

RWW/1104

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Ref...

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From:  
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30 July 1998

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**POST OFFICE COUNTERS/BENEFITS AGENCY AUTOMATION  
PROJECT "HORIZON".**

**Issue**

You are to meet with the Secretary of State for Social Services and the Chief Secretary this evening to discuss the way forward on the BA/POCL counters automation project, code named "Horizon".

**Recommendation**

2. That you note the background to this project, and are guided by the suggested "lines to take" which follow.

**Timing**

3. **URGENT:** the meeting is at 5.00 pm today.

**Background**

4. In 1993, in a bid to cut the costs of delivering social security benefits, DSS came forward with a proposal to require benefit recipients to accept payments by automated credit transfer into bank accounts (ACT). Because income from the Benefits Agency (BA) represents more than one-third of Post Office Counters Ltd (POCL)'s income, the DSS proposal would have led to a massive collapse of the nationwide network of post offices. There were also other problems with the

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proposal, such as how and at what cost the sizeable rump of “unbankable” recipients would be dealt with. The proposal leaked, and a major public campaign, led by the National Federation of Subpostmasters, caused the Government to give assurances that benefit recipients would continue to have the option of draw their benefits at post offices.

5. Out of this grew the Horizon project. It gives the Benefits Agency a modern, fraud resistant means of paying social security benefits, with a magnetic strip plastic swipe card replacing the traditional payment books and girocheques; and it gives POCL an automated platform, with on-line terminals at 40,000 counter positions in more than 19,000 post offices, to retain existing clients and to develop new business opportunities, as well as to modernise its own processes. This £1 billion project was undertaken under the Private Finance Initiative, with ICL Pathway as the private sector partner.

6. The project, one of the largest and most complex iT projects ever, is now running some 2 years behind schedule. Under pressure from DSS Ministers, concerned at the fraud savings foregone, the Government earlier this year asked DTI and DSS officials under Treasury leadership to review the project. The Horizon Working Group in turn commissioned an Expert Panel, under the chairmanship of Adrian Montague, to report on the project’s technical viability.

7. The resulting report was put to Ministers on 22 July. It concluded that the project was technically viable, and likely to be both robust and acceptably “future proof”. It suggested that there might be some nine months further delay to the project. It suggested 3 main families of options: first to continue with the project provided satisfactory terms can be negotiated with ICL (probably the most we can offer ICL within EU procurement law is to extend the payback period by two years); second to continue with the Horizon infrastructure but without the payment card; and third to cancel the project. Under all three options, which are set out in more detail at Annex B, POCL would develop “front end” banking facilities to enable account holders of some or all of the commercial banks to access their accounts for basic transactions at post offices. This facility would use either the Horizon infrastructure or alternative technology depending on the option.

8. Immediately after receiving the report, Frank Field wrote to Geoffrey Robinson on 22 July (copy at Annex A) reinforcing the DSS stance on the future of the project. This favours option 2, namely **cancelling the benefit payment card but continuing with the remainder of the Horizon infrastructure** to allow an earlier move to ACT, whilst parallel provision of “front end” banking services in post offices would be established. BA would aim to migrate to ACT over three years from October 2001. POCL would therefore need to establish banking

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facilities by that date. A summary of this option (Option 2) and Options 1 and 3 is attached at Annex B.



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### Argument

9. We have three major concerns with **Option 2**:

- we do not think ICL will agree to continue with Horizon less the payment card unless they are compensated for their development costs **and** the loss of a key revenue stream (ie we shall have to pay for the card, whether we use it or not). Frankly, any thought that DSS would get away without compensation for cancelling the card (as their lawyers claim) is absurd; and any thought that they would get away with it **and** persuade ICL to carry on with the rest of the project is even more so.
- the revenue that POCL can get from front-end banking will nowhere near cover the loss of income from BA (DSS has suggested that some of the savings from an earlier move to ACT could be recycled to help POCL, but most of these will probably go to compensate ICL. In any case, subsidy does not get customers into post offices, and the loss of “footfall” would be an additional serious blow).
- POCL are likely to keep a much higher proportion of their customers if they migrate to ACT via the payment card than if they are forced to move straight to ACT.

10. **Option 3** is even less appetising. Whilst POCL could probably put swipe card terminals to allow very limited banking transactions into post offices quite quickly and cheaply, to start anew developing an integrated computer platform would set their business prospects back by two or three years. The effects on ICL would be extremely serious, and depending on the reaction of ICL’s parent Fujitsu, currently struggling with the Asian financial crisis, could even bring the company down. Fujitsu’s plans to float ICL on the stockmarket in 2000 would be destroyed, and the effects on inward investment from Japan from Fujitsu and other companies could be considerable.

### Conclusion

11. Given that both the report of the Expert Panel and now the report of the Steering Group believe that the Government’s objectives are best met by continuing with Horizon including the payment card, we see no reason to weaken our position, especially since DSS/BA opposition appears to be driven more by a dislike of POCL than concerns about the technology.

12. The need for a decision is urgent. The ICL Managing Director is currently in Tokyo, having been called in by a worried Fujitsu main board (who were earlier



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told that there would be a decision by July). Given the uncertainties, ICL are in no position to continue indefinitely spending £8 million a month on development work, and will anyway soon need to draw down a further substantial tranche of funding. If the work slows or stops, further delays to the implementation phase of the project become inevitable.

13. A second reason is that the much publicised delays and uncertainties surrounding the project are having a damaging effect on the morale of subpostmasters (who collectively are estimated to have sunk some £1 billion of their own money into the network). Subpostmasters typically fund their retirement through sale of the business, and the risk that Horizon will collapse has now begun to depress sale values.

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**Lines to take**

- Understandable that DSS have concerns about continuing with the benefit payment card given the problems that delays have caused the BA in terms of lost fraud savings; your concerns about switching claimants from the payment card to ACT within the space of a few years; and the overall delay to moving to universal payment of benefits by ACT.
- Also recognise there are significant administrative savings to be made for DSS from a switch to compulsory ACT.
- **However, we do not believe that to pursue the Option 2 route - dropping the payment card element of the project - is sustainable.**
- We doubt whether this option is negotiable with ICL, other than by throwing huge amounts of money at them in compensation for their expenditure so far on the card and the consequent loss of a key revenue stream. And if ICL were forced to litigate on withdrawal of the card, it would certainly bring the rest of the project down with it.
- There would be presentational difficulties about paying large sums of money to ICL for the card without making any use of it (waste of taxpayers' money), especially if at the same time benefit recipients were being transferred against their will to ACT.
- There would be a major loss of confidence by **subpostmasters**, who would be quick to see that

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arrangements for “front end” banking would in no way offset the loss of direct BA business. Many might be tempted to sell up before it is too late, resulting in large numbers of network closures. DSS Ministers have very publicly expressed their commitment to the success of the project as a whole, and to the benefit payment card in particular. There would be a strong sense of betrayal amongst subpostmasters.

- **That is why we share the view of both the Expert Panel and the Working Group that the Government’s objectives can best be met by continuing with the project as envisaged in Option 1 - provided satisfactory terms can be negotiated with ICL.**
- Recognise that in the longer term ACT will be the normal method of delivering welfare benefits, but surely important to progress to that position in a phased and controlled manner that minimises the impact on the network of post offices, especially since access to post offices will be a key element in the acceptability of ACT. Unique reach of post offices is important for the less affluent and less mobile.
- POCL believes the payment card will provide a valuable bridge which will encourage customers to remain with their post office in any large switch to ACT. There are undoubtedly possibilities for POCL to generate new revenue streams, for example, offering front-end banking facilities to banks and in the context of Government Direct. Although this may never fully replace a significant loss of BA income, **option 1 offers the best prospect of achieving a viable future for POCL.**



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- Keen to see post offices playing a role in our aspirations for universal banking/social inclusion. Important, therefore, for this wider reason that migration to ACT is done in a way which does not threaten the stability of the network.
- Recognise that the post office network needs to evolve to match both inevitably lower revenue streams from its public sector clients and changing customer requirements. Need to ensure that the network matches customer and client requirements. Important that changes are made in a controlled, steady fashion.

### **If Option 1 Fails**

- Of course, if it not possible to secure a satisfactory agreement with ICL or the project experiences further significant problems, we will need to consider cancellation.