluated on a fair value basis.

The Bank defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

Available for sale

Available for sale investments are those intended to be held for an indefinite period of time, which may be sold as part of the Bank's official operations or otherwise. They include sterling debt securities and unlisted equity investments.

ii Initial recognition of financial assets

Loans and advances and reverse repurchase agreements designated at fair value through profit or loss are recognised on a settlement date basis. Purchases of all other categories of financial assets are recognised on a trade date basis. All financial assets are initially recognised at fair value.

iii Subsequent valuation of financial assets

Gains and losses arising from changes in the fair value of assets classified as fair value through profit or loss are included in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of financial assets that are available for sale are recognised as other comprehensive income until the financial asset is derecognised or impaired (see (iv) below), at which time the cumulative gain or loss previously recognised as other comprehensive income is recognised in the income statement. Any premium or discount paid on the purchase of available for sale debt instruments is amortised through the income statement using the effective interest rate method.

The fair values of quoted investments in active markets are based on current bid prices. In other cases, the Bank establishes fair value by using appropriate valuation techniques. The policy for establishing fair values of securities in non-active markets is described in note 3 'Significant accounting estimates and judgements in applying accounting policies' on page 109.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has either transferred substantially all of the risks and rewards of ownership or the Bank deems that it no longer retains control of the risks and rewards of ownership.

Notes to the Banking Department financial statements continued

2 Bases of preparation continued

iv Impairment of financial assets

Loans and advances

At each balance sheet date the Bank assesses whether there is objective evidence that a financial asset or group of assets is impaired. If there is objective evidence that an impairment loss on loans and advances has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows relating to that loan discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement. A loan is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount and, for a collateralised loan, after taking into account any value of the security which has been realised.

Available for sale financial assets

At each balance sheet date the Bank assesses whether there is objective evidence that a financial asset or group of assets is impaired. If such evidence exists for financial assets that are available for sale, the cumulative loss measured as the difference between acquisition cost and the current fair value, less any impairment loss previously recognised, is removed from equity and recognised in the income statement.

If, in a subsequent period, the fair value of a debt instrument designated as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement.

If, in a subsequent period, the fair value of an equity investment designated as available for sale increases the impairment loss is not reversed through the income statement except on realisation.

v Interest income

Interest income is recognised in the income statement using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability on initial recognition. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument, and any revisions to these estimates are recognised in the income statement. The calculation includes amounts paid or received that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

vi Dividends

Dividends on equity investments that are available for sale are recognised in the income statement when declared.

f Derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, or valuation techniques such as discounted cash-flow models. Generally the best evidence of the fair value of a derivative at initial recognition is the transaction price (ie the fair value of the consideration given or received). All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Derivatives are used for matching exposures on assets and liabilities, both individually and of portfolios. The Bank does not apply the hedge accounting rules of IAS 39.

g Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a current and legally enforceable right to offset the amounts recognised and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

h Property, plant and equipment

i Initial recognition

Expenditure on property, plant and equipment is capitalised if the asset is expected to have a useful economic life of three years or more. The amount capitalised at initial recognition is the purchase price of the asset along with any further costs incurred in bringing the asset to its present condition and location.

ii Subsequent valuation

Subsequent costs are added to an asset's carrying amount or are recognised as a separate asset as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be reliably measured. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Professional valuations of the Bank's properties are carried out each year with subsequent additions included at cost, and provisions made for depreciation as explained below.

Any surplus arising on revaluation is recognised directly in a revaluation reserve within equity, except to the extent that the surplus reverses a previous revaluation deficit on the same asset recognised in the income statement, in which case the credit is to the income statement.

iii Depreciation

Land is not depreciated. Depreciation on other property, plant and equipment is charged on a straight-line basis:

Freehold buildings over the estimated future lives which range from ten to seventy-five years

Leasehold improvements	over the estimated remaining life of the lease
Plant within buildings	over periods ranging from five to twenty years
IT equipment	over periods ranging from three to seven years
Other equipment	over periods ranging from three to twenty years

The depreciable amount of a revalued asset is based on its revalued amount less any residual value. The revaluation surplus is not transferred to retained earnings until the asset's ultimate disposal.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Assets that are subject to depreciation are reviewed at each reporting date to assess whether there is any indication that an asset may be impaired. An asset's carrying amount is written down immediately to its recoverable amount if the carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value (less costs to sell) and value in use.

iv Gain or losses on the disposal of property, plant and equipment

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

Notes to the Banking Department financial statements continued

2 Bases of preparation continued

i Leases

i As lessee

The leases entered into by the Bank are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Where property, plant and equipment have been financed by lease agreements under which substantially all the risks and rewards of ownership are transferred to the Bank, they are treated as if they have been purchased outright and classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the present value of the minimum lease payments or the fair value of the leased asset. Finance charges payable are recognised over the period of the lease based on the interest rate implicit in the lease to give a consistent periodic rate of return.

ii As lessor

Long leases granted on property owned by the Bank are treated as finance leases. Finance lease receivables are stated in the balance sheet at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated across accounting periods giving a constant periodic rate of return before tax on the net investment. Unguaranteed residual values are subject to regular review to identify potential impairment. If there has been a reduction in the estimated unguaranteed residual value, the income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

j Intangible assets

Intangible assets primarily consist of computer software and the costs associated with the development of software for internal use. Costs associated with externally purchased software and costs directly associated with the internal production of unique and separately identifiable software products, which are controlled by the Bank and which will generate economic benefits exceeding those costs are recognised as intangible assets. These costs are amortised over the expected useful lives of the software, which range from three to five years. Costs associated with maintaining software programs are recognised as an expense when incurred. Intangible assets are tested for impairment annually. Intangible assets are also subject to an impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

k Financial instruments: liabilities

i Classification of financial liabilities

The Bank classifies its financial liabilities in the following categories: liabilities measured at amortised cost and financial liabilities at fair value through profit and loss.

Liabilities measured at amortised cost

Short-term customer deposits held are carried at cost with interest expense accruing on an effective interest rate basis. Cash Ratio Deposits are taken to fund certain activities of the Bank in accordance with the Bank of England Act 1998. These deposits are held at cost and are interest free. Money market instruments are carried at cost and are issued at a discount which is amortised through the income statement on an effective interest rate basis.

Financial liabilities at fair value through profit or loss

The Bank designates the following financial liabilities at fair value through profit or loss:

– Three three-year bonds denominated in US dollars, which were issued as part of the Bank’s annual medium-term issuance programme; and

– Fixed-term deposits placed by other central banks.

ii Initial recognition of financial liabilities

Fixed-term deposits taken from central banks are recognised on a settlement date basis. Money market instruments issued, short-term deposits and bonds issued by the Bank are recognised on a trade date basis.

iii Subsequent valuation of financial liabilities

Gains and losses arising from changes in the fair value of liabilities classified at fair value through profit or loss are included in the income statement in the period in which they arise.

The fair values of these liabilities are based on current offer prices.

Financial liabilities are derecognised when the obligation to pay cash flows relating to the financial liabilities has expired. If the Bank buys any of its own securities as part of its operations, these are removed from the balance sheet.

l Current and deferred tax

Corporation tax payable on profits, based on the UK tax laws, is recognised as an expense in the period in which profits arise. The Bank is entitled to tax relief on the amount due to HM Treasury as a payment in lieu of a dividend in accordance with section 1(4) Bank of England Act 1946. Tax relief on amount due to HM Treasury is credited directly to the income statement in accordance with paragraph 52B of IAS 12.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates and laws that have been enacted or substantially enacted and which are expected to apply when the related deferred tax asset or liability is realised.

The principal temporary differences arise from depreciation of property, plant and equipment, revaluation of certain financial assets, property revaluations, and provisions for pensions and other post-retirement benefits.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences and losses can be utilised.

Deferred tax related to fair value remeasurement of available for sale securities and actuarial gains and losses on retirement benefit obligations is credited or charged directly to other comprehensive income and is subsequently recognised in the income statement together with the current or deferred gain or loss if and when realised.

m Retirement benefits

The Bank operates a non-contributory defined-benefit pension scheme providing defined benefits based on final and career average pensionable pay. The final salary element of the scheme is closed to new members. The assets of the scheme are held by the Bank in an independent trustee-administered fund. The asset recognised in the balance sheet in respect of the defined-benefit pension scheme is the fair value of the scheme's assets less the present value of the defined-benefit obligation at the balance sheet date. The defined-benefit obligation is calculated annually by an independent actuary using the projected unit method. The present value of the defined-benefit obligation is determined by discounting the estimated cash outflows using interest rates of high-quality sterling corporate bonds that have terms to maturity approximating to the terms of the related pension liability. Remeasurements on retirement benefits comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what actually occurred), as well as the effects of changes in actuarial assumptions. Remeasurements on retirement benefits are recognised immediately in equity and reflected in other comprehensive income. Current and past service costs are recognised immediately in the income statement. Any net defined-benefit surplus is limited to the benefit that is available to the Bank.

The Bank also provides other post-retirement benefits, principally related to redundancy provisions and healthcare for certain pensioners, which are accounted for on a similar basis to the accounting for pension obligations.

Notes to the Banking Department financial statements continued

2 Bases of preparation continued

Staff transferred to the Bank from the Financial Services Authority (FSA) in April 2013 retained the employment terms and conditions of the FSA. These staff members continue to be active members within the FSA pension plan, which operates on a defined contribution basis. The Bank continues to make fixed contributions for employees into this scheme which are accounted for as contributions in the period they relate to. From 1 April 2015 all members within the FSA pension plan were transferred to the Bank's defined-benefit pension scheme.

n Equity capital

The entire equity capital comprising £14,553,000 of Bank Stock is held by the Treasury Solicitor on behalf of HM Treasury.

Under Section 1 (4) of the Bank of England Act 1946, as amended by the Bank of England Act 1998, subsequent to the end of each year HM Treasury receives payments of half the post-tax profits unless the Bank and HM Treasury agree otherwise. The payments are deductible for corporation tax and charged to equity in the year to which they relate on the basis agreed at the end of the relevant year.

o Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, consisting of cash and balances with other central banks, loans and advances to banks and other financial institutions, amounts due from banks and short-term government securities.

p Fees and commission income

Fees and commissions other than those associated with financial instruments are recognised as the service is provided. Where the level of fee is contingent on a particular outcome, the Bank only recognises the fee that is known to be recoverable.

q Provisions

Provisions are recognised in respect of restructuring, onerous leases and legal claims arising from past events where it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

r Indemnified operations

The Bank may enter into arrangements where it is fully indemnified, without charge, from loss by HM Treasury. Surpluses from such indemnified operations, after the deduction of fees, operating costs and tax, are treated as a capital contribution and taken directly to equity as distributable reserves.

s Collateral pledged under sale and repurchase agreements

Securities sold subject to repurchase agreements are assets provided as collateral where the transferee has the right by contract or custom to sell the collateral. These securities remain on the balance sheet and the liability is included in deposits from banks and other financial institutions. Securities purchased under agreements to resell ('reverse repurchase agreements') are not recognised on the balance sheet; the asset is included in loans and advances to banks and other financial institutions. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements.

Securities loaned to counterparties also remain on the balance sheet. Securities borrowed are not recognised on the balance sheet, unless they are sold to third parties, in which case the obligation to return the securities is recorded at fair value as a liability.

The Bank may accept its own securities as collateral for reverse repurchase agreements. Such reverse repurchase transactions are treated as collateralised and are treated in the same way as other reverse repurchase transactions.

t Commitments on behalf of HM Treasury

Commitments on behalf of HM Treasury in foreign currencies and gold arising in the course of operating the Exchange Equalisation Account are not included in these financial statements as the Bank is concerned in such transactions only as agent.

3 Significant accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a Post-retirement benefits

Post-retirement benefits are long-term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (see note 18, which includes relevant sensitivity analysis). Members of Court consider the assumptions used by the actuary in their calculations to be appropriate for this purpose.

b Fair value of equity investments that are available for sale

The Bank's accounting policy for the valuation of financial instruments is described in note 2 (e) and (k). The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. Details of valuation techniques for the different classifications are given in note 28. Fair values of equity investments classified for accounting purposes as available for sale rely to a greater extent on unobservable inputs and therefore require a greater level of management judgement to calculate a fair value than those based on wholly observable inputs. These equity investments, disclosed in note 14, are held by the Bank for the long term as part of its central banking activities and may not be readily saleable. The values have generally been established by discounting expected future dividends reflecting the benefit that the Bank derives from the investments (see note 14b, which includes relevant sensitivity analysis).

c Intangible assets

Management has made certain judgements when capitalising intangible assets. Various costs incurred in the production of an internal project are capitalised if a number of criteria are met. Management has made judgements and assumptions when assessing whether a project meets these criteria and when measuring the costs and economic life attributable to such projects.

d Onerous lease provision

In 2013 the Bank recognised an onerous lease provision in respect to certain leased property occupied by the FSA which was vacated on the commencement of the new regulatory regime.

In determining the provision Management made certain judgements in respect of; the current contract in place sub-letting the space, the contracted income receivable and an appropriate discount rate. The provision is included within note 25.

e Restructuring provision

The result of the Bank's Value for Money review, announced in January 2014, estimated that between 80 and 100 job redundancies would occur. The affected staff population was assessed and a provision was recognised based on the best estimate of the cost of these redundancies. In the financial year 2015 an additional restructuring provision was recognised in relation to a review of the information technology function which resulted in a further seven colleagues departing the bank. At 28 February 2015 the restructuring provision has been revised in line with current estimates. The provision is included within note 25.

Notes to the Banking Department financial statements continued

4a Net operating income (excluding net interest income)

	Note	2015 £m	2014 £m
Fee income			
Funding for Lending Scheme fees	29	132	89
Payment services fee income		13	11
Banking operations		10	13
Total fee income		**155**	**113**
Income from trading activities			
Net income from financial instruments designated at fair value		(2)	12
Income from available for sale securities	14	194	184
Total trading Income		**192**	**196**
Management fees			
Fee for services to BEAPPF	31	2	2
Charges to HM Government bodies	31	82	79
PRA corporate services fee[45]	31	97	59
Total management fees		**181**	**140**
Other income			
Dividend income		9	17
Onerous lease provision release	25	–	7
Premises income		11	13
Compensation payment on Special Liquidity Scheme		8	–
Other Income		1	4
Total other income		**29**	**41**
Net operating income (excluding net interest income)		**557**	**490**

45 The bank provides certain central support services to the PRA, for which it charges a corporate services fee. During the year the Bank changed its methodology for recognition and subsequent recharging of these expenses. As a result, costs which had previously been recognised directly in the PRA were initially incurred in the Bank, and subsequently recharged, thereby driving an increase in the corporate services fee charged, with corresponding direct cost decreases in the PRA. On a comparable basis, and assuming a full 12 month operating period (2014: 11 months), the 2014 charge of £59m would have been approximately £84m. The year-on-year increase is attributable, inter alia, to IT investment and legal expenditure.

4b Operating expenses

	Note	2015 £m	2014 £m
Infrastructure costs			
Property and equipment[46]		55	30
Depreciation of property, plant and equipment	16	17	14
Operating lease rentals		8	5
Amortisation of intangible assets	17	2	2
Total infrastructure costs		**82**	**51**
Administration and general costs			
Consultancy, legal and professional fees		27	21
Subscriptions, publications, stationery and communications		3	3
Travel and accommodation		4	4
Other administration and general expenses		47	51
Total administration and general costs		**81**	**79**
Staff costs	5	**208**	**196**
Operating expenses		**371**	**326**

46 In 2014 certain property and equipment expenses were recognised directly in the PRA. In 2015, following a change in the Bank's processes, these costs were initially incurred in the Bank and subsequently recharged via the corporate services fee. On a comparable basis, and assuming a full 12 month operating period (2014: 11 months), the 2014 Property and Equipment charge of £30m would have been approximately £51m.

Notes to the Banking Department financial statements continued

5 Staff costs[47]

	2015 £m	2014 £m
Wages and salaries	154	151
Social security costs	15	13
Pension and other post-retirement costs	37	24
Costs of restructuring	2	8
	208	**196**

Average number of employees

The average number of persons employed by the Bank during the year was made up as follows:

	2015	2014
Governors and other members of Executive Team	20	14
Managers and analysts	2,230	1,921
Other staff	1,430	1,554
	3,680	**3,489**

Of which deemed to work exclusively for the PRA:

	2015	2014
Governors and other members of Executive Team	4	1
Managers and analysts	894	833
Other staff	241	119
	1,139	**953**

The number of persons employed by the Bank at the end of February 2015 was 3,868 of which 3,463 were full-time and 405 part-time (2014: 3,625; with 3,224 full-time and 401 part-time). These include 1,205 persons deemed to work exclusively for the PRA of which 1,088 were full-time and 117 part-time (2014: 1,045; with 951 full-time and 94 part-time).

47 In the 2014 financial statements, Staff Costs included the cost of staff who worked exclusively for the PRA, and excluded certain costs which were previously included within 'Other administrative expenses'. In 2015, the presentation of Staff Costs has been revised to exclude PRA staff (costs for whom are recorded in the PRA accounts to reflect that in substance, they are employed by the PRA). Recoveries in relation to staff costs form a component of the recharged direct costs £139m (2014: £132m) disclosed in note 31. 2015 Staff Costs also include expenses such as private medical insurance. The 2014 comparatives, previously disclosed at a total of £272m, have been adjusted accordingly.

6 Auditor's remuneration

	2015 £000	2014 £000
Audit fees for the Bank's audit		
– Fees relating to current year	260	260
– Fees relating to prior year	17	–
Fees payable to the Auditor for services provided to the Bank		
– Audit related services	43	43
– Taxation advisory services	25	16
– All other non-audit services	16	149
	361	**468**

Fees of £30,000 for audit services in relation to Bank of England Asset Purchase Facility Fund Limited were paid by the Bank and recovered via a management fee (2014: £30,000 for audit and £7,900 for other services).

Audit related services comprise £25,000 for providing assurance to HM Treasury on the allocation of costs (2014: £25,000), and £18,000 for the submission for Whole Government Accounts (2014: £18,000). Other non-audit fees principally relate to advisory services to the Bank.

Notes to the Banking Department financial statements continued

7 Taxation

The tax charged within the income statement is made up as follows:

	2015 £m	2014 £m
Current year corporation tax	8	6
Prior year corporation tax	1	–
Deferred tax – current year	12	14
Deferred tax – prior year	(2)	–
Tax charge on profit	**19**	**20**

The tax charged within the income statement differs from the amount calculated at the basic rate of tax on the profit for the year and is explained below:

	2015 £m	2014 £m
Profit before tax	**198**	**180**
Tax calculated at rate of 21.17% (2014: 23.08%)	42	41
Tax relief on payment to HM Treasury	(20)	(18)
Non-deductible expenses	1	1
Dividend not subject to corporation tax	(2)	(3)
Prior year items	(1)	–
Change in tax rate to 20% (2014: 20%)	(1)	(1)
Total tax charge for the period	**19**	**20**

Tax (credited)/charged to equity comprises:

	2015 £m	2014 £m
Tax (credited)/charged to equity through the statement of comprehensive income		
Current year corporation tax	8	(6)
Deferred tax	58	(120)
Tax (credited)/charged to equity	**66**	**(126)**

Tax (credited)/charged to equity comprises:

	2015 £m	2014 £m
Tax (credited)/charged to equity through the statement of comprehensive income		
Revaluation of available for sale securities	(19)	(75)
Use of tax losses brought forward	43	–
Revaluation of property	10	4
Remeasurements on retirement benefits	34	(47)
Change in tax rate to 20% (2014: 20%)	(2)	(8)
Tax (credited)/charged to equity	**66**	**(126)**

The main UK corporation tax rate was 21% for the year beginning 1 April 2014 (1 April 2013: 23%). The effective rate for the year ended 28 February 2015 is therefore 21.17% (2014: 23.08%).

The rate reduction on the deferred tax balances as at 28 February 2015 is disclosed in note 24.

Notes to the Banking Department financial statements continued

8 Payable to HM Treasury under Section 1 (4) of the Bank of England Act 1946

	2015 £m	2014 £m
Payable 3 April 2015 (2014: 4 April)	49	34
Payable 5 October 2015 (2014: 3 October)	44	46
	93	**80**

The Bank of England Act 1946, as amended by the Bank of England Act 1998, requires the Bank to pay HM Treasury, in lieu of dividend on the Bank's capital, on 5 April and 5 October, a sum equal to 25% of the Banking Department's post-tax profit for the previous financial year or such other sum as the Bank and HM Treasury may agree. When the due date falls on a non-business day, the payment is made on the last business day before the due date. These payments have been accrued and charged to equity at 28 February 2015. The payments are deductible for corporation tax in the year to which the payments relate. The overall effect is that the Bank and HM Treasury will normally share Banking Department's post-tax profits equally. This year the Bank and HM Treasury have agreed to an additional payment in lieu of dividend of £7.75mn paid 2 April 2015. This relates to compensation received by the Bank for the reduction in Special Liquidity Scheme (closed 30 January 2012) fees received as a result of manipulation by Lloyds Bank plc and Bank of Scotland plc of submissions to the British Bankers' Association GBP repo rates. The Bank believes that this payment fully compensates it for all losses which it may have suffered. The total payable is net of related costs incurred by the Bank.

9 Cash and balances with other central banks

	2015 £m	2014 £m
Balances with other central banks	1,005	584
	1,005	**584**

Balances with other central banks are correspondent accounts with other central banks used for Bank and customer business.

10 Loans and advances to banks and other financial institutions

	2015 £m	2014 £m
Reverse repurchase agreements held at amortised cost	1,529	670
Reverse repurchase agreements held at fair value through profit or loss	10,131	8,979
Other loans and advances	2	250
	11,662	**9,899**

These balances include advances and reverse repurchase agreements arising as part of the Bank's open market operations, as well as advances matching the deposits taken (notes 20 to 22). Amounts are stated after provisions for impairment, where appropriate. The level and composition of the Bank's open market operations, including the split between Banking and Issue Departments, depends on movements in the Bank's balance sheet as described in the published Bank of England's *Sterling Monetary Framework* (updated November 2014).

At 28 February 2015 loans and advances to banks and other financial institutions included cash and cash equivalents of £4,048m (2014: £3,998m) which are disclosed in note 27i.

11 Other loans and advances

	2015 £m	2014 £m
Loan to the Bank of England Asset Purchase Facility Fund Ltd	375,193	375,193
Term loans	5	4
	375,198	**375,197**

Loan to Bank of England Asset Purchase Facility Fund Limited

In January 2009, the Chancellor of the Exchequer authorised the Bank to set up an Asset Purchase Facility (APF) to buy high-quality assets financed by the issue of Treasury bills and the Debt Management Office's (DMO) cash management operations. The aim of the APF was to improve liquidity in credit markets. The Chancellor also announced that the APF provided an additional tool that the Monetary Policy Committee (MPC) could use for monetary policy purposes. When the APF is used for monetary policy purposes, purchases of assets are financed by the creation of central bank reserves.

The APF transactions are undertaken by a subsidiary company of the Bank of England – Bank of England Asset Purchase Facility Fund Limited (BEAPFF). The transactions are funded by a loan from the Bank.

In line with the MPC's most recent decision in relation to the asset purchase programme; the APF has purchased £375,000m of assets by the creation of central bank reserves. Additionally, the APF continues to operate its corporate facilities, with purchases financed by the issue of Treasury bills and the DMO's cash management operations. The loan in relation to the corporate facilities is £193m. The total loan from the Bank to BEAPFF is £375,193m (2014: £375,193m).

12 Securities held at fair value through profit or loss

	2015 £m	2014 £m
Money market instruments	2,160	2,235
Listed foreign government securities	3,000	3,855
	5,160	**6,090**

The holdings of foreign government securities are funded by the Bank's issuance of medium-term securities (note 23) and fixed term deposits placed by other central banks.

At 28 February 2015 money market instruments included cash and cash equivalents of £375m (2014: £194m) which are disclosed in note 27i.

Notes to the Banking Department financial statements continued

13 Derivative financial instruments

The Bank uses the derivative instruments described below. The main purpose of these is to manage the currency and interest rate exposures on the Bank's portfolio of financial assets and financial liabilities. They may also be used as an instrument in monetary policy transactions.

Cross-currency interest rate swaps, interest rate swaps and forward exchange contracts are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or coupons (eg fixed rate for floating rate) or a combination of these. An exchange of principal occurs for cross-currency interest rate swaps and forward exchange contracts. The Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligations. The risk is monitored on an ongoing basis with reference to the current fair value. To control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities and will take collateral, either securities or cash, if the net replacement cost of all transactions with the counterparty exceeds relevant thresholds.

The notional amounts of derivative financial instruments provide a basis for comparison with other instruments recognised in the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and therefore do not indicate the Bank's exposure to credit or price risks. The derivative instruments move into profit (in which case they are treated as assets) or loss (in which case they are treated as liabilities) as a result of fluctuations in market prices relative to their terms. The aggregate contractual or notional amount of derivative financial instruments outstanding, the extent to which instruments have moved into profit or not, and thus the aggregate fair values of derivative financial instruments, can fluctuate significantly over time. The fair values of derivative instruments are set out below.

a As at 28 February 2015

	Contract notional amount £m	Fair Values	
		Assets £m	Liabilities £m
Cross-currency interest rate swaps	3,011	510	(26)
Interest rate swaps	5,872	8	(18)
Forward exchange contracts	13,924	733	(2)
Total recognised derivative assets/(liabilities)		**1,251**	**(46)**

b As at 28 February 2014

	Contract notional amount £m	Fair Values	
		Assets £m	Liabilities £m
Cross-currency interest rate swaps	2,694	118	(48)
Interest rate swaps	6,141	14	(29)
Forward exchange contracts	13,164	47	(388)
Total recognised derivative assets/(liabilities)		**179**	**(465)**

14 Available for sale securities

	2015 £m	2014 £m
Debt securities at fair value		
British Government securities listed on a recognised UK exchange	6,423	5,543
Other sterling securities listed on a recognised exchange	280	397
	6,703	5,940
Unlisted equity investments at fair value	291	402
	6,994	**6,342**

The movement in available for sale securities comprises:

	2015 £m	2014 £m
Available for sale debt securities		
At 1 March	5,940	4,700
Purchases	915	1,792
Redemptions	(315)	(242)
Mark-to-market movements through equity	230	(249)
Amortisation of premium/discount	(65)	(62)
Movement in accrued interest	(2)	1
At 28 February	**6,703**	**5,940**
Available for sale unlisted equity investments		
At 1 March	402	479
Revaluation of securities	(111)	(77)
Disposal of securities	–	–
At 28 February	**291**	**402**
	6,994	**6,342**

There were no items in the course of settlement at the year ended 28 February 2015 (2014: £25m).

There were no gains or losses on the sale of available for sale securities transferred to the income statement during the year (2014: £nil).

Net income recognised in the year ended 28 February 2015 for the Bank's available for sale investments was £194m (2014: £184m).

a Debt securities

British Government securities and other sterling securities are held as investments and are one of the principal sources of income for the Bank. The Bank holds these securities for the long term, generally to maturity. However, as the Bank can envisage circumstances in which they might be sold before maturity they have been classified as assets that are available for sale.

All debt securities have fixed coupons.

Notes to the Banking Department financial statements continued

14 Available for sale securities continued

b Unlisted equity investments

The unlisted equity investments held by the Bank are held as part of its functions as a central bank and are thus of a long-standing nature. The Bank's holdings in any particular institution may change from time to time as part of realignments of holdings among the shareholders and participants. Fair values of unlisted equity investments reflect the price that a knowledgeable willing party would pay in an arm's length transaction.

The Bank's investment in the Bank for International Settlements (incorporated in Switzerland) consists of shares of 5,000 Special Drawing Rights, which are 25% paid. At 28 February 2015 the holding represents 8.5% (2014: 8.5%) of the issued share capital. The investment has been valued on a dividend yield basis providing a value of £287m (2014: £397m) at the end of February. A discount rate of 5.86% (2014: 6.78%) was used. Increasing the discount rate by one percentage point would deflate the valuation by £60m, while decreasing the discount rate by one percentage point would inflate the valuation by £103m.

The Bank's holding in the European Central Bank (ECB) represents 0.7% (2014: 0.7%) of the ECB's paid-up share capital. In accordance with the Treaty on the Functioning of the European Union, and in line with other non euro area national central banks, the Bank is only required to pay up 'a minimal percentage' by way of contribution to the operational costs of the ECB; in the Bank's case this is currently 3.75% amounting to €56m (2014: 3.75% amounting to €56m) of its total allocation of the ECB's subscribed capital of €1.5bn (2014: €1.5bn). If the United Kingdom were to participate in Economic and Monetary Union a further contribution would be required and the Bank's paid-up share capital would then amount to 13.7% (2014: 13.7%).

Contributions to the ECB are non-refundable and as a non euro area member the Bank is not entitled to any dividends. The fair value of the holding has therefore been assessed as £nil (2014: £nil).

15 Investments in subsidiaries

The Bank has a number of subsidiaries, which are wholly owned, that are stated in the Bank's balance sheet at an aggregate cost under £1m. These are:

The Securities Management Trust Ltd 1,000 ordinary shares of £1
Bank of England Asset Purchase Facility Fund Ltd 100 ordinary shares of £1
Houblon Nominees Ltd 2 ordinary shares of £1
Bank of England Nominees Ltd 2 ordinary shares of £1
BE Pension Fund Trustees Ltd 2 ordinary shares of £1
Prudential Regulation Authority Ltd 1 ordinary share of £1
Olive 863 Ltd, a wholly-owned subsidiary, was struck off the company register during the year.

16 Property, plant and equipment

For the period to 28 February 2015	Freehold land and buildings £m	Leasehold improvements £m	Equipment* £m	Total £m
Cost or valuation				
At 1st March 2014	230	11	55	296
Additions	5	–	35	40
Disposals/write-offs	(1)	–	(10)	(11)
Purchase of assets from PRA	–	–	6	6
Revaluation of properties	44	–	–	44
At 28th February 2015	**278**	**11**	**86**	**375**
Accumulated depreciation				
At 1st March 2014	–	1	33	34
Charge for the period	7	1	9	17
Disposals/write-offs	–	–	(10)	(10)
Revaluation of properties	(7)	–	–	(7)
At 28th February 2015	**–**	**2**	**32**	**34**
Net book value at 1st March 2014	230	10	22	262
Net book value at 28th February 2015	**278**	**9**	**54**	**341**

*Net book value of equipment at 28 February 2015 included £2m held under finance leases.

Purchase of assets from the PRA relate to assets purchased by the Bank from the PRA in the year. These assets were transferred to the Bank on 28 February 2015.

The figures for freehold land and buildings reflect independent professional valuations performed in accordance with the Royal Institution of Chartered Surveyors (RICS) on a market basis as at 28 February 2015 by Deloitte LLP, members of RICS.

Notes to the Banking Department financial statements continued

16 Property, plant and equipment continued

For the period to 28 February 2014	Freehold land and buildings £m	Leasehold improvements £m	Equipment* £m	Total £m
Cost or valuation				
At 1 March 2013	210	10	57	277
Additions	10	1	13	24
Disposals/write-offs	–	–	(6)	(6)
PRA disposals	–	–	(9)	(9)
Revaluation of properties	10	–	–	10
At 28 February 2014	**230**	**11**	**55**	**296**
Accumulated depreciation				
At 1 March 2013	–	–	34	34
Charge for the period	7	1	6	14
Disposals/write-offs	–	–	(6)	(6)
PRA disposals	–	–	(1)	(1)
Revaluation of properties	(7)	–	–	(7)
At 28 February 2014	–	**1**	**33**	**34**
Net book value at 1 March 2013	210	10	23	243
Net book value at 28 February 2014	**230**	**10**	**22**	**262**

*Net book value of equipment at 28 February 2014 included £3m held under finance leases.

PRA disposals relate to assets purchased by the Bank in respect of the set-up of the PRA. These assets were transferred to the PRA on 1 April 2013 when the new regulatory regime commenced.

17 Intangible assets

	2015 £m	2014 £m
Cost		
At 1 March	36	37
Additions	3	2
Disposals	(1)	(3)
At 28 February	**38**	**36**
Accumulated amortisation		
At 1 March	25	26
Charge for the year	2	2
Disposals	(1)	(3)
At 28 February	**26**	**25**
Net book value at 1 March	11	11
Net book value at 28 February	**12**	**11**

Intangible assets primarily comprise computer software and related costs.

Notes to the Banking Department financial statements continued

18 Retirement benefits

a Defined contribution

Staff transferred to the Bank from the Financial Services Authority (FSA) in April 2013 retained the employment terms and conditions of the FSA. These staff members continue to be active members within the FSA Pension Plan, which operates on a defined contribution basis. The Bank makes fixed contributions for employees into this scheme which are accounted for as contributions in the period they relate to. During the year total contributions made by the Bank were £8m (2014: £8m) of which, £7m was recharged to the PRA. No contributions were outstanding at the year end.

From 1 April 2015 staff on the FSA legacy contracts became members of the Bank's career average pension scheme.

b Defined benefit and career average

The Bank operates a non-contributory defined-benefit pension scheme providing benefits based on final and career average pensionable pay. The final salary element of the scheme is closed to new members. The assets of the scheme are held by the Bank in an independent trustee-administered fund. The Bank also provides other post-retirement benefits, principally healthcare, for certain pensioners.

The pension scheme is an HMRC registered pension scheme and is subject to standard UK pensions and tax law. This means that the payment of contributions and benefits are subject to the appropriate tax treatments and restrictions and the scheme is subject to the scheme funding requirements outlined in section 224 of the Pensions Act 2004.

In accordance with UK trust and pensions law, the pension scheme has appointed trustees who are independent of the Bank. Although the Bank bears the financial cost of the scheme, the responsibility for the management and governance of the scheme lies with the trustees, who have a duty to act in the best interest of members at all times.

The pension scheme's assets are mostly invested in fixed interest and index-linked gilts which are intended to match the nature of the future benefit payments due from the scheme. This helps to reduce volatility in the funding level on the scheme funding basis and, to a lesser extent, in the statement of financial position in the Bank's accounts. The effect of the liability-matching investment policy is not fully reflected in the accounting figures as the assumptions dictated for the purposes of the valuation under IAS 19 are different from those used for the funding valuation.

Valuation for funding purposes

The main pension scheme, the Bank of England Pension Fund, is valued for funding purposes at intervals of not more than three years by an independent qualified actuary, with interim reviews in the intervening years. The latest valuation for funding purposes was as at 28 February 2014; it used the Defined Accrued Benefit Method. Under this method, active members are assumed to leave the Fund on the date of the valuation and hence the past service liability does not include an allowance for any salary increases or in-service CARE revaluation after that date. Instead members' benefits are assumed to increase in line with the deferred pension revaluation assumptions.

The valuation as at 28 February 2014	**£m**
Value of Fund assets	3,075
Actuarial value of scheme liabilities in respect of:	
– In-service members	(613)
– Deferred pensioners	(663)
– Current pensioners and dependants	(1,825)
– Members' additional voluntary contributions	(5)
Total	(3,106)
Scheme (deficit)/surplus	**(31)**
Funding level	99%
Service contribution for March	55%
Future service contribution rate post OBYR	39%

For the 2014 valuation, the liabilities were valued by the actuary on an index-linked gilts yield discount rate, and no credit was taken in advance for the possibility that returns on investments held by the Fund would exceed the long-term interest rate. Allowance was made for past and prospective mortality improvements. The rate of RPI inflation used in the valuation and the pension increase assumption was 3.3%.

The Bank and the Pension Fund Trustees had agreed a deficit reduction plan and a new schedule of contributions following the valuation. The Bank paid an additional lump sum contribution of £4.4m to the Fund in July 2014 which when taken together with the contribution of £26.7m paid in March 2014 under the previous recovery plan, is sufficient to eliminate the deficit as at 28 February 2014.

Excluded from the contribution rate is the cost of administration and other services which is met by the Bank.

Summary of amounts recognised in the financial statements under IAS 19

In the statutory financial statements the Bank accounts for pension costs, other post-retirement benefits and related redundancy provisions in accordance with IAS19 (Employee Benefits). Under the standard, the difference between the market values of scheme assets and the present value of scheme liabilities is reported as a surplus or deficit in the balance sheet. The accounting value is different from the result obtained using the funding basis.

The accounts show the main scheme in surplus, while the Bank has been clearing the deficit revealed by the funding valuation. The main reason for this is the different assumptions used to value the liabilities in the accounting and funding valuations for the main scheme. The aim of the liability matching policy is that by investing in a range of assets (mostly government bonds) that broadly match the expected future benefit payments from the scheme, no surplus or deficit will arise.

The funding valuation, therefore, discounts expected future benefit payments at the appropriate yield available on government bonds to produce the value of the funding liabilities. The accounting standard requires that expected future benefit payments are discounted at the appropriate yield available on high quality corporate bonds, which is higher than the corresponding yield available on government bonds. The value placed on the liabilities for accounting purposes is, therefore, lower than the funding valuation.

In the preparation of their valuations under IAS 19 referred to in this note, the actuary has used the assumptions indicated below, which members of Court have accepted for the purposes of accounting and disclosure under the standard.

Notes to the Banking Department financial statements continued

18 Retirement benefits continued

Amounts recognised as assets/(liabilities) in the balance sheet

	Note	2015 £m	2014 £m
Funded pension schemes	(i)	540	312
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	(83)	(79)
Other pension schemes	(iii)	(9)	(8)
Medical scheme	(iv)	(116)	(110)
		332	**115**

Pension expense recognised in the income statement[48]

	Note	2015 £m	2014 £m
Funded pension schemes	(i)	32	17
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	3	3
Other pension schemes	(iii)	–	–
Medical scheme	(iv)	5	5
		40	**25**

Remeasurements recognised in the statement of comprehensive income

	Note	2015 £m	2014 £m
Funded pension schemes	(i)	173	(205)
Unfunded post-retirement benefits:			
Redundancy provisions	(ii)	(6)	(1)
Other pension schemes	(iii)	(1)	–
Medical scheme	(iv)	(4)	4
		162	**(202)**

48 Of the total defined benefit pension expense of £40m, £5m relates to staff working for the PRA and has been included in the PRA accounts.

(i) Funded pension scheme

As described above, the Bank has a final salary section within the pension scheme that provides pensions based on members' pensionable service and final salary at retirement. The pension is payable for life and increases in payment in line with inflation. Existing members of this section of the scheme continue to accrue future benefit but it is closed to new members.

Following recent changes, the Bank Final Salary scheme was closed to new accrual from 1 April 2015; former members were placed at the highest level of the reformed Career Average scheme.

For new employees, the Bank offers a career average revalued earnings (CARE) section of the pension scheme that provides pensions based on members' earnings each year revalued in line with inflation up to retirement.

The pension is payable for life and increases in payment in line with inflation.

(ii) Redundancy provisions

As part of redundancy arrangements with staff in place until 5 April 2010, the Bank could give enhanced pension entitlement in the form of added years service or early pension rights. The costs of such benefits cannot be charged to the Pension Fund. The costs are therefore borne in the Bank's accounts, and represent the future cost of decisions that have already been taken. Provision was made for the costs of these benefits at the time the redundancy offer was announced based on actuarial advice. No further similar entitlements will be given by the Bank.

The valuation of these provisions has been performed using the relevant assumptions applied for the IAS 19 valuation of pension schemes and updated annually.

(iii) Other pension schemes

As explained in the Remuneration section of the Annual Report on page 74, for Governors subject to the pensions earnings cap introduced in the Finance Act 1989, the Bank offers additional unfunded pensions so that their total pensions broadly match what would have been provided by the former Court Pension Scheme in the absence of a cap. Provision is made for these in the Bank's accounts. In addition certain former Governors and Directors and the widows of some former Governors and Directors were granted ex-gratia pensions. Provision for these was made in the Bank's accounts when the grants were made.

The valuation of this scheme has been performed by using the relevant assumptions applied for the IAS 19 valuation of pension schemes and updated annually.

(iv) Medical scheme

Some current and former staff are entitled to receive healthcare benefits in retirement. Separate provision is made for these in the Bank's accounts as these cannot be paid out of the pension scheme. The defined benefit liability is the expected cost to the Bank of the claims anticipated from the eligible members once in retirement.

Notes to the Banking Department financial statements continued

18 Retirement benefits continued

Risks

The main risks to which the Bank is exposed in relation to the funded pension scheme are:

– Mortality risk – the assumptions adopted by the Bank make allowance for future improvements in life expectancy. However, if life expectancy improves at a faster rate than assumed, this would result in greater payments from the Fund and consequently, increases in the scheme's liabilities. The Bank and the scheme's trustees review the mortality assumption on a regular basis to minimise the risk of using an inappropriate assumption;

– Investment risk – the Fund invests the vast majority of its assets in a portfolio of UK government bonds as the changes in the value of the bonds most closely match the movements in the Fund's liabilities. There remains the residual risk that the selected portfolio does not match the liabilities closely enough or that as it matures there is a risk of not being able to reinvest the assets at the assumed rates. The scheme's trustees review the structure of the portfolio on a regular basis to minimise these risks;

– Yield risk – a fall in government bond yields will increase both the scheme's assets and liabilities. As the value of the scheme's liabilities, on the funding basis used to calculate the Bank's contributions to the scheme, are greater than its assets (until the deficit is made good), the liabilities may grow by more in monetary terms, increasing the deficit in the scheme; and

– Inflation risk – the majority of the scheme's liabilities increase in line with inflation and so if inflation is greater than expected, the liabilities will increase. The scheme's investment strategy is to hold government bonds that are also linked to inflation so this risk is mostly mitigated.

The redundancy provision and other pension schemes are primarily exposed to the mortality and inflation risks above. As they are not backed by any assets, these risks cannot be so easily managed. However, these arrangements (and therefore the risks associated with them) are small in comparison to the funded pension scheme.

The two main risks to which the Bank is exposed in relation to the medical scheme are mortality risk, as described above, and increases in the costs incurred being greater than assumed, either due to inflation of future medical costs or the frequency of members' claims.

Components of pension expense in the income statement

			2015			2014
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Current service cost	45	–	1	38	–	1
Past service cost	–	–	–	–	–	–
Net interest on the net defined (liability)/asset	(13)	3	4	(21)	3	4
Total pension expense	**32**	**3**	**5**	**17**	**3**	**5**

Remeasurements recognised in other comprehensive income

	2015 Main pension scheme £m	2015 Other pensions £m	2015 Medical scheme £m	2014 Main pension scheme £m	2014 Other pensions £m	2014 Medical scheme £m
Remeasurements recognised at the beginning of the period	(130)	(27)	9	75	(26)	5
Actuarial gains/(losses) arising from changes in demographic assumptions	42	1	7	–	–	5
Actuarial losses arising from changes in financial assumptions	(314)	(8)	(11)	(48)	(1)	(2)
Actuarial losses/(gains) arising from experience on the scheme's liabilities	26	–	–	8	–	1
Return on schemes' assets excluding interest income	419	–	–	(165)	–	–
Remeasurements recognised at the end of the period	**43**	**(34)**	**5**	**(130)**	**(27)**	**9**

Reconciliation of present value of defined-benefit obligation

	2015 Main pension scheme £m	2015 Other pensions £m	2015 Medical scheme £m	2014 Main pension scheme £m	2014 Other pensions £m	2014 Medical scheme £m
Present value of defined-benefit obligation at the beginning of the period	2,758	87	110	2,676	89	113
Current service cost	45	–	1	38	–	1
Interest expense	110	3	4	108	3	4
Actuarial (gains)/losses arising from changes in demographic assumptions	(42)	(1)	(7)	–	–	(5)
Actuarial losses arising from changes in financial assumptions	314	8	11	48	1	2
Actuarial losses/(gains) arising from experience on the scheme's liabilities	(26)	–	–	(8)	–	(1)
Benefits paid out	(107)	(5)	(3)	(104)	(6)	(4)
Present value of defined obligation at the end of the period	**3,052**	**92**	**116**	**2,758**	**87**	**110**

During the reporting period there have been no plan amendments, curtailments or settlements.

Notes to the Banking Department financial statements continued

18 Retirement benefits continued

Reconciliation of the fair value of assets

	2015			2014		
	Main pension scheme £m	Other pensions £m	Medical scheme £m	Main pension scheme £m	Other pensions £m	Medical scheme £m
Fair value of schemes' assets at the beginning of the period	3,070	–	–	3,136	–	–
Interest income	123	–	–	129	–	–
Return on schemes' assets excluding interest income	419	–	–	(165)	–	–
Bank contributions	87	5	3	74	6	4
Benefits paid out	(107)	(5)	(3)	(104)	(6)	(4)
Fair value of schemes assets at the end of the period	**3,592**	**–**	**–**	**3,070**	**–**	**–**

Summary of assumptions

Under IAS 19 measurement of scheme liabilities must be calculated under the projected unit method, which requires certain demographic and financial assumptions, including an assumption about future salary growth. The assumptions used are applied for the purposes of IAS 19 only.

The significant financial and other assumptions used by the independent actuary to calculate scheme liabilities over the life of the scheme on an IAS 19 basis were:

	2015 %	2014 %
Discount rate	3.4	4.0
Rate of increase in salaries	3.5	4.6
Rate of increase of pensions in payment*	3.3	3.1
Rate of increase for deferred pensioners*	**3.3**	**3.1**

* This represents a weighted average of RPI and CPI, which are the indices used in the scheme.

The discount rate assumption reflects the investment return on a high quality corporate bond at the balance sheet date, as required by the standard.

The assumption on salary growth is for the long term over the life of the scheme.

An age-related promotion scale has been added to the increase in salaries assumption.

The assumption for life expectancy for the scheme assumes that a male member reaching 60 in 2015 will live for 29 years (2014: 29.8 years) and a female member 30.7 years (2014: 30.5 years), and a male member reaching 60 in 2034 will live for 32.1 years (2014: 32.8 years) and a female member 33.8 years (2014: 33.4 years).

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with both current industry experience and the actual experience of the relevant scheme.

The assets in the scheme were:

	2015 Value £m	2015 Percentage of total value %	2014 Value £m	2014 Percentage of total value %
UK Government fixed interest bonds	261	7.3	250	8.1
UK Government index-linked bonds	2,492	69.4	2,302	75.0
Corporate index-linked bonds	816	22.7	498	16.2
Cash and other assets	23	0.6	20	0.7
Total market value of investments	**3,592**	**100.0**	**3,070**	**100.0**

For the purposes of IAS 19, the asset values stated are at the balance sheet date. Market values of the scheme's assets, which are not intended to be realised in the short-term, may be subject to significant change before they are realised.

Of the corporate index linked bonds £319m were quoted and £497m were unquoted (2014: £182m quoted and £316m unquoted). Of the corporate index-linked bonds £772m (2014: £294m) were guaranteed by the UK Government.

Main scheme

	2015 £m	2014 £m
Present value of defined-benefit obligations	(3,052)	(2,758)
Assets at fair value	3,592	3,070
Defined-benefit asset/(liability)	**540**	**312**

The duration of the pension scheme liabilities is in the region of 19 years. A +/- 0.1% change to the discount rate would change the surplus on the pension scheme by +/- £58m (2014: +/- £50m).

A +/- 0.1% change to the to the assumed difference between CPI and RPI inflation would change the present value of defined-benefit obligations for the pension scheme by +/- £48m with a similar offsetting change expected in the value of the pension scheme's assets given the matching nature of the investment strategy.

A +/- 0.5% change to the assumed rate of increases in salaries would change the surplus on the pension scheme by +/- £35m.

If mortality rates were adjusted such that individuals were assumed to live for an additional year, the scheme's liabilities at the year end would increase by approximately £93m (2014: £74 million).

The Bank expects to pay contributions of £89 million in the forthcoming year (2014: £83 million).

Notes to the Banking Department financial statements continued

18 Retirement benefits continued

Redundancy provisions

	2015 £m	2014 £m
Unfunded defined-benefit liability	**(83)**	**(79)**

The Bank expects to make payments of £6m in the forthcoming year (2014: £5 million).

Other pension schemes

	2015 £m	2014 £m
Unfunded defined-benefit liability	**(9)**	**(8)**

The Bank expects to make payments of less than £1m in the forthcoming year (2014: less than £1m).

During the year to 28 February 2015 the Bank incurred services costs of less than £1m (2014: less than £1m).

Medical scheme

Some staff are entitled to receive healthcare benefits in retirement. Separate provision is made for these in the Bank's accounts as these cannot be paid out of the Pension Fund.

Summary of assumptions

The discount rates used for the purposes of measuring post-retirement benefit liabilities is the same as used in the IAS 19 valuation of pension scheme liabilities.

	2015 %	2014 %
Initial medical trend	5.0%	5.0%
Ultimate medical trend	5.0%	5.0%
Years to ultimate	–	–

Post-retirement benefits – medical

	2015 £m	2014 £m
Unfunded defined-benefit liability	**(116)**	**(110)**

Sensitivity analysis provided by the actuary indicates that 0.1% decrease in the discount rate would change the deficit on the other post-retirement benefits by £2m (2014: £2m) and a 1% increase in the rate of medical claims by £22m (28 February 2014: £20m). If the mortality rates were adjusted such that individuals were assumed to live for an additional year, the other post-retirement liabilities at the year end would increase by approximately £5m (2014: £4m).

19 Other assets

	2015 £m	2014 £m
Finance lease receivables	6	6
Short term debtors and other assets	345	381
Amounts due from the PRA	59	78
	410	**465**

The amount owed by the PRA includes £30m due in more than one year (2014: £44m). Finance lease receivables also include £6m due in more than one year (2014: £6m).

20 Deposits from central banks

	2015 £m	2014 £m
Deposits repayable on demand	1,271	1,926
Term deposits held at fair value through profit or loss	14,330	12,928
	15,601	**14,854**

21 Deposits from banks and other financial institutions

	2015 £m	2014 £m
Deposits repayable on demand	314,478	314,657
Cash Ratio Deposits	4,098	4,078
	318,576	**318,735**

The majority of deposits repayable on demand comprise of reserves accounts held at the Bank. Reserves accounts are sterling current accounts for banks and building societies. They are the most liquid asset a bank or building society can hold and are the ultimate means of settlement between banks and building societies.

The rate paid by the Bank on reserves account balances is also the means by which the Bank keeps market interest rates in line with Bank Rate. All reserves balances are remunerated at Bank Rate.

Under the Cash Ratio Deposit (CRD) scheme, institutions place non-interest bearing deposits at the Bank of England. The Bank invests these deposits (mainly in gilts) and the income earned is used to fund the costs of its monetary policy and financial stability operations, which benefit sterling deposit takers.

Under the Bank of England Act 1998, the percentage and threshold used in calculating the CRDs is set by HM Treasury, having regard to the financial needs of the Bank and subject to approval of both Houses of Parliament. This is reviewed, at the latest, every five years and was last reviewed in May 2013.

Notes to the Banking Department financial statements continued

22 Other deposits

	2015 £m	2014 £m
Deposit by Issue Department	57,873	55,109
Public deposits repayable on demand	1,028	1,611
Other deposits repayable on demand	1,531	1,383
	60,432	**58,103**

Public deposits are the balances on HM Government accounts, including Exchequer, National Loans Fund, Debt Management Office, National Debt Commissioners and dividend accounts.

23 Foreign currency bonds in issue

		2015		2014
	£m Fair value	US$m Nominal	£m Fair value	US$m Nominal
Total amounts issued to third parties	**3,898**	**6,000**	**3,599**	**6,000**

All changes in fair values since 1 March 2014 are considered attributable to changes in prevailing interest rates and movements in relative foreign currency exchange rates.

At 28 February 2015, as part of the Bank's annual medium-term security issuance programme the Bank had three $2 billion three-year dollar bonds in issue (2014: three $2 billion three-year dollar bonds); the first maturing on 6 March 2015, the second on 21 March 2016 and the third on 17 March 2017.

The most recent bond (the ninth in the overall programme) was issued on 9 March 2015 with settlement on 16 March 2015. This bond matures on 16 March 2018.

Of the above liabilities to third parties, £1,298m (February 2014: £1,201 million) fall due within one year.

24 Deferred tax liabilities

Deferred tax is calculated on all temporary differences under the liability method using an effective tax rate of 20% (2014: 20%).

A reduction in the UK corporation tax rate from 24% (effective from 1 April 2012) to 23% (effective 1 April 2013) was substantively enacted on 3 July 2012. Further reductions to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Bank's future current tax charge accordingly. The deferred tax liability at 28 February 2015 has been calculated based on the rate of 20% substantively enacted at the balance sheet date.

The movement on the deferred tax account is as follows:

	Note	2015 £m	2014 £m
Deferred tax			
Net liability at 1 March		60	166
Income statement charge	7	10	14
Tax (credited)/charged directly to equity		58	(120)
Net liability at 28 February		**128**	**60**

	2015 £m	2014 £m
Deferred tax liability relates to:		
Available for sale equity investments through comprehensive income	53	78
Fair value losses on available-for-sale debt securities recognised in other comprehensive income	–	(42)
Pensions and other post-retirement benefits	66	23
Other provisions	9	1
	128	**60**

25 Other liabilities

i Analysis of other liabilities

	2015 £m	2014 £m
Items in course of collection	1	26
Payable to HM Treasury	94	82
Short term creditors and other liabilities	172	157
Provisions	8	16
	275	**281**

Payable to HM Treasury includes £93m payment in lieu of dividend (note 8) and a further £1m which relates to the over recovery of costs associated with the management of the notes issue and the Exchange Equalisation Account.

Notes to the Banking Department financial statements continued

25 Other liabilities continued

ii Analysis of provisions

	Restructuring provision £m	Onerous lease provision £m	Total £m
Balance at 1 March 2014	8	8	16
Provisions made during the year	1	–	1
Provisions used during the year	(6)	(2)	(8)
Provisions reversed during the year	(1)	–	(1)
Balance at 28 February 2015	**2**	**6**	**8**

Onerous lease provision

The Bank has undertaken to bear the costs arising from certain leased property previously occupied by the Financial Services Authority and which was vacated upon the commencement of the new regulatory regime. The amount provided for represents the net present value of the future lease payments and the costs of dilapidations required as part of the lease less any expected lease income from sub-letting the floor space.

The lease expires in November 2018. Of the above provision £2m (2014: £2m) falls due within one year. The cash flows are discounted at a risk free rate at 28 February 2015. The impact of the discount unwind is negligible.

26 Capital

	2015 £m	2014 £m
Capital	**15**	**15**

The entire capital comprising £14,553,000 of Bank Stock is held by the Treasury Solicitor on behalf of HM Treasury. The Bank regards its shareholder's funds as the capital it uses to support its normal operations. For special operations it may also obtain indemnities from HM Treasury.

27 Cash and cash equivalents

i Analysis of cash balances

	Note	At 1 March 2014 £m	Cash flows £m	At 28 February 2015 £m
Cash and balances with other central banks	9	584	421	1,005
Loans and advances to banks and other financial institutions	10	3,998	50	4,048
Securities held at fair value through profit or loss	12	194	181	375
		4,776	**652**	**5,428**

ii Stock of liquidity

For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand and amounts due from banks within three months from the date of acquisition. This definition, which is required by IAS 7 (Cash Flow Statements), covers the Bank's stock of liquidity for operational purposes, but is not well suited to the Bank which as the central bank is the ultimate source of sterling liquidity. These include advances to the money market and banks, and reverse repurchase agreements which are regarded as a pool of assets for these purposes. The allocation of this liquidity between the components depends upon prevailing market conditions.

28 Financial risk management

The Bank is required to manage the financial risks that arise on its balance sheet and as a consequence of its operations to deliver its policy objectives. These include credit risk, market risk and liquidity risk.

The Bank's management seek to ensure that effective risk management processes exist for assessing, managing and monitoring risk, within clear risk policies. There are governance arrangements set out in a Balance Sheet Remit and financial risk standards approved by the Governor, and documented delegated authorities for implementation of financial risk management and oversight of the Bank's operations.

The Bank applies fundamentally the same risk management policies for off-balance sheet risks as it does for its on-balance sheet risks. In the case of commitments to lend, customers and counterparties will be subject to the same credit management policies as for loans and advances.

Specialist teams and committees support senior management in ensuring that agreed standards and policies are followed.

The Risk Management Division (RMD) within the Bank's Markets Directorate is responsible for analysing the financial risks faced by the Bank in its operations in financial markets. RMD is responsible for the development of the appropriate framework for the management of financial risks.

The Financial Risk Operations and Accounting Control Division (FROAC) is responsible for the implementation of the agreed risk framework, including reporting on credit, market and liquidity risk. It is also responsible for operational risk management processes across the Markets Directorate and for preparations for contingencies with respect to financial operations.

Notes to the Banking Department financial statements continued

28 Financial risk management continued

a Credit risk

Credit risk is the risk of loss arising from the failure of a borrower, issuer, counterparty or customer to meet its financial obligations to the Bank. The Bank is exposed to credit risk both through direct exposures and contingent exposures, such as via collateral or insurance contracts. The primary source of credit risk arises as a result of the Bank providing liquidity to financial institutions via the Sterling Monetary Framework; intraday in the Bank's provision of liquidity to facilitate the operation of the sterling high-value payment system (CHAPS) and the securities settlement system, CREST; and elsewhere in the Bank's management of its balance sheet, for example in the investment of the Bank's own funds and in the course of the banking services it provides to its customers. In addition, the Bank incurs credit risk in connection with any support operations it may undertake.

The Bank's credit risk policies define high-level risk parameters under which credit risk is monitored and controlled. Unsecured credit exposures are controlled by a system of limits based on internal credit ratings. This system applies to all unsecured credit exposures, including intra day exposures, foreign exchange settlement exposures and exposures arising from settling securities trades for customers. Separately, limits exist to control the maximum outright (uncollateralised) exposures to a single entity. Credit assessments are performed on all market counterparties, issuers and customers to which the Bank may be exposed. These are performed both regularly, following a timetable that reflects the risk of the actual or potential exposure, and dynamically, in response to market or specific entity conditions.

The Bank's Credit Ratings Advisory Committee (CRAC), chaired by the Head of RMD, reviews the creditworthiness of issuers, counterparties and customers to whom the Bank may have credit exposures. CRAC makes recommendations to the Executive Director for Markets, who is responsible for decisions on internal credit ratings. CRAC is supported by a credit risk analysis team.

Banking services are provided to the United Kingdom government and other public sector entities, overseas central banks, international institutions, infrastructure providers, Bank staff and pensioners, and other customers. The Bank may incur credit exposures to its customers in the course of providing such services. The reinvestment of customer deposits via secured on-placements may also give rise to credit exposures.

Credit risk on the securities held outright by the Bank is managed by holding only securities internally rated as equivalent to investment-grade in routine circumstances, which are issued chiefly by governments, government agencies and supranational organisations; and by a schedule of credit limits that vary based on internal rating.

Collateral management

In providing short-term liquidity via the Bank's Sterling Monetary Framework operations and, intra-day, via the Bank's operation of wholesale payment systems, credit risk is managed by ensuring that exposures are fully collateralised (with appropriate haircuts) by securities, which are issued chiefly by governments, government agencies and supranational organisations, which meet the Bank's minimum standards of liquidity and credit risk. A summary of eligible collateral can be found on the Bank's web site.

In the Bank's Indexed Long-Term Repo Operations, Discount Window Facility, Contingent Term Repo Facility and Funding for Lending Scheme, the Bank may take a wide range of private sector collateral. Depending on the facility, the collateral may include mortgage-backed securities, covered bonds backed by mortgages or public sector securities, other asset-backed securities (such as asset-backed securities backed by credit card receivables, student loans or auto loans), or pools of loans. The collateral must meet published eligibility criteria.

The Bank manages the risk in this wider collateral portfolio by applying haircuts to take account of market risk, liquidity risk, credit risk, and all other material risks to the realizable value of the collateral. Where appropriate the Bank undertakes stress testing of securities in order to ensure that haircuts are sufficient to protect against idiosyncratic risk in the underlying collateral pool and counterparty risk. The Bank may vary haircuts at its discretion, including on individual securities.

The Bank values securities daily and calls for additional collateral where the haircut-adjusted value is less than the value of its exposure. Where possible, the Bank uses a market price to value securities. Where no such market price exists, the Bank uses a model price designed to deliver a price that is as close as possible to what a market price would have been had such a price existed. The valuations methodology, the use of spreads in models, and collateral eligibility are under regular review. A Collateral Risk Committee chaired by the Head of RMD reviews issues relating to the wider collateral portfolio and considers policy issues relating to stress testing, valuation and eligibility of collateral including in response to market or entity-specific conditions.

In the Bank's Indexed Long-Term Repo Operations, Discount Window Facility, Contingent Term Repo Facility and Funding for Lending Scheme, the Bank may take portfolios of loans in unsecuritised form as collateral. A Collateral Eligibility Committee chaired by the Head of RMD reviews eligibility of a counterparty to pledge portfolios of loans as collateral, based on an assessment of the firm's risk management policies, and also reviews eligibility of individual portfolios.

In non-routine circumstances, the Bank may seek other methods of mitigating credit risk, which may include indemnities from HM Treasury.

Geographical concentration of assets and liabilities
The Bank undertakes its operations in the United Kingdom. It does, however, accept deposits from overseas central banks. An analysis of the Bank's assets and liabilities by geographical area is given below:

	2015 £m	2014 £m
Assets		
United Kingdom	391,249	388,101
Rest of Europe	9,309	9,741
Rest of the world	2,015	1,499
	402,573	**399,341**
Liabilities and equity		
United Kingdom	385,809	371,054
Rest of Europe	2,814	13,956
Rest of the world	13,950	14,331
	402,573	**399,341**

b Market risk

Market risk is defined as the risk of loss as a result of changes in market prices, including prices of securities, interest rates, foreign exchange rates, commodity prices and credit spreads. The Bank is exposed to market risk as a consequence of its operations to deliver its policy objectives and, in the course of managing the Bank's balance sheet, principally through changes in the relative interest rates received on its assets and paid on its liabilities. Limited exposure may also be incurred to changes in exchange rates (see below) and to shifts in general market conditions, such as the liquidity of asset markets.

The Bank's market risk policies set out risk management parameters, governance and control frameworks as well as reporting arrangements for key risk indicators.

The Bank is exposed to interest rate risk through the investment of the Bank's capital and Cash Ratio Deposits in high-quality securities in the sterling bond portfolio. These are bought and, in normal circumstances held to maturity, with the intention of maintaining the value of the Bank's capital and generating income to pay for the Bank's policy functions.

Notes to the Banking Department financial statements continued

28 Financial risk management continued

Value at Risk measurement

The Bank measures the Value at Risk (VaR) of all its positions. VaR estimates the potential loss that might arise if existing positions were unchanged for 10 working days under normal market conditions, given the historical volatility of the returns on different assets, and the historical correlation between those returns.

VaR on the Bank's balance sheet is calculated against the risk factors to which the Bank is exposed. During the year VaR arose mostly from market risk on the Bank's sterling bond portfolio.

Value at Risk

	2015 £m	2014 £m
At 28 February	112.4	98.2
Average	101.3	94.8

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based do give rise to some limitations, including the following:

A 99% confidence level does not reflect losses that may occur beyond this level. Even within the model used there is a 1% probability that losses could exceed the VaR.

A ten-day holding period assumes that it is possible to hedge or dispose of positions within that period. This may not be realistic in a situation where there is severe market illiquidity.

VaR data is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during the day.

The model uses two years of historical data as a basis for determining the possible ranges of outcomes and may not always cover all possible scenarios, especially those of an exceptional nature.

An assumption of log-normality, which may underestimate the size of extreme movement in market data.

The Bank back-tests its VaR by comparing actual profit or loss to the VaR estimation. The results of the back-testing process are one of the methods by which the Bank monitors the ongoing suitability of its VaR model.

The Bank also undertakes stress tests on positions on its balance sheet. The results of the stress testing complement the VaR measure in informing management about financial risk on the balance sheet.

To mitigate the fourth limitation above, the Bank has developed two additional variations of VaR: an exponentially weighted measure that gives greater weight to the most recent data and also a 'Stressed' VaR measure. The latter is calibrated not specifically on recent data, but on data drawn from the two-year period of maximum volatility since January 2000. Stressed VaR avoids the understatement problem as changes generally arise from a change in the underlying portfolio, rather than a short-run change in market volatility. The Bank introduced the Stressed VaR in June 2013; at 28 February 2015, stressed VaR was £190.97m (2014:£162.92m).

Currency risk

The Bank may take currency risk in the context of foreign exchange intervention and in the course of balance sheet management. However, the majority of these potential exposures are matched, mainly through the use of forward exchange contracts and currency swaps, and residual foreign exchange exposures are hedged on a regular basis. Therefore the Bank has no significant net foreign currency exposure, other than the Bank's investment in the Bank for International Settlements (note 14b) which is denominated in Special Drawing Rights, and held at fair value of £287 million (2014: £397 million). Excluding this, the Bank's net foreign exchange exposure at 28 February 2015 was £2 million (2014: £1 million).

c Liquidity risk

Liquidity risk is the risk of encountering difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

In sterling, liquidity risk does not arise as the Bank is able to create sterling liquidity through its market operations.

For foreign currency, in addition to holding appropriate cash balances, the Bank manages liquidity through cash-flow matching and the use of forward exchange contracts and currency swaps; the Bank also holds a portfolio of liquid foreign exchange reserves. Throughout 2014/15, the Bank continued weekly tender operations (which had recommenced in May 2010) to lend US dollar funds for 7 days against eligible collateral. From October 2011 to April 2014 the Bank has also offered monthly US dollar tender operations with a three month term. US dollar funding to facilitate these operations would be provided through a reciprocal swap agreement with the US Federal Reserve.

In view of the improvement in US dollar funding conditions and the low demand for US dollar liquidity-providing operations, the Bank of England, in co-ordination with other central banks, decided to phase out its current US dollar liquidity-providing operations. The network of bilateral central bank liquidity swap arrangements, moved on to a standing basis in October 2013, provide a framework for the reintroduction of US liquidity operations if warranted by market conditions.

The Bank's Balance Sheet Remit and Liquidity Risk standard and supporting policies set out risk tolerances and detailed parameters and controls to minimise the foreign currency liquidity risk that arises. These include limits over cash flow and maturity mismatches, and for bond holdings, minimum issue size and concentrations limits are set as well as reporting requirements for key risk indicators.

Notes to the Banking Department financial statements continued

28 Financial risk management continued

The following tables analyse the Bank's foreign currency financial assets and liabilities at the balance sheet dates into relevant maturity groupings based on the remaining period to the contractual maturity date.

Foreign currency liquidity risk

As at 28 February 2015	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Assets						
Cash and balances with other central banks	1,005	–	–	–	–	1,005
Loans and advances to banks and other financial institutions	2,714	3,575	3,843	–	–	10,132
Securities held at fair value through profit and loss	699	870	1,747	2,021	–	5,337
Derivative financial instruments:						
Cash inflow	3,817	2,804	2,645	1,989	–	11,255
Cash outflow	(3,969)	(4,169)	(5,312)	(1,652)	–	(15,102)
Other assets	–	–	–	–	–	–
Total assets	**4,266**	**3,080**	**2,923**	**2,358**	**–**	**12,627**
Liabilities						
Deposits from central banks	2,975	2,898	2,628	–	–	8,501
Deposits from banks and other financial institutions	2	–	–	–	–	2
Other deposits	164	–	–	–	–	164
Foreign currency bonds in issue	1,307	–	9	2,609	–	3,925
Derivative financial instruments:						
Cash inflow	(96)	(70)	(1)	(124)	–	(291)
Cash outflow	93	71	1	159	–	324
Other liabilities	–	–	–	–	–	–
Total liabilities	**4,445**	**2,899**	**2,637**	**2,644**	**–**	**12,625**
Net liquidity gap	**(179)**	**181**	**286**	**(286)**	**–**	**2**
Cumulative gap	**(179)**	**2**	**288**	**2**	**2**	**–**

Foreign currency liquidity risk

As at 28 February 2014	Up to 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m	Total £m
Assets						
Cash and balances with other central banks	584	–	–	–	–	584
Loans and advances to banks and other financial institutions	2,972	4,404	1,606	–	–	8,982
Securities held at fair value through profit and loss	413	1,425	2,851	1,599	–	6,288
Derivative financial instruments:						
Cash inflow	1,034	1	128	631	–	1,794
Cash outflow	(1,705)	(764)	(462)	(561)	–	(3,492)
Other assets	–	–	–	–	–	–
Total assets	**3,298**	**5,066**	**4,123**	**1,669**	**–**	**14,156**
Liabilities						
Deposits from central banks	1,903	4,387	3,247	–	–	9,537
Deposits from banks and other financial institutions	69	–	–	–	–	69
Other deposits	488	–	–	–	–	488
Foreign currency bonds in issue	1,208	–	6	2,398	–	3,612
Derivative financial instruments:						
Cash inflow	(2,611)	(4,391)	(3,139)	(1,198)	–	(11,339)
Cash outflow	2,616	4,684	3,232	1,256	–	11,788
Other liabilities	–	–	–	–	–	–
Total liabilities	**3,673**	**4,680**	**3,346**	**2,456**	**–**	**14,155**
Net liquidity gap	**(375)**	**386**	**777**	**(787)**	**–**	**1**
Cumulative gap	**(375)**	**11**	**788**	**1**	**1**	**–**

Notes to the Banking Department financial statements continued

28 Financial risk management continued

d Fair value of financial assets and liabilities

The table below shows the financial instruments carried at fair value by valuation method:

As at 28 February 2015	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets					
Loans and advances to banks and other financial institutions	10	–	10,131	–	10,131
Securities held at fair value through profit or loss	12	5,160	–	–	5,160
Derivative financial instruments	13	–	1,251	–	1,251
Available for sale securities	14	6,703	–	291	6,994
		11,863	**11,382**	**291**	**23,536**
Liabilities					
Deposits from central banks	20	–	14,330	–	14,330
Foreign currency bonds in issue	23	3,898	–	–	3,898
Derivative financial instruments	13	–	46	–	46
		3,898	**14,376**	**–**	**18,274**

As at 28 February 2014	Note	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets					
Loans and advances to banks and other financial institutions	10	–	8,979	–	8,979
Securities held at fair value through profit or loss	12	6,090	–	–	6,090
Derivative financial instruments	13	–	179	–	179
Available for sale securities	14	5,940	–	402	6,342
		12,030	**9,158**	**402**	**21,590**
Liabilities					
Deposits from central banks	20	–	12,928	–	12,928
Foreign currency bonds in issue	23	3,599	–	–	3,599
Derivative financial instruments	13	–	465	–	465
		3,599	**13,393**	**–**	**16,992**

There have been no transfers between levels in the year.

Level 1 Valued using unadjusted quoted prices in active markets for identical financial instruments.
Level 2 Valued using techniques that rely upon relevant observable market data curves. This category of instruments comprised derivatives, repurchase transactions, commercial paper and deposits.
Level 3 Valued using techniques where at least one input that could have a significant impact on the valuation is not based on observable market data. During the year this category consisted primarily of the Bank's investment in the Bank for International Settlements (note 14b).

The fair values of financial assets and liabilities classified as loans and receivables and deposits at amortised cost approximate to their carrying values due to their short-term nature.

29 Off balance sheet arrangements – Funding for Lending Scheme

The Funding for Lending Scheme (FLS) has been designed to incentivise banks and other financial institutions to boost their lending to UK households and businesses.

FLS does this by providing funding for an extended period with a direct link between the quantity and price of funding available from the scheme and participants' performance in lending to the real economy.

	Up to 1 year £m	1 to 3 years £m	3 to 5 years £m	2015 Nominal £m	2015 Fair value £m	2014 Nominal £m	2014 Fair value £m
Securities lent to banks and other financial institutions	–	39,142	17,694	56,836	56,708	41,405	41,334
Securities borrowed from DMO	–	(39,142)	(17,694)	(56,836)	(56,708)	(41,405)	(41,334)
Total obligations	–	–	–	–	–	–	–

As of the end of February 2015 34 banking groups were signed up to the latest part of the FLS extension, and a further 16 groups had signed up to earlier parts of the scheme but were not participating in the extension. Of these groups, 43 had outstanding drawings as at the end of February 2015 (2014: 39 groups). Treasury bills with a market value of £56.7bn had been advanced to participants at year-end (2014: £41.3bn). The Bank has borrowed these Treasury bills from the DMO to whom they are owed back. In the year to 28 February 2015, the Bank recognised income of £132m from FLS (2014: £89m).

30 Contingent liabilities and commitments

a Contingent liabilities

Contingent liabilities and commitments, some of which are offset by corresponding obligations of third parties, arise in the normal course of business, including contingent liabilities in respect of guarantees and indemnities in connection with liquidity support operations.

As part of its normal business, the Bank acts as custodian of its customers' assets and fulfils an agency role. No significant irrecoverable liability arises from these transactions.

Since 1930 there has also been a contingent liability in respect of uncalled capital on the Bank's investment in the Bank for International Settlements (BIS), now denominated in Special Drawing Rights (SDR). The sterling equivalent of this liability based on the SDR price at the balance sheet date was £163 million (2014: £166 million). The balance of £163m is callable at three months' notice by a decision of the BIS Board of Directors.

The Bank has been required to subscribe to the share capital of the European Central Bank (ECB) since its establishment in 1998. Subscriptions depend on shares which are fixed in accordance with Article 29.3 of the European System of Central Banks (ESCB) Statute and which must be adjusted every five years and on the accession of new states to the European Union. The next quinquennial adjustment is due in 2019.

Notes to the Banking Department financial statements continued

30 Contingent liabilities and commitments continued

As a result of our shareholding and in accordance with the Treaty on the Functioning of the European Union, the Bank is required to pay a 'minimal percentage' of its subscribed share capital, currently 3.75% amounting to €56 million (2014: 3.75% amounting to €56 million) by way of contribution to the operational costs of the ECB. The value of this contribution will be adjusted in line with amendments to our subscription to the ECB as detailed above. In addition, the 'minimal percentage' can be varied by the General Council of the ECB, as detailed above. The Bank has not been notified of any intentions to change the 'minimal percentage'.

b Capital commitments

Capital commitments outstanding at 28 February 2015 amounted to £37 million (2014: £11 million).

In addition the Bank did not have any contingent capital commitments outstanding at 28 February 2015 (2014: £nil).

c Operating lease commitments – minimum lease payments

	2015 Land and buildings £000	2015 Computer and other equipment £000	2014 Land and buildings £000	2014 Computer and other equipment £000
At the year end, minimum lease payments under non-cancellable operating leases were				
Expiring within one year	7,949	171	7,700	251
Between one and five years	28,308	288	30,944	133
Expiring in five years or more	38,830	–	44,257	–
	75,087	**459**	**82,901**	**384**

The Bank leases the premises occupied by its Agencies and the PRA.

31 Related parties

Transactions with those commercial banks which are related parties but not wholly-owned by HM Treasury have not been disclosed as the Bank does not believe such disclosures to be appropriate having regard to its financial stability objective.

a HM Government

The Bank provides a range of activities to its shareholder, HM Treasury, and to other Government departments and bodies:

- Provision of banking services, including holding the principal accounts of Government.
- Management of the Exchange Equalisation Account (EEA).
- Management of the note issue.

The Bank also engaged in transactions with the Financial Services Compensation Scheme and other related parties.

The aggregate balances on HM Treasury and other public sector accounts are disclosed in note 22 as public deposits. The total charges made to the Government are disclosed in note 4a.

A management fee of £81m (2014: £78m) was payable by HM Government in the year ended 28 February 2015 to the Bank in respect of services provided to the EEA of £9m (2014: £8m) and Issue department of £72m (2014: £70m).

Debt Management Office and Debt Management Account

The Bank has entered into agreements with the UK Debt Management Office (DMO) through the Debt Management Account (DMA) whereby the DMA lends UK government securities to the Bank with the simultaneous agreement that the Bank would deliver equivalent securities to the DMA on termination of those agreements.

At 28 February 2015 the Bank had a loan from the DMA of £193m (2014: £193m) in relation to the provision of funding to Bank of England Asset Purchase Facility Fund Limited.

At 28 February 2015 the Bank had borrowed Treasury bills with a nominal value of £56.8bn (2014: £41.4bn) under the Bank's Funding for Lending Scheme. The Bank has paid the DMA a loan fee for the Treasury bills borrowed.

In addition, the DMA placed interest bearing deposits with the Bank during the year, which is included within note 22 as public deposits.

The fees charged in respect of services provided to the DMO were £1m (2014: £1m).

HM Treasury

HM Treasury continued to indemnify the activities of Bank of England Asset Purchase Facility Fund Limited during the year.

The Bank has requested HM Treasury to require the Financial Services Compensation Scheme (FSCS) to make a payment reimbursing the sum of £2.9m in respect of expenses incurred by the Bank in connection with the resolution of Dunfermline Building Society in accordance with the Financial Services and Markets Act 2000 (Contribution to Costs of Special Resolution Regime) Regulations 2010.

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) is the UK's statutory fund of last resort for customers of authorised financial services firms set up under the Financial Services and Markets Act 2000. The FSCS is independent from the Prudential Regulation Authority and Financial Conduct Authority (formerly the FSA), although accountable to them and ultimately to HM Treasury.

The FSCS placed interest bearing deposits with the Bank during the year, which are included within note 22 as public deposits.

b Subsidiaries

Full details of the subsidiaries of the Bank are disclosed in note 15.

Bank of England Asset Purchase Facility Fund Ltd (BEAPFF)

BEAPFF is a wholly-owned subsidiary of the Bank. It was established on 30 January 2009 in order to fulfil the remit of the Chancellor of the Exchequer given to the Bank on 19 January 2009. This remit was subsequently expanded to enable the Fund to be used as a monetary policy tool at the request of the Monetary Policy Committee.

BEAPFF's operations are fully indemnified for loss by HM Treasury and any surplus for these operations is due to HM Treasury.

Purchases of assets by BEAPFF are financed via a loan from the Bank. From 6 March 2009 to 4 February 2010 and from 7 October 2011 advances on this loan were financed by the issuance of central bank reserves. Prior to 6 March 2009 and from 4 February 2010 to 6 October 2011 advances on this loan were financed by a loan from the DMO.

At 28 February 2015 the loan from the Bank to BEAPFF was £375.2bn (2014: £375.2bn). Interest on this loan is receivable at Bank Rate and amounted to £1.9bn for the year ending 28 February 2014 (2014: £1.9bn).

At the year end BEAPFF held a deposit at the Bank of £1.2bn (2014: £1.0bn), which is included in other deposits (note 22). Interest on this deposit is payable at Bank Rate and totalled £17m for the year ending 28 February 2015 (2014: £47m).

A management fee of £2m was payable by BEAPFF to the Bank in respect of the year ended 28 February 2015 (2014: £2m).

Notes to the Banking Department financial statements continued

31 Related parties continued

Prudential Regulation Authority (PRA)

The PRA is a wholly-owned subsidiary of the Bank. The company was established on 21 November 2011 and began to operate when the new regulatory framework for the UK's financial sector came into effect on 1 April 2013.

The Bank initially pays all of the expenses of the PRA. The Bank then recharges relevant expenditure either via the corporate services fee or a direct recharge. In the year the Bank charged the PRA a corporate services fee of £97m (2014: £59m) and recharged direct costs of £139m (2014: £132m).

As at 28 February 2015 the Bank was owed £14m (2014: £19m) by the PRA in respect of recharged expenditure and corporate services fee, this amount is included in Note 19.

The PRA Board had previously agreed that the costs of the transition would be recovered from the fee-payers over a period of five years. As a result the PRA has a liability to the Bank and the Bank has a receivable from the PRA as at the year end of £45m (2014: £59m) which is disclosed as a receivable within note 19. As at 28 February 2015 all tangible assets for the PRA were transferred over to the Bank at a carrying value of £5.8m.

c Key management personnel

Members of Court are covered by an indemnity from the Bank, granted in 2000 (see page 7).

The following information is presented only in respect of those employees of the Bank who would be considered as key management personnel, as defined under IAS 24 (Related Party Disclosures). This comprised the Governors, members of the Executive Team and Non-executive Directors. At 28 February 2015, the number of key management personnel was 28 (2014: 26).

The following particulars relate to loans and deposits between the Bank and key management personnel and persons connected with them:

	2015 £000	2014 £000
Loans		
Balance brought forward	43	28
Loans made during year	44	35
Loans repaid during year	(32)	(20)
	55	**43**
Interest income earned	2	2
Number of key management personnel with loans at 28 February	**3**	**5**

No provisions have been recognised in respect of loans given to related parties (2014: £nil).

	2015 £000	2014 £000
Deposits		
Governors and Executive Directors		
Balance brought forward	280	872
Deposits taken during year	546	512
Deposits repaid during year	(555)	(1,104)
	271	**280**
Non-executive Directors		
Balance brought forward	6,171	6,159
Deposits taken during year	4	12
Deposits repaid during year	(6,175)	–
	–	**6,171**
Interest expense on above deposits	6	17
Number of key management personnel with deposits at 28 February	4	5

Loans and deposits repaid during the year include movements due to changes in key management.

There were no other transactions that would be required to be shown under the provisions of the Companies Act 2006. None of the key management personnel had a material interest, directly or indirectly, at any time during the year in any other significant transaction or arrangement with the Bank or any of its subsidiaries.

All employees, excluding external MPC members, are entitled to season ticket loans (repayable monthly over five to 12 months) and may choose to take personal loans (for periods of up to five years and at a variable interest rate equal to HMRC's Official Rate of Interest currently 3.25%) as part of their remuneration package.

Staff, including Governors and Executive Directors, holding current and interest-bearing deposit accounts at the Bank of England receive interest at commercial rates.

Notes to the Banking Department financial statements continued

31 Related parties continued

Key management remuneration

	2015 £000	2014 £000
Salaries and short-term benefits[49]	6,043	4,852
Post-employment benefits	1,431	873
	7,474	**5,725**

Post-employment benefits have been estimated using an expected cost of pension on a funding valuation basis.

Full information on the remuneration (including pension arrangements) of the Members of Court is given in the Report of the Remuneration Committee on pages 74 to 80.

d The Bank's pension scheme

The Bank provides the secretariat, accounting services and some banking and custodial services to the Bank's funded pension scheme. In the year to 28 February 2015 no charge was made for these services (2014: £nil). These activities are undertaken on behalf of, and under the supervision of, the Trustee of the Pension Fund. The contribution paid to the scheme during the year was £87m (2014: £74m). There were no other material transactions between the Bank and the pension scheme during the year to 28 February 2015. At 28 February 2015 the balances on accounts held with the Bank were £13m (2014: £11m).

e Other entities with links to the Bank

In the normal course of its activities as a central bank, the Bank has relationships, involving some representation at management level and participation in funding, with international and domestic institutions. The Bank does not consider these institutions to be related parties.

32 Date of approval

The Members of Court approved the financial statements on pages 96 to 150 on 10 June 2015.

49 During the year it was identified that certain taxable expenses had been classified as business expenses, and therefore not disclosed in the key management table. This has required restatement of prior year Salaries and short-term benefits from £4,836,000 to £4,852,000, which are stated gross of relevant tax liabilities.

Issue Department account
for the period ended 28 February 2015

	2015 £m	2014 £m
Income and profits		
Securities of, or guaranteed by, the British Government	288	238
Other securities and assets	288	275
	576	**513**
Expenses		
Cost of production of banknotes	(33)	(36)
Cost of issue, custody and payment of banknotes	(27)	(25)
Other expenses	(10)	(9)
	(70)	**(70)**
Paid to National Loans Fund	**506**	**443**

Issue Department statement of balances
for the period ended 28 February 2015

	Note	2015 £m	2014 £m
Assets			
Securities of, or guaranteed by, the British Government	3	4,451	4,594
Other securities and assets including those acquired under reverse repurchase agreements	4	59,338	55,604
Total assets		**63,789**	**60,198**
Liabilities			
Notes issued:			
In circulation	5	63,789	60,198
Total liabilities		**63,789**	**60,198**

On behalf of the Governor and Company of the Bank of England:

Mr M Carney Governor
Mr B Broadbent Deputy Governor
Mr A Habgood Chairman of Court
Mr R Coates Finance Director

The notes on pages 153 to 155 are an integral part of these statements of accounts.

Notes to the Issue Department statements of account

1 Bases of preparation

The statements of account are prepared in accordance with the requirements of the Currency and Bank Notes Acts 1928 and 1954, the National Loans Act 1968 and the Currency Act 1983. All profits of the Issue Department are payable to the National Loans Fund.

- The statements of account are prepared on the basis of amounts received and paid as modified by the effects of a revaluation of securities.
- All securities are revalued quarterly at their clean mid-market price and are stated, with purchased accrued interest, in the balance sheet at this valuation. The last valuation was made as at 26 February 2015.
- If a revaluation of securities shows a net gain this is included in income. A deficit is not taken against income but is settled by a transfer from the National Loans Fund. Total gains taken to income in the year to 28 February 2015 amounted to £81m (2014: £nil) and total deficits paid by the National Loans Fund amounted to £7m (2014: £282m).
- Notes in circulation exclude those old series notes which have been written off. The value of the note is still given by the Bank on presentation. The Bank is reimbursed by HM Treasury in these instances.

2 Expenses

The expenses of £70m (2014: £70m) represent charges from the Banking Department for costs incurred in relation to the note issue of £72m (2014: £72m) less amounts over-collected in prior years.

3 Securities of, or guaranteed by, the British Government

	2015 £m	2014 £m
British Government Stocks	4,081	4,224
Ways and Means advance to the National Loans Fund	370	370
	4,451	**4,594**

The Ways and Means advance earns interest at Bank Rate.

4 Other securities and assets including those acquired under reverse repurchase agreements

	2015 £m	2014 £m
Deposit with Banking Department	57,873	55,109
Reverse repurchase agreements	1,465	495
	59,338	**55,604**

The deposit with Banking Department earns interest at Bank Rate.

Notes to the Issue Department statements of account continued

5 Notes in circulation

	2015 £m	2014 £m
£5	1,601	1,540
£10	7,371	7,182
£20	38,912	36,484
£50	11,788	11,025
Other notes*	4,117	3,967
	63,789	**60,198**

* Includes higher value notes used as cover for the note issues of banks in Scotland and Northern Ireland.

6 Assets and liabilities

a Interest rate exposure

As the liabilities of the Issue Department are interest free, the income of the Issue Department is directly exposed to movements in interest rates. As at the year end 28 February 2015, the assets of the Issue Department had the following repricing period profile.

	2015 £m	2014 £m
Repricing up to one month	59,708	55,974
Repricing in greater than one month but less than three months	–	–
Repricing in greater than three months but less than six months	–	–
Repricing in greater than six months but less than 12 months	823	222
Repricing in greater than 12 months	3,258	4,002
	63,789	**60,198**

b Currency exposure

All the assets and liabilities of the Issue Department are denominated in sterling. The collateral provided under reverse repurchase agreements may be in currencies other than sterling but this does not give rise to any direct currency exposure.

c Credit risk

Credit risk is the risk of loss arising from the failure of a borrower, issuer, counterparty or customer to meet its financial obligations to the Bank. The Bank is exposed to credit risk both through direct exposures and through contingent exposures, such as custody arrangements and holdings of collateral. Credit risk arises in the course of the operations of the Note Circulation Scheme, Agency Notes Store and Notes Printing Contract; and as a result of the Bank providing liquidity to financial institutions via open market operations.

In providing liquidity via routine open market operations credit risk is managed by ensuring that exposures are fully collateralised (with appropriate margin) by internally rated as equivalent to investment-grade securities.

Credit risk on the securities held by the Bank is managed by holding only internally rated as equivalent to investment-grade securities in routine circumstances, issued chiefly by governments and central banks.

7 Accrued interest

At 28 February 2015 the unrecognised accrued interest on the assets held on the Issue Department statement of balances was £65m (2014: £68m).

8 Date of approval

The Members of Court approved the statements of account on pages 151 to 155 on 10 June 2015.

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The Bank of England's mission is to promote the Good of the People of the United Kingdom by maintaining Monetary and Financial Stability

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