

In Strictest Confidence

POLB(06)4th
POLB 06/58 – 06/78

Post Office Limited

(company no. 2154540)

Minutes of the meeting of the Board
held at 148 Old Street, London
on June 28th 2006

Present:

Sir Michael Hodgkinson	Chairman, Post Office Limited
Ian Anderson	Human Resources Director
Alan Cook	Managing Director
Peter Corbett	Finance Director
Ric Francis	Operations Director
Graham Halliday	Banking & Financial Services Director
David Miller	Chief Operating Officer

In attendance:

Crispin Beale	Director of Customer Insight, Intelligence & Analysis (for POLB 06/74)
Simon Carter	Head of Marketing
Jonathan Evans	Company Secretary
Neil Owen	Notes
Sue Whalley	Consultant, McKinsey for POB06/75
Eoin Daly	Consultant, McKinsey for POB06/75

Apologies:

Allan Leighton	Chairman, Royal Mail Group
Brian Goggin	Chief Executive, Bank of Ireland

POLB06/58 MINUTES OF PREVIOUS MEETINGS POLB(06)3RD

- (a) The Board approved the minutes of the Board meeting of April 20th 2006.

POLB06/59 MINUTES OF JV AND ASSOCIATE COMPANIES

- (a) The Board noted the minutes of POFS Board meeting of 16th – 19th May 2006;
- (b) the Board noted the minutes of the First Rate Exchange Services Board meeting of 6th April 2006;

POLB06/60 RESIGNATION AND APPOINTMENT OF DIRECTORS

- (a) the Chairman reported the resignation of David Miller and Graham Halliday as directors of Post Office Ltd, effective from 31st July 2006. The Board expressed their appreciation

In Strictest Confidence

for the excellent contribution they had made to the business;

- (b) The Chairman reported that the appointment to the Board of Sue Whalley had been approved by the Royal Mail Holdings Nominations Committee, and her appointment would be effective from 1st September 2006.

POLB06/61 STATUS REPORT POLB(06)41

- (a) The Board noted the report, and that all actions had been completed. In addition the Board noted that:

ACTION:
Peter Corbett

- (b) Luke March, Compliance Director Royal Mail Group had agreed to join Post Office Ltd's Compliance Committee, and Peter Corbett would liaise with him about the meeting dates etc;

ACTION:
Peter Corbett

- (c) a letter to HMG to outline the consequences of failing to secure a long term funding arrangement had been drafted by Peter Corbett. However, the Group Finance Director had requested that the sending of the letter be postponed until after the Group Funding negotiations had been completed. The concern was that the letter may prejudice the overall deal. Peter Corbett emphasised that these issues only impacted on the short term funding arrangements rather than the long term. The Board agreed that a one page document would be produced to outline the issues in relation to funding, but would not be issued without further discussion. Additionally, Peter Corbett would discuss with RMG the possibility of accelerating the treatment of the SNP going through Post Office Ltd's profit and loss account, recognising that there were likely to be tax issues at a Group level which may make this undesirable from an overall Group point of view. An appropriate form of words would be considered for the letter to Government, to help ensure the funding could be considered as part of the P&L account.

POLB06/62 CHAIRMAN'S BUSINESS

- (a) Sir Michael Hodgkinson had no further matters to report.

POLB06/63 MANAGING DIRECTOR'S REPORT

- (a) Alan Cook explained that the strategic plan would be discussed in detail later in the meeting.

POLB06/64 FINANCE REPORT POLB(06)42

- (a) Peter Corbett provided the Board with a presentation on the Period 12 business performance results;

In Strictest Confidence

- (b) income was £0.4m higher than budget in the month due to higher than budgeted performances on mails (£1.2m), BBC (£0.9m) and Card Account, (£1.3m) offsetting adverse variances on Home Phone (£0.9m), POFS (£0.8m), Bill Payments (£0.3m), Lottery (£0.3m) and Banking (£0.3m);
- (c) total costs were £0.3m lower than budget in the month. Total costs for the year so far were £0.3m higher than budget due to the timing and mix of agents product payments as well as the timing of Marketing costs for the Summer Campaign offset by lower cost of sales for Home Phone and Retail as well as lower spending on non-staff costs than planned;
- (d) the loss from operations after allocations was £21.2m in the month, £0.5m worse than budget. This takes the cumulative loss to £42.8m, which was £0.1m better than budget;
- (e) the cumulative cashflow was an outflow of £65.2m against a budgeted outflow of £201.2m (£136.0m favourable variance). The most significant factor for this was a timing difference due to the effect of the bank holiday on card account withdrawals partially offset by a £37.5m adverse on Mails Reserve funding because the first transfer was budgeted for April, but had been delayed until Period 3;
- (f) the emerging position showed net risks of around £15m for the full year 2006/07. Action was being taken to strengthen mitigating actions against risks wherever possible and to identify additional cost reductions to bridge the gap. Cost reductions would be embedded into the budgets which would be reissued following the launch of the new organisational design in September;
- (g) Audit Update: During June, Branch Audits had confirmed two significant losses in branches:
 - (i) £300k was initially missing at Marlow MSPO. £186k was discovered in bags at the back of the premises but it was too early to determine the likelihood of recovery for the remaining £114k. The agent had been suspended. It appeared to have been a fairly short, rapid rise in cash holdings at this office. The audit was triggered by routine indicators in the audit risk models (cash trends and transaction correction levels).
 - (ii) £41k shortage was found at Porteynon. This audit followed on from the cash remittance enquiries that were initiated after the major losses in February and March where operations had been reviewing branches who had failed to send back expected cash returns. Following enquiries and a visit, the audit was requested and confirmed this loss;
 - (iii) in general, the business was getting better at detecting fraud. Ric Francis explained that this was

ACTION:
Peter Corbett

In Strictest Confidence

because there was now higher visibility of cash movements. Peter Corbett stated that further analysis was being conducted on an ongoing basis to ensure these issues continued to be picked up quickly.

POLB06/65 SOLVENCY AND FUNDING STATUS POLB(06)42

- (a) Funding discussions continued with Government including formal weekly meetings. There had been no material change to the cashflows previously discussed, although a more robust split between "client" and "business" funds had been incorporated into modelling which should reduce the level of "business volatility" to £50m for forecasting and planning purposes. The remaining volatility (total previously used was an average of £170m with peaks of £250m) had been separately classified as "client" and under arrangements valid until 2010, this could be covered by the working capital loan;
- (b) formal weekly meetings had also been recommenced with Government to discuss network transformation and all related issues including funding. POL/RMG was represented by Martin Gafsen, Sue Huggins, Sue Whalley and Peter Corbett;
- (c) discussions continued with RMG and Government to optimise both short and long term funding. This should enable the Mails Reserve to be used as part of the overall RMG funding solution and have separate funding provided for Post Office Ltd;
- (d) the first quarter Social Network Payment of £37.5m had been delayed from April 1st to June 2nd to assist in this endeavour. The second slice of £37.5m was due on July 1st. Alternatives sources of funding were being urgently considered by RMG and Government - the fallback would be to use the Mails Reserve as previously agreed by all parties;
- (e) December remained the target for the long term funding deal, but there were many issues to be dealt with to ensure this happened. A draft note had been prepared to outline to Government the consequences of failing to secure a long-term funding deal;
- (f) a particular sensitivity had arisen in relation to the Fujitsu contract renegotiation. Fujitsu had requested that the contract be signed before the conclusion of the long term funding deal, but with a conditionality clause. This would allow reversion to the old contract by February 2007 should no funding deal be in place. A separate note was being prepared on this to advise relevant parties, including Government.

In Strictest Confidence

POLB06/66

FINALISATION OF THE STATUTORY ACCOUNTS

- (a) A timetable has been agreed for the finalisation of the POL statutory accounts following deliberations by the Audit Committee on whether or not to adopt International Accounting Standards for RMG subsidiary companies (to avoid unnecessary work). The target date was the end of July 2006.

OTHER EXECUTIVE REPORTS

POLB06/67

SALES & SERVICE REPORT. POLB(06)43

- (a) The Board noted the report, and also noted that:
- (b) Sales: the primary focus for the Sales team during Q1 to date had been the launch of Instant Saver. At the end of Week 11, 42,896 accounts had been opened with total balances of £293m - equal to 197% of target. A further 8,923 applications were awaiting processing with deposits of £58m. The product has been very well received across the network in both Directly Managed and Agency branches;

(c)

Irrelevant

- (d) Rural Strategy: discussions with DTI about the future Government policy towards, and funding of, the rural network continued in conjunction with Group colleagues. Pending a change from Government, the formal current position remains that of 'no avoidable closures' and the £150m pa Social Network Payment stays in place until March 2008. Net rural closures in 2005/06 were reported at 149 which had maintained the low rates of recent years. In 2006/07 the intention would be to keep branches open in line with Government policy whilst utilising the cheaper service provision techniques that had been demonstrated in the pilots;
- (e) Stakeholder: discussions continued with the DTI on network

In Strictest Confidence

options, and the indications were that officials were stepping up their preparations for a public consultation exercise. Various stakeholders had expressed concern that the consultation had not already started. Postcomm appeared to be broadly supportive of a slimmer network, so long as there were alternative forms of service provision if branches were to close. Postcomm were also trying to put pressure on the DTI to form a view, and were holding a conference in July for key industry players (including Alan Cook and Andy Furey) to talk about the network. Postwatch were also very keen to engage, and had been active in critiquing the rural pilots. They were due to hold a closed session with members of the Counters Advisory Group (eg National Consumer Council, Age Concern) on 22nd June to talk about how they should make their views on the network heard;

ACTION:
Ian Anderson

- (f) Age Discrimination Legislation: Jonathan Evans informed the Board that the Company would need to ensure it was prepared for the consequences of the new age discrimination legislation. The legislation would not just apply to employees but would also include 'office holders', and these could include subpostmasters. Ian Anderson undertook to ensure that the implications of the new legislation were being fully covered.

POLB06/68

MARKETING & DIRECT SALES POLB(06)44

- (a) The Board noted the report and in addition that:
- (b) Foreign Currency: Foreign Currency sales had hit record levels in May – 2% up on last year's record performance, with 125,000 more transactions than at the same time last year. However this was still 6% below target. The summer campaign was in full swing, and increased performance was expected. The Commercial Package was still proving to be extremely popular with 60 new branches applying last month alone. Mike Hodgkinson stated that there were now many new players moving into the currency market, including Sainsburys, Asda, Tesco and Marks & Spencers. Simon Carter clarified that Marks & Spencers were growing the greatest share at Post Office Ltd's expense, and that the Tesco proposition had so far had slow take-up;
- (c) Government Services: whilst the Government's procurement process for the new ID Card tender had been delayed until September, a large number of discussions had taken place with potential bidders including EDS, Siemens, Serco, Vertex, Capita and Fujitsu, by a cross-Group team. Alan Cook has been proposed as Group Executive Sponsor. Whilst the value of the contract was now believed to be lower than once suggested, it would still be a multi-million pound opportunity for both Royal Mail Letters and Post Office Ltd. All potential bidders were keen to work with Post Office, some on an exclusive basis. Separately IPS

In Strictest Confidence

(previously UKPS) had identified 22 locations where remote interview capability was required by February 2007. 20 of these could be covered by existing branches, although this may also involve the use of some mobile vans;

POLB06/69**BANKING & FINANCIAL SERVICES POLB(06)45**

- (a) The Board noted the report and in particular that:
- (b) Direct Payments: the RFI for a Simple Money Transmission Service was sent to 23 organisations. 10 responses had been received and five had been taken forward to stage two. MBNA had since been added given the representations that had been made to the Chief Executive of RMG. The relationship with James Plaskitt was positive and interest had been expressed in Post Office's proposal to minimise the impact of card account closure on customers. Although the campaign to migrate people from Card Account had been less aggressive recently, it would continue to have a significant impact on Post Office Ltd;
- (c) Compliance: National Savings & Investments (NS&I) were expected to formally submit evidence of alleged mis-selling of Instant Saver and of 'rubbishing' of NS&I products by branch staff. Three cases were being investigated and it had been suggested to NS&I that a fuller analysis could be achieved by looking for correlations in data for sales with NS&I withdrawals or closures. NS&I were concerned that counter assistants were stepping over the line from giving information to giving advice;
- (d) Alliance and Leicester Renegotiation: £12m - £15m of risk had been identified, which was less than the risk currently identified in the 5 year plan
- (e) Separate LINK Scheme: the draft agreement for a separate LINK scheme was being considered by Camerons. The scheme was scheduled to be in place for July, but it was unclear whether the banks that supported the arrangements would actually sign up to it. If this happened the OFT may assign a task force to investigate, although under the new APACS transparency model it was possible that these task forces could be dispensed with. There remained potential to do a deal with the banks who were nervous about large numbers of 'unbanked' opening accounts. This would require further analysis by KPMG which the DWP would be required to fund;
- (f) Credit Cards: The colleague offer on credit cards was likely to take place in July.

POLB06/70**OPERATIONS REPORT POLB(06)46**

- (a) The Board noted the report, and in particular that:

In Strictest Confidence

- (b) Stock Programme: business cases had been approved for system and security upgrades at Swindon, and the Hemel warehouse functions would migrate to Swindon during autumn this year. The migration of the Swindon call desk activities to Royal Mail Sales and Customer Services commenced on 19 June and would be completed by July. Feasibility studies were underway to scope other cost saving and efficiency measures such as in-branch secure stock destruction rather than return to the warehouse; an "Our Range" brochure to promote many products in one 12/16 page brochure, rather than individually, for smaller non commercial branches; electronic ordering from branches of secure and transaction stock products;
- (c) Horizon S90: the S90 release of Horizon had now been fully deployed.

POLB06/71**HUMAN RESOURCES REPORT POLB(06)47**

- (a) The Board noted the report and in addition that:
- (b) Industrial Relations: the climate remained fragile due to the pay impasse. A national consultative ballot was due to be opened on 14 June concerning pay;
- (c) Have Your Say: 'I enjoy working here' for 2005-06 closed at 58% which was down 4% on last year. May 2006 returned a figure of 57% which was down 2% on May 2005. Response rates were also falling (64% – down 3%). Alan Cook explained that the results reflected the uncertainty people were feeling as the strategic plan had not yet been communicated.

POLB06/72**MARKETING BUDGET**

- (a) Peter Corbett provided an update on the marketing budget: which had been incorporated into the strategic plan. The budget of £20m was confirmed as agreed.

POLB06/73**HORIZON UPDATE**

- (a) Ric Francis provided an update on Horizon Next Generation;
- (b) RM Holdings Board would consider the business case on 2nd August;
- (c) the contract negotiations were proceeding to plan and the new contract was expected to be ready by mid July. Slaughter and May had recommended the inclusion of a conditionality provision so that if long term funding was not secured within a reasonable time the new contract would

In Strictest Confidence

revert to the existing terms. Fujitsu were currently invoicing in accordance with new contract. This would provide a saving of £8m in 2006/07, as envisaged in the budget;

- (d) PWC had been appointed by Group Tax to provide a formal legal opinion on outsourcing some further services to Fujitsu associated with Horizon. This would have the added benefit of transferring some of POL's capital losses to Fujitsu. This would be treated as a separate business case and was not expected to delay the progress of the new contract.

POLB06/74**CUSTOMER SATISFACTION INDEX REVIEW**

- (a) Simon Carter introduced Crispin Beale, Director of Customer Insight, Intelligence & Analysis, who provided a presentation on the proposed revised CSI measure:
- (b) the current system included a lot of subjective measures which were hard to influence, including reputation, customer service, usage, minimalisation of dissatisfaction, service, satisfaction with new products and new product customer service;
- (c) the new measure included some of the elements of the current solution, but there was more emphasis on the objective measures. In addition, there were service elements included, which were needed to counterbalance the drive for sales. The target would likely be harder to achieve, but it would be easier to influence the result;
- (d) the Board agreed that the new CSI proposal would be presented to the Remuneration Committee chaired by David Fish. Data would be provided to justify the target, together with example graphs. The effect of the queuing levels on the overall CSI score would need to be demonstrated, and the information should also be prepared with a view to discussing with Government.

ACTION:
Simon Carter
Crispin Beale

POLB06/75**STRATEGIC PLAN POLB(06)48**

- (a) Alan Cook introduced Sue Whalley and Eoin Daly of McKinsey. A presentation was provided which outlined the Post Office Ltd's strategic plan. It was explained that the purpose of the discussion was to consider any last amendments before the plan was submitted to the Royal Mail Holdings Board for consideration.
- (b) During the discussion, the Board agreed a number of amendments including the following additional slides to illustrate:
 - (i) the scale of the aggregate loss of income from Government business, such as Card Account,

In Strictest Confidence

- passport and DVLA;
 - (ii) the scale of the change of the business mix over the 7 years, excluding the last 2 years;
 - (iii) how automation may be able to help with issues faced by the bill payments business, and that this would be considered in detail in the autumn;
 - (iv) a chart would be produced to show the likelihood of it being viable for a zero fee ATM;
 - (v) that a possible mobile phones venture would be considered in September;
 - (vi) the potential benefit that would be realised of processing ID cards through Crown Offices;
 - (vii) extended stationery was best solution for additional retail;
 - (viii) the probabilities of the potential net risks and opportunities would be made clearer.
- (c) The Board further agreed that before presentation to the RMH Board, a summary would be provided for each section. To confirm each element of the plan a large ticklist of all section summaries would also be provided.
- (d) The Board agreed the strategic plan, subject to the above amendments to the presentation.

POLB06/76

SEALINGS POLB(06)49

- (a) The directors approved the affixing of the common seal of the Company to the documents set out against item number 77/06 and 109/06 inclusive in the seal register.

POLB06/77

ITEMS FOR NOTING POLB(06)50

The Board also noted the SPV business case which had been approved by the Executive Team.

POLB06/78

CLOSE

- (a) There being no further business, the meeting was closed.