



OFFICIAL-SENSITIVE: COMMERCIAL



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Director General: Charles Donald (UKGI)

Lead Official: Alex Cole (UKGI), Eleanor Brooks / Beth White (BEIS)

Lead Official Telephone: GRO

Recipient	To Note / Comment	To Approve / Decide
Permanent Secretary	X	
Minister Scully	X	

Post Office Limited (POL): Quarterly update

Summary

1. This quarterly update is for your information. Officials will meet POL for the formal Quarterly Shareholder Meeting on Monday 27 July.

Timing

2. Routine.

Overview

3. POL's operations are beginning to move towards a new normal following the significant impact of Covid-19, as the numbers of branches closed or operating reduced hours have stabilised. POL's financial performance has beaten the budget agreed in May as the recovery has begun earlier than forecast, although POL is still projecting £9m trading profit for the year (vs. £90m forecast pre-Covid-19).
4. On litigation, the Historical Shortfalls Scheme has been launched and has had 745 applicants so far. The CCRC has referred 47 of the 61 criminal cases to the Court of Appeal. The Independent Review's terms of reference have been announced and Chair selection is underway. The BEIS Select Committee's interest remains although it has not yet invited Minister Scully/BEIS/UKGI officials to give evidence on the Horizon case. The All-Party Parliamentary Group (APPG) on Post Offices have also asked Nick Read and Minister Scully to attend, probably in September.
5. POL has kicked off its preparations for the Spending Review (SR) and will be putting a new 4-year plan to the Board in the coming weeks (forming the basis of its SR request). An opening proposal of a £350m equity injection plus a separate postmaster compensation scheme to deal with any overturned convictions has been provided by POL. These will underlie POL's formal proposal, which officials will challenge during August ahead of submitting a full business case in September.

Background

6. As Permanent Secretary and therefore POL's Principal Accounting Officer, you are accountable to Parliament and for ensuring that arrangements are in place for effective shareholder oversight of POL. You are responsible for advising the responsible Minister on POL's objectives in light of BEIS's wider strategic aims and priorities, an appropriate allocation of BEIS's budget for POL in light of BEIS's overall expenditure priorities and how well POL is achieving its strategic objectives and if it is delivering value for money. To support this, the BEIS/UKGI Post Office teams provide quarterly updates on POL and hold quarterly shareholder meetings (which Minister Scully usually attends, although he will be unable to attend the next meeting on 27 July).

Covid-19

7. POL's leadership, teams and postmasters have performed well during Covid-19, delivering continued post office services throughout the lockdown period. POL was very proactive in its handling of issues during the Covid-19 lockdown, particularly regarding 'self-help' for postmaster remuneration and communicated well with BEIS on all Covid-19-related issues. Minister Scully also sent a letter to postmasters and postal workers to thank them for their efforts.
8. During the lockdown, POL reported that they were not able to meet the minimum 11,500 branch requirement or the network access criteria because of closures due to Covid-19. BEIS Ministers therefore agreed to waive these requirements for 3 months, to allow the continued payment of the next quarterly installment of the network subsidy to POL as payment is normally dependent on compliance. A further three-month waiver was agreed on 25 June but only to relax the 11,500 minimum branch number to 10,500 as POL still have 839 branches closed (down from ~1000 during lockdown). Officials have made clear to POL that they need to continue to make efforts to reopen branches where practical, keep BEIS informed of progress and minimise the impact of branch closures, especially in under-served areas. POL also required waivers related to the Working Capital Facility (see next para).
9. Financial support update. Covid-19 reduced the revenue and cash generated by POL which, in turn, reduced POL's security on the BEIS Working Capital Facility (WCF). POL's forecasts expected a breach of the security headroom for several months and so, on 30 April, a one-month waiver (later extended by one month) of this event of default was granted by HMG while officials worked with POL to secure a longer-term solution. In the event POL did not ultimately breach and with evidence of a recovery happening earlier than originally forecast, the waiver expired at the end of June and was not renewed. POL do not anticipate headroom breaches for the rest of 2020/21 (unless there is a second lockdown or slower recovery); officials will closely monitor this.

Legal [Subject to Legal Privilege]

10. 'Sparrow' litigation. Media and parliamentary pressure has continued over the past quarter, including numerous PQs and a BBC Panorama special on 8 June accompanied by a BBC R4 mini-series that ran from 25 May – 5 June. Officials are also aware of a complaint to the Parliamentary Ombudsman alleging maladministration by BIS/BEIS which is in progress (a crowdfunding target was reached on 14 July by the Justice For Subpostmasters Alliance (JFSA) to prepare the paperwork). On 10 June, Minister Scully announced via an Urgent Question the draft Terms of Reference for the Independent Review. These received a mixed reception. BEIS has continued to work to identify a suitable Chair. The new Chair of the BEIS Select Committee restarted their inquiry into Horizon that was delayed due to Covid-19 and wrote to the current and former POL CEOs, Fujitsu and BEIS requesting written evidence, all of whom replied by the end of June and we expect an oral session to be scheduled in due course. On 1 May, POL launched the Historical Shortfalls Scheme which has been receiving a steady stream of applicants (745 by 9 July). The application window closes on 15 August and POL has committed to coming to BEIS for spending approval once they have finished quantifying the claims.
11. By 3 June, the Criminal Cases Review Commission (CCRC) decided to refer 47 cases from POL's applicants to the Court of Appeal. It is still considering a further 7 cases. On 8 July, the Court of Appeal approved POL's request for an extension to respond to these referrals by 4 October. On 28 April, the POL Chair wrote to BEIS confirming POL were reviewing c.900 historical prosecutions in which evidence from Horizon was used to secure the conviction. This was provided alongside a worst-case estimate of the financial exposure to POL should claims materialise.

Legal Privilege

Legal Privilege

POL is considering how the business could be structure internal governance arrangements to make sure this work is properly resourced and to free up management time (a proposal is going to the 28 July Board) and we are working up a proposal for a compensation scheme for postmasters who get their conviction overturned as part of the bid into the upcoming Spending Review. For this work UKGI have been engaging with colleagues across government on similar compensation schemes to help guide POL's thinking and apply lessons learned.

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Legal Privilege

4 Year Plan (4YP) and Spending Review (SR)

13. Strategic work and 4YP. Ahead of its July Board away day, POL has been working on a strategic review of its network and its main business units. This will look at how it will respond in the medium-term to the impact of Covid-19, with separate strands of work on reviewing the network size and shape (Project Neo, see para 20), the services provided in branches, the approach to cash, insurance, identity and the relationship with postmasters. This will be brought together into a coherent 4YP to be assured by KPMG that will be the foundation of POL's SR bid. We will update you with the key outcomes of the strategic review and how the 4YP is shaping up once POL has presented its plan.

14. SR. Informed by the 4YP, POL will develop its SR bid. There had been a presumption within HMG that POL would be financially self-sustainable in the coming years but progress has been slower than hoped for in reducing the cost base (mainly due to litigation costs reducing the ability to invest elsewhere). The impact of Covid-19 on POL makes this even more difficult. An early proposal from POL at the start of July asks for £350m of equity funding for the SR period (to cover both investment funding and network subsidy) as well as the rolling over of its WCFs. Officials have requested more evidence of the need for this funding through detailed profitability and cash flow forecasts, as well as options on the size, nature and timing of the proposed funding and a path to future self-sustainability. We expect to see a draft of this for POL's July Board. Officials will then challenge this during August before submitting a business case in early September. Pre-Covid-19, officials had obtained significant detail from POL on the size and geography of the uncommercial network IRRELEVANT a year, largely in rural areas in the North and Scotland) funded by the current subsidy. POL's WCF expires in March 2021 and an extension needs to be agreed by the end of 2020 so that POL's 19/20 accounts can be signed as a going concern. We will update you alongside the 4YP once we have more information on this. A separate business case for the litigation compensation scheme will be submitted, as discussed in para 11.

Key business issues

15. Telecoms Sale – Market Sensitive Information POL undertook a strategic review of its Telecoms business in 2019 that led to the decision to sell the business if the right price can be obtained. Although it drives c.£150m of revenue and c.£25-30m of trading profit per year, it requires significant investment to be competitive in the future. A new contract to secure the back-office supply via TalkTalk (to replace Fujitsu) was completed on 20 July and allows POL to undertake and complete a sale process by 31 March 2021. POL intend to formally launch the sale in

August, after it was put on hold in March as Covid-19 soured market appetite POL and its advisors are preparing analysis of a reserve price and compliance with MPM and a submission for noting this will be with you ahead of the sale process launching.

16. Royal Mail (RM) and Mail Strategy - Market Sensitive Information POL's 10-year contract with RM is the source of around a third (IRRELEVANT) of POL's revenues and has been in place since the separation in 2012. POL and RM have been negotiating a new 10-year contract which has been delayed due to Covid-19 and a change in RM leadership, but have agreed on the heads of terms. POL and RM are expecting to finalise the contract in August, while the signing of this contract does not require shareholder approval we will write a for information submission of the key terms once they are finalised.

Government Policy

17. Verify. Verify is the Government programme providing virtual identity services. Numbers of providers have reduced over time as Cabinet Office have reduced payment levels. There are only two remaining digital identity providers: Digidentity as a sole provider and POL with Digidentity providing the technical capability. GOV.UK Verify volumes have surged as a result of Covid-19 redundancies generating more Universal Credit applications, and the numbers are likely to continue growing as the crisis deepens. DWP are encouraging customers to use online routes. This situation has placed immense operational and financial pressure on both POL and Digidentity. Recognising this situation, Cabinet Office (CO) have offered to increase pricing for 12-months (from IRRELEVANT per identity payment) to cover the direct costs of identity account creation. Digidentity have accepted this deal and committed to maintain service continuity to CO for the year ahead, this means that in the short term POL agreed to provide Verify for the next 12 months at a small net loss. POL have also encouraged DWP to accept a lower standard of checks for those customers who can't achieve the higher standard of identity verification and to making use of POL branch network for those customers who can't get through the online process.
18. Post Office Card Account (POCa). DWP are in the process of phasing out POCa with the aim of moving existing POCa customers onto alternative options (basic bank accounts or payment vouchers). They implemented a so-called POCa Hard Stop, meaning that Post Office have stopped accepting any new POCa applicants since May 2020. Due to Covid-19 DWP has had to suspend conversion letters to POCa customers to encourage them to migrate away from POCa and onto mainstream banking products in March. Instead DWP and POL had to refocus their efforts during the pandemic towards supporting shielding customers and allowing them to access their benefits, pensions and cash. POL was really proactive in this space and did an enormous amount of work with DWP to set up the fast PACE and Payout Now, two cash delivery services designed for self-isolating or shielding customers that require cash.
19. POCa conversion letters and all conversion type activity will restart in August. As a result, it seems unlikely that DWP will exit the POCa contract by November 2021 as was planned and they are in conversations with POL around extending the POCa contract for one or two more years. Formal contractual negotiations between DWP and POL will be held in September with a view to agreeing an extension by November 2020.
20. Project NEO and Directly Managed Branches (DMB)¹. When Nick Read joined POL as CEO in late 2019, he initiated a review of the business to inform his vision for the company. Project Neo

¹ DMBs are branches operating in profitable locations, with unprofitable models as their share of overheads outweighs any marginal contribution. DMBs are the worst-performing branches in the network generating overall losses of £46.6m.

builds on this by focussing on the future of the business and the network, taking into consideration the likely long-term impact of Covid-19, established and emerging trends in customer demand and the rapidly changing competitive landscape POL faces across many of its markets. Given the critical importance of the network, this work will form an important part of POL's future strategy and underpin their SR bid

21. Project Neo is expected to conclude before the end of the year. Its recommendations will be reviewed by POL's Board and discussed with Government as POL's Shareholder. It is expected that Project Neo will recommend network changes and increasing flexibility in the branch network. In addition, the franchising and potential closure of DMBs are also expected to feature in POL's plans. This will be an incredibly sensitive issue. Franchising of post offices is a long-standing programme that the government has supported because of the benefits it can bring to POL, but it is unpopular with the unions (CWU in particular) and with some in Parliament. Closures would provoke a much stronger negative reaction as there have been no formal closures programme since 2009. CWU is already lobbying on this issue and Marion Fellows, Chair of the APPG on Post Offices has written to Minister Scully to ask about DMB franchising and closure plans. We have asked POL to write to us outlining their plans for the DMB network by September before taking any final decisions and advise them to present their proposals within the context of their overall vision for the shape of the future network

Financial and Operational performance

22. Trading update. POL achieved a trading loss of [IRRELEVANT] in the first two months of the 2020/21 financial year. This performance was ahead of budget by [IRRELEVANT] and was due to trading showing signs of an earlier recovery than expected. POL, however, remains cautious of future trading conditions due to the possibility of a lockdown if there is another Covid-19 outbreak. Mails and Banking Services were above budget with weaknesses experienced in Bill Payments and Insurance. Annex A has more detail.
23. Investment spending. POL finalised its investment spending plans for 2020/21 at the Board in June. These were assessed for appropriateness by KPMG and this review showed that POL had reduced discretionary spending by as much as it could without harming the business in the long-term. POL are forecasting to spend [IRRELEVANT], all of which will be self-financed. The largest spend item is c[IRRELEVANT] of Group Litigation costs which includes legal fees, the costs of the Historical Shortfall Scheme but not any compensation associated with any convictions that might be overturned. Total in-year benefits from investment spend are now expected to be [IRRELEVANT] with the largest benefit drivers being staff redundancies and the DMB franchising programme.
24. Network performance and sustainability. As of 14 July, 839 branches were closed due to Covid-19 (621 for 3 days or more), with 5,628 branches operating reduced hours. POL has been able to meet its network access commitments but due to branch closures network numbers are below 11,500 at 10,937. More detail is provided in Annex B. See paragraph 8 above for more detail on the network waiver currently in place.
25. Network programmes (franchising and new branch openings) are currently under review post Covid-19 and Nick Read has commissioned a review of POL's network to ensure alignment with POL's future strategy. The outputs from this review are becoming increasingly important, given the changing retail landscape, the current customer demand patterns, the likely fallout of Covid-19 and the funding available in the Spending Review.

Governance

26. 19/20 and 20/21 STIP and LTIP. On 15 June Minister Scully met with POL's Chair and Head of the Remuneration Committee (RemCo) to discuss POL's remuneration proposals. Following further legal advice, POL are now proposing Short-Term Incentive Plan (STIP) bonus reductions of 50% for the Exec Directors, a 20% reduction for the General Executive (GE)/Senior Leaders and no reductions for Senior Managers and lower grades. They propose to pay the Long-Term Incentive Plan (LTIP) in full for eligible grades— in practice only 5 of the current GE are eligible for this as most payments are for those who have left the business and are contractually entitled to them. POL management believe the 50% / 20% STIP reduction is reasonable in the circumstances, demonstrates the desire by the senior leaders to support the organisation through the impact of Covid-19 and is a prudent way to manage risk across the organisation. We had envisaged seeking approval from Minister Scully before recess; however, on 10 July UKGI was provided with the draft proposal and it is clear further work is needed to ensure POL's proposal is properly articulated and justified. It also will not be formally signed off until the 28 July Board meeting so it is now very likely that this will go to Ministers over recess. For FY20/21, POL are yet to finalise performance targets and are waiting until the Covid-19 situation stabilises and the financial outlook becomes clearer. UKGI are drafting a submission for your consideration that will be ready shortly before it goes to Ministers.
27. Postmaster NEDs. On 30 June, POL wrote to BEIS outlining their desire to create 1-2 NED positions on the Board for postmasters and providing an update on their wider postmaster engagement plans (incl. on a consultation with the postmaster community on a new engagement model). We support this initiative as a positive step to demonstrate to postmasters a change of approach by POL. Minister Scully strongly supports the initiative and we are awaiting BEIS SoS sign off (since all board appointments require his approval) before allowing POL to announce their plans to the postmaster community. We have drafted a letter to go from Minister Scully once final approval is given that emphasises the need for POL to work with Ministers and officials at every stage of the recruitment campaign to ensure the right candidates are found for the roles. There is also a question as to whether it might be best to have an employee NED and a postmaster NED; we have put this to POL for their consideration.

Annex A: Financial performance

Financial performance for 2020/21 (Year to Date – until end-May):

	Actual (£m)	Budget (£m)	% var to Budget	% var to 19/20
Retail	IRRELEVANT			
Financial Services &				
Telecoms (FS&T)				
Identity				
Supply Chain/Other				
Total Revenue	142.3	128.8	10%	-11%
Cost of Sales	(19.6)	(20.0)	2%	10%
Agents Pay	(64.2)	(60.4)	-6%	-5%
Staff Costs	(28.0)	(28.5)	-2%	9%
Non-Staff Costs	(38.8)	(37.5)	3%	15%
FRES	IRRELEVANT	0.0	-	-145%
Other Income	1.5	1.0	50%	-40%
Trading Profit/(Loss)	(9.1)	(16.7)	46%	-205%

2020/21 Budget

POL's budget for 2020/21 was approved by the Board in June. POL forecast to generate a revenue of £867m and a £9m trading profit. POL's budget assumes no second national or regional lockdown as result of Covid-19.

Revenue

Revenue is higher than budget by 10% due to an earlier than forecast improvement in trading conditions as the country emerges from the Covid-19 lockdown. Retail revenue is up 15% versus budget as there were improved trading volumes across all Mails products, particularly in Labels, International, Returns and Special Delivery while improved withdrawals and deposit volumes mean that banking was also above budget. There was weak performance in Bill Payments due to a fall in resellers income that All Pay, POL's payment partner, is investigating. FS&T was ahead of budget by 2% due to higher than expected volumes from MoneyGram. Although Insurance is in line with budget (year to date), it was behind budget in May and POL are working on re-instating travel insurance which has been off the market due to Covid-19.

Costs

Overall, costs were higher than budgeted and this was primarily driven by variable agent pay, which is higher than budget in line with the increased revenue. The agent pay top-ups to support postmasters during Covid-19 were included in the budget. However, there was a **IRRELEVANT** generated by FRES (the Foreign Exchange joint venture) due to the fall in demand for foreign currency as a result of Covid-19.

Annex B: Network Access Criteria and Branch Numbers**Access Criteria**

Criteria	Number of branches	Total Population within 3 miles	Total Population within 1 mile	Deprived Urban Population within 1 mile	Urban Population within 1 mile	Rural Population within 3 miles
Target	11,500	99%	90%	99%	95%	95%
31/05/2020	10,937	99.5%	91.7%	99.3%	95.3%	96.8%

POL is currently meeting its geographical access criteria however, network numbers are under 11,500 but well above the minimum network number waiver of 10,500 branches

Branch numbers at the end of May 2020

Type	Mains	Local	DMB	Traditional	Outreach	Total
Number	3,354	4,032	116	2,165	1,270	10,937