BANKRUPTCY AND DEBT ADVICE (SCOTLAND) BILL
[AS AMENDED AT STAGE 2]

SUPPLEMENTARY FINANCIAL MEMORANDUM

INTRODUCTION

1. As required under Rule 9.7.8B of the Parliament's Standing Orders, this Supplementary Financial Memorandum is published to accompany the Bankruptcy and Debt Advice (Scotland) Bill (introduced in the Scottish Parliament on 11 June 2013) as amended at Stage 2.

2. This Memorandum has been prepared by the Scottish Government. It does not form part of the Bill and has not been endorsed by the Parliament. It should be read in conjunction with the Financial Memorandum on the Bill as introduced.

3. The Bill aims to ensure that appropriate, proportionate, debt management and debt relief mechanisms are available to the people of Scotland which are fit for the 21st Century. The purpose of this Memorandum is to provide information on areas where the Scottish Government's original estimates of costs arising as a result of provisions in the Bill, provided in the Financial Memorandum for the Bill[1], now require to be adjusted as a result of amendments at Stage 2.

4. This Memorandum also provides additional detail on the estimated costs and/or benefits associated with some of the provisions included in the Bill on introduction, where further detail is available as a result of research carried out since introduction.

COSTS ON THE SCOTTISH ADMINISTRATION

Minimal asset process: maximum debt ceiling

5. The majority of the amendments made to the Bill at Stage 2 are technical and do not significantly affect the information provided in the original Financial Memorandum. This section, therefore, principally addresses the implication of one of the amendments made at Stage 2: amendment 16[2] which changes section 5 of the Bill which sets out the maximum amount of debt allowed for entry into the new Minimal Asset Process ("MAP") route into bankruptcy. Section 5(1)(c)(ii) of the Bill, as introduced, provided that this maximum amount should be £10,000. Amendment 16 revised that figure upwards, to £17,000.

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[1] Available at: http://www.scottish.parliament.uk/S4_Bills/Bankruptcy%20and%20Debt%20Advice%20(Scotland)%20Bill/b34s4-introd-en.pdf

[2] lodged by Fergus Ewing MSP and agreed by the Economy, Energy and Tourism Committee on 22 January 2014

6. In making this change, the Scottish Government is responding to feedback from stakeholders such as StepChange Debt Charity who, in their written evidence to Committee[3] said that:

> *[W]e are concerned that the eligibility criteria for the Minimum Assets Process (MAP) - in particular the level of debt fixed at £10,000 - will reduce access to this route for some clients. The average debt of a Scottish StepChange Debt Charity client in 2012 was £14,506, which would result in around 50% not being eligible for MAP. Indeed, AiB's own data shows that nearly 65% (2,262) of current LILA clients (3,481) would not be eligible for MAP.*

7. The policy intention behind this change, therefore, is to ensure that the MAP would be available to vulnerable debtors in greatest need of quick, efficient debt relief. This Memorandum provides an analysis of this extended provision in terms of the potential number of additional cases which would enter bankruptcy via the MAP route as opposed to going into full administration bankruptcy.

8. The Scottish Government's assessment of the implications of this change is that the change will result in a reduction in revenues, however this reduction does not equate to a new cost requiring additional funding because its analysis shows that the introduction of the MAP should still result in a potential overall reduction in costs compared to the cost of administering the existing Low Income, Low Asset ("LILA") system.

9. These figures are based on the estimated MAP administration costs, subtracted from the estimated current LILA administration costs (provided at paragraph 20 of the original Financial Memorandum)[4]. A detailed analysis supporting this assessment is set out below. This is in 3 parts, as follows:

- analysis of the reduction in application fee revenues arising as a result of the change;
- analysis of the administration costs of the MAP, compared to the administration costs for LILA; and
- analysis of any reduction in other revenues arising as a result of the change.

Additional MAP costs: reduction in application fee

10. The MAP will be a more automated process than its predecessor scheme, the LILA route into bankruptcy and the unit costs for the MAP are expected to be lower than those for LILA. Both the MAP and LILA are intended to operate as alternatives to full-administration bankruptcy. The Scottish Government has indicated that the application fee for the MAP will be < £100. This application fee will cover the unit cost of each individual MAP case.

11. The application fee for LILA is currently £200 per case. There were 3,481 LILA awards recorded in 2012/13, for which AiB received £696,200 in revenue from application fees. It may appear, therefore, that the introduction of the MAP will give rise to a reduction in revenues as a

[3] Available at: http://www.scottish.parliament.uk/S4_EconomyEnergyandTourismCommittee/Inquiries/StepChange_Debt_Charity_Scotland.pdf

[4] "[T]otal costs for the administration of the MAP, based on 2012-13 LILA volumes, [are estimated to be] in the region £348,100 (although case volumes for the MAP may vary from those for LILA).

result of the lower fee. In practice, however, the increased revenues which previously accrued as a result of the higher application fee for LILA were off-set by the higher unit costs incurred in operating LILA and this reduction in revenues will not, in fact, occur.

12. An increase in the number of MAP cases, as a proportion of the overall total number of bankruptcies will lead to a reduction in the amount of fees paid in relation to cases where the maximum debt level is £10,000 to £17,000 (i.e. cases which would otherwise have been full-administration cases, had the amendment not been made). The table below summarises the Scottish Government's findings based on 3 scenarios which assume an overall level of bankruptcies per year, of which MAP bankruptcies would form a proportion[5]. (These figures are based on existing trends and may not account for potential increased demand generated by a new product and/or a lower fee):

Scenario	**Number of Bankruptcies in the year**	**Expected MAP cases (£10k debt ceiling)**	**Expected MAP cases (£17k debt ceiling)**	**Additional MAP cases due to increased debt ceiling**	**Additional MAP cases due to increased debt ceiling (% of Total)**
Scenario 1	8,800	1,255	1,941	686	8%
Scenario 2	7,000	998	1,544	546	8%
Scenario 3	6,000	856	1,323	467	8%

13. The Scottish Government's analysis shows that the proportional increase in the number of MAP bankruptcies which will arise as a result of this amendment is estimated to be 8% of the overall number of bankruptcies awarded. This means that an estimated increase in the number of MAP cases in the range 467 (scenario 3) to 686 (scenario 1) would result in a reduction in revenues of between £46,700 and £68,600. However, the Scottish Government has calculated that this increase in the number of MAP cases will not, in and of itself, lead to a direct increase in costs, because the unit cost of each additional case will be covered by the application fee. The reduction in revenues will be offset by the subsequent reduction in costs due to the lower admin costs incurred in a MAP case.

Additional MAP costs: administration costs

14. In the Financial Memorandum published alongside the Bill, the Scottish Government estimated the cost of administering the MAP's predecessor scheme (LILA) to be in the region of £348,100 per year. This was the best available figure at the time and was based on the total number of LILA awards. As shown in the table provided above, AiB have since been able to refine this figure, in order to estimate MAP caseloads.

15. This has been possible because a significant number of cases in which sequestration is awarded via the LILA route are subsequently converted to full administration bankruptcy. AiB's analysis has now excluded these converted LILA cases as these would not fulfil the criteria to enter the MAP. This accounts for approximately 15% to 20% of the variation between the estimated MAP caseload and LILA.

[5] The total number of bankruptcies awarded in 2012/13 was 8,838.

16. AiB's analysis has also subtracted, from their caseload figures, cases which breach the maximum debt ceiling. LILA had no maximum debt ceiling. Existing LILA cases can be grouped approximately by debt level, as follows:

Total Debt	% of LILA Cases	Cumulative %
Under £5k	16%	16%
£5k to £10k	33%	50%
£10k to £15k	20%	69%
£15k to £17k	5%	75%
Over £17k	25%	100%

17. Based on the £10,000 debt ceiling on introduction, leaving out cases which breach this ceiling accounts for a 45% to 50% variation between predicted MAP caseload and current LILA awards. Raising the debt ceiling to £17,000 reduces this to a variation of 25%.

18. Working this through, using an example from the table provided at paragraph 12, shows that the highest predicted MAP caseload (with the £17,000 debt ceiling), which is 1,941 cases per year, represents a reduction of approximately 44% compared to the number of LILA awards in 2012/13, which was 3,481.

19. This variation is made up, as follows:

- 19% being cases which would have transferred out of LILA (i.e. cases which would not meet the other MAP criteria on introduction); and
- 25% being cases which would have met the other MAP criteria on introduction but which breach the £17,000 maximum debt ceiling.

20. Based on these refined caseload figures, the Scottish Government estimates the administration costs of the MAP to be as follows:

- In the range: £132,300 per year to £194,100 per year
- (These figures are based on: the estimated number of MAP cases per year, multiplied by £100 per case and added to the estimated reduction in revenue arising from the increase in the maximum debt ceiling, i.e. (856 MAP cases x £100 + £46,700 in reduced full administration fees) to (1255 MAP cases x £100 + £68,600 in reduced full administration fees))

Additional MAP costs: loss of other revenues

21. Debtors entering bankruptcy via the MAP will not pay any contribution towards the cost of their bankruptcy. This is because two of the principal eligibility criteria for the MAP are that the debtor "has been assessed by the common financial tool as requiring to make no debtor's contribution[6]" and that the debtor "has been in receipt of a prescribed payment for a period of at least six months[7]" (prescribed payments meaning benefit payments). The effect of these criteria will be to ensure that no debtor enters the MAP who is able to pay a contribution which, in turn, means that there would be no additional revenues to ingather. The only loss of revenues,

[6] New section 2ZA(a)(i), inserted by section 5(1)(b) of the Bill
[7] New section 2ZA(a)(ii), inserted by section 5(1)(b) of the Bill

therefore, which will arise as a result of this tranche of cases entering via the MAP rather than full-administration will be the reduction in the amount of application fees levied.

22. It is the Scottish Government's position, therefore, that the increase in the maximum debt ceiling, from £10,000 to £17,000 - when taken in context with a comparison between the current cost of administering LILA and the estimated costs of administering the MAP- will lead to a reduction in revenues of between £46,700 and £68,600 per year.

23. However, this reduction in revenues does not equate to a cost requiring additional funding because the introduction of the MAP should still result in a potential overall reduction in costs compared to the cost of administering the existing LILA system.

Cost of developing and delivering systems to support the MAP

24. As in the Financial Memorandum, this analysis excludes the cost of developing and delivering IT systems to support the MAP. However, the Scottish Government believes that it would be appropriate, at this stage, to also provide some further detail on AiB's programme to procure and deliver a new Case Management System ("CMS"). An agreement has been reached with AiB's supplier to deliver the new CMS for a fixed price of £899,950 (excluding VAT)[8]. When compared with the estimated costs set out in the Financial Memorandum, which were in the range £1.5 million - £2 million, this represents a potential reduction in estimated costs in the range: £420,000 to £920,000.

COSTS ON LOCAL AUTHORITIES AND OTHER PUBLIC BODIES

25. There will be no significant costs requiring additional funding on local authorities or other public bodies specifically as a result of this or any other amendment made at Stage 2.

COSTS ON OTHER BODIES, INDIVIDUALS AND BUSINESSES

26. There will be no significant costs requiring additional funding on other bodies, individuals and businesses as a result of this or any other amendment made at Stage 2. There will be some benefits as the additional group of debtors (who would previously have been prevented from applying via the MAP because their debts exceeded the old, £10,000 limit) will now be able to apply and will share savings in the range £46,700 to £68,600 (depending on how many debtors apply), as a result of their being eligible to pay the £100 application fee for the MAP instead of the £200 application fee for full-administration bankruptcy.

27. The Scottish Government also believes that it would be appropriate, at this stage, to provide some additional detail on the estimated costs and/or benefits associated with certain other provisions in the Bill, because further detail is now available as a result of research and other work carried out since introduction.

[8] AiB's contract with its supplier also includes an option for an increase in costs up to an additional 10%. This is included as contingency against the need to specify further requirements (or re-specify existing requirements) during the development. This is normal project management practice and is intended to avoid expensive change control.

Financial education for the debtor

28. Section 2 of the Bill provides that debtors who meet certain specific, targeted criteria are required to undertake a course of financial capability education, in the form of a module delivered to a Scottish national standard. The Financial Memorandum set out the cost of developing the national standard at £8,300 and the module at £13,000. The Financial Memorandum also made clear that these costs would be one-off and not recurring costs which would be met from the Scottish Government's existing MATRICS budget.

29. In the Stage 1 debate on the Bill, on 18 December 2013, the Minister for Energy, Enterprise and Tourism, Fergus Ewing MSP, said that[9], "in recognition of the concerns about the funding of the bill's financial education provisions, we intend to support the roll-out of that programme with an additional £200,000 of ring-fenced funding."

30. This additional funding does not pertain to money advisers' caseload and it is not needed because of any increase in the development costs of the module or the national standard. In the Financial Memorandum accompanying the Bill, the Scottish Government stated as follows[10]:

> *63. The criteria which will trigger the requirement for a debtor to be offered financial capability education are set out above. In order for these criteria to be triggered, the debtor must already have an ongoing relationship, in some shape or form, with a money adviser. This is because the criteria can only be triggered if the debtor has current financial difficulties which require him or her to obtain advice.*
>
> *64. AiB considers, therefore, that this provision will not lead to a rise in money advisers' caseload as they will already be providing advice to debtors who meet the criteria for financial education. It will lead to a change in advisers' existing relationships with some of their clients, for example, it may create a requirement for advisers to spend more time with existing clients, in order to ensure that they receive the financial capability education that they need however it is AiB's position that this change in the amount of time that money advisers may need to spend with some of their existing clients will not have a material impact on their overall capacity and caseload.*

31. The Scottish Government's position is still that, "this provision will not lead to a rise in money advisers' caseload as they will already be providing advice to debtors who meet the criteria for financial education". However, after further discussions with stakeholders, the Scottish Government has agreed to provide the £200,000 of ring-fenced grant funding, announced during the Stage 1 debate, to Money Advice Scotland, in order to develop training and support to help the Scottish advice sector prepare for the roll out of the module and the national standard.

32. This funding is a one-off payment allocated in 2013/14 for activity to be carried out in 2014. This funding will be ring-fenced and used to help money advisers across the sector strengthen their skills on financial capability and ensure that they are equipped to provide high quality financial capability advice and to assist their clients to complete the learning module. The funding will not be used to develop either the module or the standard.

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[9] Available at:
http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=8716&mode=pdf (col. 25930)

[10] Available at:
http://www.scottish.parliament.uk/S4_Bills/Bankruptcy%20and%20Debt%20Advice%20(Scotland)%20Bill/b34s4-introd-en.pdf (p. 32)

33. The Scottish Government expects that this funding will achieve the following outcomes:

- development and delivery of training and support for money advice agencies to equip advisers to develop the skills and knowledge required to assist clients to complete the financial capability module;
- development and delivery of training and support for money advice agencies to work towards and meet the national standard on financial capability; and
- development and promotion of online financial capability learning materials to support money advice agencies.

34. The Scottish Government expects to receive a quarterly report in relation to this additional funding which will summarise the outcomes, current and forecast spend and would be happy to report on these matters to the Parliament in due course.

Debtor contribution order: payment period and intervals

35. Section 4 of the Bill provides that a debtor must pay a contribution towards the cost of their bankruptcy over 48 monthly payments. This is an extension of the existing contribution period of 36 months. This provision was questioned by stakeholders at Stages 1 and 2. The Law Society of Scotland said that "there is insufficient evidence that a debtor contribution order for four years will improve returns to creditors[11]". Citizens Advice Scotland said that the increase, "could decrease the returns, if more breakages occurred" and also that it was "concerned that no research has been done into whether the proposal has any benefits[12]."

36. The Scottish Government's position was that (as noted in paragraph 67 of the Financial Memorandum), the overall financial implications of the Bill (including the Common Financial Tool (CFT) setting the debtor's contribution) for creditors should be positive but it was not possible to quantify those benefits. It is considered that the extension of the contribution period from 36 to the equivalent of 48 monthly payments will benefit creditors (mostly businesses, including banks and credit unions, although some individuals may benefit as well). This position is supported by analysis carried out by AiB. AiB has examined various scenarios in order to produce estimated figures on total additional contributions under the 48 month contribution period. Figures below are based on the following 3 key assumptions (which are in line with AiB's latest data on current projected totals):

- that there will be an overall, estimated 7,000 bankruptcies in a year;
- that only a third of bankruptcies in year will involve a debtor who can make a contribution; and
- that there is a current, estimated breakage rate of 25%

37. On the basis of these 3 key assumptions, AiB has calculated 2 average monthly contribution figures, as follows:

[11] Available at:
http://www.scottish.parliament.uk/S4_EconomyEnergyandTourismCommittee/Inquiries/Law_Society_of_Scotland(1).pdf
[12] Available at:
http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=8856&mode=pdf (col. 3488)

- £72 – this is the average monthly contribution based on a sample of bankruptcy cases administered by the Providers.
- £99 – this is the average monthly contribution based on a sample of bankruptcy cases administered by AiB.[13]

38. Using these assumptions, AiB has assessed the impact on contributions ingathered if the breakage rates increase under a 48 month contribution period. The following table shows the <u>additional</u> amount of contributions which AiB would expect under a 48 month contribution period, based on these estimated new breakage rates.

New Breakage Rate	Additional contributions (based on £72 average monthly contribution)	Additional contributions (based on £99 average monthly contribution)
30%	£1.29 million	£1.78 million
40%	£780 k	£1.08 million
50%	£270 k	£380 k

39. Therefore even if the breakage rate were to increase all the way to 50%, AiB would still expect an increased in contributions ingathered in the range £270,000 to £380,000, which would increase the amount returned to creditors. Furthermore, AiB's analysis has shown that the new breakage rate would have to increase to <u>over</u> 55% before there was an overall reduction in the total amount ingathered. These results can also be expressed in terms of the percentage change in expected contributions based on the increased breakage rates, as follows:

New Breakage Rate	Percentage change in contributions ingathered
30%	25% increase
40%	15% increase
50%	5% increase

40. If breakages increase from the assumed current figure of 25%, to a new rate of 30%, therefore, AiB would still expect contributions ingathered to increase by a quarter. If breakages increase to 50%, the total contributions ingathered should still increase by 5%.

41. There will be some additional administration costs for ingathering and monitoring contributions in the fourth year (with the additional 12 months' contributions) and these will vary depending on the individual IP's time costs and the nature of each bankruptcy case. This means these costs are difficult to estimate. However AiB believe that these additional costs will be offset in the majority of cases, by the additional contributions ingathered.

42. On the basis of the assumptions and analysis set out above, the Scottish Government believes that it would be reasonable to say that, unless the breakage rate was to rise to over 55%, then the extension of the payment period to the equivalent of 48 monthly payments would result in an increase in the overall level of contributions (from the third of debtors who are able to pay a contribution) delivering a benefit and not an increased cost to creditors.

[13] (**N.B**. Both of the these figures are based on only the third of all debtors who can and are making a contribution.)

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Produced and published in Scotland on behalf of the Scottish Parliamentary Corporate Body by APS Group Scotland.

ISBN 978-1-78392-934-4