File RWW/1/05

RESTRICTED - POLICY & COMMERCIAL

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MR McCARTNEY

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ci: Mr Scholar
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BA/POCL AUTOMATION PROJECT: HORIZON

Issue

1. We are to meet later today to discuss the future of the Horizon project. Is there anything further we could or should do to prevent termination of the project? What should our strategy be if the project is terminated?

Recommendation

2. To note, as a basis for our discussion.

Argument

3. The attached aide memoire sets out the recent history of the negotiations with ICL to try to find a commercially acceptable basis for taking forward the project; the recent ICL proposals which have succeeded brilliantly in alienating what little support remained within Whitehall for continuing with the project; the key areas of the proposals which the public sector side find unacceptable: the ICL and Fujitsu perspectives as revealed at two recent meetings with Alastair Macdonald and finally a section on the likely effects on the post office network of various scenarios. Supporting Annexes cover the main Ministerial level correspondence with ICL (included simply for ease of reference) but you will wish to note in particular Annex H which contains an assessment of the likely effects on ICL/Fujitsu of termination.

Should you now see ICL?

4. ICL have been pressing very strongly to meet Ministers in order to set out at first hand their case. At their meeting on 17 November Ministers concluded that to allow ICL to conduct an intensive political lobbying campaign would not assist in finding the commercial solution which is essential if the project is to continue. The ICL case is of course already well known, and there is at this stage little that could be said to ICL that has not already been said on numerous occasions. Our strong advice

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therefore is to continue to resist the pressure for a meeting, although we accept that as the deadline for completion of this round of negotiations approaches, the pressure from ICL for access to ministers may become irresistible.

The case against continuing with Horizon

5. DSS/BA have argued strongly that the case for terminating the benefit payment card element of Horizon is overwhelming. Given ICL's indifferent performance on the contract so far - and it is true that most of the difficulties and delays have centred round the development of the benefit payment card - they continue to challenge ICL's ability to deliver a working system even to the revised timetables. More fundamentally, however, they argue that the benefit payment card is yesterday's approach and that all the advantages lie in migrating benefit recipients as quickly as possible to the payment of benefits directly into bank accounts (ACT).

6. They argue that this course will not only produce £0.4 billion administrative savings annually for Government, but will provide a powerful impetus to wider Government policy objectives around promoting greater access to bank accounts for those who currently do not have them (social or universal banking); underpinning developments around the Single Government Account initiative; and generally creating a Government infrastructure to support a modern approach to Government dealings with its citizens (electronic government, Government Direct, etc). They argue that a proportion of the £0.4 billion administrative savings (which stem essentially from the difference in cost to the Benefits Agency of an ACT transaction (less than 2p) and a transaction through the benefits payment card or through the existing paper based system (around 60p)) could be used to support the Post Office Counters network and/or help it to purchase alternative technology. DSS/BA accept that compulsory ACT will be politically difficult or impossible unless benefit recipients - especially those in areas where banks and ATM machines are few and far between - can be offered access to their accounts through post offices. This will only become a practical proposition when post office counters are equipped with a modern on-line IT platform whether it be the Horizon infrastructure but without the benefit payment card or a different system altogether.

The case for continuing with Horizon

7. Benefits Agency payments to POCL currently run at around £400 million a year and represent more than one third of POCL's annual income. Without this income stream, large numbers of offices would become commercially unviable and could be expected to close. Because the overwhelming majority of such offices are franchised operations run in conjunction with a small retail outlet, typically a general store or a newsagent/tobacconist, the precise effect is difficult to forecast. What is clear, however, is that the payment of benefits brings footfall to the private side of the retail outlet (as well as generating additional post office business) so that the loss

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of this business would have a leveraged effect. What will therefore be of crucial importance to POCL in any move to ACT will be to retain as many benefit customers within the Post Office system as possible. There are two aspects to this. First, migration to ACT via the benefit payment card is likely to be much the most effective means of achieving this objective. Second, any move direct from the present paper based payment method directly to ACT would need to be very carefully phased in time with the introduction into post offices of front-end banking facilities. If Horizon, or the benefit payment card element of it falls, our strategy must be to optimise the trade off between, on the one hand the desire to achieve as quickly as possible, the administrative savings that will flow from the earliest possible move to ACT, and on the other hand the need to ensure that post office counters are able to offer front-end banking facilities before benefit recipients are obliged to accept payment to bank accounts.

8. There is a more brutal point. There remain unresolved issues about how willing the banks will be in practice to accept large numbers of accounts on which they are likely to find it very difficult to make a profit. What is clear however is that the banks will welcome such customers accessing their accounts through post offices rather than bank branches. They are, therefore, likely to be willing to pay POCL for carrying out the sort of transactions on their behalf. But this is likely to be true only if POCL can offer something approaching the full range of current account facilities. Even so, we suspect that they would be unwilling to pay more than around 10p per transaction as against around 60p per transaction paid by the Benefits Agency. POCL would therefore need to attract six or eight times the volume of banking transactions (after allowing for the higher costs of handling the greater volumes) as compared with Benefits Agency transactions to maintain an equivalent level of profitability and this, of course, is simply not credible. Worse still, if POCL is forced into using simple swipe card terminals to cover the gap until a replacement system for Horizon is ready, the banks would be more likely to want to charge POCL per transaction than to pay them. In time, other new business including electronic Government may make a major contribution to POCL's revenue stream, but over the next few years migration to ACT via the benefit payment card offers by far the best chance of achieving the transition with minimum damage to the post office network.

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