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Annex B

**BA/POCL AUTOMATION: COMPARISON OF THE ALTERNATIVE
OPTION TO CONTINUATION WITH THE BENEFIT PAYMENT CARD**

WHAT ARE THE OPTIONS?

Following discussion with ICL, ICL have proposed an alternative option which would entail:

- dropping the Benefit Payment Card;
- the Post Office would set up simple "benefit accounts" on the back of the Horizon infrastructure;
- benefits would be paid via the BACS system into these PO accounts, or else into existing accounts;
- the account could be run by a bank on behalf of the Post Office, and would simply be a vehicle for the cash withdrawal of benefit;
- cash withdrawals from a benefit account could only be made from a post office.

We asked KPMG to model scenarios around this alternative option.

On the basis of this further work, we believe there are two main options:

Continue with the Benefit Payment Card: option 1

- project as currently envisaged;

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- transition to a smart benefit card from 2001;
- benefits paid by ACT into bank accounts from 2005 when POCL has full network banking in place.

Drop the BPC and transfer benefit recipients to a PO benefit account: option 2A

- POCL contract with a banking partner to set up PO benefit accounts accessed by a smartcard by end 2001;
- benefits paid by ACT into PO benefit account from early 2002;
- POCL offer full network banking from 2003.

CONFIDENTIAL - COMMERCIAL**WHAT IS THE OVERALL IMPACT ON THE PUBLIC SECTOR?**

The following table shows the NPV (1999-2010 discounted to 1999) of options 1 and 2A relative to a base case of "business as usual".

net impact on DSS	1.37	2.51
net impact on POCL	0.17	-1.29
overall NPV	1.54	1.21

- the modelling suggests that the alternative option 2A is less beneficial to the public sector than continuation with the BPC
- whilst the savings to DSS are much larger under the alternative option, the costs falling on POCL are consequently much greater (reflecting the costs of setting up and operating the PO benefit account and the loss of BA income). KPMG also assumed there would be lower footfall under option 2A, though this looks pessimistic. Assuming no loss of footfall, the NPV for option 2A would improve by up to £70 million (see refinements section below)
- there are significant uncertainties attached to the modelling (although these are likely to be greater for option 2A than option 1)
- the NPVs do not fully reflect the risks under each scenario

CONFIDENTIAL - COMMERCIAL**REFINEMENTS TO THE OPTIONS**

KPMG also considered sensitivities around the alternative scenarios:

BA move to start ACT transfer more quickly

- it might be possible to start the ACT transfer more quickly than BA currently envisage - but we would need to discuss this with BA. In particular, this may be constrained by BA's IT systems
- would risk moving to ACT faster than PO could implement PO benefit accounts

BA completes transfer to benefits via ACT more quickly

- completing transfer to ACT over 18 months rather than 3 years would improve the NPV of option 2A by £130m as DSS savings come on stream more quickly
- we would need to discuss with BA whether this was operationally possible
- note this would not close the gap between option 1 and option 2A

POCL markets its full banking more aggressively under option 2A

- NPV on 2A might be improved if PO manage to transfer these customers to full banking more quickly

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BA/POCL work together to maintain footfall in option 2A at the same level as option 1

- option 2A entail greater loss of footfall than option 1, since some changes implemented by BA (e.g. periodicity) will encourage a larger shift to ACT into conventional accounts than under option 1
- it might be possible for BA and POCL to work together to reduce footfall loss - possibly saving up to £70m NPV under 2A
- note this would not close the gap between option 1 and option 2A

POCL offers a more conventional bank account

- envisages PO bank accounts offering simple bank services. Could be accessed at points other than the Post Office
- significant risk to PO commercial banking strategy - to become network banker for all banks - since banks would see this as a competing product
- greater risk to footfall - since accounts can be accessed at other non-post office locations e.g. ATMs

CONFIDENTIAL - COMMERCIAL**THE POTENTIAL RISKS**

Comparing the alternative option 2A with option 1:

- the figures are dependent on the outcome and timing of a further round of negotiations:
 - with ICL over the cost of Horizon without the BPC, and the cost of smartcard. It is far from clear that we could keep ICL to the same NPV loss negotiated by the public sector parties following Corbett. In particular, ICL would argue that they should be paid for their sunk development costs for the BPC, and it is not clear what they would charge for the smartcard;
 - with potential clearing bank partners for POCL to provide benefit accounts;
 - with all the banks to allow POCL to offer network banking services (allowing post offices to provide counter services on behalf of banks). The modelling of the alternative options assumes that POCL is able to offer network banking services from 2003. If this date were to be delayed it would hit the financial projections for option 2A compared with option 1.
- the fraud risk (e.g. from the use of a stolen card). Under Option 1, this risk is borne by ICL, and there are various BPC-specific IT systems planned to manage this (e.g. to verify the identify of the cardholder). Under ACT, fraud risk falls to the banks - in the case of the alternative approach, POCL or POCL's banking partner.

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- the development risk. The development of the BPC is almost complete. In contrast, the alternative approach requires development of a number of IT systems - in particular, the interface with the Horizon platform in Post Offices and the POCL benefit accounts.
- the impact on the network. The reaction of sub-postmasters to the removal from the project of the BPC would have to be carefully managed.