POL00273832

POST OFFICE LIMITED
THE BOARD OF DIRECTORS

DISCUSSION PAPER

CEO Report

Author: Al Cameron

Meeting date: 30 April 2019

The GLO

Our request for leave to appeal on the recusal and the claimants' counter-argument have been submitted to the Court of Appeal.

To ensure we have sufficient, full-time advice, experienced in litigation and capable of testing the views of advisors, we have asked Herbert Smith to lead the GLO, reporting to the Board sub-committee. There are no plans to amend the rest of the team other than standing down Norton Rose.

The sub-committee met on Wednesday and debated the grounds for appeal on the common issues trial and whether we should accelerate that appeal, requesting that the two appeals be heard together. On balance and against the QC's advice, we decided to proceed with two separate appeals, although ultimately it will be a matter for the Court of Appeal to determine how it wishes to hear them.

Consequently, POL will first apply for permission to appeal in respect of the common issues trial on 16 May 2019 before Justice Fraser. On 23 May 2019 it will be determined how the costs of the common issues trial should be apportioned. The Horizon issues trial will recommence on 10 June through to the first week of July.

Various workstreams are underway to agree changes to the way we work in line with the objectives of serving agents better and reducing legal risk in our contractual relationships. This is already changing the structure in Chesterfield with a Tier 2 contact centre team created to focus on disputes. A full update will be presented to the Board in May.

The GLO has received limited media attention. For the most part it has escaped the public's attention: only around 10pc are aware of having seen or heard something about Post Office in the media recently. However, within this group, negative sentiment about the business increased significantly.

Commercial Performance

In our management accounts, we reported a trading profit for 2018-19 of £61.5m, broadly in line with expectations.

Gross revenue grew 2% year-on-year to £968m, £3m ahead of budget. This included Mails trading up 6% including some stamp buy-forward ahead of the price rise. Banking income grew 15% offset by declines in Payment Services, POCA and Postal Orders. Identity grew its trading profit 33% to £34m, a peak before the changes in UKVI and Identity pricing flow through. Insurance grew its revenue by 15% but trading profit by just 1%.

Change spend of £272m exceeded the Q4 forecast by £7.6m, although half of this related to non-cash onerous lease provisions. Benefits of £37.5m were delivered, in line with forecast but £2.7m below budget.

POL00273832

On cash, we ended the year with £747m in use, £135m better than the previous year-end. £90m of the lower usage was in branch.

Delivery

Network.

Network location numbers grew to 11,638 at year-end, subject to audit. This is an increase of 91 in 2018-19, a significant achievement. We opened 328 New Network Locations in areas that didn't have any Post Office provision, increasing convenience for customers. We also exited 67 DMBs, leaving 188 remaining.

A team from Post Office attended the recent NFSP conference. The audience and NFSP leadership recognised that change was underway, including higher sales incentives for telecoms and insurance, greater ability to sell travel insurance in Locals, higher pay on banking deposits and we waived the clause preventing the NFSP from criticising us in public. Our new field leadership structure is also now in place

The areas we discussed aligned with the results of the survey they had undertaken with 1,000 Postmasters, prioritising concerns around pay and competition. While our change of tone was appreciated, it also underlined the extent to which Postmasters have felt neglected – a typical question was "Do you view us as an asset at all?" – and how much there is to do in delivering our strategy of "Making it easier for Postmasters to earn more money for less effort." We confirmed that we will be undertaking a review of Postmaster remuneration for the Board in October.

The publication of the survey did generate some press attention and the strap line that 20% of Postmasters are thinking of handing the keys in will continue to gain attention. This reinforces our strategy and we should not complain about the NFSP trying to put us and Government under pressure to do more. We do, however, think that they are a little naïve and the story predictably played into the hands of the CWU.

We challenged the NFSP from the platform to recruit more active members, ensuring that they remain representative of Postmasters.

Banking Framework 2.

We continue to have 25 Banks signed up for BF2, with three more expected to join at the end of May: RBS; Barclays; and the Co-op. RBS has just requested additional and legally binding commitments in areas like change spend. Our response is that with 25 banks on board we are beyond the negotiation period and they need to re-join or stay out. Barclays has said that it no longer views PCI as an issue for BF2.

POL00273832

Bank of Ireland.

The Board sub-committee has agreed to the commercial construct for Credit cards with CapOne. Details will be provided at the May Board. We expect to sign both the CapOne agreement and the associated back book agreement with BoI in early May. New CapOne-backed PO branded credit cards will be launched by the end of October.

Following agreement of Heads of Terms on the new relationship with BoI, work is underway to agree a new FSJVA. We are driving for completion by the end of May but it may slip into June, given the number of outstanding legal complexities.

I am meeting Francesca McDonagh straight after this Board meeting.

Back Office Transformation.

Progress has been made resolving reconciliation through to our financial system with failure rates much reduced. Cash depots continue to count physical cash weekly, confirming a match to Transtrack. The inventory team has reduced excess cash in the network close to expected levels. The Phase 2 forecasting solution for sterling cash went live over Easter weekend and is now being tested in parallel run. We continue to work closely with PwC on the year-end audit.

Security.

Following the known exploit of a number of our email accounts, we shared our Office 365 data from October 2018 to February 2019 with the National Cyber Security Centre (NCSC). The NCSC noted high activity during December 31, 2018 and February 23, 2019 but were unable to identify any credible malicious activity. It is satisfied with the controls and monitoring systems implemented in December.

For PCI, as set out in a separate paper, progress is being made on the deployment of point-to-point encryption on all pin-pad devices across our branch estate. This will meet our PCI compliance for retail transactions ie using your card for mails or bill payment transactions.

The challenge to the overall timeline relates to the estimated work to the back-end systems for processing banking services transactions. An alternative solution design is being urgently investigated that would remove our back-end systems from the scope of PCI, processing transactions directly via the Ingenico/ Vocalink networks. This will take some weeks to work through but has obvious advantages.

POCA

POCA customers are expected to decline from c.1.2m today to c.0.5m in March 2021 when the current contract ends. DWP then plans to terminate the provision for 350k customers, forcing them onto bank accounts and is about to tender provision for the remaining 150k who are unlikely to be offered a bank account.

POL00273832

We have requested a meeting with Amber Rudd and are writing to her and to DWP officials. We are recommending that the tender process properly reflects the vulnerability of these customers many of whom are elderly, resistant to normal communications and anxious. We also believe that space should be left for a single solution that could encompass all 0.5m customers.

In addition, it seems appropriate to highlight that although POCA is marginal for our finances, it is important to some Post Offices. Removing the product from Post Office may be interpreted as anti-Postmaster by the NFSP and may lead individual Postmasters to hand the keys in, making Government policy harder to deliver. The overall impact on remuneration over the next few years is substantial with 200 Post Offices badly hit and around 20 becoming loss-making, especially in Northern Ireland.

Compliance and regulation:

Select Committee

We have been invited to attend a BEIS Select Committee on the future of Post Office on 21 May. We will submit evidence by 6 May. This is in draft and will be shared with Government in advance.

We have also worked with BEIS colleagues to support our minister through a further House of Commons debate, this time on the sustainability of the branch network.

Team

As the Board is aware, Jane MacLeod is leaving at the end of May, focusing on GLO handover before then. Ben Foat is promoted to General Counsel, leading Legal, Compliance and Company Secretary, with the latter being undertaken by Veronica Branton. Audit & Risk will move to the CFO, with disaster recovery moving to Operations. We will follow the process with RemCo for Ben to become a member of GE.

Afua Kyei is still expecting to join us as CFO and should resign her current position on 1 May. She requested one contractual change, backdating LTIP if she is appointed to the permanent position. UKGI consider this unlikely and we are seeking other ways to provide equivalent compensation in this circumstance. We are understandably anxious that this might make her vulnerable to a counter offer from Barclays.

Rob Houghton has, with our support, been appointed a Non-Executive of the new NHS Supply Chain vehicle.

Jonathan Lewis has been appointed Head of Strategy and Corporate Development on a fixed term contract.

POL00273832

Decisions for today

Budget. We have amended the budget for the Board's feedback and for changes arising from the GLO judgement. We are seeking Board approval, subject to agreeing the recent changes, as the details are finalised, with UKGI.

Succession. As requested, we are submitting a paper setting out risks and actions around GE succession. No specific decisions are required.

Strategy

At the May Board, we will bring back the outcomes from the McKinseys work, to fill capability gaps, deliver cost reductions and simplify the organisation. In addition, we will revert on the Mails negotiations and on our plans for Insurance.

We have started a formal tender process for the future of the Telco supply chain and a smaller, private RFP to test a sale of the business.

In July, we will revert with our financial strategy, taking us beyond 2021. We will also bring back a recommendation on the future of Telco; how we manage the incumbency trap for Travel Money; the opportunity to support a cash utility; the future of Identity; and a forward strategy roadmap.