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Meeting with Alex Chisholm, Permanent Secretary, BEIS

You are meeting with Alex Chisholm on 5 March, following a letter he sent you on 4 February in which he set out the Government's expectation for the Post Office in FY 19/20. Most of the individual items came from UKGI.

This briefing sets out some suggested responses to the issues he raises in his letter: we have set out the letter content of each issue in black and the proposed response in blue. The responses are mostly worded to demonstrate support for the shareholder's position with a couple of watch-outs.

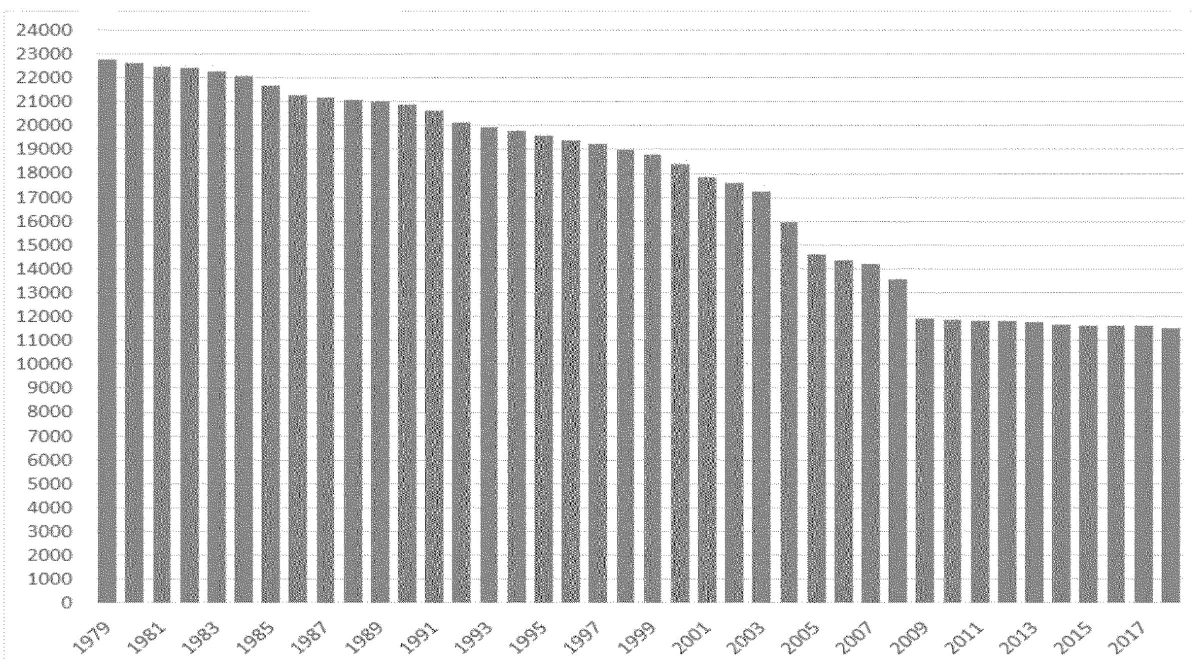
As discussed, our most significant concern is that a combination of remuneration moving further from market, reduced decision making rights under the proposed Framework Agreement, increased day to day scrutiny and a tone of not valuing the expertise and experience of individual executives could make senior roles unattractive. Our executive team appears relatively mobile.

We believe it is in our shared interest to ensure we have a commercial leadership team at PO who can continue our progress financially, sustainably delivering the social purpose. This is not straightforward and we need his support in ensuring that the balance of remuneration, ability to make decisions and recognition of the expertise individual members bring continues to ensure we have the team we need.

You asked for some performance highlights to demonstrate that we should be earning trust:

Network

The size of the Network is being maintained for the first time in generations.



We have added over 200,000 extra opening hours per week, with 4,000 branches open on Sunday, the largest Sunday network.

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Government Support

We have significantly reduced government support, freeing up £360m per annum for other spending priorities. We share Government's aspiration to have no funding (beyond working capital) after 2021.

	2013	2014	2015	2016	2017	2018	2019	2020	2021
Other Government Grants	200	215	170	150	140	70	168	42	
Network subsidy	210	200	160	130	80	70	60	50	50
Total Government Grant	410	415	330	280	220	140	228	92	50

Financial performance

We have delivered a continuously improving financial performance founded on tight financial management of costs, in spite of a reduction in Government revenues of £65m since independence. In that period from 2012-13 to 2017-18 we reduced costs from £1172m to £960m, a reduction of 18% not adjusted for 5 years of inflation. Trading profit has increased every year from a loss of £116m to a profit last year of £35m. We expect full year profits for 2018-19 to be nearing £60m.

Our performance is also exceeding expectations and we continue to beat our recent and three year plan (3YP) targets for Trading Profit, as shown below.

	2017/18		2018/19		2019/20		2020/21	
£m	Actual	Vs Plan	Forecast	Vs 3YP	Draft Budget	Vs 3YP	Current Estimate	Vs 3YP
Profit	35	+5	58-60	+8-10	77	+11	Tbd- 140	+50?

Risk reduction and other change

We have replaced some 85% of our IT hardware, software and networks while simultaneously reducing costs and making a significant reduction in the risks of business interruption and data loss.

We have made substantial progress on the diversity and inclusion agenda which is set out in response to Q2 below.

We are proud of our progress as an employer more widely. We are supporting the drive for apprenticeships but do not have unpaid interns. We pay above the Living Wage. We do not offer zero hours contracts but do offer flexible, part time arrangements. We auto-enrol employees into our pension scheme on 9% company contributions and will pay up to 11%. We are improving our safety and wellbeing, with a focus on mental health. We are a signatory to the Armed Forces Covenant.

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Topics Raised by Alex Chisholm

1. New CEO Appointment

New CEO Appointment: The Government is grateful for Paula's dedicated service to the Post Office, in particular as CEO since the split from Royal Mail. Once her move has been confirmed, one of your immediate priorities will be the appointment of a new CEO and ensuring a smooth transition. This is an important appointment and will require shareholder engagement throughout the process.

We are working closely with UKGI to agree the process for selecting the new CEO, and the remuneration package for the successful candidate. We continue, however, to wait for confirmation of the interim arrangements which we are keen to be able to confirm to colleagues as soon as possible, to ensure we can settle the team and reinforce our positions with third parties.

2. Opportunity and Diversity

As you are aware, there is a deliberate and sustained commitment by Ministers to promote diversity on appointments to public bodies. We are absolutely committed to improving diversity on our respective boards, and recognise POL's progress in this area. Diversity is essential to make sure we have the right mix of skills, abilities and backgrounds represented. We will need to continue to work closely to promote a strong and diverse field of applicants on future appointments and improve the overall diversity of the Post Office board and across the organisation. To that end, I look to you to ensure that Post Office champions equality, diversity and inclusion.

Overall, our perception is that the management changes and appointments that have been made in recent years have led to an improvement in the quality of the management team and have also improved the diversity of the senior management group. Given the forthcoming changes to the senior management team, I am conscious that a new appointment will change the mix of skills in the team and the appointment itself may lead to consequential changes. I believe this would be an opportune time to consider succession planning, both ahead of, and subsequent to a new chief executive being appointed. It is of continued importance to ensure a mix of skills and experience to equip the business to meet the challenges it faces now and in the future. We will retain our close focus on equality, diversity, and inclusion.

Thank you for recognising our progress. 42% of our senior leadership team is female, up from 38% in 2017, and 9.5% from ethnic minorities, also on an improving trajectory. We have an aspiration to get to 50% and 14% respectively by 2020. We are recognised as a Top employer of women. Our gender pay gap was 17.5% in the first year, considerably below the average, and improved to 17% to April 2018. In 2017, we were recognised by the DWP as a Disability Confident Leader, one of the first 40 businesses in the UK to achieve this status. Diversity and Inclusion remains a critical part of our agenda. It will absolutely form part of the new CEO's accountabilities and will be reflected in our succession planning.

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3. Board Development

We expect that POL fully complies with relevant aspects of the Governance Code. We welcome the current board review, and, in line with our policy in this area, expect that this will be an annual exercise, with independent input at least once every three years. We also expect director appraisals to be conducted on an annual basis and that we can input into Chair and CEO appraisals. Finally, POL will need to comply with the Corporate Governance Code's requirement for workforce engagement and we look forward to hearing about how you propose to do so.

We fully recognise and support this agenda.

Ken McCall, the Senior Independent Director (SID), helped to facilitate the Board and Committee Evaluations for 2018 with input from the Nominations Committee, fellow Board Directors and UKGI. The process is annual with an externally facilitated review every third year. Board Directors and the Company Secretary were invited to participate through an on-line questionnaire which covered leadership and ways of working; decision-making and risk; information and support; and, stakeholders. The Report also set out the work done to implement the actions from the previous Board Evaluation.

The Evaluation Reports were discussed at the January Board meeting. The assessment of the operation of the Board and its Committees was positive with most scores in the good or very good bracket. Discussion focused on areas for further development. The Board wanted to spend more time understanding the needs of Postmasters and agents, suppliers and customers. It has been agreed that Ken McCall will attend a number of employee engagement events and feedback to the Board on employee views. These findings chimed helpfully with the requirements of the Companies (Miscellaneous Reporting) Regulations 2018 under which boards will be required to report on how they have considered employer, customer and supplier views and how this has affected the decisions they have taken. The Board also agreed that papers and discussions should focus more on the competitor landscape, financial impact and performance and how strategic initiatives were addressing strategic pressures.

The Audit Risk and Compliance Committee, Nominations Committee and Remuneration Committee discussed their Evaluation Reports at their January and February meetings and agreed actions arising from these which will be reported back to the March Board. The ARC agreed to increase the length of its meetings to reflect a growing agenda but to focus more on material risks with additional assurance on how less material risks were being managed by the executive. The Nominations Committee agreed to spend more time on succession planning. The Remuneration Committee agreed to spend more time on the remuneration framework and the approval processes across the group.

Ken McCall led the Non-Executive Director (NED) discussion on the evaluation of the Chairman after the January Board meeting. These discussions will take place annually. The NEDs considered a number of aspects of the Chairman's role and provided their thoughts and feedback. Ken provided feedback to the Chairman and to UKGI.

We note the need for shareholder feedback to be included in the Chair and CEO appraisals.

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4. Investment Spend Controls

We are very focused on the need for government funding to be used prudently and efficiently in accordance with the objectives of the three-year strategic plan, whilst recognising the need for some flexibility for a commercial business engaged in investment projects. I wrote to Paula Vennells recently to emphasise this point. Appropriate monitoring and reporting must be in place and I understand that the format of reporting is being finalised with UKGI officials.

We completely share the agenda: driving benefits from our change spend is critical to success. We have shared both our processes and outcomes in detail with UKGI as part of the quarterly approval process and our reporting has been designed working with them. Following the January iteration, we believe that reporting formats are agreed and this has been checked with Tom Cooper. We will, of course, continue to evolve it to suit changing requirements. We are working through a broader set of improvements in our change process, recognizing that we now have a complex portfolio of change, where previously we had a small number of very large projects such as Network Transformation. This has formed part of the Board's agenda and will continue to do so.

5. Company Restructuring (including framework document)

We are supportive in principle of the Company's proposed restructuring and it is important that it also meets Government's requirements, including the completion of the framework document and updated articles as well as a structure that facilitates future dividend payments. I know that UKGI and BEIS officials are already working with the Post Office team to ensure our requirements are clear. We have been working closely with UKGI on our plans. The key next area of work is to ensure that the proposed creation of a new holding company will not destroy value (for example on the use of retained tax losses) or make it more difficult for us to create future dividend streams. A piece of assurance by KPMG is being commissioned to report jointly to ourselves and UKGI.

We are working through the framework document with UKGI and BEIS and we fully understand and support your need for appropriate oversight. We do have some concern with the suggestion that the SoS would make all decisions over £20m rather than the current £50m. If we simply mean that UKGI, who sit on our Board, would have the right to pause and escalate controversial issues, then we completely support it.

If however we mean that any investment decision over £20m must be personally approved by the SoS then we have concerns which we would like to discuss: will the SoS resent having to approve, say, a series of submissions including, for example, a 7 year, £3m a year facilities management contract? Will this add significant and uncertain delay into our commercial decision making: recent decisions have taken c. 3 months a time? And will it become even harder to retain a commercial leadership team, all of whom could be better paid elsewhere, if they perceive limited decision-making ability? [Informally at least Tom Cooper has been sufficiently bothered by the decision process on Paula and the interim arrangements that he now agrees we should not reduce delegated authorities].

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6. Company Strategy and funding beyond 2021

I am conscious that POL is facing a number of significant strategic challenges, both in relation to the changing conditions in the retail sector and the substantial changes to some of the Company's key business relationships. The company has significant positive opportunities as well: the continued restructuring of the network, improved IT and greater use of automation, the potential to expand the network following the Payzone acquisition and to co-operate more closely with the banks in the supply chain and ATMs. I believe that together these offer POL a major opportunity to improve its offer to customers and the efficiency of the business. We also have an objective that the Company should be financially self-supporting by the time the current funding period ends. To enable us to consider these issues and the policy options and other implications that could follow, I would like you to carry out the necessary strategic work, in conjunction with UKGI officials, for presentation to me and senior colleagues in BEIS.

We are commissioning work, again working closely with UKGI, which we will review at the Board Strategy awayday at end July. We agree that there is a commercial opportunity which, with the right team, can be developed and may indeed create the opportunity to be financially self-supporting after March 2021.

We fully understand and support the commercial perspective of our shareholder and have no commercial issue with developing the ability to pay dividends. Nonetheless, much of our stakeholder narrative with agents and others will change as we exceed £100m EBITDAS and would change further if there was a public commitment to or perhaps even conversation about dividends. This could emerge as a political issue with agents demanding a different share, perhaps even different ownership, from their local MP. Tom Cooper has raised this with Kelly Tolhurst who apparently recognized the agent perspective.

7. Litigation

The ongoing litigation trials may have important financial, operational and reputational consequences for Post Office. As the Minister and I emphasised at the meeting we held with Paula and her team at the House of Commons in October, Government needs to be kept fully appraised of developments, ahead of significant decisions being taken.

We understand BEIS' legitimate interests in this matter, and we will consult and engage appropriately, including on any resulting decisions. The Horizon trial begins on 11 March, and we will continue to ensure we keep BEIS fully appraised of developments. We now understand that the embargoed verdict on the first trial will be given to us sometime in the week of your meeting (w/c 4th) and may be made public on the first day of the Horizon trial.

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8. Agent Pay

I know that you are looking at revisions to Agent Pay, in part as a consequence of the renegotiation of the Banking Framework. The structure of remuneration should ensure that being a postmaster is an attractive proposition, thereby safeguarding the sustainability of the network. We ask the Company to keep us informed as that work progresses.

We completely agree that ensuring Post office is a desirable proposition is critical to maintaining a sustainable network. While we appreciate that questions over the level of agents' remuneration continue to be raised, it remains our view that the fees within the remuneration package reflect the competitive commercial environment in which we operate. We continue to invest in further efficiencies for retailers though transactional/operational simplification and improved technology to support retailers in making their businesses as efficient and profitable as possible.

More directly, Post Office plans to increase the per-transaction revenue rates we pay for deposit banking transactions this year. These will be announced at the National Federation of Subpostmasters Annual Conference in April.

Nonetheless, we share the concern and part of our forward financial planning will be assessing the value of the overall package for agents. We will keep you informed as we look beyond 2021. As noted above, a public conversation on dividends may well ignite further debate.

9. DMB Franchise Programme

Government have been supportive of the franchising programme and the contribution it has made to the sustainability of the Post Office. However, it is clear from feedback from MPs and other stakeholders that closures are highly sensitive and often negatively received by the public. We want to work with you to develop a more effective communications and engagement strategy to better promote the benefits to consumers, taxpayers and the Post Office network. We would also welcome closer collaboration on the timing of future announcements.

Our DMB franchising programme clearly does attract negative comment and correspondence from constituency MPs and other stakeholders. Our communications team, including the public affairs managers in the regions, have been working extremely hard to communicate the rationale for, and customer benefit of, this programme. We have been providing UKGI with regular updates and support.

Our Communications team reached out to colleagues in BEIS in the light of your comments and a productive conversation is happening. Nonetheless, any programme of franchising is an easy target, particularly for the Unions, and there is a degree of noise which we will be unable to eliminate. Areas that may be fruitful are creating a myth-buster for MPs and working together on communicating the success of the new branches.

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10. Post Office Card Account

We would like to ensure that there is a robust plan developed in partnership with DWP to manage the transition from POCA, including the resolution of legacy issues.

We are working closely with DWP as they develop their requirements for a new replacement product, and discussing how best we can support customers make the transition. While we intend to bid for the POCA replacement system, our critical interest lies in ensuring that, whatever system DWP chooses to operate, Post Offices remain the key physical channel through which customers are able to access their funds. This will see our POCA transaction volumes retained as banking transactions.

In addition to ensuring that all POCA customers, including those at the most vulnerable end of the spectrum, are properly supported, we must recognise that postmasters also have a live interest in the future system. Some with particular POCA customer profiles are likely to face a degree of reduction in their revenues (since POCA transactions are typically better remunerated that banking framework transactions). We will be offsetting this negative news with a positive set of messages in relation to increased remuneration for banking transactions at the National Federation of Subpostmasters Conference in April.

Conclusion

I would welcome an opportunity to meet with you and POL management to discuss the contents of this letter. I also propose that you meet with UKGI and BEIS at six-monthly intervals for a formal shareholder meeting, which I hope we would both find useful.

We will be happy to support this process.

ADDITIONAL ISSUE TO RAISE

Note Circulation System

We are working with the Bank of England to see if the NCS arrangements can be modernized to reflect the increasing role we pay in cash provision and financial inclusion. At the moment, because NCS arrangements are based on cash sent out, which is falling overall because of the decline in POCA, our NCS funding is falling just as our funding need increases with much higher banking deposits. If we are unable to make progress with the Bank of England we will escalate the issue to BEIS: if our funding comes under pressure in future we would either have to seek more working capital from the BEIS facility or reduce access to cash, undermining both the Banking Framework and the role we play in financial inclusion.