

MONGOLIA ADOPTS INVESTMENT (SPECIALIZED) BANKING LAW

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On 20 January 2023, the Parliament of Mongolia adopted the *Law of Mongolia Investment-Specialized Banking Law* (the “**Investment Banking Law**”) after six years of pending approval since the draft law has been prepared and submitted to the Parliament of Mongolia (the “**Parliament**”) in 2016 for parliamentary discussions and enactment.

The Investment Banking Law entered into force on 1 March 2023.

1. INTRODUCTION

The main purpose of the Investment Banking Law is to establish the legal basis to allow foreign banks to enter the domestic market by way of engaging in banking activities with a limited scope. These activities include funding major projects by credit, issuing bank guarantees for major projects, selling and buying securities and financial instruments for financing projects, issuing securities in the international and domestic securities markets, and engaging in the activities of underwriting, custodial services and professional investment advice. To some degree, the name of the law is somewhat misleading, as the Investment Banking Law does not correspond precisely to traditional investment banking services.

Lawmakers expect that the Investment Banking Law will have a positive impact on the banking and finance sector, with the hope that it will introduce new technology and know-how to the sector, promote the efficiency of credit allocation, improve the financial system infrastructure and increase access to different financial services and products.

The Investment Banking Law regulates only certain matters such as establishment, authorization and licensing, scope of activities and management requirements for investment-specialized banks. The law leaves many other issues subject to further detailed regulations and procedures to be approved by the Bank of

Mongolia (the “**BoM**”) and the Financial Regulatory Commission (the “**FRC**”).

Below we provide general information on certain regulatory matters that may be of interest to those involved in or considering participation in this investment-specialized banking sector.

2. REGULATORY BODIES

The BoM, FRC, and the Ministry of Economy and Development (the “**MED**”) are the three primary regulators involved in the supervision of investment-specialized banking activities. The BoM jointly with FRC oversees policy-related matters and independently issues licenses to set up investment-specialized banks.

The BoM and FRC are now in the process of drafting and finalizing various supplementary regulations and procedures referred to in the Investment Banking Law.

The MED is responsible for monitoring and issuing relevant prior approvals for the equity investment by foreign state-owned legal entities to the investment-specialized banks under the Law of Mongolia on Investment, enacted on 3 October 2013 (the “**Investment Law**”).

3. ESTABLISHMENT AND SHARE CAPITAL OF INVESTMENTS-SPECIALIZED BANKS

Investment-specialized banks may be incorporated either in the form of a limited liability company or a closed joint stock company and must always use “investment-specialized bank”

in the name, or their foreign parent entity's name, as the case may be.

The BoM, jointly with FRC, will adopt relevant procedures concerning the establishment, reorganization, and liquidation of investment-specialized banks and any conditions and requirements in relation to the issuance and acquisition of shares of investment-specialized banks.

The BoM will independently and on a case-by-case basis determine the amount of the minimum share capital taking into consideration various factors such as national economic security, foreign investment status, national currency rate changes, the financial capacity of the bank and funds required for project financing.

Since the banking sector is a strategic sector in Mongolia, should a founder of an investment-specialized bank be a foreign state-owned legal entity, or should a state-owned entity hold 33 percent or more of the shares or credit sources of the investment-specialized banks, such founder or shareholder must obtain prior approval from the MED as required under the Investment Law.

It is another statutory requirement that a foreign founder of an investment-specialized banks must be a licensed bank and financial institution in their jurisdictions of incorporation in addition to satisfying requirements imposed on the founders of other commercial banks of Mongolia. This effectively means that the investment-specialized banks must be subsidiaries of foreign banks or financial institutions.

The share capital of an investment-specialized bank founded by a foreign bank or financial institution, and their funding capital for projects, must only be sourced from foreign countries and in foreign currencies.

Any shareholder of an investment-specialized bank may not transfer or dispose of its shares (or any securities related to shares) without obtaining the BoM's approval.

4. **SCOPE OF ACTIVITIES OF INVESTMENT SPECIALIZED BANKS**

As set out in the Investment Banking Law, investment-specialized banks are for-profit legal entities engaging in the activities specified in Article 6.1 of the Investment Banking Law only to

provide financing for projects using medium and long-term stable capital resources. From this very definition, it is understood that investment-specialized banks are specialized banks to fund projects to be implemented by local legal entities, who are defined as customers thereunder.

Investment-specialized banks are not permitted to engage in any other banking activities, other than those set out below, for the purpose of financing projects to be implemented in Mongolia. In particular, it is prohibited for investment-specialized banks to purchase shares in Mongolian commercial banks or to hold more than 20 percent of the shares of any other Mongolian legal entity.

(a) **Lending**

The BoM and the FRC will jointly determine the loan amount for projects, and requirements for investment-specialized banks for their loan disbursement based on various factors, including the amount and terms of loans provided to legal entities by Mongolian commercial systemic banks.

Subject to that, the law provides that the loan term must not be less than two years. In the event investment-specialized banks use mineral licenses as collateral for a loan, licenses may only be transferred through an auction to an eligible person who is duly incorporated under the laws of Mongolia and registered as a taxpayer in Mongolia.

The aggregate amount of a loan to any one legal entity and their related persons must not exceed three times the amount of the equity of the investment-specialized bank.

The total aggregate amount of its loans or credit equivalents must not exceed the amount of ten times its equity.

(b) **Issuing bank guarantees**

The investment-specialized bank may issue bank guarantees of customers' obligations in relation to the project financing for the benefit of third parties.

The general requirement is that the total aggregate liability and investment amount under bank guarantees, warrants issued by, and securities held by an investment-

specialized bank must not exceed the amount of five times its equity.

(c) Conducting payment settlements

The Investment Banking Law also stipulates that investment-specialized banks may conduct payment settlements for customers who directly participate or involve in their activities regarding loans, guarantees, securities, and underwriting, banks and the BoM.

(d) Buying and selling securities and other financial instruments from both domestic and international capital and money markets

A separate procedure in relation to this type of activity is expected to be adopted jointly by the BoM and FRC, including procedures on the type of securities and other financial instruments to be sold and purchased by investment-specialized banks, their registration, amounts, and transactional procedures.

Investment-specialized banks are generally allowed to participate in securities and money market activities by issuing securities both on domestic and international securities market and by purchasing and selling securities and other financial instruments of their customer, for the purpose of financing

projects, subject to the following general requirement.

Investment-specialized banks are allowed to hold shares of any company for up to 5 years and the number of shares to be held is limited to 20 per cent of the total issued and outstanding shares of a customer and its related persons, without having voting rights.

(e) Foreign exchange

An investment-specialized bank is authorized to conduct foreign currency trading and related currency transactions in order to manage foreign currency exchange rate risks that may occur during customer payments and operations within the activities of providing loans and operations.

(f) Underwriting and custody services; financial and investment advice

In connection with other services, an investment-specialized bank will be permitted to provide underwriting and custodial services.

The BoM shall authorize, and issue permits for the activities specified in item (a) through (e). The FRC shall authorize, and issue permits for the activities specified in item (f) based on the prior opinion and approval from the BoM.

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