Coversheet: Farm Debt Mediation

Advising agencies	MPI and MBIE
Decision sought	Approval to commence drafting a Government Bill to establish a statutory scheme for the mediation of farm debt
Proposing Ministers	Minister of Agriculture and Minister of Commerce and Consumer Affairs

Summary: Problem and Proposed Approach

Problem Definition **What problem or opportunity does this proposal seek to address? Why is Government intervention required?**
Farm debt is often complex, and resolving the debt problems of financially struggling farms can be a challenging and drawn-out process for farmers and lenders. Farmers face a significant power imbalance in their dealings with lenders which can be a barrier to timely and constructive engagement between farmers and lenders when debt problems arise. Farming is distinct from other sectors of the economy in being vulnerable to a large number of risks outside the control of individual farmers.

Proposed Approach **How will Government intervention work to bring about the desired change? How is this the best option?**
A statutory farm debt mediation regime that requires lenders to offer mediation before taking enforcement action will provide a structured and consistent process for resolving debt problems of financially struggling farms that all parties can have confidence in. A statutory regime would apply across all secured lenders, including non-bank lenders, and could help to address the power imbalance between farmers and lenders.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
The main expected beneficiaries are: • **Farmers** experiencing or likely to experience financial difficulties, who will have the right to engage in mediation with lenders who have security over farm assets. In some cases, mediation, if initiated early enough, could help to turn around a failing farm business, while in other cases mediation can provide the means for a 'dignified exit'. • **Secured lenders** will benefit from a structured and timely process for resolving debt issues. They can be more confident that their actions (including any enforcement action arising from a binding mediated agreement) will be perceived as reasonable if they have followed a mandated process in good faith, thus avoiding reputational damage.

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Where do the costs fall?
• It is currently proposed that the direct costs of mediation are split equally between parties, but this will be considered further as the design of the proposed scheme is further developed. Based on data provided by the New South Wales Farm Debt Mediation scheme, we estimate the average cost of mediation to be around $6,000 ($3,000 per party) based on 20 hours of mediation at $300 per hour. It is estimated that the largest individual lenders would be engaged in a maximum of 20 mediations per annum with a total cost of $60,000 to that lender. This may sometimes be a substitute cost, not an additional cost because some lenders already provide mediation on a voluntary basis, and invest significant resources in resolving debt issues. • Lenders will be required to delay enforcement action until mediation has taken place. This may also be a substitute cost in some cases, as mediation could enable a more timely resolution for debt problems. • The Government will bear the cost of administering, monitoring and enforcing the regime. Depending on administration arrangements, the estimated costs are around $250,000 - 300,000 per annum. Establishing the scheme is estimated to cost $350,000 including IT, establishing a register of mediators and communications. This assumes the scheme will be run by an existing organisation.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?
Based on evidence provided by lenders, we estimate that the numbers of farm debt mediations conducted under a statutory scheme are likely to be low even following a downturn, with around 50-100 mediations per annum. Experience of compulsory farm debt mediation schemes overseas suggests that there are not likely to be any significant risks or unintended impacts. Risks include: • lenders may not mediate in good faith and may initiate enforcement earlier because of the requirement to mediate • farmers may not mediate in good faith • the power imbalance between farmers and lenders may not be adequately addressed • parties may have unrealistic expectations of what the scheme might achieve • farmers may choose to opt out of mediation • farmers may not choose to trigger mediation, thus losing the opportunity to take early action while options to save the business are still available • the effect on New Zealand's international reputation of a scheme that provides special treatment for farmers. We would seek to mitigate these risks through the design and implementation of the scheme – for example through ensuring the appropriate incentives are in place for lenders and farmers to mediate in good faith, putting support in place to address the power

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imbalance, and working with industry and support networks to raise awareness of the scheme and encourage farmers to take action early to resolve debt issues. In addition, we have not yet engaged extensively with the secondary lending sector, and the impacts of the scheme on this sector are not yet fully understood. For example, the scheme may have an impact on credit availability from this sector. We would seek to mitigate this by working with this sector as part of the system design work. Risks would be monitored once the scheme was implemented.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.
At this stage, no significant incompatibility with the Government's 'Expectations for the design of regulatory systems' has been identified. Further impact analysis will be carried out as the scheme is designed (see Section 1 below). This will consider the compatibility of the design and implementation of the scheme with the Government's 'Expectations for the design of regulatory systems'.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
There is limited quantitative evidence available on the nature and scale of the problem. We talked to a wide range of stakeholders who provided evidence based on their experience on the nature and scale of the problem. Stakeholders also shared their views on how it might be addressed. Evidence from overseas included data and independent evaluations of farm debt mediation schemes in Australia, Canada and the US. There has been a recent independent evaluation of a Canadian scheme, as well as recent data on success rates of mediation schemes in three Australian states. Conversations with a range of stakeholders in New South Wales and Queensland provided useful insights on farm debt mediation schemes in place there.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
The Treasury, the Ministry for Primary Industries and the Ministry of Business, Innovation and Employment
Quality Assurance Assessment:
A Quality Assurance Panel with representatives from the Regulatory Quality Team at the Treasury, Ministry for Business Innovation and Employment, and the Ministry for Primary Industries has reviewed the Regulatory Impact Assessment (RIA) *"Farm Debt Mediation"* produced by the Ministry for Primary Industries. The Quality Assurance panel considers that this **partially meets** the quality assurance criteria at this stage in the process. The RIA is not complete because analysis of the risks facing farming businesses is more developed for dairy than other farming sectors. Further analysis will be required for all

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sectors, taking into account the outcome of broader stakeholder consultation in the next stage of the design process.

The RIA is clear and concise and the limitations and constraints on the analysis have been well outlined. The problem appears to be small-scale and there is limited local quantitative evidence on the problem. This has been supplemented with some historic and recent evaluations of overseas regimes and insights gained from discussions with overseas stakeholders. There has been initial consultation with a number of stakeholders that could be covered by the scope of the proposed scheme.

Reviewer Comments and Recommendations:

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Impact Statement: Farm Debt Mediation

Section 1: General information

Purpose
The Ministry for Primary Industries is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing decisions to be taken by Cabinet in relation to commencing drafting of a government Bill that would establish a statutory scheme for farm debt mediation.

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Key Limitations or Constraints on Analysis

The scope of the analysis has been limited to the farming sector

Ministers have determined that the scope of the analysis would be limited to the farming sector.

Further regulatory impact analysis will be provided to support decision-making on design and implementation

Officials have been asked to provide advice on a statutory farm debt mediation scheme, with a view to working with Parliamentary Counsel Office to start preparing a Farm Debt Mediation Bill in early 2019, subject to Cabinet approval.

For the regime to succeed, the system that administers and supports the legislation will need to be carefully considered. For this reason, the Ministers of Agriculture and of Commerce and Consumer Affairs are initially seeking Cabinet approval to start drafting the Bill, with further advice to be developed on the design and implementation of a farm debt mediation scheme in 2019.

This regulatory impact analysis has been drawn up to support decision-making on approval to start drafting the Bill. Further impact analysis will be undertaken to support decision-making on the design and implementation of a farm debt mediation scheme.

There is limited quantitative evidence from New Zealand to support the analysis, but this has been supplemented by evidence provided by stakeholders, and evidence from overseas

There is limited quantitative evidence on the scale of the problem. There is no data on enforced sales of assets in the farming sector. We were able to gain evidence from stakeholders, including from the banking sector, on the scale and nature of debt problems and receiverships. There is very little evidence on the non-bank sector, but non-bank lending is a small proportion of lending to the farming sector.

There is some evidence about the behaviour of banks and on relationships between farmers and banks. This was supplemented by engagement with stakeholders who provided us with insights based on their experiences.

There is some limited evidence on the link between financial stress and mental health issues faced by farmers. Stakeholder engagement also provided us with insights into these issues.

Independent evaluations and data from farm debt mediation schemes in Australia, Canada and the US supported our analysis, as did conversations with stakeholders with experience of farm debt mediation schemes in New South Wales and Queensland.

It is important to note that almost all stakeholders we spoke with (whether they represented lenders or borrowers) supported the proposal to introduce a statutory farm debt scheme in New Zealand. While there is limited quantitative data available in this area, evidence provided by stakeholders and evidence from farm debt mediation schemes overseas underscores the benefits of a scheme in terms of:

- more effective management of farmer distress and its associated costs (including a

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strong anecdotal link with mental health problems)

- more effective management of farm assets and the productivity of the farming business overall
- more enduring resolution of farm debt issues with greater longevity of outcomes.

These benefits serve the interests of lenders as well as borrowers and the scheme was endorsed by both groups.

A full consultation exercise was not carried out due to time constraints

Time constraints have meant that a full consultation exercise could not be carried out. However, we engaged with a wide number of stakeholders from the farming and lending sectors.

Responsible Manager (signature and date):

Emma Taylor

Director

Agriculture, Marine & Plant Policy

Ministry for Primary Industries

29 November 2018

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Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

The farming sector is New Zealand's largest export producer and is an essential part of New Zealand's economy, society, culture and environment. Farming is distinct from other sectors of the New Zealand economy due to a number of inter-related factors:

- Many farms in New Zealand operate as relatively small-scale family businesses. Farm business models are often complex, with multiple owners and interests. Farm finances can involve multiple lenders with security over different assets such as land and farm equipment. Farming business arrangements are often conducted on an informal basis and farmers vary in their levels of financial expertise. Geographical isolation can make it difficult for farmers to access appropriate financial and other support.

- Farming is particularly vulnerable to unpredictable events outside the control of individual farmers. Pests and diseases such as the recent kiwifruit PSA virus and the *Mycoplasma bovis* outbreak can significantly affect the financial viability of farming businesses. Farming can also be disrupted by climate fluctuations, adverse weather events and natural hazards. Commodity prices can be very volatile, particularly in the dairy sector.

- Farming is distinct in its exposure to international markets. For example, biosecurity incursions can have widespread and dramatic impacts. A number of New Zealand's trading partners are particularly sensitive to changes in biosecurity status. In the event of an incursion, markets can close to New Zealand product either within a geographical range or entirely, whether or not the product has been directly affected. This has immediate consequences on product value and it could be some time before market credentials and product value can be regained.

- The largely seasonal nature of cashflows in combination with climate and price volatility can mean that a loss-making season can sometimes lead to a number of years of financial stress while debt continues to accrue. For some businesses, the determinant of a successful season can come down to a short seasonal window that is a culmination of a year or more of preparation.

- Farm debt has increased steadily in recent decades. The dairy farming sector in particular is highly indebted and the Reserve Bank notes in its May 2018 Financial Stability Report that this sector is "vulnerable to a future downturn in dairy prices"[1]. Much of this debt is held as interest-only terms, leaving more indebted businesses vulnerable to asset value downgrades. Asset values can change rapidly in many sectors of farming – this is a particular problem for sharemilkers where the value of livestock can fluctuate from year to year.

- The farming sector faces a number of significant challenges such as the impact of tighter environmental regulations, changes in global markets and the effects of

[1] Reserve Bank of New Zealand, Financial Stability Report for May 2018, accessed at: https://www.rbnz.govt.nz/financial-stability/financial-stability-report

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climate change, which are likely to increase uncertainty and place increasing pressure on farmers and lenders.

2.2 What regulatory system, or systems, are already in place?

The dispute resolution regime under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act) requires all financial service providers (including banks and other lenders) to be registered and, if they provide services to retail clients, to belong to an approved dispute resolution scheme. There are currently four approved schemes, including the Banking Ombudsman Scheme.

Our view is that the FSP Act does not amount to being a regulatory system that is analogous to farm debt mediation. The FSP Act is about dealing with disputes between financial service providers and consumers. It is not designed for negotiating solutions in relation to insolvent businesses, particularly where there is no dispute about the fact that a business is in default. This is why the Banking Ombudsman Scheme excludes, among other things, complaints that relate to a bank's commercial judgment about lending or security decisions.

2.3 What is the policy problem or opportunity?

Farm debt is often complex, and resolving the debt problems of financially struggling farms can be a challenging and drawn-out process

Because many farms operate as family businesses, failure of a farming business can result in the farmer and their family losing both their business and their home and can also affect the wider community. Often farms have passed down through generations of the same family and farmers can have an emotional attachment to their land. Making decisions about the future of a financially struggling farm business can be highly complex and emotionally charged for farmers and their families, especially where there are multiple interests involved.

Where there are multiple lenders with security over different assets, one lender taking enforcement action over an asset can affect the viability of the farm business as a whole.

The small-scale nature of many farms means that there can be a power imbalance between farms and lenders. Farmers may lack financial expertise, and may have limited access to financial advice because of geographical isolation. In a situation of financial stress, farmers may lack the capacity to objectively enter into significant business negotiations. Lenders are usually well-resourced and have a clear understanding of the most optimal outcomes for their interests. This power imbalance may be a barrier to fully exploring options for resolving debt problems.

Secured lenders, particularly banks, generally view repossession of farms and farming assets as a last resort. Lenders are often reluctant to sell assets, particularly during a downturn when prices are low. Lenders can sometimes find it difficult to engage with financially stressed farmers. Banks in particular are concerned about the effect on their reputations of repossessing farms.

As a result, the process of resolving the debts of financially struggling farm businesses can

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become drawn-out. We were told by stakeholders that banks can often work with farmers for more than a year and sometimes for several years to resolve debt issues. This creates additional stress for farmers and it can also mean that debt continues to accrue and equity is eroded. There are often other problems associated with financial difficulties such as animal welfare and poor environmental outcomes which need to be addressed promptly.

High levels of farm debt and challenges facing the farming sector could mean this becomes an increasing problem in future.

While farm finances and debt resolution might be perceived as largely an economic problem, debt resolution problems have wide-reaching social implications for farmers, their families and wider communities.

Although there is no clear evidential link between debt stress and farmer suicide, the link was drawn anecdotally by a number of people that officials met with; and the clear view was expressed that the opportunity to mediate the management of farm debt before the farm hit crisis point could be material in promoting better mental wellbeing amongst rural communities.

It was also clear from discussions that effective management of farm debt mitigates other poor outcomes particularly in relation to animal welfare, and environmental standards. These things often suffer when a farm business becomes distressed.

Policy objectives

Policy objectives would be to provide a consistent, structured, equitable, cost effective, and timely process that all parties can have confidence in, that will:

- support farmers in financial distress in their dealings with lenders
- enable the identification and exploration of options for turning around a failing farm business
- enable a farmer with an unviable business to 'exit with dignity'.

There is limited quantitative evidence on the problem, but stakeholders provided us with useful insights

Evidence suggests that there are currently relatively few farm receiverships

There is no available data on enforced sales of assets in the farming sector as a whole. Stakeholders with insights into the banking sector told us that numbers of farm receiverships have fallen recently. One major bank told us that they had only had one farm receivership in the last three years and another that they had had no farm receiverships in the past two years.

It is more common for farmers themselves to sell land or other assets, or the farm business as a going concern when the lender has concluded that the farm business is not viable. Again, there is no available data on the scale of this. Evidence from stakeholders would suggest that the numbers of sales of financially stressed farm businesses are relatively low.

This could change in the event of a future downturn. In 2016, the Reserve Bank carried out

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stress testing on lending to the dairy sector which suggested that a severe downturn could result in between four and 25 percent of dairy farmers with non-performing loans[2].

There is limited evidence on the non-bank lending sector. Reserve bank data suggests this is a relatively small proportion of lending to the agricultural sector – around $328 million as at 30 September 2018 compared with $62 billion lent by banks[3] and that most of this appears to be lending for equipment finance. There is no data on enforcement actions by the non-bank lending sector.

Evidence on lender behaviour and lender-farmer relationships is mixed

The Federated Farmers biannual banking survey shows consistently high rates of satisfaction from farmers with their banks, although the most recent survey (May 2018) showed a slight drop in satisfaction – 79 percent of farmers said they were satisfied with their banks, and only 8 percent were dissatisfied. The proportion of farmers reporting feeling 'undue pressure' from banks has increased in the past six months, most noticeably in the dairy industry (including sharemilkers) over the past six months with a rise from 10 percent to 14 percent[4].

A survey carried out in 2010 (during a dairy downturn), by s 9(2)(a) (a farming advocate) and Massey University found that over two thirds of farmers did not trust their bank to support them through financial difficulty, and over a third felt their banking relationship had worsened over the past 12-24 months. Nearly half of respondents had had their overdraft facility limited or removed in the past 24 months, one third had been refused funding by their bank to continue farming operations and nearly one third had been required to sell land or other assets to reduce debt. It is likely that there was a negative bias in the survey results due to the nature of the survey but this cannot be quantified[5].

A recent review of retail bank conduct and culture carried out by the Financial Markets Authority and the Reserve Bank found a small number of issues relating to poor conduct by bank staff, in particular, incentives for staff that were highly focused on sales performance, some instances of inappropriate lending and sales, along with weaknesses in the governance and management of conduct risks. The report concluded that 'conduct and culture issues do not appear to be widespread in banks in New Zealand' and the report does not indicate that problems are more significant in any particular sector[6].

Some mediation already takes place between lenders and financially stressed farmers, however it has not been possible to quantify this as mediation is a confidential process.

Stakeholders provided us with insights based on their experiences – these are set out in more detail in section 2.5. There were mixed views from stakeholders. Farmer support

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[2] Reserve Bank of New Zealand, An updated assessment of dairy sector vulnerabilities, Bulletin Vol 78, no 8, December 2015, accessed at: https://www.rbnz.govt.nz/research-and-publications/reserve-bank-bulletin/2015/rbb2015-78-08

[3] Reserve Bank of New Zealand, statistics on non banks: funding and claims by sector – T4, accessed at: https://www.rbnz.govt.nz/statistics/t4

[4] Federated Farmers Banking Survey May 2018, accessed at: http://www.fedfarm.org.nz/FFPublic/Policy2/National/2018/Federated_Farmers_Banking_Survey_May_2018.aspx

[5] Edlin B (2010) 'Despite stress, few asked for help', Farmer's Weekly, June 7, pp15-16

[6] Financial Markets Authority and Reserve Bank of New Zealand (2018) Bank Conduct and culture: findings from an FMA and RBNZ review of conduct and culture in New Zealand retail banks, accessed at: https://fma.govt.nz/news-and-resources/reports-and-papers/bank-conduct-and-culture-review/

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groups and farming industry bodies felt that lenders were not always willing to explore options and sometimes took action without reasonable notice, and a range of stakeholders commented on the power imbalance between farmers and banks. Other stakeholders felt that banks usually acted reasonably.

Stakeholders told us that timeliness was a problem. We were told that sometimes neither banks nor farmers act promptly when financial difficulties first arise, that farmers can sometimes be reluctant to engage constructively with their banks to find solutions and that resolving debt issues can take a number of years.

Stakeholders in Australia, who have experience of the farm debt mediation schemes in operation there, were unanimous that the schemes supported better outcomes for both farmers and lenders. In particular, as well as the benefits noted above for farmers; the Australian Bankers Association said that mediated agreements have greater longevity and tend to deliver better and longer lasting outcomes for both parties.

There is evidence that financial difficulties cause stress and farmers are unlikely to seek help

International and New Zealand evidence shows that occupational stress is pervasive in the agricultural sector and that key stressors are uncontrollable events such as the weather and global economic conditions, along with isolation, bureaucracy and financial pressures. Mental health problems and suicide rates are high in the farming sector, however evidence suggests that while financial stress can contribute to mental health problems, it is rarely the single most important factor. A recent study concluded that financial stresses made a negligible contribution to farm suicides[7]. The Janette Walker/Massey University survey found that over two thirds of farmers had found 'the past two years' (that is, 2008-2010 which was during a dairy downturn) had had a 'stressful' effect on their families, and nearly half reported that their general wellbeing had worsened as a result of bank pressure (as noted above there is likely to be a negative bias in these survey results).

Research indicates that farmers are unlikely to seek help for stress and mental health problems – for example, the Walker/Massey University survey found that 79 percent of respondents had not accessed support services for assistance despite high levels of reported stress.

Some stakeholders told us that in their experience financial issues were often the 'tip of the iceberg'; that farmers in financial difficulties faced other problems including mental health problems, and farmers were often reluctant to seek help. Many of the people we spoke to drew a clear link between debt stress, mental health issues and farmer suicide.

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[7] Beautrais, A L (2018) Farm suicides in New Zealand 2007-2015: A review of coroners' records, Australian & New Zealand Journal of Psychiatry Vol 52(1) 78-86

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2.4 Are there any constraints on the scope for decision making?

Officials have been asked to provide advice on a compulsory farm debt mediation scheme, with a view to working with Parliamentary Counsel Office to start preparing a Farm Debt Mediation Bill in early 2019, subject to Cabinet approval.

For the regime to succeed, the system that administers and supports the legislation will need to be carefully considered. For this reason, the Ministers of Agriculture and of Commerce and Consumer Affairs are initially seeking Cabinet approval to start drafting the Bill, with further advice to be developed on the design and implementation of a farm debt mediation scheme in 2019.

This regulatory impact analysis has been drawn up to support decision-making on approval to start drafting the Bill. Further impact analysis will be undertaken to support decision-making on the design and implementation of a farm debt mediation scheme.

2.5 What do stakeholders think?

We engaged with a wide range of stakeholders

The main stakeholder groups with an interest in farm debt are farmers and secured lenders. Rural support organisations and networks, financial advisors and accountants, and insolvency practitioners also have an interest in the problem. Mediators also have an interest as they are sometimes called on to help with debt resolution.

We engaged with a wide range of stakeholders including:

- Federated Farmers
- HortNZ
- DairyNZ
- Beef + Lamb New Zealand
- Dairy Women's Network
- Rural Women New Zealand
- Rural Support Trusts
- Farmers' advocates
- Te Tumu Paeroa
- The Reserve Bank of New Zealand
- The Restructuring, Insolvency and Turnaround association of New Zealand (RITANZ)
- Financial advisors and chartered accountants serving the rural sector
- New Zealand Banker's Association (NZBA)

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- ANZ and Westpac banks
- Banking Ombudsman Scheme
- The Arbitrators' and Mediators' Institute of New Zealand (AMINZ)
- The Resolution Institute

Scale of the problem

Stakeholders with knowledge of the banking sector told us that numbers of farm receiverships have fallen recently. One bank told us that they had only had one receivership in the past three years and another that they had had no receiverships in the past two years.

A number of stakeholders including financial advisors, accountants, insolvency practitioners and banks told us that banks view receivership as a last resort, and go to 'extraordinary lengths' to avoid it. Banks are very concerned about the reputational impacts of being seen to repossess farms, and are also reluctant to sell assets during a downturn when prices are low.

We were told that it is more common for farmers themselves to sell part or all of their farm businesses as a going concern when the lender has concluded the business is not viable. Stakeholders from the banking sector told us that the numbers of financially stressed farmers selling their businesses is relatively low.

Benefits of addressing the problem

Nearly all the stakeholders we spoke to felt that despite the small scale of the problem in economic terms, there would be both social and economic benefits in addressing this.

Farming industry bodies, farmer support groups and mediators felt particularly strongly that something needed to be done to:

- address the power imbalance between farmers and lenders
- ensure that lenders explored all options before taking enforcement action
- provide farmers with financial advice and emotional support
- ensure that farm debt problems could be resolved in a timely and dignified way.

Financial advisors, accountants and lenders felt there would be benefits in addressing inconsistent practices between bank and non-bank lenders and providing a means for debt issues to be resolved in a timely way.

Lender behaviour

There were mixed views from stakeholders on the behaviour of banks and other lenders:

- Some farmer support groups and farming industry bodies told us that banks and other lenders can behave badly when dealing with farmers in financial difficulty, for example putting undue pressure on farmers, taking action without reasonable notice and being reluctant to explore all options for turning around the business. The Banking Ombudsman Scheme told us that common complaints about bank behaviour included banks not acting fairly or respectfully and acting too quickly with no

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opportunity to explore other options.

- Accountants, financial advisors, farmer support groups and the Reserve Bank commented on the power imbalance between farmers and banks. We were told that farmers can feel intimidated and stressed by the behaviour of banks. In particular farmers dislike their accounts being transferred away from the local bank representative with whom they have an established relationship to 'faceless' centralised banking teams that specialise in debt.
- Some stakeholders including financial advisors, accountants, and farmer support groups considered that banks sometimes lent irresponsibly and did not take due account of risk. We were told that the cyclical nature of farming means that banks tend to over-lend when commodity prices are high. Accountants and financial advisors commented that some banks will provide budgets for farmers to justify lending to them.
- On the other hand, some stakeholders were of the view that that banks usually behave reasonably. A farmer support group commented that banks have recently improved their practices and HortNZ told us that banks had acted reasonably during the kiwifruit PSA crisis. The banks we spoke to told us they often went 'above and beyond' what they considered to be reasonable for farmers facing financial difficulty.
- We were told by the banking sector that banks routinely offer mediation and other assistance (such as independent legal and financial advisors) to farmers in financial difficulty and will explore all options before taking enforcement action. Mediator representatives and accountants questioned whether mediation offered by banks was independent and suggested that banks varied in their practice, and that there may be inconsistency even within banks.
- Banking sector representatives, mediator representatives, and farming industry bodies considered that non-bank lenders tended to take enforcement action more quickly, and sometimes acted less fairly than banks. A financial advisor told us that banks will often pick up debts owed to non-bank lenders in the interest of keeping the farm running.

Timeliness

- We were told by accountants, RITANZ and financial advisors that sometimes neither banks nor farmers act promptly when financial difficulties first start to arise, meaning that opportunities might be lost to save a business.
- Financial advisors, banks, mediator representatives and farmer support groups told us that some farmers can 'bury their heads in the sand' and can be reluctant to engage constructively with banks to find solutions.
- Accountants, financial advisors, farming industry bodies and banks also commented that banks often work with financially struggling farmers for a very long period of time (sometimes for years) to resolve debt issues.

Financial stress and mental health problems

A number of stakeholders, particularly financial advisors and farmer support groups drew a link between financial stress, mental health problems, and farmer suicide. A financial advisor told us that financial problems are often the 'tip of the iceberg' and some stakeholders told us that that farmers with financial difficulties often also had mental health issues.

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Farmers face unique challenges

Stakeholders were asked whether they thought farmers faced unique challenges in relation to financial problems and debt that meant that farming should be treated differently from other businesses.

Most stakeholders argued that they did, although some banking and insolvency sector representatives considered that the issues farmers face are not significantly different from other small businesses.

Stakeholders came up with a number of issues that they considered were specific to farmers with debt problems, including:

- nearly all stakeholders felt that farmers had an emotional attachment to their land, particularly if the farm had been in the same family for several decades and this made farming a 'special' type of business
- a number of stakeholders, particularly farmer support groups and farming industry bodies told us that that farming foreclosures affect whole families and wider communities
- farming industry bodies and farmer support groups were concerned about the vulnerability of the sector to high levels of debt
- some stakeholders mentioned that farming is a significant part of the economy
- a wide range of stakeholders commented that farming is subject to uncontrollable forces such as pests and diseases, natural hazards, adverse weather events, and global market conditions
- farming industry bodies, farmer support groups and banks mentioned an increasing number of future challenges for farming such as environmental regulations, effects of climate change, and uncertainty in global markets, which could create financial difficulties in the near future
- accountants, farmer support groups and farming industry bodies considered that farmers are subject to unique stressors such as isolation and the fact that farming is a '24/7' business.

Further engagement with appropriate stakeholder groups is planned to inform the detailed design and implementation of the proposal.

Engagement with Māori

Up to now, collectively-owned iwi, hapu and whānau farmland has tended not to be mortgaged, but this is changing as Māori farming businesses expand their operations and land holdings. So far, we have engaged with Te Tumu Paeroa and the Māori Crown Relations Unit within the Ministry of Justice. We also intend to carry out consultation with non-government Māori entities to address design and implementation of the proposal. This could include providing adequate timescales for collective owners to be involved in the process, ensuring there is flexibility for different Tikanga Māori practices to be followed, and ensuring that mediators have appropriate cultural knowledge.

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Section 3: Options identification

3.1 What options are available to address the problem?

Four options have been considered to address the timely and equitable resolution of farm debt issues. These include the status quo, as there are already informal processes offered by banks, as well as a non-regulatory option (a formalised voluntary mediation scheme). The four options are:

- option 1: status quo
- option 2: a formalised voluntary farm debt mediation scheme
- option 3: a requirement for all secured lenders to offer farm debt mediation (preferred option)
- option 4: a requirement applying only to banks (and not to non-bank secured lenders) to offer farm debt mediation.

Stakeholders were asked for their views on different options. Consideration of options was also informed by data and independent evaluations on farm debt mediation schemes in Australia, Canada and the US, and by conversations with stakeholders in New South Wales (NSW) and Queensland.

The criteria for analysing the options were:

- cost effectiveness
- whether it would provide a consistent and equitable process that would address the power imbalance between lenders and farmers
- whether it would provide a timely means of resolving debt issues that allows options to be fully explored
- whether it would provide certainty for all parties.

All options, except the status quo, involve increased use of mediation as a mechanism for enabling the timely and equitable resolution of farm debt. The benefits of mediation are generally recognised and it is widely-used as an inexpensive and confidential mechanism for resolving disputes. Mediation can:

- bring all parties together for a frank exchange of views and information in a non-threatening atmosphere, and enable the weaker party to gain some control over the process
- provide a structured and consistent framework that all parties can have confidence in
- enable the exploration of a wide range of issues and options and the constructive negotiation of solutions.

If entered into early enough, farm debt mediation could help farmers to turn around a failing farm business, while at the worst, it could allow a timely and 'dignified exit' for a farmer with an unviable farm business.

Both AMINZ and the Resolution Institute were confident that an increased demand for mediation could be met from the available supply of mediators. There is already a pool of qualified and accredited mediators in New Zealand, many of whom have experience in rural issues. There would also be the potential to use Australian mediators if there was a shortage in New Zealand.

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Option 1: Status quo

Key features

Under the current arrangements, some lenders would continue to offer mediation to farmers in financial distress on a voluntary basis. This may not involve independent or trained and experienced mediators. Not all lenders would offer mediation. Where there are multiple lenders, the actions of one lender could continue to create problems for other lenders, and could undermine the viability of the farm business.

Lenders, particularly banks, are likely to continue to be reluctant to take enforcement action for two reasons:

- concerns about harm to their reputation particularly where a receiver is appointed
- it can reduce the value of farm assets over which they hold security interests - this risk would be greater if large-scale enforcement action was taken.

Analysis

The scale of the problem is currently small – it appears that very few farm repossessions take place currently, and relatively small numbers of farms face significant debt problems. However the indebtedness of the farming sector and its vulnerability to future shocks means that the number of farmers facing financial difficulties could increase. While banks are unlikely to take large-scale enforcement action for the reasons noted above, this would mean a large increase in the number of farms that have debt issues that need to be resolved with banks.

While the status quo would not involve any direct additional cost to government, it does not meet the criteria for addressing the problem.

- Lenders have different approaches to resolving debt issues which means there is not a consistent and equitable process. Farmers are disadvantaged by a power imbalance when dealing with lenders, particularly large banks.

- While some lenders may use mediation to try to resolve debt issues in a timely manner, there is no incentive for farmers to participate in this. Some lenders use informal approaches such as mediation and financial advice to resolve debt issues, but this may not change public perceptions that they are acting unfairly. Some lenders may be reluctant to fully explore all options. There is no incentive to instigate action at an early stage when financial issues first arise.

- There is a lack of a structured framework for resolving debt, meaning that all parties face uncertainties over the process. This can be stressful for farmers as the less powerful party.

Stakeholder views

Engagement with stakeholders has helped with identifying the problems inherent in the status quo.

Not all stakeholders considered that these problems needed to be urgently addressed, but most stakeholders from across the range of sectors that we engaged with considered that there would be social and economic benefits in addressing them. On the whole, farming industry bodies and farmer support groups felt most strongly that problems with the status

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quo needed to be addressed, while banking sector representatives felt least strongly that there was a need for change. One bank considered that their current approach was adequate, while another felt it would be useful to have more certainty in resolving debt issues.

Option 2: A formalised voluntary mediation scheme

Key features

A formalised voluntary mediation scheme would involve lenders signing up to an agreement that they would offer mediation as part of a debt resolution process, and before entering into any enforcement action. The NZBA started to develop a code of conduct for its members, which involved them agreeing to enter into mediation. However, the NZBA decided not to proceed with this when the now withdrawn Member's Farm Debt Mediation Bill was introduced in May 2018.

To have credibility with farmers, a voluntary mediation scheme would need to be developed and agreed jointly between lenders and farmers – for example by the NZBA and Federated Farmers. NZBA membership is restricted to banks however.

Analysis

A formalised voluntary mediation scheme would be developed and administered by industry bodies. There would be no cost to government.

This option could encourage more widespread use of mediation by lenders and would be a better option than the status quo. A voluntary scheme partly meets two of the criteria - more use of mediation could increase consistency and lead to more timely debt resolution. However it would be unlikely to increase certainty for parties involved as there would be no requirement for banks to sign up to a voluntary scheme even if they were members of the NZBA, and there would be no requirement for other lenders to join the scheme. Furthermore, there would be no consequences for lenders signed up to the scheme should they fail to comply.

A voluntary scheme would have limitations in addressing power imbalances, because lenders would still be able to conduct mediation according to their own terms. For example, it would not be possible to require parties to the mediation to provide relevant documentation and this could hinder the transparency and fairness of the process, and lenders could charge the costs of mediation to farmers.

Stakeholder views

Most stakeholders were of the view that a voluntary scheme would not work because lenders would be able to opt out of it. Farmers were less likely to be aware of a voluntary scheme, and lenders may not offer mediation as an option. s 9(2)(ba)(i) Farming industry bodies, farmer support groups and financial advisors also felt that a voluntary scheme would not be effective.

Overseas evidence

Queensland introduced a voluntary farm debt mediation scheme – the Queensland Farm Finance Strategy. The voluntary agreement was developed by the Queensland Farmers

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Federation and the Australian Banking Association, with input from stakeholders. This has since been replaced by a statutory scheme. A Queensland Parliamentary report on the Farm Business Debt Mediation Bill 2016 noted that many witnesses and submitters supported the introduction of a mandatory scheme to replace the voluntary scheme[8]. Explanatory notes for the Bill state that many large lenders 'readily participated in mediation' under the voluntary approach, but not all lenders did so[9]. The voluntary agreement lacked independence as there was no separation between ownership of the agreement and its operation.

An evaluation of the NSW Farm Debt Mediation scheme carried out in 2000 considered whether the scheme should become voluntary. Although settlement rates for voluntary mediation schemes were found to be comparable with compulsory schemes, the report concluded that there was not a strong justification for changing the regime to a voluntary one on the grounds that take-up would be lower and there was not strong support among users of the scheme to warrant making the change to a voluntary scheme[10].

Option 3: A requirement for all secured lenders to offer farm debt mediation (preferred option)

Key features

This option would require all secured lenders to offer mediation before they could take enforcement action to repossess assets. Lenders would also be able to offer mediation when a farming business was in default. Farmers would have the ability to initiate mediation, which, combined with industry bodies raising awareness of the scheme, would encourage them to seek mediation early in the process. The regime would be largely based on the NSW Farm Debt Mediation scheme which is regarded as best practice in Australia.

Key aspects of the scheme would be:

- it would cover all farming activities including sharemilking, horticulture and aquaculture, but would exclude forestry, lifestyle farms and wild harvest fishing and hunting (criteria and rationale for the farming activities included is attached at Annex 1).
- it would only apply in relation to loans secured by assets that are an integral part of the farming operation
- lenders would be required to offer mediation when a farmer was in default and the lender intended to take any form of enforcement action; farmers would be able to initiate mediation with secured lenders at any time
- mediation would be provided by independent mediators
- mediation would take place within specified time limits with a moratorium on the lender enforcing their security interest
- there would be measures in place to avoid participants acting in bad faith and gaming the system:
    - where lenders fail to comply with a request for mediation or to offer mediation,

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[8] Queensland Parliament, Finance and Administration Committee, Report No. 34, 55th Parliament – Farm Business Debt Mediation Bill 2016 and Rural and Regional Adjustment (Development Assistance) Amendment Bill 2016, pp 25-27, accessed at: https://www.parliament.qld.gov.au/documents/tableOffice/TabledPapers/2016/5516T2083.pdf

[9] Farm Business Debt Mediation Bill 2016 Explanatory Notes, accessed at: https://cabinet.qld.gov.au/documents/2016/Aug/FarmDBill/Attachments/ExNotes.PDF

[10] Altobelli T (2000) Research into Farm Debt Mediation Act 1994, University of Western Sydney Macarthur report, accessed at: https://www.raa.nsw.gov.au/__data/assets/pdf_file/0004/275953/uws-macarthur-report-research-farm-debt-mediation-act.pdf

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any enforcement action taken in breach of it would be rendered void
    - where farmers have acted in bad faith, lenders would be able to take enforcement action
    - there would be restrictions on how frequently farmers would be able to require lenders to mediate.

Work still needs to be undertaken on the detailed design and implementation of the system, and this would be subject to further impact analysis. Particular aspects of design and implementation that are still to be developed include:

- how the scheme would be administered
- who would have independent oversight of the scheme
- ensuring the scheme is appropriate for Māori farming businesses
- how the scheme would be monitored and reviewed
- arrangements for financial and other support for farmers
- how to publicise the scheme
- how to incentivise farmers and lenders to use mediation as early as possible
- how mediators would be accredited (currently both AMINZ and the Resolution Institute provide accreditation and training for their members).

Analysis

This option would meet the criteria.

- It would provide a consistent and equitable process that applied to all secured lenders, including non-bank lenders. Mediation can help address the power imbalance between lenders and farmers, but evidence from overseas suggests that this needs to be carefully considered in the design of the scheme.

- Compulsory mediation would provide a timely means of resolving debt issues that allows options to be explored, as well as allowing a farmer to 'exit with dignity' from an unviable business.

- It would provide certainty for lenders and farmers by introducing a structured and time-bound process.

This option would need to be implemented and administered directly by government, or contracted by government to another body. It is estimated that costs of administering a scheme would be $250,000-$300,000 per annum.

Stakeholder views

Nearly all the stakeholders we spoke to supported a statutory farm debt mediation scheme, although stakeholders varied in the strength of their support for a scheme. The s 9(2)(ba)(i) did not support the scheme as they felt that it would not help address the power imbalance between farmers and lenders. s 9(2)(ba)(i) felt a compulsory scheme would be beneficial but should be offered to any failing business. s 9(2)(ba)(i) noted that other businesses can be affected by farmers spending less money during a downturn and suggested that a scheme should not be limited to farming.

- Stakeholders from the banking sector stated that a compulsory scheme would not make a significant difference to their practice as banks already offer mediation. However, a formalised scheme would help 'level the playing field' when non-bank

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lenders were involved, and would also help with public perceptions that there was a structured process to be followed. They also commented that it could 'smooth the down' for farmers with unviable businesses.

- Farming industry bodies, farmer support groups and mediators were the strongest supporters of a statutory scheme. Federated Farmers have changed their position on this relatively recently – previously they did not support a statutory farm debt mediation scheme, but now believe this is needed in view of upcoming challenges facing the sector.

- Financial advisors and accountants were also strongly supportive of a scheme because they believed it would provide a consistent approach, could provide a 'backstop' where bank processes had failed, and could help farmers face the reality of their situation and work through available options before it was too late.

Other benefits identified by stakeholders included:

- an independent mediator would help address the power imbalance between lenders and farmers
- where there were a number of lenders it would be helpful to get everyone around the table
- everyone with an interest in a farm business could be involved, including family members
- it would encourage earlier conversations about financial problems and help farmers to think strategically
- even if the mediation resulted in farm foreclosure, it would help farmers to come to terms with this because it would give them an opportunity to be heard and to obtain 'closure'
- mediation would stop banks 'rushing things' before all options had been explored
- it would prevent farmers drawing out the process, often to their own detriment, and would mean that if there were animal welfare and environmental issues, these could be addressed in a timely way
- some stakeholders pointed to the success of compulsory farm debt mediation schemes in Australia and felt this could work well in New Zealand.

On the whole, stakeholders did not think there were significant risks of unintended consequences if a compulsory farm debt mediation scheme was to be established. Banks were of the view that there were no risks as they already offer mediation.

- Several stakeholders stressed the importance of having qualified and capable mediators. Some thought that mediators should have knowledge of farming while others thought it didn't matter as long as all parties agreed on the choice of mediator.

- Banks and financial advisors thought the scheme needed to be able to address situations where parties were not acting in good faith

A number of stakeholders, particularly financial advisors, farming industry bodies and farmer support groups considered that other support needed to be offered alongside mediation. A financial advisor told us that financial problems are often the 'tip of the iceberg' and there were usually a host of other issues relating to how the farm was being run. Some

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stakeholders told us that that a significant proportion of farmers with financial difficulties also had mental health issues.

These stakeholders considered that mediation should also include independent financial advice and expert help with farm plans, as well as support for emotional and mental health issues. HortNZ referred us to their industry-led PSA response which included independent financial advice – they considered this scheme had been a very effective way of working with lenders to explore options for keeping businesses viable.

Overseas evidence

A number of overseas jurisdictions have statutory farm debt mediation schemes, where secured lenders are required to offer mediation to farmers before they can take enforcement action. These are generally regarded as being successful and evaluations have shown that they have benefits for farmers, and also for lenders.

There are a number of independent evaluations of farm debt mediation schemes in the US, Canada and Australia, although most of these were carried out some time ago.

Evaluations of farm debt mediation schemes in the US carried out in the 1990s found that:

- the vast majority of parties reached mutual agreements
- most parties were satisfied with the mediation process
- mediation was faster, cheaper and more private than Court proceedings, and parties were usually more receptive to a final agreement[11].

In Minnesota, a compulsory farm debt mediation scheme was found to have 'reduced tension, improved communications, promoted settlements and helped farmers make decisions about their future'[12].

However, some US evaluations commented that mediation did not protect the weaker party and that farmers were often inadequately prepared for mediation. Schemes that helped the farmer develop financial plans and proposals helped mitigate the power imbalance. In fact, evaluations stressed the need for farmers to be provided with emotional, financial and legal assistance alongside the mediation process to ensure the effectiveness of the programmes[13].

An evaluation of the Canadian farm debt mediation scheme was carried out in 2016 by the Office of Audit and Evaluation. This found that the scheme was 'largely achieving its intended outputs and outcomes' and 'there continues to be a need for a neutral service that offers financial mediation' for farmers in financial difficulty[14]. The mediation process in Canada includes a detailed review of the farmer's finances and the preparation of a 'recovery plan' drawn up with the help of a financial professional – this was seen as 'a crucial step' in the process. Lenders were less satisfied with the scheme than farmers and mediators and felt it had resulted in less favourable outcomes for themselves (this was also the case in some of

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[11] Bailey C A (1994) The role of Mediation in the USDA, Nebraska Law Review, Vol 73, Issue 1, pp 142-153

[12] Willardson N D (1987) Alternative Dispute Resolution in Farmer-Lender Disputes: Mandatory Mediation in Minnesota, Law & Inequality: A Journal of Theory and Practice, Vol 5, Issue 3 pp 487-511

[13] Bailey, ibid., Willardson ibid., Cooper C L (1993) The Role of Mediation in Farm Credit Disputes, Tulsa Law Review, vol 29, Issue 1, pp 159-182

[14] Office of Audit and Evaluation (2016) Evaluation of the Farm Debt Mediation Service, accessed at: http://www.agr.gc.ca/eng/about-us/offices-and-locations/office-of-audit-and-evaluation/evaluation-reports/evaluation-of-the-farm-debt-mediation-service/?id=1464291484565

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the evaluations of US schemes). The evaluation also found that there was limited awareness of the programme which meant that farmers were not applying early enough to explore all the options for business turnaround.

Data from Canada on the outcomes of mediation showed that from 2008 – 2014:

- 46 percent of cases involved debt restructuring
- 21 percent of cases involved a satisfactory exit arrangement
- 15 percent involved the disposal of some assets.

A detailed evaluation of the NSW farm debt mediation scheme was carried out around 2000, which concluded that farm debt mediation was 'working quite satisfactorily in NSW'[15]. Mediation was perceived as a better alternative than going to court by all parties – benefits included convenience, cost-effectiveness, speed, allowing parties to create tailor made settlements and engage meaningfully, encouraging communication and information sharing.

Benefits for farmers were that farm debt mediation often resulted in lenders writing off part of the debt, that it helped address emotional issues for farmers, and helped farmers understand the realities of their situation and the possibilities open to them.

In contrast with the US and Canada, lenders were very positive about the NSW farm debt mediation scheme and there was no evidence that suggested that rural lending had been affected in any way as a result of farm debt mediation

However the evaluation also found that farmers had a high level of dissatisfaction as to the outcomes of farm debt mediation, which may have been due to unrealistic expectations about lenders writing off part of the debt. Farmers also felt there was a power imbalance in favour of the lender as lenders were more experienced in mediation. The Act has been amended in response to the evaluation findings – there is now provision for farmers to initiate mediation to help address the power imbalance; and other mechanisms have also been introduced including more education about the process to ensure farmers are better prepared and enter mediation with more realistic expectations.

A review of the NSW Act conducted in 2017 found broad stakeholder support for the key features of the Act including its simplicity, flexibility and structured approach to informal dispute resolution and its procedural fairness and equitable cost sharing.

Of the 1659 'satisfactory mediations' that have taken place under the NSW scheme between 1995 and 2016, parties reached agreement in 90 percent of cases[16].

There have been good success rates for other Australian state-run compulsory farm debt mediation schemes:

- In Victoria, 96.4 percent of farm debt mediations reached settlement in the 2015-16 financial year[17]

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[15] Altobelli T (2000) Research into Farm Debt Mediation Act 1994, University of Western Sydney Macarthur report, accessed at: https://www.raa.nsw.gov.au/__data/assets/pdf_file/0004/275953/uws-macarthur-report-research-farm-debt-mediation-act.pdf

[16] Rural Assistance Authority, *Farm Debt Mediation Act 1994 (NSW) Revies: Consultation Paper*, 23 March 2017, accessed at: https://www.raa.nsw.gov.au/fdm/2018-amendments

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- In Queensland, where the scheme has only been running since 1 July 2017, 85 percent of mediation cases have reached agreement[18].

The interim report from the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, published in September 2018, was supportive of compulsory farm debt mediation and was in favour of introducing legislation for a consistent national approach[19].

Officials visited NSW and talked to a number of stakeholders there about how the NSW scheme operates and its effectiveness. This included officials from the Rural Assistance Authority which administers the scheme, the NSW Farmers' Association, mediators, the Resolution Institute and the Australian Bankers' Association. Officials also talked to representatives from ANZ bank with experience of dealing with schemes in NSW and Queensland. Australian stakeholders provided valuable insights that could help inform the design and implementation phase of the proposed scheme. Stakeholders were positive about the benefits of the scheme. An important component of the NSW system that supports the farm debt mediation scheme is a financial counselling service. All relevant stakeholders considered this to be critical to ensure farmers are adequately prepared for mediation and to address the power imbalance.

A number of stakeholders in NSW commented that the farm debt mediation scheme had resulted in lenders changing their culture, and being prepared to enter discussions earlier. In fact, the number of mediations carried out under the NSW scheme has fallen in recent years. It appears that banks are now more proactive in working with farmers at an earlier stage, including conducting mediations on a voluntary basis, rather than using the compulsory farm debt mediation scheme. ANZ bank representatives commented that while mediation involves upfront costs, it mitigates their losses.

Option 4: A requirement applying only to banks (and not to non-bank secured lenders) to offer farm debt mediation

Key features

This option is similar to the option described above but would apply only to banks, and not to non-bank lenders.

Analysis

This scheme would also need to be implemented and administered directly by government, or contracted by government to another body. Costs of administering the scheme are estimated to be similar to a scheme that encompasses all lenders.

This scheme would partly meet the criteria in that it would provide a consistent, timely and structured approach but only in relation to banks. Although non-bank lending is a small proportion of overall farm sector lending, we were told that non-bank lenders often act more quickly to enforce, and that their actions can affect the viability of farm businesses. A bank-

[17] Victoria Small Business Commissioner, Annual Report 2015-16, accessed at https://www.vsbc.vic.gov.au/wp-content/uploads/2016/10/vsbc-Annual-Report-2015-16.pdf

[18] Queensland Rural and Industry Development Authority, Annual Report 2017-18, accessed at: http://www.qrida.qld.gov.au/annual-report

[19] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, accessed at: https://financialservices.royalcommission.gov.au/Pages/interim-report.aspx

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only scheme would not therefore provide a consistent approach across the lending sector.

Stakeholder views

A Farm Debt Mediation Bill was introduced as a Member's Bill on 15 May 2018. The Member's Bill proposed a statutory scheme that would apply to banks only and only when the bank intended to appoint a receiver. A number of regulatory and legislative quality issues were identified with the Member's Bill and it has since been withdrawn. Several submitters to the Member's Bill were of the view that a farm debt mediation scheme would also need to apply to non-bank lenders.

Our conversations with stakeholders supported this view with a number commenting on the value of getting all lenders and farming interests 'around the table', while others including accountants and AMINZ felt that non-bank lenders took enforcement action more quickly than bank lenders. A farmer support group commented that as farmers get desperate, they borrow from more and more lenders. Banks were of the view that non-bank lenders should be included to 'level the playing field'.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The criteria for analysing the options were:

- cost effectiveness
- whether it would provide a consistent and equitable process that addresses the power imbalance between lenders and farmers
- whether it would provide a timely means of resolving debt issues that allows options to be explored
- whether it would provide certainty for all parties.

3.3 What other options have been ruled out of scope, or not considered, and why?

Ministers determined that the scope of the work would be limited to the farming sector. For example, we have not considered the introduction of compulsory mediation before lenders can take enforcement action on any business.

The scope was limited to farm debt because the problems (as discussed above) only relate to the farming sector (for example weather events and pest and disease incursions) or the problems are accentuated in the farming sector (for example price volatility).

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Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

	Option 1: Status quo	Option 2: Formalised voluntary mediation	Option 3: Requirement for all secured lenders to offer farm debt mediation	Option 4: Requirement for banks only (and not other secured lenders) to offer farm debt mediation
Costs	**0** This would involve no direct additional costs to government.	**-** This would be developed and administered by industry bodies and therefore would be a low cost option compared with the status quo. **Lenders who sign up to scheme:** costs of their share of mediation (estimated at $3000 on average) and of delaying enforcement. For some lenders this may be a substitute cost as they already invest significant time and effort in debt resolution. Costs to industry bodies of developing and administering the scheme would depend on the detail of the scheme but likely to be less than a compulsory scheme. **Farmers**: costs of their share of mediation (estimated at $3000 on average). Costs to industry bodies of developing and administering the scheme would depend on the detail of the	**--** This option will need to be implemented and administered by government. **Lenders**: costs of their share of mediation (estimated at $3000 on average) and of delaying enforcement. For some lenders this may be a substitute cost as they already invest significant time and effort in debt resolution. **Farmers**: costs of their share of mediation (estimated at $3000 on average). **Government**: Implementation costs are estimated to be $350,000 and administration costs are estimated to be around $250,000-$300,000 per annum. It is envisaged that there would be an adequate supply of qualified mediators.	**--** This option will need to be implemented and administered by government. **Banks**: costs of their share of mediation (estimated at $3000 on average) and of delaying enforcement. For some lenders this may be a substitute cost as they already invest significant time and effort in debt resolution. **Farmers**: costs of their share of mediation (estimated at $3000 on average). **Government**: Implementation costs are estimated to be $350,000 and administration costs are estimated to be around $250,000-$300,000 per annum. It is envisaged that there would be an adequate supply of qualified mediators.

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		scheme but likely to be less than a compulsory scheme. **Government**: minimal cost		
Consistent and equitable process	0 Lenders have different approaches to resolving debt issues which means there is not a consistent and equitable process. Farmers are disadvantaged by a power imbalance when dealing with lenders, particularly banks.	+ Could encourage more use of mediation but would not be consistent across all lenders. Would have limitations in addressing power imbalance.	++ Would provide consistent and equitable process for all secured lenders. Can help address power imbalance if scheme is carefully designed.	+ Would improve consistency in relation to banks but would not be consistent or equitable across all lenders. It would not address the power imbalance in relation to non-bank lenders.
Timely means of resolving debt issues	0 Some lenders offer mediation but there is no incentive for farmers to participate. Some lenders may be reluctant to fully explore all options. There is no incentive to instigate action at an early stage when financial issues first arise.	+ Where mediation is used this could improve timeliness, but would not be consistent across all lenders.	++ Would meet this criterion as mediation would be time-bound, but would also allow for fully exploring options.	+ Would meet this criterion, but only for banks. Non-bank lenders could disrupt the debt resolution process by taking enforcement action.
Provides certainty for all parties	0 A lack of a structured framework for resolving debt means that all parties face uncertainties over the process.	0 This would not improve certainty because not all lenders would be signed up to a scheme or be required to comply with it.	++ Would provide certainty through a consistent structured process.	+ This would improve certainty where banks were the only lenders that a farmer was dealing with. Where non-bank lenders were involved, they could disrupt the debt resolution process by taking enforcement action.
Overall	0	+	++	+

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assessment	Does not meet the criteria. The problem is small scale but most stakeholders felt there would be benefits in addressing it. Some – particularly farming industry bodies and farmer support groups – strongly felt the status quo needed to be changed.	Would be an improvement on status quo but would have fewest benefits of all options. Most stakeholders did not support this.	Meets the criteria and is supported by most stakeholders.	Would be an improvement on the status quo, and meets the criteria in relation to banks. If non-bank lenders are not involved, there is potential for them to disrupt the debt resolution process. Most stakeholders did not support this option.

Key:

++ much better than doing nothing/the status quo

+ better than doing nothing/the status quo

0 about the same as doing nothing/the status quo

- worse than doing nothing/the status quo

- - much worse than doing nothing/the status quo

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Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

The preferred option is a statutory farm debt mediation scheme that requires all secured lenders to offer mediation to farmers before they can take enforcement action.

While the problem appears to be small-scale and there is not a pressing case for taking action, a statutory farm debt mediation scheme that applies to all lenders would provide social and economic benefits for both farmers and lenders. It would provide a consistent and structured process that would enable options for financially struggling farm businesses to be fully explored and would provide for a 'dignified exit' for farmers with unviable businesses. It could also help address the power imbalance between farmers and lenders. Risks are not significant and can be addressed through careful design of the scheme.

A statutory scheme would be expected to have the greatest benefits. This meets the assessment criteria because it would be applied across all lenders and would therefore provide a consistent and equitable process and would provide certainty for both lenders and farmers. It would also provide a timely means of resolving debt issues that allows all options to be fully explored. Because the other options do not apply to all lenders, there is the potential for the process to be disrupted by a lender that was not part of the debt resolution process taking enforcement action. While it is a more expensive option than the status quo or a formalised voluntary scheme, it would still be low cost to implement and administer.

Stakeholders from the farming and lending sectors generally support a statutory farm debt mediation scheme. Most stakeholders consider that farming businesses face some unique challenges that mean that farming should be treated differently from other businesses, such as emotional attachment to land, vulnerability to uncontrollable events and high levels of debt in the sector.

Only one stakeholder was opposed to a statutory farm debt mediation scheme, because they felt that it would not address the power imbalance between farmers and lenders. Evidence from overseas indicates that mediation schemes can address power imbalances but need to be carefully designed to do so. Providing financial advice and support to farmers so that they are adequately prepared for mediation is critical to addressing power imbalances.

Two other stakeholders considered that a farm debt mediation scheme should be applied more widely – Ministers have determined that the scope of the work would be limited to the farming sector.

Quantitative evidence on the scale and nature of the problem in New Zealand is limited but this has been supplemented by evidence from a wide range of stakeholders. There are a number of evaluations of farm debt mediation schemes overseas. These are positive about the benefits of farm debt mediation schemes. Conversations with stakeholders in NSW also provided valuable insights that supported the analysis.

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5.2 Summary table of costs and benefits of the preferred approach

Affected parties *(identify)*	**Comment**: *nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks*	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*	**Evidence certainty** *(High, medium or low)*
Additional costs of proposed approach, compared to taking no action			
Lenders and farmers	It is envisaged that the costs of mediation will be shared equally between parties. Individual mediations are estimated to cost an average of $6000 ($3000 for each party) based on 20 hours at $300 per hour[20]. This will vary depending on the complexity of the case. Individual lenders are unlikely to be involved in large numbers of mediations – we estimate there would be a maximum of 20 per annum for an individual lender. For most lenders this would be significantly less. As some lenders already provide mediation on a voluntary basis, this may be a substitute cost for some lenders. This may also be a substitute cost for farmers as a prolonged debt resolution process could lead to increased losses. There is no data available on how many mediations currently take place so it is not possible to calculate the marginal cost.	Average $3000 per mediation per party. An estimated maximum cost of $60,000 for an individual lender (20 mediations per annum). For most lenders this cost would be significantly lower.	Medium
Lenders	Lenders will be required to delay enforcement action until mediation has taken place. Whether this creates an additional cost for lenders will vary depending on circumstances. In many cases, mediation could enable a more timely resolution to debt issues.	Low	Low
Farmers	Farmers will need to prepare adequately for mediation – this might involve obtaining financial advice and drawing up farm plans. Farmers may also require wider support and	Costings to be provided as part of implementation and design	Low

[20] These costs are based on data provided by the New South Wales Farm Debt Mediation scheme

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	counselling. What support is needed for farmers at this stage and how it could be funded will be considered as part of the design and implementation of the scheme. It is possible that industry bodies could provide some support funded through industry levies.		
Regulators	The government will bear the costs of administering the regime. Detailed costings cannot be prepared until the implementation has been designed, however, based on comparable schemes elsewhere, these are estimated to be low provided the scheme is administered by an existing body – in NSW the scheme is administered by 1 FTE. There will be an implementation set up cost including publicising the scheme, IT systems – again assuming the scheme is to be administered by an existing body. Costs will depend on the final design of the scheme.	$250-300,000 per annum for administering the scheme if administered by an existing body $350,000 to set up a scheme, subject to details of final design	Medium
Regulators	Regulators may also bear some of the cost of providing additional support for farmers – for example financial and emotional counselling. What support is needed for farmers at this stage and how it could be funded will be considered as part of the design and implementation of the scheme.	Low	Low
Wider government	N/A		
Other parties	N/A		
Total Monetised Cost	Does not include costs for farmers and lenders as it is not possible to calculate the marginal costs – these will vary depending on individual circumstances.	Regulators: $250-300,000 per annum $350,000 for implementation	Medium
Non-monetised costs		Low	Medium

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Expected benefits of proposed approach, compared to taking no action			
Farmers	Farmers will be provided with a structured and timely process for exploring available options to resolve debt issues with lenders. In some cases, earlier intervention may lead to turning around a failing business, while in others it provides a means for a 'dignified exit'. It is not possible to quantify these benefits as they will vary depending on individual circumstances.	Medium	Medium
Lenders	Lenders would benefit from a structured and timely process for resolving debt issues. The benefits are likely to be greatest for bank lenders which already invest significant time and resources in debt resolution, and have the greatest concern for their reputations. The benefits are likely to be less for the non-bank sector. This sector represents a very small proportion of overall farm lending. It is not possible to quantify these benefits as they will vary between individual lenders and cases.	Low	Medium
Regulators			
Wider government			
Total Monetised Benefit	It is not possible to quantify these benefits as they will vary between individual lenders and cases.		
Non-monetised benefits	More timely debt resolution, consistent and equitable process, certainty for all parties.	Medium	Medium

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5.3 What other impacts is this approach likely to have?

International reputational risk

This proposed regulatory intervention does not appear to conflict with New Zealand's international trade obligations. Depending on how the intervention is structured it may be inconsistent with New Zealand's longstanding position in international fora that fully exposing the primary sector to market forces makes it more responsive to consumer demands, improves environmental outcomes and ensures the sector makes decisions that optimise outcomes and most appropriately manage risk.

This risk is low if a 'light touch' farm debt mediation scheme (that is, one that does not provide a subsidy that distorts markets, nor one that undermines New Zealand's advocacy of and reputation for minimal government intervention in the market) is developed. A 'light touch' regime would avoid government subsidies that distort markets and would avoid undermining New Zealand's international advocacy of and reputation for minimal intervention in the market. The Ministry of Foreign Affairs and Trade would be consulted during the design process.

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

At this stage, no significant incompatibility with the Government's 'Expectations for the design of regulatory systems' has been identified.
Further impact analysis will be carried out as the scheme is designed (see Section 1 below) – this will consider the compatibility of the design and implementation of the scheme with the Government's 'Expectations for the design of regulatory systems'.

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Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

The implementation of the scheme has yet to be designed and will be subject to further consultation and impact analysis.

Key aspects of design and implementation that are still to be worked through include:

- how farmers will access support, counselling and advice to prepare them for mediation
- ensuring the scheme is inclusive of Tikanga Māori principles
- ensuring mediators are appropriately qualified and experienced
- how the scheme will be administered and monitored.

6.2 What are the implementation risks?

The implementation of the scheme has yet to be designed and will be subject to further consultation and impact analysis.

Based on evidence from stakeholders, we estimate that the numbers of compulsory farm debt mediations in New Zealand are likely to be low even in the event of a downturn, with around 50-100 mediations per annum. Experience of compulsory farm debt mediation schemes overseas suggests that there are not likely to be any significant risks.

Implementation risks include:

- lenders may not mediate in good faith and may initiate enforcement earlier because of the requirement to mediate
- farmers may not mediate in good faith
- the power imbalance between farmers and lenders may not be adequately addressed
- Parties may have unrealistic expectations of what the scheme might achieve
- farmers may choose to opt out of mediation
- farmers may not choose to trigger mediation, thus losing the opportunity to take early action while options to save the business are still available
- the effect on New Zealand's international reputation of a scheme that provides special treatment for farmers.

We would seek to mitigate these risks through the design and implementation of the scheme – for example through ensuring the appropriate incentives are in place for lenders and farmers to mediate in good faith, putting support in place to address the power imbalance, and working with industry and support networks to raise awareness of the scheme and encourage farmers to take action early to resolve debt issues.

In addition, we have not yet engaged extensively with the secondary lending sector, and the impacts of the scheme on this sector are not yet fully understood. For example, the scheme may have an impact on credit availability from this sector. We would see to

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mitigate this by working the secondary lending sector during system design and implementation work to ensure that impacts on this sector are understood and appropriately managed.

Risks would be monitored once the scheme was implemented.

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Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
An approach to monitoring, evaluation and review has yet to be designed and will be subject to further impact analysis.

7.2 When and how will the new arrangements be reviewed?
As above.

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Criteria and rationale for farming activities to be included in options 3 and 4

Four criteria were developed for determining which farming activities should be included in a requirement for lenders to offer mediation before taking enforcement action (options 3 and 4).

- Criterion 1: The level of vulnerability to business down-turns as a result of susceptibility to conditions outside the farmer's control (e.g. adverse weather and climate fluctuations, biosecurity incursions or volatile global market conditions)
- Criterion 2: The extent to which the form of farming usually means that the farmer lives on the farm or the location of the home is integral to the business
- Criterion 3: The potential for mental wellbeing, animal welfare or environmental issues as a result of financial stress
- Criterion 4: A significant imbalance in negotiating power between the borrower and lender.

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Farming activities which should be included:

- **Agriculture (including sharemilking)**

  Criteria 1-4 are met for owner-operated agriculture businesses. Climate, weather, biosecurity and global markets can all have significant impacts on farm businesses. For sharemilking businesses, global market fluctuations can have immediate impacts on asset values thereby impacting equity. It is typical for the family home to be on the farm, and animal welfare can be of great concern when a farm business is financially distressed. An example is a drought situation where a lack of cash flow can prevent a farmer from adequately feeding and caring for the animals. In these situations it is likely that the farmer will not be able to enter into significant business negotiations with their lender on an equal footing.

- **Horticulture**

  Horticulture is particularly vulnerable to adverse weather and climate fluctuations. Hail and storm events at critical times such as bud-burst and picking can have significant impacts on both volume and quality of product. Horticulture industries are particularly vulnerable to biosecurity incursions both from a market access perspective and a productivity perspective. The spread of PSA in the kiwifruit sector is one recent example. Owner-operators would also typically reside on horticultural farms.

- **Aquaculture**

  Climate fluctuations and biosecurity incursions can be catastrophic to aquaculture businesses (criterion 1). Furthermore for owner-operated businesses, the family home is often located in remote locations that are close to boat access to designated aquaculture areas (criterion 2). Criterion 3 is also met because environmental sustainability and fish welfare can become compromised when a business is under financial stress. Criterion 4 is also likely to be met for owner-operated businesses.

Farms that carry out a range of activities:

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- Any activity involving primary production carried out in connection with any of the included activities should also be included. This will avoid the risk that a farming business is excluded because it also undertakes secondary activities, such as having a plant nursery as part of an orchard; and
- A business where two or more of the included farming activities, taken together, meet a “primarily involved” test should also be included, for example, a farm that is 40 percent dairy, 40 percent horticulture, and 20 percent plant nursery.

Farming activities that should be excluded:

- **lifestyle farms** because they are not intended to be operated as true commercial businesses that provide a primary household income
- **forestry** because criterion 2 is rarely met. There are no daily tasks associated with forestry that require an operator to live in close proximity to the land. The risks in relation to criterion 1 are not as high because forestry is a long term investment and is less vulnerable to business downturns. For example, forestry business operators have choices about when to harvest trees. Agricultural, horticultural and aquaculture businesses do not have those same options in relation to their primary production activities
- **wild harvest fishing, and the hunting or trapping of wild animals** because criteria 2 and 3 are not met and such activity is less susceptible to the risks associated with criterion 1.

In future it might be appropriate to include forestry within the FDM regime if increasing numbers of family-owned farms become more heavily engaged in forestry over coming decades, as the government introduces pro-afforestation policies to contribute to meeting New Zealand’s obligations under the Paris Agreement on Climate Change and the Climate Change Bill.

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