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POLB 17(6th)
POLB 17/65 – 17/79

POST OFFICE LIMITED
(Company no. 2154540)
(the 'Company')

Minutes of a meeting of the BOARD meeting
held at 10.30am on Tuesday 26th September 2017
at 20 Finsbury Street, London EC2Y 9AQ

Present:

Tim Parker	Chairman (TP)
Richard Callard	Non-Executive Director (RC)
Tim Franklin	Non-Executive Director (TF)
Ken McCall	Senior Independent Director (KM)
Carla Stent	Non-Executive Director (CS)
Virginia Holmes	Non-Executive Director (VH)
Paula Vennells	Group Chief Executive (CEO)
Alisdair Cameron	Chief Financial and Operations Officer (CFOO)

In Attendance:

Jane MacLeod	General Counsel and Company Secretary (Secretary)
Steve Ashton	Post Office Management Services Limited Chairman
Nick Kennett	Chief Executive Financial Services and Telecommunications, and Chief Executive Officer of Post Office Management Services Limited (NK)
Martin Edwards	Group Strategy Director (ME)
Kevin Gilliland	Chief Executive Retail (KG)
Rob Houghton	Group Chief Information Officer (RH)
Owen Woodley	Managing Director, Post Office Money (OW)
Paul Willmott &	McKinsey & Co
Megha Kansal	McKinsey & CO

Apologies for Absence: None

POLB 17/65 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.

POLB 17/66 MINUTES OF THE PREVIOUS BOARD MEETING INCLUDING STATUS REPORT

(a) The minutes of the Board meeting held on 25th July 2017 were approved and the Chairman was authorised to sign them as a true record.

(b) The actions status report was noted as accurate.

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POLB 17/67 **CEO REPORT**

(a) The Board noted the CEO report. The CEO made the following additional points:

(b)
- Concern had been expressed to her by Board members as to the bandwidth of Rob Houghton (CIO), whether he was getting enough support and whether he was a flight risk. The CEO noted those concerns and advised that the CIO had recently finished recruiting his lead team. She recognised that he was critical to the successful delivery of IT transformational plans that were currently in flight. The CEO confirmed that she did not believe that retention was an issue, although if the CIO were offered a role with a substantially increased remuneration package, we would not be able to match that.

(c)

Irrelevant

(d)

(e) Security Operation Centre

- In response to a question the CEO advised that Fujitsu had been given the opportunity to bid for the SOC and disappointingly, their proposal was substantially more expensive than Verizon's.

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POLB 17/68 **LITIGATION UPDATE**

(a) The Board received a verbal update on the Postmaster Litigation from the General Counsel, noting that the Case Management Conference would be held on 19 October, and the outcome of the CMC would be directions given by the Court as to the conduct of the case over the next 12-18 months. There were key strategic issues to be decided as to Post Office's preferences for the sequence in which the legal arguments were to be addressed, and Post Office had receive legal advice as to the preferred sequence.

(b) The Board discussed the advice and its implications, and approved the proposed strategy.

POLB 17/69 **FINANCIAL PERFORMANCE REPORT**

(a) The CFOO presented the financial performance report for September 2017.

(b) The Board <u>noted</u> the financial performance report and in discussion the CFOO made the following points:

- Irrelevant

(c)

(d)
- Conversions of DMBs were behind plan with a consequent impact on staff costs.

(e)
- Within Supply Chain and also DMB higher than normal illness levels have created operational issues. In the case of Supply Chain they are under increased pressure for collections as a result of higher cash levels in the network.

(f)
- Cash losses have been a concern however additional audits are being undertaken and the number of material losses seem to be reducing. The resourcing model for branch oversight is being reviewed to ensure that branch losses can be monitored effectively and losses identified before they become material. There have been 80 agency branches shut since the beginning of the financial year of which 50 were due to suspensions (usually involving a loss > £10k). The position has improved recently and the rate of large losses seems to be declining. As part of the rollout of the new branch equipment, cash audits are being undertaken on a random basis of c 10% of branches. To date none of these random audits have identified cash losses. The CFOO also commented that compliance with the cash declaration process was improving.

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(g) On this point the Board stressed the importance of Post Office being seen by the agency network to take action proactively in relation to cash shortfalls.

(h) • The 5 + 7 reforecast was underway. There are a number of challenges including benefits expected in the Retail BU which will now be delayed until 2018-19. Nevertheless the CFOO expected that the £28 million EBITDAS target would still be achieved, although the factors contributing to that outcome may change.

POLB 17/70 POMS PERFORMANCE AGAINST STRATEGY

(a) The Chairman welcomed the POMS Chairman, Steve Ashton and the POMS Managing Director Rob Clarkson to the meeting to present their report on the performance of Post Office Management Services Limited (POMS) for full year 2016/17,.

(b) The Board noted the report and Mr Ashton and Mr Clarkson made the following additional points:

(c) • POMS is broadly on track with delivery of its longer term strategy, however there are challenges including:
  - o Overspend and delay on implementation of the Zeus (travel insurance) platform has caused slippage on delivery of certain plans, however overall, the project had delivered he planned benefits.
  - o There is increased regulatory attention on oversight of Appointed Representatives by regulated entities such as POMS which poses an increased pressure for branch sales;
  - o The restructure of the marketing function has impacted adversely;
  - o Changes to the branch distribution network through Project Finch have also impacted adversely.

(d) • POMS is responding to these challenges by reviewing its strategy – particularly around the car/van/home/ markets, and the POMS Board is reviewing the strategy at its November meeting. Among other issues, is the need to change and improve the distribution options.

(e) • There have been a series of successes and the transition to Royal London and better negotiated outcomes with Collinson have resulted in significantly increased margins.

(f) • The consumer focussed strategy being developed by the wider Post Office financial services business will assist in framing the POMS strategy, and there will be common challenges for IT, compliance and technology support.

(g) • There continue to be challenges between the strategic goal of building shareholder value, and the need to deliver in year targets.

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During the subsequent discussion:

(h)
- The Chairman asked whether there was a clear enough guidance from the shareholder as to how to balance long and short term objectives. It was noted that there is investment available for longer term strategic development, however this will require identification of an investable proposition, which could include acquisitions or joint ventures.
- It was noted that the Post Office brand was well suited to a general insurance proposition and the POMS team should ensure there was a sufficiently ambitious plan to develop that brand value. For example, there were opportunities for home insurance as a result of increasing home automation.
- Digital channels need to become much stronger and the new marketing strategy would substantially aid this, although there are challenges to ensure that digital channels support customer retention measures. To this end better customer platforms and improved claims handling performance will be key to retaining customers. Innovation was needed as much in the distribution strategy as in manufacturing.

The Chairman thanked Mr Ashton and Mr Clarkson for their report.

POLB 17/71 **ANNUAL REPORT AND ACCOUNTS 2016/17**

(a) The Committee received a report from the CFOO which included a draft of the Annual Report and Accounts 2016/17 ('ARA'). The Board noted that the ARA had been considered by the Audit, Risk and Compliance Committee on 25 September 2017 which had recommended the ARA for onward submission and approval to the Board. The Board recognised that given timing the ARA was a living document and that changes continued to be made.

(b) The CFOO recognised that a significant amount of work had gone into the preparation of the accounts to address changes during the year, and that due to the delays in finalisation of the funding, additional work had been required to address post balance sheet events. In particular, since the last discussion of the draft accounts in May:

- The pensions scheme having closed as at end March 2017, the Trustees had arranged and effected a buy in of the pensions liabilities with Rothesay Life;
- Agreement on the future funding from government was necessary to establish the sustainability of Post Office;
- Significant work had been undertaken to establish that the impairment of assets could be reversed and to undertake the necessary work to validate the inclusion of those assets on the balance sheet, as well as to determine that the future approach to depreciation and amortisation was viable.

The combination of these had meant that significant work had been undertaken on the subsequent events review.

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(c) The timetable for finalisation was as follows:
- Signing of the accounts targeted by the end of the week (29/9/2017)
- Announcement of the further funding could happen during the week commencing 2/10/2017
- Publication of the accounts could not occur until they had been laid before Parliament and the earliest date for this was in the week commencing 9 October.

(d) The Chair of the Audit & Risk Committee confirmed that at the Committee meeting the previous day, EY had confirmed the process that had been undertaken by them to prove that Post Office was sustainable going forward.

(e) The Board noted that the Chairman's and CEO's statements remained outstanding and that further work was required to ensure consistency between the various sections, and for EY to finalise their technical and quality review.

(f) The Board further noted that each director had been requested to review and sign their respective Certificates of Director's Remuneration and Interests in Shares, and that the details set out in each certificate had been reviewed by both the Finance and HR teams.

(g) The Board approved the ARA subject to finalisation and delegated authority to the Chairman, CEO and CFOO to finalise all outstanding matters and the text of the front end, and once done so to their satisfaction, to sign the accounts.

POLB 17/72 FUNDING DOCUMENTS

(a) The Chairman welcomed ME to the meeting to provide an update on the status of the funding documents.

(b) ME advised that the funding documents were substantially similar to those relating to the current funding period, and that once executed would replace the interim documents signed in March 2017.

(c) ME noted that there were two documents currently under negotiation:
a) the Entrustment Letter which set out the access criteria (including Services of General Economic Interest 'SGEI's); and
b) the Funding Agreement under which the Network Subsidy Payments for 2018-19, 2019020 and 2020-21 (totalling £160 million) , and the 'investment funding' of £210 million, would be paid.

Together the two documents required Post Office to:
- maintain a network of at least 11,500 branches, of which at least 11,000 must provide the SGEIs. These services, which are defined in the Entrustment Letter, include mails, access to cash (banking and POCA), bill payments and access to

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specific government services.

- meet the Access Criteria (as set out in the Entrustment Letter and which have not changed) which are designed to ensure a reasonable geographic spread of branches across the UK, based on population and post code districts.
- prepare and deliver a 3 year Strategic Plan for the 2018-2021 funding period by end November 2017;
- prepare and provide annual strategic plans in an agreed form before 31 March in each year during the funding period; and
- provide quarterly reporting of progress against the annual and 3 year Strategic plans.

(d) The key changes between the current funding documents and those under discussion relate to:

- payment mechanics as BEIS has indicated that it would prefer quarterly drawdowns;
- if the number of branches falls below 11,500 then Post Office would be required to develop a remediation plan for approval by the Secretary of State and if Post Office wished to withdraw SGEI services from the 11,000 branches Post Office would need to seek the Secretary of State's consent; and
- Post Office's quarterly reporting obligations to the Secretary of State.

(e) In addition ME advised that he had been discussing with BEIS whether it would be possible to amend the terms of the Post Office Credit Facility to review the commitment fee and rates, rates, move from weekly to monthly reporting and potentially introduce greater flexibility under the 'event of default' provisions in certain scenarios relating to the security headroom.

(f) ME advised that the State Aid process had begun and although the timeframes were tight, BEIS had advised that they believed it would be possible for the approval process to be completed in time to allow drawdown of the first tranche of the Investment Funding and the Network Subsidy Payment for 2018-19 in early April 2018, subject to delivery of the 3 year Strategy by the end of November 2017 and the Annual Strategic Plan by end March 2018.

(g) RC confirmed that this summary was consistent with BEIS' expectations.

RC left the meeting during the further discussion due to his conflict as a representative of Post Office's shareholder.

(h) In response to a question ME confirmed that BEIS had withdrawn their earlier proposals which would have given the Secretary of State additional approval rights over the application of funds.

(i) The Board noted that should a Labour Government be elected, then it was Labour party policy to nationalise Royal Mail Group,

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Action: Martin Edwards

(j) and it was likely that fundamental changes would be required to the Post Office Board and operating strategy. **The Board requested management to develop plans to address the possible scenario of an election and Labour victory.**

(k) The Board:

- noted the timetable for agreeing the revised funding documents;
- approved the terms of, and the transactions contemplated by, the following draft documents:
    - Funding Agreement between the Secretary of State and Post Office Limited contemplating a total of £160 million network subsidy payments for 2018/19, 2019/20 and 2020/21 and £210 million 'investment funding (the 'Funding Agreement');
    - Entrustment Letter being a letter from the Secretary of State for the Department of Business, Energy and Industrial Strategy addressed to Paula Vennells as Chief Executive Officer of Post Office Limited and headed 'Entrustment of Post Office Limited with the Delivery of Certain Public Services' (the 'Entrustment Letter' as further described below);

  (together: the 'Funding Documents')
- resolved to execute and perform each of the Funding Documents;
- authorised any director or Authorised Signatory to execute each of the Funding Documents on behalf of Post Office Limited; and
- authorised any director, Authorised Signatory or the Company Secretary to sign and/or dispatch all documents and notices to be signed and/or dispatched by it under or in connection with each of the Funding Documents.
- authorised the CEO and CFOO to negotiate and agree any amendments to the POL Credit Facility which have the purpose of improving pricing or giving POL greater operational flexibility in the management of cash in its operations, reviewing the interest rates, switching from weekly to monthly reporting and introduce greater flexibility around the use of proceeds and/or the authorised investments and the segregation undertakings and corresponding events of default , and
- authorised any director or Authorised Signatory to execute any amendments to the POL Credit Facility for this purpose.

ME left the meeting.

POLB 17/73 **PROJECT PEREGRINE UPDATE**

(a) The Chairman welcomed Paul Willmott and Megha Kansal of McKinsey & Co, Nick Kennett and Owen Woodley.

(b) Mr Kennett noted that at the July Board management had been requested to update the Board on the Bank of Ireland ('BoI') proposal once received, and that in addition the Board had requested that management consider what other opportunities might be available. To that end management had worked with McKinsey to consider options, and with KPMG to consider the impacts if the BoI contract was allowed to expire.

(c) Mr Wilmott made the following points:
- the banking landscape was changing with the introduction of open banking; particularly as manufacture and distribution of banking products could now be separated with the availability of low cost banking platforms, as was being seen in Asia. Equally the barriers to entry were coming down and the speed to market for new entrants was increasing;
- Post Office has a number of strengths including brand and its extensive branch network. These suggested three possible options as outlined in the paper, all of which would offer Post Office significantly increased revenues and ahead of remaining with BoI::
  - customer interface providing access to both 3rd party and Post Office branded products;
  - provision of Post Office branded products only but sourced from a range of manufacturers , and/or
  - investment in a challenger bank.
- Critically, given the constraints under the current BoI contract, Post Office will be able to explore options through till c 2020, and should focus on 'no regrets' initiatives. These could include the development of the customer hub and expansion of the digital customer base through on-line travel insurance and similar products.

(d) The Board discussed the contribution that Post Office makes to BoI's profits (both on a UK and group basis), and the residual risks to BoI should Post Office withdraw from the relationship. In light of this, Mr Willmott was asked what advice would McKinsey give to BoI if it was advising the bank? Mr Wilmott suggested that BoI should lock in the current benefits and seek to stimulate growth going forward. However he also recognised that the objectives of the UK management and the perspective of the Irish based Group management may be quite different – particularly given the imminent arrival of the new BoI Chief Executive.

(e) The Board then discussed the BoI proposal and the options set out in the paper, the considerations relevant to each of them including the impact on FRES; the level of investment that would need to be made to deliver the possible alternative options; the development of the customer hub; the balance between short term profits and longer term investment; our understanding of BoI drivers of behaviour, and the best means of engagement.

(f) The Board noted that the recommendations were not mutually exclusive, and that it was possible to implement one or more of them sequentially, and that we would have greater clarity on BoI's objectives as 2020 approached. Further, although Post Office needed to respond to the offer made by BoI, there was no immediate urgency to take any particular course of action. Mr

Woodley noted that we need to maintain a constructive working relationship but that we could put more pressure on BoI to deliver the contractual obligations such as delivery of viable propositions for a current account, investment products and credit cards.

(g) The Board therefore recommended that:

- BoI's offer should be rejected and management should follow the negotiating path set out in the paper;
- 'business as usual' needed to continue, and
- management should continue to develop options in the background as a contingency.

The Board thanked the team for their work.

Carla Stent also left the meeting at this point.

POLB 17/74 **CHIEF EXECUTIVE RETAIL PERFORMANCE REPORT**

(a) The Chairman welcomed Kevin Gilliland to the meeting to introduce the commercial performance report for the Retail BU for period 5 and noted the paper.

(b) KG reported:

- Retail had had 5 positive months trading which offset delays in the implementation of DMB franchising and product simplification. In branch footfall remained stable and volumes and margins in mails continued to show good performance;
- Competitor activity continues to be of concern however the trial between Rymans and Doddle had ended after 3 months, and Rymans were now back in discussions with Post Office;
- Launch of the eBay shipping platform had been delayed to after Christmas and we were working with RMG to ensure that both parties were able to participate; this work is helpful in positioning future joint strategy work with RMG;
- Threatened industrial action at RMG remained of concern. 17 October was the likely earliest date for a strike. We are working closely with the RMG team to develop contingency plans. At this stage we believe that 24 hour rolling strikes are most likely affecting collections and deliveries alternatively.
- Product Simplification was launched this week which will be worth £11 million to the bottom line once fully rolled out. At the time of reporting over 5 million transactions have occurred using the simplified product processes, with only 22 emails received mainly regarding requests for support or complaints. Meetings have been held with multiples who were supportive of the rationale for simplification but were concerned about loss of remuneration. Transitional payments are being offered to all postmasters and we will work with postmasters – and particularly multiples, to consider cost savings measures.
- 'No Queues at Christmas 'is underway with a range of

initiatives including increasing the number of Drop & Go accounts; remote diagnostic and fixing of SSKs; social media videos for customers; extra Christmas makers and staff (including a new lower paid back office role), all of which should have a positive impact on queues.

Action: KG

(c) KG was requested to consider:

- the economics of products – both for Post Office and agents given the declining volumes and margins, and have a view as to which products were genuinely necessary to support footfall;
- the implications of increasing use of Post Office supplied cash.

The Board noted the report.

POLB 17/75 **TECHNOLOGY STRATEGY UPDATE**

(a) The Chairman welcomed RH to the meeting to present his report.

(b) RH noted that this was the third in a series of presentations to update the Board on the development and implementation of the technology strategy. Focus at present was on:

- Roll out of the branch technology upgrade which is challenging both in terms of the number and scale of the network, and the fact that was being delivered into third party sites which creates unexpected issues. The target is to have completed the hardware roll out by March 2018, and the upgrade to HNGA by June 2018, in each case to avoid increased costs arising from among other issues, failure demand. Already we are seeing positive reports from agents due to faster transaction processing. This will further improve as we move to HNGT which can be accessed via third party point of sale systems and which is particularly of benefit to the large multiples.
- Upgrade of the communications network from BT to Verizon and upgrade of ISDN lines. In branch routers are being replaced in every branch; while we are trying to coordinate engineer visits with the technology upgrade this is not always possible.

(c) In discussion, the Board noted that the combination of the upgrades currently underway, and in planning will result in simpler processes, faster transaction times, and as a consequence reduced in branch training time as the system is more intuitive. This would assist in the discussions on agents' remuneration as well as improve compliance.

(d) RH also advised that his leadership team was now in place although attracting and retaining IT architects was currently an issue.

(e) RH further commented on the work underway to develop the

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Digital Roadmap. FS was being prioritised although the outcome of the discussions with BoI needed to be factored in. the current focus was the customer journey for Travel Insurance and this was a joint effort between POMS and the IT team. The 'customer hub' is a platform for products which will be accessed through it, and therefore products and the platform needed to be developed in parallel. The investment return of launching the products on this platform will be carefully assessed.

(f) RH noted that discussions with Fujitsu were ongoing and that he would be reporting more specifically on these negotiations in October. He noted that the shape of the deal is now broadly agreed with a shift to a variable costs base, with savings invested in change. There are opportunities to develop greater digital capability and Fujitsu are keen to leverage their growing cloud, security and retail capabilities, of which we will seek to take advantage of cloud and retail technologies. Improved personal relationships at a senior level have proved helpful in moving the discussions forward.

(g) RH then update on the discussions with Atos which he described as 'testing'; there is a revised deal under discussion and although the revised position is not as good as he had hoped to achieve, it is better than the current model.

(h) Overall RH felt that as each of the programmes were developed and rolled out, both operational risk and cost were being reduced. Overall there was a better engagement between the business and IT, however there was still a cultural challenge in developing the mindset of 'digital by design'.

(i) The presentation concluded with a demonstration of the changes resulting from the redesigned branch software.

(j) The Board commented positively on the progress to date; noted that there was significant amount at stake and were sympathetic to temporary setbacks. They recognised the cultural challenge (digital thinking/approach to business) and asked to be kept up to date.

RH left the meeting.

POLB 17/76 BACK OFFICE TRANSFORMATION

The Board noted the paper and the CFOO commented on the following:

(a) • The replacement and transformation of POLSAP and HRSAP was challenging. As had been previously discussed with the Board, the systems were complicated and the supporting infrastructure was fragile, and as a result and as discussed at previous meetings, the overall cost of the programme had increased. There was still further work to be done to finalise the strategy - for example regarding Swindon where the benefits case remained outstanding.

(b) • While the plan was to continue with the current plans, there was a risk that POLSAP would need to be stabilised on short

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notice by way of upgrade. This is being monitored closely as the cost of the upgrade would be c£6 million and the CFOO noted that he was seeking delegated authority to incur this expenditure if it proved unavoidable.

(c) The CFOO also noted that he was seeking approval for drawdown of £7.3 million to deliver the next phase of work which would increase the cumulative investment in the Back Office Transformation to £16.2m for the period to end February 2018 which a total expected cost of Phase 1 of £20.9 million (including the contingency). Phase 2 will now include the changes to procurement and the Swindon stock ordering systems. A separate business case is under development in relation to these, and the site strategy for Swindon is being reviewed.

The Board noted that the total project could therefore cost up to £31.3 million and that further approvals would be sought once a more detailed view of the Phase 2 costs had been obtained.

The Board approved the drawdown of £7.3 million as requested.

(d) The Board noted that the potential stabilisation of POLSAP at a cost of c £6 million was effectively an insurance policy and that the objective was to get off the current infrastructure.

The Board therefore delegated authority to the CEO, CFOO and CIO to approve and incur the additional costs to upgrade POLSAP should that be required due to material increase in operational risk, at a cost of up to £6m.

POLB 17/77

Irrelevant

POLB 17/78 **ITEMS FOR NOTING**

(a) <u>Register of Sealings</u>
The Directors <u>resolved</u> that the affixing of the Common Seal of the Company to documents numbered 1544 to 1575 inclusive in the seal register was confirmed.

(b)

Irrelevant

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Irrelevant

(c)

(d) Meeting Dates and Forward Agenda for September 2017

The Board noted the future meeting dates and proposed forward agenda. Ms Holmes note that she had a conflict on 1 February, 2018 and **the Chairman requested that the Secretary see if an alternate date could be identified**.

Action: Company Secretary

POLB 17/79 **ANY OTHER BUSINESS**

(a) The Company Secretary advised the Board that at its meeting ARC that morning, the ARC had reviewed the proposed insurance renewal for Post Office Limited and summarised the changes to the policy cover including:

- Aligned renewal dates across all policies
- Extended cyber insurance across Post Office, and
- No change to the other coverage including Directors & Officers Insurance.
- The Company Secretary noted that the renewal was within the CEO's delegated authority and therefore would be renewed, effective 1 October 2017.

(b) Tim Franklin noted that he had been requested to join the Board of Topaz Finance Limited which was an FCA regulated provider of mortgage services and part of the wider Computershare Group. He also noted that he expected to step down from the Land Registry Board in January.

(c) There being no further business the Chairman closed the meeting at 3.00pm.

GRO

31/10/17

Chairman **Date**