



RESPONSE

Future of the Common Financial Tool
Consultation 2017

About us

Money Advice Scotland is Scotland's Money Charity.

Our mission is to be the driving force towards financial wellbeing for the people of Scotland.

Background

Money Advice Scotland welcomes the opportunity to respond to the Accountant in Bankruptcy (AiB) consultation on the future of the Common Financial Tool (CFT) – and most pertinently – the decision on whether to adopt the Standard Financial Statement (SFS).

To help inform this response, we held a membership event at our offices in Glasgow on 16 October 2017. We also tested a sample of 25 cases received from member organisations to determine the differences in assessing affordability under the Common Financial Statement (CFS) and the SFS. The insight from this engagement with our members – alongside close reference to the analysis of 1,511 cases undertaken by the AiB – forms the evidence which underpins our response to the consultation questions.

When a consultation asks respondents to agree to replace an existing system with a new system, it is inevitable that deliberation is also directed to the advantages and drawbacks of the current format. In that sense, many of the concerns outlined within this response apply equally to the CFS and the SFS. It is our view that the consultation offers the chance both to scrutinise the proposed changes, and to take a closer look at how we do things already.

At the very outset, it is important to stress that whether assessed under the CFS or SFS, a financial statement performs a function that transcends merely setting a contribution for creditors – a money adviser is in a position of considerable responsibility in effectively setting out the standard of living for a person in debt over the course of an agreement. This principle is a recurring theme throughout our response.

1. Do you agree that the Standard Financial Statement (SFS) should be adopted in Scotland as the new Common Financial Tool?

Yes No Don't know

2. If introduced, should the SFS be used in the review of existing contributions which were not originally determined using the SFS?

Yes No

If you answered 'No' to Q2, what would be the appropriate method for reviewing the contribution amount?

As we will proceed to outline in this response, the application of the SFS may result in increased contributions for clients previously assessed under the CFS. In certain types of cases, this may also lead to different outcomes for clients.

3. For what reason(s) do you believe the SFS is not the appropriate tool for all Scottish statutory debt management and debt relief solutions?

Please provide information and any evidence that supports your reason(s).

The AiB's consultation states that the case for adopting the SFS is a "strong one" but our members were of the view that the advantages were not set out persuasively.

One of the key advantages identified in terms of adopting the SFS is the use of a single tool across the UK. During our membership event, a selection of advisers suggested that the case for a single tool across the UK was somewhat overstated within the consultation. Members highlighted the fact that Scotland has a distinct system of statutory debt management and debt relief solutions, and few if any voices are advocating the complete alignment of debt and insolvency legislation between Scotland and the rest of the UK.

Even if the case for a single tool across the UK is accepted, there is an obligation to ensure that there is no detriment to people going through the debt advice process. Consistency alone does not outweigh concerns about the impact of the proposals: a single tool with more trigger breaches and tighter spending guidelines – albeit applied consistently – is still a tool with more trigger breaches and tighter spending guidelines.

In light of our own comparative analysis of cases tested through the CFT and SFS respectively, engagement with our membership, and the publication of the AiB's own analysis of more than 1500 cases, our concerns about the SFS can be summarised under four main headings:

- There are more spending guideline breaches under the SFS
- Spending guidelines are tighter under the SFS
- Budgets need more slack and the existing contingency allowance is already inadequate
- The spending guidelines are not linked to living standards

There are more spending guideline breaches under the SFS

As mentioned at the outset of this response, we compiled a sample of 25 cases to determine the differences in assessing affordability under the CFS and SFS formats respectively. A summary of the key findings of our testing is included below:

- 15 out of 25 cases (60%) breached the spending guidelines under SFS
- By contrast, CFS had breaches in 7 out of 25 cases
- 8 cases (32%) breach SFS where there was no previous breach in CFS
- 6 cases (24%) breach both CFS and SFS
- 1 case breached CFS, but did not breach SFS

In our view, the key indicator in terms of measuring the change moving from one format to another is where there is a new trigger breach to justify that did not have to be explained previously. The caveat, of course, is that our testing was carried out with a relatively small sample of cases. However, the AiB's analysis highlights concerns about a higher prevalence of trigger breaches across a larger sample size of cases.

Of 1,511 cases tested by the AiB, the housekeeping category is breached in CFS in around 1 in every 9 cases. For SFS, however, the rate of trigger breaches increases to around 1 in every 4 cases. Importantly, the analysis focuses on the housekeeping category only – both our testing and that of the AiB shows that breaches are equally apparent in the new personal costs category. It is also worth emphasising that this sample is compiled of cases that the AiB has already approved and accepted. Moreover, the median household income for the cases tested by AiB was £1,183 per month – these are not cases of high income households with correspondingly high levels of expenditure.

During our membership event, it became clear that money advisers can rely on the trigger figures as a guide for expenditure that may be difficult to estimate. Again, this exacerbates concerns about the absence of an adequate link within the trigger figures to what is required for a socially acceptable living standard. Furthermore, if these trigger figures are squeezed under the new format, this raises concerns that people in debt will fall further below a decent living standard. The consultation document notes that “it must be emphasised the analysis did not give any consideration to the potential for evidence or acceptable explanations to justify any trigger breach.” Equally, it must be stressed that the analysis cannot anticipate changes in adviser or client behaviour: namely, where evidence cannot be provided, this may also lead to inaccurate and unrealistic recording of expenditure.

The consultation document states that “there should be no direct correlation between the level of the trigger figures and the level of the resulting contribution.” However, this raises questions over the purpose of trigger figures if not to ultimately influence the resulting contribution. It is also asserted that additional trigger breaches can be explained with additional evidence from advisers and clients. Members report that this experience is often inconsistent and far from straightforward, however. During our membership event, advisers raised concerns that evidence requests are often excessive. For example, one adviser raised the case of an elderly female client who was challenged on the costs of incontinence pads. Another adviser noted disputes around train fares purchased by a student working part-time to visit his children. The decisions that people make around expenditure are often very personal and this calls for a greater degree of sensitivity, flexibility and respect.

The move to SFS also reallocates certain spending categories from fixed expenditure (where evidence must be provided to AiB in *all* cases) to flexible expenditure (where evidence must be provided in cases that breach trigger figures). The reallocation of travel from flexible to fixed expenditure was a particular cause for concern amongst our members. Travel expenditure is often difficult to evidence and capture accurately. One adviser in particular noted that this was the part of the proposals to adopt SFS which brought him most concern.

Incidentally, we are of the view that the AiB’s own analysis should have featured more prominently as part of the consultation. Previous consultations such as the DAS review included several pages of statistical analysis as part of the consultation document. This is particularly important when the impact of the proposals is significant. The CFT process is already considered as unnecessarily burdensome and the increase in evidence requirements for trigger breaches threatens to stretch money advice agencies to breaking-point. Analysis from the Institute of Chartered Accountants of Scotland (ICAS) estimates (conservatively) that the additional annual costs relating to additional trigger breaches are in the region of £450,000.

Spending guidelines are tighter under the SFS

That the analysis indicates there are more breaches under the SFS suggests the spending guidelines are tighter. We completely accept that this is not the policy intention of the SFS, but our own testing and that of the AiB suggests that this is the result.

In cases where there is a breach of triggers, we found the value of the breach to be greater within SFS. On average, the total breach in CFS was £47.38. By contrast, the average breach in SFS was £97.42. In one case concerning a household of two adults and two children aged under 14, the housekeeping category changed from no breach on CFS, to a breach of £291 in SFS. Again, we must be cautious and note that our analysis considered a relatively small number of cases. Nonetheless, these are real cases and the upshot of these proposals may yet lead to different outcomes for clients.

One member cited the example of a client who had been granted a MAP after being assessed under the CFT (CFS) as having no contribution to pay with no breaches to spending guidelines.¹ The client suffered from mental health problems and the pressure of the outstanding debts was exacerbating this condition. The client noted that the MAP (£90 fee, no contribution, discharge after six months) had helped her enormously and alleviated the stress that she had been living with. If assessed under the SFS, however, a different picture emerges. Whereas the CFS assessment resulted in a negative disposable income of around £50 with no breaches to spending guidelines, the SFS assessment shows expenditure in excess of the spending guidelines of over £100 per month. If this surplus income is considered as available income, this client is no longer eligible for MAP and faces a £200 fee and a contribution for 48 months.

In our view, the analysis of the proposals is also hindered by the inability to openly discuss and critique the spending guidelines. The code of conduct for both the CFS and the SFS precludes publication of the spending guidelines, but this means that it can be difficult to set out a clear comparison. A majority of advisers at our membership event had not had sight of the new spending guidelines that they were being asked to agree to. One member likened this to being asked to offer advice to a client without first ascertaining a full picture of the client's circumstances.

Even out with this consultation process, the issue of transparency is a pertinent one. In the relationship between the adviser, the client, and the AiB/creditors, it is only the

¹ Minimal Asset Process (MAP) is a route into bankruptcy for people with few assets. A debtor does not pay a contribution and (as long as certain requirements are met) can apply to be discharged from bankruptcy after six months. A £90 application fee must be paid. By contrast, under Full Administration Bankruptcy (FAB) a debtor will pay a contribution for 48 months and a £200 application fee must be paid.

client who cannot access the spending guidelines and this fuels the myth that people in debt cannot be trusted. This lack of openness and transparency is in stark contrast to the approach in other countries such as Ireland (see question 5) where a debtor can access a reasonable living expenses calculator online. Transparency is also central to the approach in Sweden where the Konsumentverket (Swedish Consumer Agency) have developed a model which represents what is deemed a reasonable standard of living that is modest but adequate:

All the material related to the reference budget is published so that anybody can see in detail how it has been calculated and which products are included. This transparency is very important, as it makes it possible for everybody to judge for themselves if the standard is high or low, and if it is reasonable in different situations to have that standard. Everybody has an opinion about how much money is needed for different budget items estimated from their own experience or rather on what they think they know. The transparency of the reference budget facilitates this kind of discussion. If somebody argues that a person could cope with for example half of the sum that is calculated for clothing and footwear, they must also be able to tell what clothes or shoes are unnecessary or unreasonable and therefore should be taken away. Usually, that is not so easy.²

Budgets need more slack and the existing contingency allowance is already inadequate

Again, this criticism is equally applicable to the current system as the proposals to adopt the SFS. The lack of adequate flexibility in the current CFT format was highlighted during the recent review of the Debt Arrangement Scheme when the AiB pitched more flexibility across the term of a debt payment programme (DPP), partly in recognition of the unexpected expenditure that occurs during the lifetime of an arrangement. At that time, our members noted that the requirement for 100 per cent surplus income alongside the trigger figures often put clients off the DAS route. With the trigger figures set to become tighter still under the SFS, it is reasonable to envisage a further drop-off in the rate of clients opting for statutory options.

It is frequently suggested that a key component of good financial capability is about having a savings buffer to cope with unexpected expenditure, yet this isn't always possible within a debt repayment plan as a consequence of the 100 per cent surplus income requirement and the contingency allowance of 10 per cent capped at £20 per month. During our consultation event, we surveyed members on what a single parent household with two children aged under 14 realistically required to budget for

² Vilhelm Nordenankur, *More than A Minimum Budget in Sweden*, 2009

unexpected expenses. Responses ranged from £50 to £150 per month, suggesting that the current contingency is set at too low a level to make a difference. Our members also rejected the assertion that take-up of the contingency allowance is low. Rather, it seems that there is no single spending category in which this is universally recorded within the CFT.

Research shows that consumers continually underestimate the cost of unexpected purchases – exceptional expenditure is anything but the exception.³ If adequate contingency allowances are not included as part of client budgets then this increases the risk of default, or the client turning to credit to meet unexpected costs. The 100 per cent surplus income requirement leaves little room for manoeuvre. A major creditor we consulted noted that they had relaxed the requirement leading to a 30 per cent increase in successfully completed payment plans. In that sense, concerns about tighter guidelines and additional trigger breaches have clear implications for the creditor sector as well as the advice sector.

Even where cases do not breach a trigger figure under either CFS and SFS, we were keen to determine the scale of the gap up to the trigger limit under each format. This analysis helps to measure the total capacity within the spending allowances. From our sample of test cases, 24 out of 25 cases were closer to, or in excess of, the trigger under the SFS format. Average expenditure in CFS amounted to 82 per cent of the trigger allowance, compared to 88 per of the trigger allowances in SFS.

The decision on whether to adopt the SFS as the new CFT must also be viewed within the wider socio-economic context: inflation is outpacing wage growth; the real terms value of social security is falling; in-work poverty is rising. These external factors must be taken into account when considering whether to adopt this new approach.

The spending guidelines are not linked to living standards

As we note at the outset of this response, the process of completing a financial statement calculates a contribution for creditors, but it also sets out the standard of living for an individual or household over the course of an agreement. In our view, it is a considerable drawback that both the current format and the new proposals fail to incorporate what households need to meet a basic living standard.

The consultation process offers the opportunity to review the methodology that underpins both the CFS and the SFS. As the AiB consultation document notes:

³ Abigail B. Sussman, Adam L. Alter; The Exception Is the Rule: Underestimating and Overspending on Exceptional Expenses, *Journal of Consumer Research*, Volume 39, Issue 4, 1 December 2012

The SFS figures are based on the Living Costs and Food Survey (LCF) conducted by the Office for National Statistics throughout the year. The LCF collects information on spending patterns and the cost of living that reflect household budgets across the UK.

This point requires clarification. It is important to emphasise that the spending guidelines under both the CFS and SFS are based on the average levels of expenditure observed among typical households within the bottom income quintile. For a household in the bottom quintile, typically around 70% of income comes from social security benefits. This is a low benchmark upon which to set spending guidelines.

In recent times, we have frequently raised concerns that to base spending guidelines on the bottom quintile – effectively the spending patterns of the poorest households – is to capture the spending habits of those who might spend what they have, rather than what they need. The ONS Living Costs and Food Survey is not intended to measure what constitutes a socially acceptable living standard. If we wish to determine what a household or individual requires to live to a basic level, we need to use a measure such as the Minimum Income Standard (MIS) – a research method undertaken by Loughborough University in partnership with the Joseph Rowntree Foundation. MIS is considered as the gold standard in assessing affordability – a recent Supreme Court judgment on the abolition of tribunal fees held up MIS as representing a reasonable living standard.⁴

Following the Money Advice Scotland annual conference in June 2017, the Money Advice Service committed to review the SFS in line with MIS. We welcome this work and have been calling for this exercise to be carried out since early 2016. In the interim, to help form our response to this consultation, we mapped the spending guidelines within the SFS to what the Minimum Income Standard (MIS) considers households need to live to a decent standard. For a majority of household types, we found that the spending guidelines fell below the MIS. A lone parent with one child at toddler age will have 93 per cent of what they need for an acceptable living standard if expenditure is capped at trigger levels. Increasing the number of children within a household means that the gap between MIS and SFS grows, however, so that a lone parent with three children at preschool, primary and secondary level, reaches just 75 per cent of MIS.

The level of income required to meet MIS also varies across regions. Highlands and Islands Enterprise (HIE) report that households in remote and rural Scotland require significantly higher incomes to reach the same minimum living standard as those

⁴ See R (on the application of UNISON) (Appellant) v Lord Chancellor (Respondent)

living elsewhere in the UK. This is a result of additional travel costs, the higher cost of buying essential items, and increased expenditure on energy costs.⁵

It is important to reiterate that MIS represents a basic living standard and covers needs rather than wants. If the spending guidelines fall below MIS, we must consider what that individual or household may be forsaking to meet obligations to creditors. Money Advice Scotland members attest to the growing prevalence of debts that are directly related to living costs: people who are in debt not out of recklessness or a lack of financial capability, but because their level of income cannot sustain a socially acceptable living standard. A person might get into debt because they cannot meet their essential living costs. But when they get advice, agree a solution, the current approach means that they could then be put back in a scenario where they are not left with enough money to live on.

The current system (and the proposals within the consultation) alert advisers, clients and creditors to expenditure that is considered excessive. We are of the view that there should also be a formal way of identifying expenditure that is insufficient to sustain a socially acceptable living standard – particularly where there are children in households.

4. What do you consider an appropriate method for determining a debtor's contribution for a Scottish statutory debt management and debt relief solution?

Please provide information and any evidence that supports this and detail who you consider should manage and fund this process.

If the proposals to adopt the Standard Financial Statement fail to attract the support of the majority of respondents to this consultation, we are of the view that a full review should be undertaken that both robustly scrutinises the impact and effectiveness of the current system, as well as considering a range of potential options going forward.

Nonetheless, alternative methods for determining a contribution may include (in no order of preference):

- Commissioning a piece of work around the Minimum Income Standard (MIS)

⁵ Highlands and Islands Enterprise, *A Minimum Income Standard for Remote Rural Scotland 2016*, November 2016

- Develop a model similar to that pursued by the Insolvency Service of Ireland⁶ where figures are arrived at through a consensual budgeting model
- Develop an equivalent approach to the Konsumentverket model around reference budgets based on household type and regional variations in living costs
- A set percentage deduction from earnings (excluding certain types of income such as disability benefit, tax credits etc.)
- A set percentage deduction from earnings (after consideration of essential expenditure)
- Application of a single I&E format such as SFS, but without trigger figures
- Application of CFS or SFS, but with no requirement for 100 per cent surplus income
- Application of CFS or SFS with spending guidelines observed at a higher income quintile

This list is not exhaustive and we emphasise that comprehensive engagement and consultation would be required before adopting a new method of assessing a person's contribution. This process must include close engagement with people in debt and we recommend that experience panels are formed of people with direct experience of the debt advice process. It is also worth noting that the original consultation on a Standard Financial Statement was undertaken in 2014.

Above all else, it is imperative that any method of assessing a contribution has a closer relationship to what individuals and households need to meet a basic living standard. We recommend the introduction of a living standards check on all financial statements. This would be a relatively simple process – allowing the adviser, client and creditor to compare the levels of spending within a financial statement to the levels identified within MIS – and could be incorporated into existing practices even whilst the AiB decides on whether to adopt the SFS or pursue an alternative approach.

The question of funding an alternative method is difficult to answer given that the consultation does not include information or insight on how this is funded currently, and whether the AiB currently makes a contribution towards the maintenance and licencing of the CFS.

The timing of the consultation is prescient: the decision on whether to adopt the SFS arrives at the same time that the Scottish Government is taking historic steps toward delivering a new social security system for Scotland. A stated aim of this landmark process is to shape a distinctly Scottish social security system with dignity and respect at its heart.

⁶ The calculator is available here https://www.isi.gov.ie/en/ISI/Pages/RLE_calculated

People going through the debt advice process can encounter a very different experience, however, and it is our view that the current approach of determining a contribution for creditors is often at odds with wider Scottish Government objectives and national outcomes.

- 5. If the SFS is to be introduced from 1 April 2018, will you be able to make any required changes to your IT and other operating systems, in time to use the SFS from this date?**

We do not support the introduction of the SFS.

RESPONDENT INFORMATION FORM

Please note that this form must be returned with your response to ensure that we handle your response appropriately.

1. Name/Organisation

Organisation Name

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Please tick as appropriate

Advice Sector

Creditor

Local Authority

Solicitors/Advocates

Insolvency Practitioners

Debtor

Sheriff Officer & Messenger at Arms

Judiciary

Other If other please specify _____

4. Permissions - I am responding as...

Individual / **Group/Organisation**

Please tick as appropriate

(a) Do you agree to your response being made available to the public (in Scottish Government library and/or on the Scottish

(b) Where confidentiality is not requested, we will make your responses available to the public on the following basis

Please tick ONE of the following boxes

Yes, make my response, name and address all available

or
Yes, make my response available, but not my name and address

or
Yes, make my response and name available, but not my address

(c) The name and address of your organisation **will be** made available to the public (in the Scottish Government library Are you content for your **response** to be made available?

Please tick as appropriate

Yes No

(d) We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

Please tick as appropriate

Yes No

Please return your response to OPC@aib.gsi.gov.uk or to: Graeme Perry, AiB, 1 Pennyburn Road, Kilwinning, Ayrshire, KA13 6SA by 27 October 2017.