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To: Secretary of State

From: Sarah Graham PFD Sp Proj

Date: 08 April 1999

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BA/POCL AUTOMATION PROJECT: TAKING FORWARD MINISTERS' PREFERRED OPTION

Issues:

To alert you to:

- the Prime Minister's meeting with Naruto, Vice Chairman of Fujitsu, on Monday 12 April; and the briefing from HMT that will be coming forward for your review tomorrow;
- the pressure being exerted by ICL for an early decision in their favour;
- the current position on the HMT-led discussions with ICL, POCL and ourselves about Ministers' preferred way forward;
- to seek any views you may have at this stage;

and to suggest:

- that Lord Falconer joins the Fujitsu/ICL meeting with the Prime Minister on Monday.

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Background:

1. You will be aware from earlier updates that I have put to you that there has been some lack of transparency about the nature of the remit that Steve Robson believes he is carrying forward. The way the remit has been presented to POCL and ICL is to find a way forward that will:
 - "enable electronic payment of benefits using a Smart Card; (which does not necessarily have to mean ACT);
 - involve mass conversion of passbook holders without the offer of choice in order to help protect POCL footfall;
 - involve a system which has the capacity to grow to offer other services but does not involve such services;"

and, most recently, Steve has said to me that he regards his remit as "not to marginalise ICL". (I suggested that that may be taking his remit beyond what is more probably the basic requirement - to give ICL enough to stop them going out of business and to protect their planned flotation.)

2. I have been assuming - and I believe my DTI opposite number shares this assumption - that the way forward implied by the proposals put forward to the Prime Minister, agreed by you and colleagues, were designed to meet some additional, and wider objectives:
 - to move straight to the payment of benefits via ACT, in order to achieve for Government (and possible financing of the continuation of the project) the £400 million administration savings that will achieve - and also the transfer of risk to the established banking systems (as with the 30% of payments already made via the ACT/BACS system), and the potential to piggy back on anticipated commercial/technological developments;
 - to give POCL a reasonable chance of retaining "footfall" from benefit recipients - in the short term, on a par with the situation that would have pertained under the Benefit Payment Card arrangements; and in the medium to longer term, to maximise its commercial viability - to the advantage of tax payers, who will otherwise be funding a national network to a greater or lesser extent;
 - to achieve, via the Post Office/project arrangements the potential to carry forward in a positive way the Government's wider policy agenda, particularly in relation to combating social exclusion - the Social Exclusion Unit's report on financial exclusion is due in July and is likely to recommend greater access to *mainstream* banking and financial services for all;
 - to provide a positive example of carrying forward the Modernising Government agenda.

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3. These wider objectives may have an important role in justifying the continuation of the project in accounting terms, given ICL's failure to deliver.
4. Against this background there have been two proposals on the table for implementing Ministers' preferred way forward:
 - one put forward by ICL (known as B1) which essentially uses the current Horizon/Benefit Payment Card technology to allow the payment of benefits via ACT/BACS into a Post Office "moneybox";
 - the second option, put forward by POCL: to work with one or more strategic banking partners to set up simple bank accounts (into which benefits could be paid via ACT/BACS) - with the potential to migrate to something more sophisticated over time but with ICL playing a lesser role;
5. This second option has fallen by the wayside because of:
 - POCL unwillingness to engage: they still prefer Option 1 (the Benefit Payment Card);
 - the self-evident greater complexity of having to work up a strategic relationship with one or more banks at the same time as working out the future of the project;
 - POCL's concern in parallel to build systems to support "network banking" - whereby they could provide a service for *all* banks; and unwillingness to develop strategic relationships with banks on a selective basis in the interim.

The current position:

6. Against this background, Steve Robson (with our concurrence) has concluded that the only way forward **within the time available** is around Option B1. However, in order to meet DSS concerns that we would be able to achieve payment via ACT/BACS without entering into a contractual relationship with ICL, this option is now being worked up on the basis that POCL become a bank or hold a banking licence - something it has not been keen to do - in order that they (rather than DSS or ICL) own the accounts.
7. The key features of the proposal are now as follows:
 - the Benefit Payment Card is cancelled;
 - POCL bank (probably a subsidiary of POCL) would be formed and authorised under the Banking Act;

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- POCL bank would provide simple "accounts" into which benefits were paid via ACT and withdrawn in cash using a smartcard at Post Offices;
- BA would transfer benefits to POCL via the BACS system - in the same way as is currently done for benefit recipients who receive payment by ACT;
- ICL would deliver and operate the infrastructure required, and would manage the smartcards;
- ICL would contract with a bank to administer the accounts;
- POCL's aspirations to become an agent for the banks ("network banking") would be developed in parallel.

Assessment of the position:

8. This option now looks capable of meeting the key DSS objectives, subject to some key reassurances around, for example, the handling of risk; incentives to ensure a timely move to ACT; provision to ensure that we (and our customers) are not vulnerable should ICL fail to deliver etc.
9. Our key concern may be rather that this option is so far from POCL's desired way forward that it will fail to gain their agreement (for example, as it stands, this option does little to help reassure POCL on retaining "footfall" - unless and until it migrates to a system whereby these accounts can do more than simply receive and pay out benefit money). This, against POCL's continuing resistance to give serious consideration to any alternative to an option involving the Benefit Payment Card, which they continue to push.
10. If the Post Office Board resist the proposed alternative option, Stephen Byers - and indeed Number 10 - may not feel able to endorse it; and we may be thrown back on the Benefit Payment Card. In any event, it is not in this Department's interests to go down a route whereby we become dependent on ICL and their systems for the foreseeable future; and run a risk of upsetting our most vulnerable customers if the Post Office network does indeed fall apart within the next few years.
11. It is in our interests to give POCL some support in key areas which might help with their commitment to the alternative option. Most crucially they could be given some reassurance that their financial position under the alternative option would not be materially worse than under an option with the Benefit Payment Card. So far HMT have strongly resisted this. We are due to discuss this further on Steve Robson's return next week.
12. A high risk strategy is to assume that even if POCL did wish to fall back on the Benefit Payment Card option, neither ICL nor Ministers could now agree to that, given the further delays.

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13. DSS/BA have been valiantly trying to keep the lid on a disagreement with POCL over the risks of going ahead with the next stage of live trial. Recent developments suggest that we can no longer avoid calling a halt in the existing trialing plans, in a way which will put a further six months on the overall timetable for delivery. Urgent discussions are taking place between POCL and BA to try to find a mutually agreeable way forward. It will be difficult for the BA to delay a decision on calling a halt to trialing plans without compromising on the quality and acceptability of the software, which they are not prepared to do against a background of the recent difficulties with NIRS2.

Handling the meeting between the Prime Minister and Naruto:

14. I attach a letter from Sekizawa, Chairman of Fujitsu to the Prime Minister of 7 April, in preparation for the meeting scheduled for Monday afternoon. The key points are:
- ICL are pushing very hard for an early decision in their favour;
 - there will be pressure for a clear way forward to be decided by Ministers no later than the Fujitsu board meeting on 23 April; the HMT view is that what they say about their accounting position is likely to be true.
15. The briefing for the Prime Minister's meeting is being provided by HM Treasury. It is in the form of a joint note from the Chief Secretary and Lord Falconer. I have asked for it to be produced in time for you and other Ministers with an interest, to review it if you wish before it goes to the Prime Minister. An agreed draft is unlikely to be available until tomorrow (Friday morning).
16. The early draft we have seen, however, suggest that we will have few difficulties with it:
- the Prime Minister will be alerted to the need to protect our negotiating/legal position; and
 - he will be advised simply to make encouraging noises about the progress that is being made; and undertake to reach a decision before the Fujitsu Board meeting.
17. It may be helpful, however, if Lord Falconer were to attend the meeting on Monday, both in his capacity as guardian of our interests and as a commercial lawyer. The Fujitsu/ICL team will be Naruto, Keith Todd and George Tall (the ICL Corporate Affairs director); and so far as I am aware the only Government representative present will be Steve Robson.

Next steps:

18. In order to meet a timetable which would enable a decision before the Fujitsu board meeting, urgent discussions are currently under way to flesh out the technical detail

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of the alternative options, and to sort out the commercials. The intention is to have some draft non-binding Heads of Agreement on the table by Monday.

Action requested:

19. Are you content with the way discussions are going?
20. In case you wish to review the briefing for the meeting with the Prime Minister, we will fax it to you tomorrow as soon as it is ready.
21. If you wish to promote Lord Falconer's attendance at the meeting, I am happy to discuss this on your behalf with Stephen Ward (to whom I am copying this note, in the usual way). Or alternatively you may wish to discuss with Lord Falconer yourself.

MRS. SARAH GRAHAM
PFD Special Projects