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On 29 January 2021, the Parliament of Mongolia adopted the *Law of Mongolia on Amendments to the Banking Law* (“**Amendments**”).

Together with the Amendments, the Parliament of Mongolia adopted the *Law of Mongolia on Procedures for Implementing the Law on Amendments to the Banking Law* (“**Implementation Law**”). The Amendments and the Implementation Law entered into force on 25 February 2021.

Below we highlight some of the key changes introduced in the Amendments and the Implementation Law.

1. INTRODUCTION

The *Banking Law of Mongolia* was adopted by the Parliament of Mongolia on 28 January 2010 (“**Banking Law**”). There have been 22 amendments to the Banking Law since its enactment in 2010.

On 18 January 2018, the Parliament of Mongolia approved comprehensive amendments which took effect from 1 April 2018 (“**2018 Amendments**”). The 2018 Amendments revised the definition of related parties, tightened requirements applicable to bank management, restricted banks risk-taking activities and established the legal framework for enforcing risk-based supervision.

The recent Amendments aim to reduce the concentration of banks' shareholders, improve the structure and quality of banks' capital through encouraging new investment, increase risk tolerance, further introduce international banking standards, and strengthen banking supervision and restructuring measures. They are also designed to improve the legal environment for the development of the capital market, public participation in banking, and the overall stability of the banking and financial sector. The Amendments also expand compliance requirements and impose additional prohibitions on banking activities.

The Amendments contain several key measures, including:

(a) Requiring banks to become public companies;

- (b) revising requirements applicable to influential shareholders;
- (c) introducing the definition of “systemically important banks”;
- (d) imposing limits on share ownership; and
- (e) revising the sequence and priority in payment of claims.

Below we address these important changes in more detail.

2. REORGANIZATION OF BANKS INTO PUBLIC COMPANIES

The Amendments provide that systemically important banks shall be open joint stock company (i.e. a publicly listed company) and other banks shall be joint stock companies in terms of organizational form. This effectively prohibits the incorporation of a bank in the form of a limited liability company.

The *Company Law of Mongolia*, enacted on 6 October 2011, defines an “open joint stock company” as a “company whose capital invested by shareholders is divided into shares, which are registered with a securities trading organization and which may be freely traded by the public”.

Currently, there are 12 banks operating in the Mongolian banking system, and five banks that are considered to be “systemically important banks”. As per the Implementation Law, the change of form must take place before 30 June 2022. Banks are required to

submit their plan for implementing the above requirements to the Bank of Mongolia (“**BoM**”) and the Financial Regulatory Commission of Mongolia (“**FRC**”) by 1 July 2021 in accordance with a temporary regulation to be adopted by the BoM and the FRC. The BoM is authorized to undertake a number of measures in respect of banks that fail to comply with the obligations and timeframe specified in the Implementation Law.

Further, the BoM and the FRC are to approve regulations on obtaining authorization for making any changes in the amount and structure of a bank’s share capital, issuing new shares and securities classified as shares, offering shares to the public, selling or transferring a bank’s shares and entering into similar transactions, as well as notifying and obtaining authorization from the BoM in respect of becoming an influential shareholder, and making changes in the amount and structure of shares owned by an influential shareholder. Prior to the Amendments, the procedures were solely approved by the BoM.

The Amendments do not change the current prohibition on sale of shares of a bank established in accordance with the requirements for the establishment of a foreign-invested bank, bank branch, or representative office without the permission of the BoM.

The Amendments require the board of directors of a bank to have nine or more members, and no less than one-third to be independent members. The Implementation Law provides that this requirement shall become effective from 30 June 2022.

3. REQUIREMENTS APPLICABLE TO INFLUENTIAL SHAREHOLDERS

Previous amendments to the Banking Law extended the concept of “influential shareholder” which is defined as a *person holding five or more percent of the bank shares solely or together with a related person, or a shareholder that can influence the policy, decisions and management of the bank*. The Amendments extend the definition

to include the ultimate beneficial holders of such persons or shareholders. Further, the Amendments changed requirements applicable to an influential shareholder. As a result, an influential shareholder must meet the following criteria:

- (a) must not be a respondent, or a governing person of a legal entity, in bankruptcy proceedings;
- (b) has not committed economic crimes, crimes against property rights, engaged in corruption, bribery or conflict of interest, or crimes against national or international security or public safety;
- (c) has financial capacity;
- (d) if the influential shareholder is a legal entity, the consortium of the bank shall have a structure which enables inspection by the BoM;
- (e) has sufficiently evidenced the ultimate beneficial owner of its shares;
- (f) the influential shareholder and its ultimate beneficial owner must not be a high-ranking government official.

The Amendments slightly amended criteria (c) and added criteria (f). The term “high ranking government official” is not defined in the Banking Law, but the term is thought to include the President of Mongolia, the Speaker and members of the Parliament, the Prime Minister and the members of the Cabinet and other high-ranking officials within the government.

The Amendments provide that a bank must obtain authorization from the BoM when issuing new shares and securities classified as shares and changing its share capital amount and structure, and for any person becoming an influential shareholder.

In order to obtain such permission, the bank must prove with evidence the source of the funds for share capital and that the relevant shareholder meets the requirements specified in laws and regulations. This requirement must be satisfied throughout the period of holding shares.

The BoM is to decide whether to provide authorization within 60 days of receiving an application requesting authorization in respect of changes in the amount and structure of shares owned by an influential shareholder and issuance of shares and other securities classified as shares.

If the BoM has not provided an authorization or the requirements specified in the law have not been satisfied, the relevant shares will have no voting rights or dividend rights, and the BoM shall deduct the amount of unauthorized shares and securities classified as shares from the bank's equity. The shareholder shall further be obliged to sell or transfer such shares within 30 days.

Also, a shareholder is prohibited from pledging and reselling shares and securities classified as shares to the bank (i.e. redemption) without the permission of the BoM.

4. MAXIMUM SHARE OWNERSHIP

The Amendments set a maximum percentage of shares to be owned solely by a shareholder, together with its related persons. This requirement is likely to revolutionize the banking system in Mongolia. Previously, banks did not have any limitations with respect to shareholding percentage.

As per the Amendments, no individual solely or together with its related persons may own more than 20 percent of the total issued shares and securities considered to be shares of a bank. Banks are required to comply with this mandatory provision by 31 December 2023. Banks are to submit a plan to the BoM and the FRC on the implementation of this requirement by 1 July 2021. The Implementation Law provides for a number of measures the BoM may undertake in respect of a shareholder which fails to comply with the above requirement such as suspension of voting rights and not distributing dividends.

This restriction does not apply to state-owned banks established by the Government, special purpose banks or in respect of state ownership of banks recapitalized by the state.

Through this change, the Amendments aim to improve banking governance, encourage unbiased decision-making, reduce risks such as conflicts of interest, and ensure stable operations. This would mean that each bank operating in Mongolia will be required to have at least five shareholders, and no shareholder would be able to make arbitrary decisions on behalf of the bank.

In this regard, we note that the Banking Law prohibits individuals and legal entities from indirectly owning shares of a bank in another's name. It is not exactly clear if this prohibition applies to trust arrangements for foreign shareholders. However, as the wording is drafted in a generic and broad manner, we understand that this provision could apply to trust, custodian or depository arrangements.

5. INTRODUCTION OF THE DEFINITION OF "SYSTEMICALLY IMPORTANT BANK" AND OTHER AMENDMENTS

The Amendments introduced the term "systemically Important bank" which is defined as a "*bank determined by the Bank of Mongolia to be systemically important taking into account of criteria such as the bank's assets and liabilities, its share in the total transaction in the payment system, the bank's core activities, and its relation in respect of the financial system concurrently*". Internationally, this depends on the scale and the degree of influence they hold in global and domestic financial markets.

Previously, the definition of a systemically important bank was contained in the *Law of Mongolia on Ensuring the Banking Sector Stability*, enacted on 22 June 2018, as a "*bank possessing more than 5 per cent of the total banking system [turnover] throughout the last six months*", and now the term in the law is aligned with that of the Amendments.

The Amendments introduced new provisions in respect of circumstances in which the BoM may consider a bank to be insolvent or likely to become insolvent and also added an additional ground for revoking the banking license of a bank.

The Amendments provide that executive management of the bank must be appointed with the approval of the BoM, and also clarified the liabilities of governing persons of a bank.

The Amendments also clarified certain powers of the BoM in respect of bank supervision, early intervention and provisional administration. For example, the BoM may undertake provisional administration of a bank in the event of a loss of proper banking governance, the bank temporarily becoming unable to operate normally, or if a serious breach of the law by a person or an official in charge of the bank's management has led to a loss of banking operations or increased risk of the bank incurring significant losses.

6. PRIORITIES IN PAYMENT OF CLAIMS

Priorities in payments of claims upon an insolvency event were changed in an effort to protect consumers' right and interests ahead of the shareholders of the bank. The sequence of the priorities in payment of claims is now as below:

- (a) Court ordered payments made by the bank to others for damage caused to life or health of others;
- (b) Wages and salaries of employees, other than banks governing persons, the amount which does not exceed five times the minimum wage;
- (c) Operational expenses incurred by the bank's receiver/liquidator;
- (d) payments of cash deposits other than insured deposits to be reimbursed in accordance with the Bank Deposit Insurance Law;
- (e) payments of current accounts other than insured deposits to be reimbursed in accordance with the Bank Deposit Insurance Law;
- (f) Payments of cash deposits of a legal entity other than insured deposits to be reimbursed in accordance with the Bank Deposit Insurance Law;
- (g) Payments of current accounts of a legal entity other than insured deposits to be reimbursed in accordance with the Bank Deposit Insurance Law;
- (h) Claims of the Deposit Insurance Corporation, which has obtained a right of claim with respect to an insured depositor in accordance with the Bank Deposit Insurance Law;
- (i) Insurance payments not covered by insurance specified in Articles 7.2.1-7.2.3 of the Bank Deposit Insurance Law;
- (j) Payments and taxes owed to the Government;
- (k) Deposit insurance fund assets;
- (l) Payment claims owed to the BoM;
- (m) Insurance payments not covered by insurance specified in Articles 7.2.4-7.2.6 of the Bank Deposit Insurance Law;
- (n) Loans and similar liabilities specified in loan and debt instrument agreements which are specified to rank higher than other bank liabilities and subordinated debt;
- (o) Other payments; and
- (p) Subordinated debt.

7. CONCLUSIONS

To summarize, these are relatively bold changes to the banking sector compared with previous amendments and reforms.

The Amendments have long-term objectives and therefore will have a significant impact on the banking sector over the next several years.

The key objective of the Amendments is to further strengthen Mongolia's banking and financial sectors. The changes relating to influential shareholders, the requirement to operate as a public company and the restrictions on share ownership are designed to bring improved transparency and

accountability. The Amendments introduced a comprehensive set of measures aimed at reducing the concentration of bank's shares and improving the legal environment for the development of the securities market.

However, there are various uncertainties in the law which could result in issues during the implementation stage. We understand that the BoM and the FRC will issue specific regulations to implement the key changes under the Amendments, and according to the principle of the 'devil is in the detail', these regulations will likely be just as important as the Amendments themselves.

Restricting a single or related party shareholding percentage at 20 per cent of a bank is a good idea in principle to strengthen corporate governance and transparency, but requiring banks to be reorganized as a listed company is another interesting but challenging requirement. This is obviously aimed to promote the securities market and increase its liquidity. However, without carefully prepared regulations on implementation, this requirement could be difficult to achieve within the required timeframe.

As regards FDI, BoM's recent regulations and requirements do not make a distinction between privately owned influential

shareholders, or listed company or investment fund shareholders. This can create unenforceable legal challenges for public companies and investment funds that are, or wish to become, an influential shareholder of a Mongolian bank, particularly given that beneficial owners are now included in the definition of an influential shareholder.

The requirement for prior BoM approval of any changes in structure with respect to such influential shareholders is in practice impossible to comply with, prevents those shareholders from trading in shares or securities in offshore jurisdictions, and results in a risk of inequitable measures being taken by BoM.

Furthermore, the Amendments retain broad prohibitions on trust arrangements, which could restrict certain professional and institutions or investment funds from investing into the banking sector. While aimed at strict AML compliance, these prohibitions do not reflect international practice. For instance, they likely discourage foreign institutional investors, which are structured as investment funds, or institutions whose shares are publicly traded and widely held through custodial or nominee arrangements from holding shares in Mongolian banks. These uncertainties and obstacles need to be clarified and addressed in due course.

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