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POST OFFICE LIMITED BOARD MEETING
Strictly Confidential

MINUTES OF A MEETING OF THE BOARD OF DIRECTORS OF POST OFFICE LIMITED HELD ON TUESDAY 25 SEPTEMBER 2018 AT 20 FINSBURY STREET, LONDON EC2Y 9AQ AT 11.30 AM

Present:	Tim Parker	Chairman **(TP)**
	Paula Vennells	Group Chief Executive **(PV)**
	Ken McCall	Senior Independent Director **(KM)**
	Tom Cooper	Non-Executive Director **(TC)**
	Tim Franklin	Non-Executive Director **(TF)**
	Shirine Khoury-Haq	Non-Executive Director **(SK)**
	Carla Stent	Non-Executive Director **(CS)**
	Alisdair Cameron	Group Chief Financial and Operating Officer **(AC)**
In Attendance:	Jane MacLeod	Company Secretary **(JM)**
	Veronica Branton	Head of Secretariat **(VB)**
	Owen Woodley	CEO – FS&T **(OW)** (item 7)
	Debbie Smith	Chief Executive Retail **(DS)** (items 8, 9 and 10)
	Martin Kearsley	Banking Director **(MK)** (item 8)
	Tom Moran	Network Development Director **(TM)** (items 8, 9 and 10)
	Andrew Clatworthy	Retail **(ACL)** (item 8)
	Mark Siviter	MD Mails & Retail **(MS)** (item 9)
	Rob Houghton	Group Chief Information Officer **(RH)** (item 12)
Apologies:	None	

ACTION

1. INTRODUCTION AND CONFLICTS OF INTEREST

a) A quorum being present, the Chairman opened the meeting.

b) The Directors declared that they had no conflicts of interest in the matters to be considered at the meeting in accordance with the requirements of section 177 of the Companies Act 2006 and the Company's Articles of Association.

2. MINUTES OF PREVIOUS BOARD AND COMMITTEE MEETINGS INCLUDING STATUS REPORT

The minutes of the meeting of the Board held on 31st July 2018 were **APPROVED** and **AUTHORISED** for signature by the Chairman.

3. CEO's REPORT

a) Paula Vennells updated the Board on the following recent issues:

- Irrelevant
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Irrelevant

b) A number of points were raised, including:

Irrelevant

c) The Board **NOTED** the CEO's report.

4. FINANCIAL PERFORMANCE REPORT

a) The CFOO introduced the report and highlighted a number of issues:

- we were £4.7m ahead on EBITDA but expected this to reverse in the second half of the year because of the cut in fees for Identity and the cost reductions in IT not

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coming through in the second half of the year. The latter was partly due to delays in the Belfast exit negotiations. The parcels market had been resilient

- Travel money had underperformed against the plan; this was in part because of period specific issues such as the extended period of warm weather and Brexit that had affected the whole market but we were conscious of market disruptors whose margins were minimal
- Insurance was not achieving the volumes or the returns planned in all areas. There were some specific reasons: the difficult summer in travel and delays in Customer Hub. A review of marketing efficacy was underway
- Telco was likely to miss its income targets but meet its trading profits. We would be returning to the Board to discuss the longer term strategy for Telco. Pricing was higher out of contract and was going to be increased, while we remained competitive on in-contract pricing. The strategic work would consider a variety of options including sales, partnering, removing Fujitsu and the product range.

b) A number of points were raised, including:

- The position on former agents' losses was discussed. It was noted that we were not bringing prosecutions currently where these related to the Horizon system because of the ongoing litigation. The increase in cash in branches further increased the risks. We had improved our ability to identify branches with potential fraud issues and target them for audits. Prosecutions could potentially start again after the Horizon Trial (assuming a positive outcome), however as matters go "stale" after c6 months, it is unlikely that we would be able to prosecute retrospective cases
- Security in branch and in the supply chain was discussed. Introducing CCTV in high risk branches had been and continued to be considered but there were costs associated with this. Analysis had been done to identify high risk branches but this covered a range of factors such as a branch handling high volumes of cash; however, the correlation between high risk indicators and the location of thefts and fraud was not high in practice
- The physical management of cash in branches was going to be critical to the business and it was thought that we should consider whether security provisions such as CCTV were simply the cost of doing business. ATMs and closed cash systems also formed part of this conversation on security measures and the safety of staff as POs became increasingly the place to go for cash. It was reported that while we had experienced health and safety improvements overall we had suffered a spate of ATM rip outs. A Business case was being considered to roll out fogging devices to many more branches. It was **AGREED** that an update on security measures would be included in the Health & Safety Report to the Board. We needed to recognise **AC** that this was an investment discussion where there was no immediate prospect of return
- It was reported that a project was being run on closed cash where the safe and till were combined. Feasibility and cost were key issues and to be achievable might require co-funding from the banks. An approach to the banks on investment would have to be considered very carefully as we were proposing a significant increase in fees through Banking Framework 2. We might consider a segmented approach where equipment such as closed cash cartridges could be deployed in the top branches for cash, with cameras for other branches

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- Our cash borrowing was discussed. We had made efficiency improvements in branches on cash management but we were borrowing more than we had expected.

c) The Board **NOTED** the Financial Performance Report.

5. FUNDING BEYOND 2021

a) The CFOO introduced the report and highlighted a number of issues:

- we were six months into a three year funding plan and would not normally be starting a conversation about the period beyond that plan at this stage; however, UKGI and BEIS were preparing for the anticipated Government Comprehensive Spending Review and we wished to provide them with some sensible placeholders notwithstanding the significant degree of uncertainty in our plans beyond 2021. Our baseline assumptions were:
  - we should not need substantial investment funding if we are achieving our trading profit targets
  - network subsidy would continue to be needed to keep unprofitable branches open. Network subsidies were currently provided at around £50 m per annum and we had to provide evidence of the costs required to meet the Services of General Economic Interest (SGEI) set out in our Funding Agreement with Government
  - that we would need a borrowing facility.
- work was being done on the costs of running the unprofitable branches, our IT costs, the cost of re-investment in the network and regulatory changes etc.

b) A number of points were raised, including:

- that there were a number of moving parts with IT transformation, investment requirements for business developments such as Identity, the need for funding for loss making branches but with the prospect of the EBITDA figure being significantly higher with the increase in fees with Banking Framework 2
- we would need to consider whether we should be asking Government for a contingency fund, how that conversation should be structured and the fund level required
- that we could not expect indefinite funding from the taxpayer other than to run unprofitable branches but that meant we needed to have the capability to borrow. The preference would be to be able to access external funding. We needed to consider our capital investment requirements, the returns we thought we could get from these and any assets we might sell
- whether we should consider a symbolic drop in what we sought as the network subsidy to show our intended direction of travel. It was noted that the reverse argument was that inflation and the cost of managing cash in branches meant that a £50m network subsidy was less in reality anyway and that there should be a fee attached to providing an unprofitable service. To understand this better the Board asked to see the costs associated with running the unprofitable branches. **AC/ DS**

  The scope to retain the network subsidy but look at dividend payments was discussed.

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c) The Board **NOTED** the Report and endorsed the proposed approach of having open conversations with BEIS and HMT to seek longer term alignment around future government support.

6.

a)

b) **Irrelevant**

OW/ VB

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Irrelevant

7. PEREGRINE UPDATE

a) OW provided a verbal update on the Peregrine negotiations. Bank of Ireland (BoI) had held an investor day in June 2018 which had focussed on its cost reduction programme. This had included a strategic review of its credit card operations in the UK. We had re-started our negotiation process with BoI which would reach its final stage in October 2018.

BoI was claiming not to be making a profit on its joint venture with PO. Their figures did not stand up to scrutiny and appeared to be a negotiating position rather than genuine sharing. However, BoI was making less money than 18 months ago because of the reduction in mortgage margins. We needed to know what their fixed costs and average achieved margins were. We had always asserted that there was a mismatch on FRES costs but BoI was now saying that there were several million pounds of unallocated costs. BoI's strategic intent did not appear to align with PO's.

BoI appeared to be intent on selling its part of the credit card book. We would like a better partner on credit cards but had always said this would be part of the wider Peregrine negotiations. BoI had written to us to notify us of its intent to proceed with selling its part of the credit card book. At this stage it was felt appropriate for PV to meet with the Group CEO of BoI to get a clearer view of BoI's real strategic position. PV had met earlier in the day with the outgoing UK CEO of BoI. The view from this discussion was that the new BoI negotiating team were trying to get up-to-speed. The UK market was more dynamic than the Irish so BoI learnt from developments here making the view that BoI was seeking to get out of the UK less credible. Failing to do a deal with PO would force BoI to consider more niche parts of the UK market as there was no credible replacement partner of our scale.

b) A number of points were raised, including:

- that the Irish economy was growing rapidly and it was feasible that BoI was seeking to retrench in light of Brexit and its likely impact on UK economy
- that we should consider accelerating our work on "Plan B" in case the Peregrine negotiations did not develop as we wished them to. BoI might be amenable to us finding an alternative partner so a "friendly divorce" could be an option. **OW**

8. BANKING FRAMEWORK 2

a) The Chairman welcomed Debbie Smith and Martin Kearsley to the meeting. MK introduced the paper and highlighted a number of issues:

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- Banking Framework 2 was seeking to appropriately charge the banks a commercial rate for our services which reflected the true value that PO offers the banks as they reduce costs arising from branch closures
- A number of variations to the original framework were being worked through. The Framework Fee, transaction rates and Ad Valorem fee changes were being proposed
- Issues regarding Automation, Balance Sheet funding and future cash volumes impacting the Supply Chain were being work through by the team.

b) A number of points were raised,

- it was noted that Santander did not have a branch network for business customers and this differentiated them from other banks
- we could consider transitioning increased tariffs over a period of time and should factor in what charges the banks would be prepared to pay to secure certainty for a longer period of time. However, it was noted that we had greatest leverage now as the banks had not developed strong alternative networks and cash transaction volumes remained high. The increased tariffs proposed reflected savings to the banks, our costs and investment requirements. It was also noted that the largest growth area was business deposits and these were the most timing consuming and problematic banking transaction for us so it was reasonable for our proposed tariff increases to focus on that transaction
- the specialist advice we had received was discussed. It was reported that KPMG had advised us on the savings being made by the banks through branch closures but not on our pricing proposals. Andrew Clatworthy had been recruited to lead on the negotiations with the banks. It was suggested that it would be worthwhile engaging another third party to test our thinking and proposals on the negotiations, including how the banks might view our proposals **DS/ MK**
- whether the banks were aware of the likely scale of the pricing changes. It was confirmed that the banks were aware that the increases would be substantial and that this was justified
- whether we had any red lines on the pricing. It was reported that the target rate was viewed as a market sustainable rate.

c) The Board **NOTED** the report and supported the option of allowing the banks until 31 March 2019 to confirm or terminate their inclusion in the Banking Framework 2.

Irrelevant

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Irrelevant

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b) **Irrelevant**

12. BACK OFFICE TRANSFORMATION

a) The Chairman welcomed Rob Houghton to the meeting. AC introduced the paper and reported that testing through TRANSAP was taking longer than through SAP. We had considered carefully whether we could migrate off POLSAP and go live in November 2018. However, this would have disrupted the cash forecasting solution before Christmas. We were confident that we could go live with the new system in January 2019 and that the training requirements would have been completed. The only reason we would have considered migrating earlier, given the risks of doing so, would have been experiencing deterioration in POLSAP. The cost of the work from Autumn 2018 to January 2018 was in the region of £10m and the incremental cost from November 2018 to January around £2m.

b) The Board noted that the work was necessary to the running of the business and **RESOLVED** to **APPROVE** the additional £9.4m drawdown.

13.

a) **Irrelevant**

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b) The number of points were raised, including:

- that we needed traction in the next year on the actions we had identified so clear ownership of the policy was important
- whether we could audit our compliance with the MSA when our network was predominantly operated by agents running their own businesses.
- that we should change the wording of the statement to refer to due diligence for on boarding but not for the subsequent operation of the business **JM**
- whether we carried out subsequent checks when we visited agencies. It was reported that there was a vetting check when PMs took on staff. In order to access Horizon, those checks had to have been completed and included checking that the individual was a real person and eligible to work etc.
- whether there was as retail consortium which produced a standard on modern slavery which we could sign up to. It was noted this would be investigated
- that raising awareness through training was important. It was noted that we would consider whether there was scope to strengthen our existing arrangements.

c) The Board **RESOLVED** to **APPROVE** the 2017/18 Modern Slavery Act Statement, subject to incorporating the change agreed at the meeting, and endorse the proposed actions for the business to take forward in the 2018/2019 financial year.

14. POSTMASTER LITIGATION (Confidential and subject to legal privilege)

a) JM updated the Board on the Postmaster Litigation. The first hearing for the Common Issues would start on 5 November 2018. It was thought that the judgement was likely to be published at the end of December 2018 or the beginning of January 2019. We were preparing in parallel for the second trial on the Horizon system. Two experts (one for each party) had been appointed to provide their view of the Horizon system and had a series of questions to answer from the Judge. In effect the judge's decision would reflect which expert he believed.

We were preparing our communications approach and material. One Freelance journalist was seeking crowd funding to be able to attend the trial.

Work on contingency planning was happening in parallel.

b) The Board **NOTED** the update.

15. ITEMS FOR NOTING

15.1 Sealings

The Board **RESOLVED** that the affixing of the Common Seal of the Company to the documents set out against items numbered 1697 to 1710 inclusive in the seal register was confirmed.

15.2 Irrelevant

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Irrelevant

C

15.3 Future Meeting Dates

The future meeting dates were **NOTED**.

15.3 Forward Agenda

The forward agenda was **NOTED**.

Meeting closed at 3.00 pm.

GRO

Chairman **Date**