

Mongolia

**DATA COLLECTION SURVEY
ON
BUSINESS ENVIRONMENT REFORM
IN
MONGOLIA

FINAL REPORT**

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**JAPAN INTERNATIONAL COOPERATION AGENCY
(JICA)**

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ALMEC CORPORATION
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Abbreviations

ADB	Asian Development Bank
AML	Anti Money Laundering
AQR	Asset Quality Review
ARDP	Agricultural and Rural Development Project
ASB	Advice for Small Business
BOM	Bank of Mongolia
BAS	Business Advisory Service
CG	Corporate Governance
CGDC	Corporate Governance Development Center
CGFM	Credit Guarantee Fund of Mongolia
CIB	Credit Information Bureau
CIDB	Credit Information Database
CLO	Collateralized Loan Obligation
CRD	Credit Risk Database
CSR	Corporate Social Responsibility
DBM	Development Bank of Mongolia
DICOM	Deposit Guarantee Corporation
EBRD	European Bank for Reconstruction and Development
EFF	Extended Fund Facility
ESG	Environment Society Governance
FRC	Financial Regulatory Commission of Mongolia
GAIPSR	General Agency for Intellectual Property and State Registration
GDP	Gross Domestic Product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
IFC	International Finance Corporation
IMF	International Monetary Fund
IFRS	International Financial Reporting Standards
JICA	Japan International Cooperation Agency
JST	JICA Study Team
LTV	Loan to Value
MASD	Mongolian Association of Securities Dealers
MBA	Mongolian Bankers Association
MECS	Ministry of Education, Culture and Science
MEF	Mongolian Employers' Federation
MNT	Mongolian tugrik
MNCCI	Mongolian National Chamber of Commerce and Industry
MOF	Ministry of Finance

MOFALI	Ministry of Food, Agriculture and Light Industry
MONICPA	Mongolian Institute of Certified Public Accountants
MOU	Memorandum of Understanding
MP	Master Plan
MSE	Mongolian Stock Exchange
MSME	Micro-, Small and Medium-sized Enterprises
NBFI	Nonbanking Financial Institution
NCCG	National Council on Corporate Governance
NDA	National Development Agency
OT	Oyu Tolgoi LLC
PD	Probability of Default
PPP	Public-Private Partnership
PSDC	Private Sector Development Credit
SCC	Savings and Credit Cooperative
SDR	Special Drawing Rights
SME	Small and Medium-sized Enterprises
TAM	Turnaround Management
TDB	Trade and Development Bank of Mongolia
TSL	Two Step Loan
UB	Ulaanbaatar
USAID	United States Agency for International Development
WB	World Bank

1 Project Overview

1.1 Background

Led by the development of its mining resources, the Mongolian economy achieved remarkable growth between 2006 and 2013, when per capita GDP quadrupled and real GDP growth peaked at 17.3% in 2011. However, economic growth has slowed down significantly in recent years because of political instability caused by commodity price decline and regime changes, as well as a slowdown in the Chinese economy, the destination of 80% of Mongolian exports. In May 2017, the International Monetary Fund (IMF) decided to provide a USD 4.3 billion package for a three-year period under its Extended Fund Facility (EFF) program to support Mongolia fight its fiscal and economic crisis. With this kind of support from the IMF and other international counterparts, the Mongolian government is carrying out efforts to stabilize its macroeconomy.

In addition to the short-term efforts to revitalize the economy, it is necessary to promote economic diversification towards the realization of sustainable and stable economic growth. To this end, the main challenge is to improve the business environment in Mongolia. In particular, given the fact that approximately 97% (61,909) of the 64,301 private businesses in Mongolia are in the category of micro-, small and medium-sized enterprises (MSMEs), including micro-enterprises, with fewer than 50 employees, these companies play a major role in the country's effort to promote economic diversification.

The JICA conducted the "Data Collection Survey on Investment Environment and Promotion" (November 2015 to March 2017) and the following main issues were found: (1) difficulty in acquiring corporate credit information (e.g., background, management, ownership, size and financials) and its impact on SMEs' access to finance; and (2) lack of penetration of corporate governance including even the most basic components, such as disclosure, transparency and responsibilities of boards of directors. Corporate credit information and business practices were also highlighted by Japanese firms as barriers. So, in order to revitalize corporate activities and diversify the economy, as well as improve the foreign investment environment, it is necessary to improve the business environment.

As a follow-up to the above issues, a data collection survey will be conducted with a focus on SMEs, and especially the current status of their "credit information management" and "corporate governance" practices, with a view to proposing effective measures for improving

the business environment and economic diversification.

1.2 Objectives and Scope of Project

(1) Project Objectives

Objectives: This study aims to identify the current situations and issues to be addressed in the area of credit information management and corporate governance among SMEs (including self-employment), and make recommendations for improving the business environment in these areas in Mongolia.

(2) Coverage Area

Nationwide coverage (with a major focus on the Ulaanbaatar area).

(3) Relevant Ministries, Governmental Entities and Specialized Organizations

A specific counterpart entity is not set in this study; however, the JICA Study Team (JST) collected information from, and worked closely with relevant Mongolian ministries, agencies and organizations, including:

- Ministry of Finance (MOF)
- Ministry of Food, Agriculture and Light Industry (MOFALI)
- National Development Agency (NDA)
- Bank of Mongolia (BOM)
- Financial Regulatory Commission (FRC)
- Credit Guarantee Fund of Mongolia (CGFM)
- Mongolian Bankers Association (MBA)
- Corporate Governance Development Center (CGDC)
- National Council on Corporate Governance (NCCG)
- Mongolian National Chamber of Commerce and Industry (MNCCI)

In addition to the above, the JST conducted interviews with local commercial banks, financial institutions, such as nonbanks, and Japanese companies based in and outside of Mongolia. Local

SMEs also participated in the corporate governance seminar.

1.3 Survey Period and Terms of Reference

(1) Survey Period

From February 2018 to August 2018 (field study period: February to June).

(2) Terms of Reference

In this study, the terms of reference (TOR) covered 1) to conduct the survey on the actual conditions of the business environment, 2) to scrutinize credit information management, and 3) to study corporate governance.

1) Business Environment

Update and organize the information mainly in relation to the following points in order to grasp the actual situation in the Mongolian business environment.

- Business-related laws and regulations
- Main policies, systems and plans
- Structure of relevant organizations
- Company overview

From the following points of view, the JST also collected information to review the current business environment.

- Business development of Japanese companies and problems faced in Mongolia
- Other Japanese aid
- Aid from other donors including the Asian Development Bank (ADB), the International Finance Corporation and the European Bank for Reconstruction and Development (EBRD)

2) Credit Information Management

In order to improve financial access for SMEs including micro-enterprises and individual enterprises through resolving the negligible and excessive loan conditions, this study carried out an environmental analysis by focusing on the following two aspects of credit information management. The JST collected and analyzed information to contribute to the introduction of

future credit risk-based loans, which are loans without collaterals and guarantees, in Mongolia.

i) Establishment of the “Credit Risk Database” (CRD)

ii) Development of “Scoring Model”

In this survey and analysis, the JST paid particular attention to the trend of banking estimate assessments by the BOM (AQR) and other considerations as below:

- Clarification of merits and demerits for the introduction of the CRD in Mongolia
- Comparison with other loan examination instruments
- Effects on the promotion of foreign investment including the possibility of expanding future credit inquiry functions and impact analysis

【Implementation of Seminar】

The JST held two seminars aimed at explaining the concept of the CRD and exchanging opinions focused on the outline and significance of the CRD. Representatives from a CRD association, which had worked on a scoring model for financial institutions as a forerunner of the CRD in Japan, joined these seminars as lecturers. Targeted organizations for the two seminars were government-related and related private sector organizations.

3) Corporate Governance

Regarding corporate governance, there have been several assessments, with support from other donors, of listed companies. However, since there are only a few cases involving the systematic analysis of the SMEs, including micro-enterprises, the JST focused mainly on SMEs.

i) Grasp the actual situation of corporate governance in Mongolian enterprises, mainly SMEs, including micro-enterprises and individual business owners,

ii) Development of a practical self-assessment tool (“Self-assessment Sheet”), which companies can use for self-assessment of their companies’ corporate governance status,

iii) Identify effective measures that contribute to improving the business environment, especially corporate governance, through exercises undertaken by companies.

【Actual Condition Survey and Workshop Implementation】

As fieldwork for corporate governance, the JST conducted a survey on the actual corporate governance situation (re-entrusted) and held a workshop to report on the actual situation faced by SMEs and verify the utilization of the Self-assessment Sheet.

The subjects of the survey were the following SMEs including individual business owners in Mongolia, especially companies based in Ulaanbaatar. For the selection of targeted companies, the JST selected 500 companies from four categories as follows, although many of the companies were from the category “a”. The JST also considered industries/sectors that are expected to contribute mainly to industrial diversification, excluding the mining, real estate and finance industries.

- a) Business course participants in Mongolia – Japan Center for Human Resources Development (approximately 500 companies)
- b) Listed companies in both the first and second sections of the Mongolian Stock Exchange (MSE) (approximately 300 companies)
- c) ODA loan: borrowing companies using Small Business Development and Environmental Protection two-step loan (TSLs) (approximately 780 projects)
- d) MNCCI member companies (approximately 3,400 companies)

(3) Study Team Members

The JST members and respective research areas are show in the below table.

Table 1.1 Study Team Members

Name	Affiliation	Research area
Masayuki Ishida	Exeidea Ltd.	Team leader / business environment reform ①
Natsuki Shimegi	Exeidea Ltd.	Deputy team leader / business environment reform ②
Keita Inoue	A.I. Network, INC.	Business legal affairs/business administration
Hiroshi Matsuo	ALMEC Corporation	Corporate finance/credit risk management
Enkhjargal Gombo	ALMEC Corporation	SME development

2 Current Condition of the Mongolian Business Environment

2.1 Legislative Framework for the Business Environment

(1) Related Laws for the Business Environment in Mongolia

The primary sources of business environment legislation in Mongolia are the Company Law, the Investment Law (formerly the Foreign Investment Law), the Economic Entity Registration Law, the General Taxation Law, the Credit Information Law, the Credit Guarantee Fund Law, the Intellectual Property Law (copyright and intellectual property), the Bankruptcy Law and the SME Law.

The following table summarizes laws related to the business environment in Mongolia and their amendments.

Table 2.1 Related Laws for the Business Environment

Law	Approval date	Amendments	Contents	Line Ministries
Bankruptcy Law	11/20/1997	12/4/2015	Provisions for bankruptcy filing, review, decision, corporate capital restructuring, liquidation etc.	Ministry of Justice and Internal Affairs (MOJIA)
Technology Transfer Law	5/7/1998	12/4/2015	Principles of technology transfer, evaluation of technology, conditions of technology transfer etc.	Ministry of Education, Culture and Science (MECS)
Labor Law	5/14/1999	4/21/2017	Regulations on common rights and obligations of employers and employees, labor contracts, labor disputes, labor conditions, management and monitoring, and liabilities for violators of the law etc.	Ministry of Labor and Social Protection (MLSP)
Law on Licensing	2/1/2001	5/11/2017	Provisions to grant, delay or invalidate licenses for activities that may have negative impacts on the public interest, people's health, environment and national security, which may require specific terms and expertise.	MOJIA, General Agency for State Registration and Intellectual Property (GAIPSR)
Civil Law	1/10/2002	5/18/2017	Regulations on relations with respect to material and non-material wealth arising between legal persons.	MOJIA
Investment Law	10/3/2013	11/10/2016	Protection of investors' legal rights and interests in Mongolia, establishment of a common legal guarantee for investment, promotion of investment, stabilization of the tax environment, establishment of investors' rights and obligations, and the government agency's authority on investment, and other investment matters.	Ministry of Foreign Affairs (MOFA), NDA

Company Law	10/6/2011	12/4/2015	Regulation of the establishment, registration and reorganization of companies, their management, boards of directors, organizational structure, monitoring system, establishment of rights and obligations of shareholders, and liquidation etc.	MOJIA
Law on Registration of Legal Entities	1/29/2015	11/9/2017	Regulation of the state registration of the establishment, reorganization and liquidation of legal entities, and updates made for the registration, issuance of information to citizens, legal entities, authorized organizations and people, and keeping records of the state registration of legal entities.	MOJIA
SME Law	7/27/2007	2/4/2016	Definition of SME, SME promotion policy, policy direction, implementation, SME registration, provisions on issuing certificate	MOFALI
Banking Law	1/28/2010	6/22/2018	Regulation of the relations concerning licensing of banks, the revocation of licenses, the establishment of general principles of a bank's management, organization and activities, supervision of banks and financial conglomerates, and taking enforcement measures against them.	MOF, BOM
Nonbank Financial Institution Law	12/12/2002	5/18/2017	Regulation of the establishment of a legal environment for nonbank financial institutions, management, establishment of a monitoring system, licensing and suspension or revocation of licenses etc.	FRC
Customs Law	5/20/2008	5/18/2017	Regulations on customs clearance and control over goods and means of transport crossing the national customs frontier of Mongolia, as well as defining customs procedures and their requirements, regulations on settlement of complaints and appeal of the customs decisions, customs organizational structure, rights and obligations of customs officers and liabilities against customs offences.	MOF, Customs Agency
Customs Tariff and Tax Law	5/20/2008	7/6/2017	Provisions on the determination of customs tariffs, prices, categories and origins of goods, imposition, payments and collection of customs and other taxes etc.	MOF, Customs Agency
Excise Tax Law	6/29/2006	30/11/2007	Regulations concerning the imposition of excise tax on certain domestic and imported goods, special purpose technical devices and equipment used for quizzes and gambling activities, and individuals and legal entities conducting these activities and transference thereof to the budget.	MOF, General Agency of Tax
Value Added Tax Law	6/9/2015	2/5/2016	Regulations concerning the imposition of value added tax, its payment to the state budget and its refund from the state budget.	MOF, General Agency of Tax
Corporate Income Tax	6/29/2006	11/10/2017	Regulations concerning the imposition of tax on economic entity income, transference thereof to the budget, and its reporting.	MOF, General Agency of Tax

Competition Law	6/10/2010	5/18/2017	Regulations on creating the conditions for fair competition in the market for entities conducting business activities, identification and implementation of legal and organizational basis for prohibition, restriction and prevention of any activities impeding competition.	Authority for Fair Competition and Consumer Protection
Public Procurement Law	12/10/2005	6/9/2017	Regulations concerning planning and organizing procurement of goods, works and services with state and local funds, exercising oversight of the procurement procedures, making and disposing of complaints and imposing liability for breaches of this law.	MOF, NDA
Law on Accounting	6/19/2015	2/2/2017	Regulations on determining the legal grounds for accounting principles, management and institutions, and regulating the relationship concerning accounting records and the preparation of financial statements of the business entity or organization.	MOF
Law on Securities Market	5/24/2013	5/18/2017	Regulation and monitoring of activities of participants in the securities market, and the protection of the rights and interests of investors.	FRC
Law on Pledge of Immovable Property	7/9/2009	19/1/2016	Regulations on pledging real estate and rights, establishing a pledge contract, and ensuring the performance of obligations.	MOJIA, GAIPSR
Law on Pledge of Movable and Intangible Property	6/2/2015	8/30/2016	Provisions for protecting rights and legal interests of the parties involved in transactions and thereby increasing circulation of assets and access to finance.	MOJIA, GAIPSR
Law on Mediation	22/5/2012	12/4/2015	Provisions for the establishment of a legal environment for achieving an amicable resolution of conflict with the assistance of a mediator.	MOJIA
Law on Credit Information	10/2/2011	12/4/2015	Regulations concerning the construction of a credit information database, processing, safety, protection and usage of credit information, rendering a credit information service, licensing of the legal entity that renders a credit information service, the revocation of licenses and obtaining control.	MOF, FRC, BOM
Credit Information Database Rule	2005		Regulations governing collection, processing, and preservation of information on loans, guarantees, letters of credit, credit cards, credit cards, credits, and collateral provided by banks, nonbanks, individuals and corporations.	MOF, FRC, BOM
Credit Guarantee Fund Law	2/10/2012	12/4/2015	Regulation for establishing legal grounds for a credit guarantee fund with the purpose of increasing financing possibilities for SMEs, supporting employment and ensuring income stability of citizens, and for rendering credit guarantee services for SMEs.	MOFALI, FRC
Law on Violations	5/11/2017	6/27/2018	Regulations for strengthening the justice system by imposing liabilities for violators of the law and its enactment of administrative norms	MOJIA

Source: JICA Study Team based on Mongolian laws

(2) Legal Framework for the SME Business Environment

Numerous laws, from the Law on Accounting, to the Law on Taxation, the Bankruptcy Law and the SME Law, shall apply to enterprises if they are regarded as SMEs in the business environment. The draft revision of the SME Law, which is the most relevant law for SMEs, is being developed with a view to being approved. “Developing and Approving the Draft Revision of the SME Law” is reflected in 2.48.2 of the “Action Plan of the Government 2016-2020”, while “Developing the Draft Revision of the SME Law” is reflected in 186 of the Appendix in Resolution No. 11, that is, “Approving the Main Directions for Improving Legislation”, as approved in 2017 by the Parliament of Mongolia. These have become the legal grounds for developing drafts of this law. Moreover, conclusions in the report entitled “Survey on Duplications, Omissions and Violations of the SME Law”, by the MOJIA shall be coordinated with and reflected in the draft of revision of the law.

In addition to changing the name of the law, clarification of the classification of SMEs is included in the draft revision of the law, with four categories are proposed, namely, start-up companies, micro-enterprises, and SMEs. By clarifying the classification of SMEs, it is expected that it will be possible to provide support that is compatible with the needs of the legal entities. Therefore, the competitiveness of SMEs and the number of participants in value chains should increase, industries should develop in clusters and SMEs’ operations should expand.

Regarding improvements to the SME business environment, certain actions directed at reducing tax burdens, increasing financially favorable conditions, improving accessibility to information and training coverage, establishing efficient, red tape-free public services and industrial and technological centers, and supporting SMEs to enter the market need to be taken. It has been proposed to include regulations on gradually reducing tax and other payments with the increase un employees, and to determine types of support to be provided for the four categories (start-up companies, micro-enterprises and SMEs).

SME-related laws, excluding the SME Law, are summarized in the table below.

**Table 2.2 Outline of Laws, Regulations and Material Provisions
for the Business Environment**

Provisions of the Law		Contents
Law on Registration of Legal Entities Approval date:29/1/2015 Last revised:11/9/2017	Outline	Regulations of the state registration of the establishment, reorganization and liquidation of legal entities, and updates made for the registration, issuance of information to citizens, legal entities, authorized organizations and people, and keeping records of the state registration of legal entities.
SME Law Approval date:7/27/2007 Last revised:1/28/2010	Outline	Regulations for setting up policies for SME development and general measures to promote SMEs in order to ensure economic development.
Bankruptcy Law Approval date:11/20/1997 Last revised:12/4/2015	Article 4	Insolvency shall be constituted by not fulfilling the obligations in the amount equal to no less than 10% of equity by the deadline specified by law or contract.
	Article 5	The court shall start a bankruptcy case on the following grounds:
	Article 5.1.1	A party that has the right to demand the fulfillment of obligations has submitted a claim to start a bankruptcy case;
	Article 5.1.2	The debtor has declared its inability to meet the obligations and submitted a request to start a bankruptcy case.
	Article 5.3	Within five days of the start of a bankruptcy case, the court shall give a copy of the claim to the debtor and shall determine within 30 days whether the debtor is insolvent or not.
	Article 7.7.1	The following shall be attached to the request: financial statements of the last three years.
Law on Accounting Approval date:6/19/2015 Last revised: 2/2/2017	Outline	Regulations on determining the legal grounds for accounting principles, management and institutions, and regulating the relationship concerning accounting records and the preparation of financial statements of the business entity or organization.
	Article 4.1	The financial statement of a business entity and organization shall be in conformity with the international accounting standards.
Law on Licensing	Outline	Provisions to grant, delay or invalidate licenses for activities that may have negative impacts on the public interest, people's health, environment and national security, which may require specific terms and expertise.
Corporate Income Tax Approval date:6/29/2006 Last revised: 11/10/2017	Outline	Regulations concerning the imposition of tax on economic entity income, transference thereof to the budget, and its reporting.
Value Added Tax Approval date: 6/9/2015 Last revised: 2/5/2016	Outline	Regulations concerning the imposition of value added tax, its payment to the state budget, and its refund from the state budget.
Audit Law Approval date:6/19/2015 Last revised:12/4/2015	Article 10.1-10.4	Legal entities/organizations that are required to be audited by an audit firm: a. legal entities and organizations required to report on the International Financial Reporting Standards (IFRS); b. legal entities and organizations subject to preparing consolidated financial statements; c. legal entities and organizations going through a restructure and liquidation or proposing to sell all of its assets through an auction; d. foreign-invested business entities and organizations.
Law on Violation Approval date:5/11/2017 Last revised:6/27/2018	Outline	Regulations for strengthening the justice system by imposing liabilities for violators of the law and its enactment of administrative norms.
	Article 10.11 11.18	Joint-stock companies shall inform, report on and present information, statements and data stipulated in the law to the public, authorized organizations and shareholders, when financial statement audit or review, or other confirmations/auditing are conducted for one legal entity for more than five years consecutively.

Source: JICA Study Team from Mongolian laws

(3) Legal Framework for Credit Information

The activities of banks and financial institutions, as well as the confidential handling of information, are significant parts of the legislation for the credit information management of banks and financial institutions, one of the pillars of this study. The content of this legislation is summarized in the following table.

Table 2.3 Outline of Laws Related to Credit Information and Provisions to Be Considered

Provisions of the Law		Contents
Banking Law Approved:1/18/2010 Last revised:6/22/2018	Article 1-4	Purpose of law, definitions, types of bank.
	Article 5	Unless the law specifically provides to the contrary, the BOM and/or competent public administrative body shall not interfere with the activities of a bank and illegitimately influence the bank's management and/or decisions. (*) For a list of related laws on the supervision of the BOM, see the attachment document.
	Article 6	Banking activities Banks shall carry out the following activities under license from the BOM: accepting deposits, disbursing loans, providing payments and settlements services, providing guarantees, purchasing, selling, and accepting and placing safety deposits of precious metals and stones, receiving valuables into custody, conducting foreign remittance services, issuing, buying and selling securities, dealing in financial leasing transactions, selling and buying loan portfolios and other financial instruments, and other financial transactions and services permitted by the laws and regulations and authorized by the BOM.
	Article 7.2	Shareholders, the chairman and members of the board of directors, executive directors, the supervisory council and officers of a bank shall not release nor disclose to others or use any information that is considered by the bank, its customers and/or third parties as confidential.
	Article 10.1	Loans A bank may extend loans to individuals or legal entities based on its terms and conditions. The bank shall set lending rates on its own. A bank may accept, under an agreement with the borrower and/or based on a court decision, the borrower's property, shares and their dividends for payments of an overdue loan principal and interest.
	Article 12	Issuance of warranty and guarantee A bank may issue a guarantee and warranty to third parties on a contractual basis within the restrictions set out in provision 17.1-17.3 of this law.
	Article 18-28	Incorporating and reorganizing a bank.
	Article 29-34	Bank management and organizational structure.
	Article 35-41	Bank capital and financial statements.

	Article 43-46	The BOM's power to conduct supervision 43.1 Banks, financial institutions, citizens and legal entities shall furnish their documents related to the activities, financial condition, statements and the other relevant documents to the BOM.
	Article 47-61	Bank stabilization and restructure planning.
	Article 62-67	Bank stabilization fund, fund assets/liabilities, special contributions to the fund, foreign cooperation.
	Article 68-75	Liquidation of the bank.
Law on Central Bank Approval: 9/3/1996 Last revised: 1/12/2018	Article 1	Purpose of the law The purpose of this law shall be to establish the legal grounds for the powers of the Central Bank of Mongolia, its management, organization and activities, and to regulate relations concerning the implementation of state monetary policy undertaken by the Central Bank of Mongolia ("BOM").
	Article 2-3	Legislation on the Central Bank, scope of the law, legal status of the BOM
	Article 4	Objective of the Bank of Mongolia 1. The main objective of the BOM shall be to ensure stability of the national currency – MNT. 2. Within its main objective, the BOM shall maintain the stability of the financial market and the banking system to support the balanced development of the national economy.
	Article 5	Direction of the BOM's activities.
	Article 6-9	Exclusive right to issue currency into circulation, unit and form of currency.
	Article 10-11	Formulation and implementation of monetary policy.
	Article 14	Unified interest rate policy.
	Article 19	Supervision of banking 19 ¹ . Issuing licenses for credit information activity and conducting supervision. 1. Regulations for issuance, suspension and revocation of license for activities of credit information, and conducting supervision.
	Article 25	Powers of supervisor Examine documents of bank activities of business entities, institutions and individuals.
	Article 25 ³	Supervision credit information service provider.
	Article 27 ³	Monetary Policy Committee 4.2 Determine rate of monetary instruments.
	Article 31 ¹	The BOM's coordination with the FRC.
Article 32	Relation of the BOM with banks.	
Law on the Legal Status of the FRC Approval: 17/11/2005 Last revised: 1/18/2018	Outline	The purpose of the law is to establish the legal foundations for the organization and activities of the FRC and to regulate and supervise financial services other than those of banks.

<p>Law on Nonbank Financial Institutions Approval: 12/12/2002 Last revised: 5/18/2017</p>	<p>Outline</p>	<p>Regulation of the establishment of legal foundations for nonbank financial activities concerning management, establishment of a monitoring system, licensing and suspension or revocation of licenses etc.</p>
	<p>Article 1-4</p>	<p>Purpose, scope of law, definitions.</p>
<p>Credit Information Law Approval: 10/20/2011 Last revised: 12/4/2015</p>	<p>Outline</p>	<p>Regulations concerning the creation of a credit information database, processing, safety, protection and usage of credit information, rendering a credit information service, licensing of the legal entity that renders a credit information service, the revocation of licenses and obtaining control</p>
	<p>All Articles</p>	<p>All articles are shown in the Appendix.</p>
	<p>Article 23</p>	<p>Special license to provide a credit information service 23.1 Special license for conducting a credit information service shall be granted by the BOM. 23.2 When applying for a special license, the applicant shall submit the documents listed in 11.1.1 and 11.1.2 of the “Law on License” and the following documents. 23.2.1 Name, copy of national ID, telephone number, email address of shareholder or major manager engaged in the management of the credit information service provider; 23.2.2 Information of the proportion and the amount of capital invested to each shareholder who owns 5% or more of the corporation’s shares; 23.2.3 With regard to the key personnel who is planning to work as a senior manager of the credit information service provider, the relevant information, i.e., educational background, work experience and documents showing no criminal record and overdue payments; 23.2.4 Business plan; 23.2.5 Documents that prove that the applicant owns the appropriate software and hardware equipment that meet all the requirements to protect the safety of the credit information database; 23.2.6 Regulation on information exchange by users of the credit information database, and a sample contract strictly stipulating rights and obligations; 23.2.7 Ethical rules including principles and responsibilities relating to the internal and external activities of the organization; 23.2.8 Documents proving that an entity holds the minimum requirements for capital set by the BOM. 23.3 The BOM shall receive the application stipulated in Article 23.2 of this law with the accompanying documents, decide whether or not to grant a special license and notify the applicant of the result within 30 working days in written form. 23.4 The BOM shall set pricing concerning the granting of a special license for a credit information service, the creation of credit information database, processing, using, storing, protecting and transferring credit information. 23.5 Entities that do not have a special license are prohibited to use the term “credit information database”.</p>

		(This article defines the conditions for acquiring a special license to provide a credit information service by using the CIBB ¹ of the BOM. As of the survey date, there are no applicants meeting the conditions to acquire a license. Furthermore, applicants' names are not disclosed.)
Credit Information Database Rule	Outline	Regulations concerning collecting, processing, storing and providing banks and nonbanks with information regarding loans, guarantees, letters of credit, credit cards, credits, and collateral provided by banks and nonbanks to individuals and legal entities.
	Chapter 1, 2, 4 Appendix 1	Related chapters and articles in this study are listed in the Appendix.
Credit Guarantee Fund Law Approval: 2/10/2012 Last revised: 12/4/2015	Outline	Provisions on legal matters related to credit guarantee funds and their legal status.
Company Confidentiality Law Approval: 5/16/1995 Last revised: 12/1/2016	Article 1-3	Purpose of law, related law and general provisions.
	Article 3.1	"Company confidentiality" means information, documents and tangible materials that are deemed as confidential by relevant laws in order to protect human rights, dignity, honor and the legitimate interests of the company.
	Article 3.2	Unless specified otherwise by other laws, characteristics of the business activities of the company, undisclosed information, technological solutions, projects, research and science documents and equipment that are protected by the company to ensure its advantages in the market or fair competition or that can affect the lawful interests of the company can be subject to company confidentiality.
	Article 5	1. Confidential information of the company shall be protected by the company. 2. The company shall set up its own rule to protect its confidential information in accordance with the relevant legislation. 3. The company shall protect the confidential information of an individual that was provided to the company as a result of its own activities.
	Article 6	The following information are not confidential: information that shows whether the production, services, equipment and technology used or run by the company are affecting people's health and the environment.
	Article 7.2	Confidential information acquired shall only be used in accordance with the regulations stipulated in the relevant laws and not be disclosed to a third party.
	Article 8, 9	Filing a complaint to the court, liabilities for violators of the law.
Law on Personal Information Confidentiality Approval: 4/21/1995	Article 1-3	Purpose of law, overview, related laws.
	Article 4	Types of personal information: 1. Letters and communication information 2. Healthcare records

¹ In this report, the CIB database operated by the BOM is referred to as the Credit Information Database (CIBB). This is to avoid confusion with "CIB" as a general term or private CIB company such as "CIB LLC".

Last revised:12/13/2015		<p>3. Property/asset information</p> <p>4. Family information</p> <p>5. Other information by law</p> <p>Definitions:</p> <ul style="list-style-type: none"> - Letters and communication information refer to information, documents, tangible materials such as emails, postal items and application forms to be exchanged with other individuals and organizations through the postal service. - Healthcare records refer to information on individuals' disability and diseases other than infectious diseases causing danger to the public. - Property information refers to property, intellectual property or information, documents, agreements and tangible materials found or possessed through an accredited person or as a result of being an employee of an authorized organization. - Family information refers to information that is of an interest to an individual and his/her family members, which can affect their dignity, honor and interests. <p>3. Personal archives, savings, memos, notes and related images and recordings can be confidential.</p>
	Article 5	<p>1. Personal information is protected by the individual.</p> <p>2. In accordance with relevant laws and regulations, the state or an organization can keep personal information confidential.</p> <p>3. An employee of an authorized organization with special authorizations can only be presented with personal information in accordance with relevant laws and regulations.</p> <p>4. Persons who acquire personal information through an accredited person or in accordance with relevant laws shall keep this personal information confidential.</p>
	Article 6	<p>Personal health records and other information can be disclosed in a critical situation in accordance with relevant legislation following the decision of an authorized state organization or person to prevent possible harm to national defense, security and interests, and people's health and their lawful interests.</p>
	Article 7	<p>An individual can file a complaint to the court when he/she believes that the person stipulated in Provision 4 of Article 5 of this law has disclosed his/her personal information.</p>
	Article 8	<p>8.1 If the violation of this law is not subject to a criminal case, liabilities stipulated in the Public Service Law shall be imposed on the violator.</p> <p>8.2 An individual or legal entity violating this law shall be subject to liabilities stipulated in the Criminal Law or the Law on Violations.</p>
Rule of Asset Classification and Establishment and Operation of Fund for	Outline	<p>Regulations for the BOM in determining minimum requirements for classifying savings, payment, credits and the activities of banks and authorized legal entities, and establishing and operating a fund to protect against possible loss from loans and other actives, and for regulating bank activities.</p>

Active Risk Approval: 7/1/2017	All Articles	The rule is shown in the Appendix.
Law on Pledge of Immovable Property Approval: 7/9/2009 Last revised: 1/19/2016	Outline	Regulations on pledging real estate and rights, establishing a pledge contract, and ensuring the performance of obligations.
	Article 33	Repledging immovable property 33.1 The pledgor is entitled to repledge the bailment to another party. 33.2 As stipulated in 33.1, the pledgee’s requirements shall be met in accordance with the order registered with the state. 33.3 If the provisions of the former pledge contract are included in the latter contract, these provisions shall be reflected in the latter pledge contract. 33.4 Regardless of knowledge of the latter pledgee, regarding the breach of contract stipulated in 33.3, the court shall declare the latter contract invalid on the basis of the claim of the former pledgee. 33.5 When the pledgee/pledgor of the former and latter contract are the same person, regulations stipulated in the article will not apply.

Source: Japan Study Team based on Mongolian laws

(4) Legal Framework for Corporate Governance

Corporate governance legislation generally correlates with business environment legislation, namely, Company Law, the Law on Securities, and the Corporate Governance Code from the FRC, among others.

The Company Law was revised in 2011 and its corporate governance-related provisions, 75.8 and 79.2, are shown in Table 2.4. In the event of the violation of these provisions, individuals and legal entities will be fined by MNT 500,000 and MNT 5 million, respectively, according to Provision 10.11.6 of the Law on Violations.

As shown in Table 2.4, issuers of securities are expected to observe corporate governance principles according to Provision 20.1.10 of the Law on Securities. In the event of violating this provision, legal entities will be fined MNT 20 million, according to Provision 11.10.3 of the Law on Violations.

In addition, the Corporate Governance Code was approved by Resolution No. 210 of the FRC on December 26, 2007, and revised by Resolution No. 162 of the FRC on May 7, 2014.

Moreover, securities issuers are defined in 2.3.2.6 of the “Rule for Information Transparency of Securities Issuers”, which was approved by Resolution No. 443 of the FRC on December 17, 2015.

According to FRC Regulation No. 443 of December 17, 2015, entitled “Provisions on the Transparency of Information by Securities Issuers”, in Section 2.3.2.6, the securities issuer is responsible for managing compliance with the Corporate Governance Code, as approved by the FRC. It is prescribed that the evaluation by management should be reflected in an annual report. In addition, based on FRC Regulation No. 34 of January 29, 2016, after March 1 of the same year, companies have been required to present the corporate governance evaluation conducted by the NCCG to shareholders.

According to Section 11.1.6 of the “Securities Registration Regulations”, approved as Resolution No. 14 of the MSE on December 30, 2015, the issuers of securities² listed in Part 1 have to comply with the principle of corporate governance, which is domestically and internationally accepted. On the other hand, Section 12.1.5 stipulates that securities issuers listed in Part 2 have to follow corporate governance principles, which are domestically and internationally accepted. For the implementation of these, the “comply or explain³” principle is applied. However, compliance provision does not exist for companies listed in Part 3.

In addition, items that reflect the principles of corporate governance are stipulated in the Audit Law and the Accounting Law as well. Moreover, in the Law on Violations enforced in 2017, the penalty provisions for violations of each of the above laws are clearly stipulated. As a result, compliance with laws and regulations is being strictly enforced, even in areas where execution had not been insufficient in the past, partially due to securing government revenues.

Table 2.4 Outline of Laws Concerning Corporate Governance and Provisions to Be Considered

Provisions of the Law		Contents
Company Law 10/6/2011 12/4/2015	Chapter 1 Article 3	A legal entity, whose capital invested by its shareholders is divided into numbers of shares, with its own separate property, and whose primary purpose is making profit, shall be called a company. A company shall take the form of a limited liability company or a public company. The types of public company shall be open or closed.
	Chapter 2 Article 9	Liabilities of a company and its shareholders All companies, irrespective of their form of ownership, the size of their property, the amount of their production, or their internal organization, shall be subject to this law.

² As of July 2018, there are nine companies in Part 1, 42 companies in Part 2 and 169 companies in Part 3.

³ A regulation method of implementing the principle or explaining the reason if not implementing it.

		<p>Rights of shareholders</p> <p>The rights of shareholders are defined by this law and by the company charter; and the fundamental rights of a shareholder shall be to receive dividends, to participate in shareholder meetings, to vote on issues discussed at such meetings and, following the company's liquidation, to receive their share of the proceeds from the sale of assets of the company.</p> <p>A founder who pays for expenses related to establishment of a company shall be entitled to receive reimbursement for such expenses from the other founders in proportion to the value of the shares owned or subscribed by such other founders, or to receive shares of value equal to such expenses.</p> <p>Upon the demand of shareholders holding at least 10% of a company's shares, the company must make a list of shareholders with the right to attend a shareholders meeting available to such shareholders.</p>
	Chapter 3. Article 11,12,13	Establishing a company, founder of a company.
	Chapter 4	Reorganization and liquidation of a company and debt-for-share exchanges, shareholders' rights.
	Chapter 5	Charter capital, shares and other securities of a company.
	Chapter 6	Dividends, dividend terms and transfers of a company's property.
	Chapter 7	Redemption and repurchase of a company's securities.
	Chapter 8	Acquisition of the controlling block of shares of a company.
	Chapter 9	Shareholders meetings, board of directors, meeting of the board of directors, executive management.
	Chapter 9. Article 75.8	The member and secretary of the board of directors shall have attended corporate governance training and obtained a certificate.
	Chapter 9 Article 79.2	In the case of a state-owned and state-dominated company, a person with high professional skills to lead the company may be nominated by a nongovernmental organization with the purpose of supporting good corporate governance.
	Chapter 10	Liabilities of governing persons of a company.
	Chapter 11	Major transactions.
	Chapter 12	Conflict of interest transactions.
	Chapter 13 Article 94-97	Review of financial and economic activities of company, accounting records, statements, financial statements and business operational reports, keeping of a company's documents.
	Chapter 14 Article 100	Liability for violators of legislation.
Law on Securities Market	Chapter 1	Regulation and monitoring of activities of participants in the securities market, and the protection of the rights and interests of investors.

5/24/2013 1/18/2018	Chapter 2	Issue of securities, procedures for issuing securities by way of public offer, selling securities on the primary securities market and related reporting. Article 17. Issue of securities in a foreign jurisdiction by a company listed on the stock exchange. Article 18. Issuing of securities in Mongolia by a legal entity registered in a foreign jurisdiction.
	Chapter 2 Article 20.1.10	General obligations of the issuer. To observe the corporate governance principles issued by the FRC.
	Chapter 3	Purchasing all or a controlling block of the shares of a company.
	Chapter 4	Regulated activities, granting a license.
	Chapter 5	Securities market information, information of regulated entity, information of investor, FRC information, receiving of information by the FRC.
	Chapter 6	Securities market regulation, state regulation of securities market.
	Chapter 7	Prohibited activities in the securities market.
	Chapter 9	Miscellaneous.
Corporate Governance Code (Rule of the FRC) 26/12/2007 12/5/2014	Chapter 1	Corporate Governance Code Establishment of corporate governance, legal impact on corporate governance, transparency of implementation of legal documents, allocation of responsibilities of authorized persons, supervision and coordination.
	Chapter 2 Article 2	Rights of shareholders.
	Chapter 3 Article 1	Professional investors.
	Chapter 4 Article 5	Shareholders meeting Power of shareholders meeting, preparation for shareholders meeting, conducting shareholders meeting, shareholders meeting decisions.
	Chapter 5 Article 9	Board of directors Duties of the board of directors, rights and structure of the board, election and dismissal of board members, committees of the board of directors, auditing committee, transactions with conflict of interests of the board members and parties with common interests.
	Chapter 6 Article 1	Executive management: rights of the executive management.
	Chapter 7 Article 3	Financial reporting, third-party auditing, information transparency.
	Chapter 8 Article 1	Internal control system and internal auditing functions.
Chapter 9 Article 3	Risk management The board of directors shall be in charge of general activities to provide management for all risks of external and internal operations, finances and compliance, other risks, and matters such as development, implementation and monitoring on implementation of the risk management procedures and rules.	

	Chapter 10 Article 6	<p>Stakeholders</p> <p>The company shall respect the rights of its stakeholders (employees, creditors, customers, suppliers, local citizens and the public) and shall provide an opportunity for its stakeholders to access company information such as its plans and reports. The company shall make decisions upon the consideration of the interests of employees, creditors, suppliers, purchasers, customers, and environmental and social issues, and such decisions to be issued shall be based on the considerations on whether or not they would affect the stakeholders.</p>
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Source: JICA Study Team based on Mongolian laws

2.2 Major Relevant Policy, Institutions and Planning

(1) Policy, Institutions and Planning Relevant to the Business Environment

Within the “Mongolia Sustainable Development Vision 2030”, which was approved by the Parliament of Mongolia in February, 2016, there are 10 objectives with four policy priorities. In order to achieve these goals, one of the objectives, “Sustainable Economic Development”, includes “Establishing a favorable business environment”.

As set forth in the Action Plan of the Government of Mongolia for 2016-2020, works to overcome the economic difficulties and stabilize the economy, promote foreign and domestic investments, and support domestic production through customs and taxation policies, small and medium-sized enterprises (SMEs) and small and medium-sized household production and microbusiness owners are underway. In order to ensure the implementation of the Action Plan, a total of 65 national programs such as the Industrialization 21:100⁴ National Program, the National Production Program, the Program for Supporting SMEs, the Financial Market Development Program and the Market Competition Support Program shall be developed and implemented. Furthermore, it is planned to continue the implementation of 14 national programs such as the Customer Rights Protection Program, the Tourism Development Program and the Mortgage Loan Program. One of the main programs, the Program for Supporting SMEs, to support the implementation of policy for supporting SMEs is being developed. Phase I and Phase II, specified in the “Mongolia Sustainable Development Vision 2030” and the “Action Plan of the Government of Mongolia for 2016-2020”, which will be implemented from 2018-2019 and 2020-2021, respectively, are expected to be reflected in the program and implemented. In order to increase the share of SMEs in terms of GDP, enhance their

⁴ A program to establish 100 factories in 21 prefectures in Japan. Small and medium-sized factories are also targeted.

competitiveness in domestic and international markets, and create workplaces, goals such as 1) supporting SMEs with favorable taxation and tariff policies, 2) reducing loan interest, 3) developing and supporting national consultants, 4) intensifying introduction of innovations and technologies and improving requirements set forth in the standards, 5) supporting domestic production through state policy, and 6) developing the One Soum – One Product campaign will be reflected in the program.

To achieve these goals, the program should be aligned with the relevant legislation, policies and programs. Particularly, the following should be taken into consideration.

1) Regarding supporting SMEs through taxation and tariff policies, relevant provisions should be reflected in the revision of the Law on Taxation, even though start-up businesses are to be promoted, with SMEs to be supported in phases. These provisions are yet to be reflected in the draft revision of the Law on Taxation. Discussion about the revision of the law by the organizations in charge should be intensified.

2) Regarding the creation of favorable financial conditions by reducing loan interest and extending terms, objectives such as increasing the state budget, loan and grant financing and reducing interest rates of commercial banks have been set out. To ensure the achievement of these objectives, coordination of works by the MOF and relevant organizations, as well as the legal grounds, need to be taken into consideration. A joint working group of the MOF, the BOM and the FRC was established in accordance with the main direction of activities for 2018 of the Government of Mongolia to reduce interest rates. The working group developed a strategy for reducing interest rates and conducted a number of discussions with stakeholders to improve the strategy, which was approved on June 12, 2018. Eleven objectives directed at ensuring a macroeconomic environment, where interest rates are reduced, increasing the impact of interest transfers of monetary policy, and improving the risk management, efficiency and governance of banking sectors, were set forth in the strategy. By implementing this strategy, the work coordination of the relevant organizations is to be improved and financial sources for SMEs are expected to be increased.

3) Regarding developing and supporting national consultants, consultancy in the fields of management, strategic planning, information technology, marketing, human resources, corporate governance, finance, accounting, taxation, auditing, environment, quality

management system, investment, occupational safety and engineering should be improved, while the content and implementation of training should be taken into consideration, while training itself should be conducted.

4) Regarding developing the One Sum – One Product campaign, ensuring coordination with the concerned organizations and relevant programs is a priority, even though public-private partnership (PPP) is going to be supported. For example, this goal should be coordinated with the Industrialization 21:100 National Program developed by the MOFALI and the Regional Development Policy developed by the NDA. Evaluation indicators to be reflected in the Program for Supporting SMEs were agreed as follows.

Table 2.5 Indicators for Evaluating the Implementation of the Program for Supporting Small and Medium-sized Enterprises

No	Indicators	Measuring Unit	Level as of 2017	Target level until 2021
1	Number of actively operating SMEs	Number	45,911	67,612
2	Number of employees in SMEs	Number	260,000	290,000
3	Number of legal entities involved with incubator and promotion centers	Number	180	280
4	Number of SME owners participating in training	Number	8,917	11,380
5	As a percentage of GDP	Percentage	17.8	21
6	As a percentage of exports	Percentage	2.3	5.3

Source: MOFALI, Program for Supporting SMEs (draft)

Within the framework of works to support exports, it was aimed for non-mining exports to reach 30% of total exports in the National Program to Support Exports, as approved by the Government of Mongolia in 2003. However, as of 2017, exports of mineral constituted 79.5% of total exports and the non-mining exports constituted 20.5%. Therefore, an opinion poll is being conducted on whether to continue to implement this program within the scope of the “Action Plan of the Government 2016-2020”, as well as develop a Mongolian export program (project). The purpose of this program is to increase non-mining export in the same way as the previous program and will be implemented in two phases from 2018 to 2022. During Phase I from 2018 to 2019, objectives to create a legal and favorable tax environment, increase industrial capacity, and introduce advanced technologies are intended to be implemented.

During Phase II from 2020 to 2022, objectives to increase manufacturing of non-mining sector

end products, facilitate export sales and expand the market are intended for implementation. Expected outcomes include creating a supply chain of other raw materials of wool, leather and animal husbandry and bringing the processing level to 60%. In addition, it is expected to increase export revenues of animal husbandry and the food sector by 50% to 2021, and to increase the percentage of processing industry products of animal origin from 9% to 15%. Meanwhile, the number of non-mining export products is expected to increase from 150 to 225. The agreed objectives indicate that the implementation of the previous program would be continued. However, the current program gives notable significance to products of animal origin, specifically wool, and expects to support exports by increasing the production of products such as meat, dairy and sea buckthorns⁵.

Activities by SMEs are significant in ensuring the implementation of these objectives, such as establishing a restricted zone for special purposes in local areas, supporting the development of industries and laboratories through foreign direct investment and concessional loans, and creating a network of trade and production directed at exports to support producers. Furthermore, new ideas are suggested in the objectives, for instance, conducting a survey on the needs of customer from the EU, the US Canada and Russia to avoid being too dependent on the Chinese market. On the other hand, tax and other policies directed at the tourism sector, one of the promising sectors with resources, and tangible support and promotion for the technology sector, with a broad market and large of number of customers and innovative products, were not reflected, but should be considered from the perspective of improving the business environment for SMEs.

Even though a number of state policies and programs is being developed, their feasibility and optimality need to be assessed. Additionally, in spite of the existence of low interest rate loans, which are directed at SMEs, only enterprises whose sales income is less than MNT 150 billion are eligible for consideration according to the current SME Law. Therefore, SMEs with many years of business history and companies that are capable of contributing to the diversification of industries are not provided with an opportunity to expand their businesses and renew their equipment etc. Furthermore, there are many cases in which SMEs are not able to receive concessional loans due to the requirements of commercial banks, such as business sustainability

⁵ The fruit of the gummy plant harvested in Mongolia. Given its high nutritional value, it is processed into health food.

and pledging property, which are stipulated in the same law.

That is why this is the most appropriate time to start revising the SME Law by reconsidering the basic factors that are hindering the growth of SMEs, while the proposed revisions should be managed to reflect actions that are consistent with the reality. Even though it has been in practice for some time, it is important to reflect the proposals from business owners and professional associations by organizing public discussions in order to implement comprehensive and optimal policies.

(2) Policy, Institutions and Planning for Credit Information Management

A Credit Information Database (CIDB) was established at the BOM at the end of 1990 in Mongolia. The current system operates by supplying the BOM's credit information along with credit information from commercial banks and nonbank financial institutions, according to the CIDB Rule, as contained in Resolution No. 131 of the President of the BOM from 2005 and other relevant legislation. Banking and financial organizations must inform the BOM of bad loans with overdue repayments exceeding 90 or more days, after which the BOM updates the loan default database monthly. Besides the above rule, the Law on Credit Information was approved in 2011, which consists of regulations concerning the CIDB, in terms of processing, safety, protection and usage of credit information, and licensing of the legal entity that renders the credit information service.

Prior to the approval of the Law on Credit Information, the Credit Information Bureau (CIB) LLC was established on the initiative of the MBA with supports from the US Agency for International Development and International Financial Corporation in 2009. The CIB LLC contracted Interactive LLC to develop a credit information system in 2014 in order to introduce credit rating system. However, as of today, there is still no entity granted with a license to render credit information services, despite three legal entities (including the CIB LLC) having attempted to obtain a license according to Article 23 of the Law on Credit Information⁶. Functions, shareholders, business plans, equipment and software, information supervision, ethics rules and minimum capital amounts are stipulated in Article 23 of the Law on Credit Information. No clarifications have been made about why these requests by the entities were denied; however, according to an unofficial source, there is speculation that the BOM concluded

⁶ The detail of this is described in the Chapter 3.5, (1), i).

that requirements set by the law were not met.

Recently, international financial organizations have been urging the BOM to update its CIDB system. The functions of banking and financial organizations related to the supervision of credit information and the BOM CIDB are discussed in detail in Chapter 3.

(3) Corporate Governance-related System, Policy and Planning

After Mongolia's transition to democracy, the Company Law was approved in 1999, in which general legal grounds concerning companies and corporate governance principles were stipulated. With the approval of the Company Law, a working group in charge of corporate governance was established by the Standing Committee on Economic Affairs of the Parliament of Mongolia. A securities committee conducted an inspection for all registered joint-stock companies from October 2000 to 2002 under the direction of the Standing Committee on Economic Affairs.

Subsequently, the "Corporate Governance Code of Mongolia"⁷ based on the corporate governance principles of the OECD was approved in 2007. The National Program for Corporate Governance Development was approved by Resolution No. 69 of the Government of Mongolia in 2011. Detailed information on corporate governance is included in Chapter 4.

2.3 Structure and Activities of Relevant Organizations

(1) Creating a Favorable Business Environment

Due to the extensive nature of this sector, there are many professional associations operating, which have submitted their proposals to the relevant ministries and organizations in direct charge. The MBA and the Mongolian Nonbanking Financial Institutions Association, both prominent financial organizations, and the MNCCI, the CEO Club, the British Council, the American Chamber of Commerce, the Japan Chamber of Commerce and Industry and the Business Council of Mongolia, organizations that operate in many sectors, can be named as the most notable organizations on the business environment scene.

At the government level, the Ministry of Mining (MOM) is in charge of heavy industry, the MOFALI is in charge of light industry and the NDA is in charge of carrying out activities to

⁷ The corporate governance code revised in 2014 has been enforced.

attract and promote investments. Information on the MNCCI, an organization predominantly in charge of operations by SMEs, and the NDA, which is in charge of comprehensive investment policy and PPPs, are included in the following sections.

1) Mongolian National Chamber of Commerce and Industry

The MNCCI was established in 1960. As of today, it has 3,226 members, 70% of whom are SMEs. One third of the members of the chamber are operating in Ulaanbaatar, which has 21 local branches and 42 representative offices (12 honorary representatives). The chamber is a nonprofit organization working a) to establish a public-private dialogue mechanism to engage entrepreneurs in the improvement of the business environment, b) to protect the common interests of the business community in all stages of processing business-related laws and policy documentation, c) to support members and entrepreneurs to help them expand their market and improve their competitiveness in all directions, d) to provide valuable knowledge and information to members, entrepreneurs and partner organizations, e) to ensure the multilateral cooperation of businesses and develop a sustainable network, and f) to improve the chamber's governance and management, enrich its internal collaboration and strengthen its resources.

2) National Development Agency

The NDA was established in 2016 under the direct management of the Prime Minister as a regulatory agency of the Government of Mongolia after the formation of the new government. It comprises the Director General and 55 employees working in five divisions across three offices, as follows: 1) Development Policy and Planning Division, 2) Sectoral Development and Policy Regulation Division (with a Research and Analysis Office), 3) Integrated Investment Policy Division (with a Concession and PPP Office), 4) Registration, Information and Promotion Division, 5) Administration Division (with a Monitoring and Auditing Office).

Within the framework of its activities, the NDA is in charge of developing comprehensive development policy and programs, regional development and investment policies, and administering the development policy database. Additionally, the NDA's functions include the expansion of comprehensive development policy and programs, as well as state investment programs, collecting and studying proposals, ensuring the coordination of sectoral development policies, developing proposals on integrated investment policy, foreign direct investment and relevant legislation, providing information and methodological support to foreign investors,

developing PPP policies, conducting relevant studies and assessment, and administering the database.

(2) Credit Information Management

The BOM, which administers the credit information system, is in charge of credit information in the banking and financial sector. The MOF and the MOFALI contribute to the advanced use of credit information by using the BOM's CIDB and operating their own database. At the government level, the FRC, which is in charge of supervising nonbank financial institutions, is also involved in the framework of supervisory organization in the financial sector. Moreover, the MBA, which represents the interests of commercial banks, is working to establish a new CIB, which is founded on the current CIDB of the BOM. Finally, the Mongolian Nonbanking Financial Institutions (NBFI) distributes necessary information to its members and delivers awareness sessions and training to nonbank members. Detailed profiles of major organizations are given in Chapter 3.

(3) Corporate Governance

The MOF is working to prepare a handbook for removing duplicated financial statements and ensuring that statements will comply with international standards, as stipulated in the Law on Accounting, in relation to the transparency of information and respecting laws within corporate governance. The NCCG and the CGDC are actively working to ensure the implementation of and promote the Corporate Governance Code, as approved in 2007, with help from the Government of Mongolia. Moreover, the MNCCI and professional associations are distributing information to their members and conducting training in corporate governance. Profiles of the main organizations are given in Chapter 4.

2.4 General Information on Mongolian Legal Entities and Previously Conducted Surveys

(1) Mongolian Legal Entities and Employee Numbers

As shown in the data from the National Statistical Office of Mongolia, there are over 155,065 legal entities with state registrations as of late 2017. However, the number of entities with active operations are 78,585. The table below shows the number of legal entities from the last seven years by sector.

Table 2.6 Number of Legal Entities (by Sector)

Sector	2011/4	2012/4	2013/4	2014/4	2015/4	2016/4	2017/3
Agriculture, hunting and forestry	3,514	4,765	5,360	6,374	6,661	7,078	7,500
Mining	513	691	728	945	1,155	1,259	1,429
Processing plant	5,853	7,425	8,044	9,188	9,934	10,406	10,981
Electricity, gas, water supply	239	280	320	381	344	346	357
Construction	4,226	5,430	6,529	8,940	10,496	11,430	11,911
Wholesale and retail, home appliances, and maintenance	26,504	41,123	44,590	48,865	54,303	60,171	63,645
Hotel and restaurant	2,344	2,967	3,097	3,254	3,349	3,632	3,783
Transportation, warehouse business, communication	3,182	4,039	4,336	5,063	5,529	6,217	6,708
Financial transactions	2,167	1,754	1,839	2,069	1,920	1,946	2,045
Real estate, rent and business	6,543	8,951	10,251	11,642	12,656	14,183	15,092
Public administration, defense and social insurance	1,428	1,387	1,390	1,433	1,434	1,435	1,450
Education	3,016	3,186	3,293	3,598	4,209	4,844	5,097
Health and social welfare	2,770	2,993	3,114	3,472	3,831	4,071	4,214
Other services	5,093	5,528	6,698	8,353	10,715	14,460	16,035
Total	67,392	90,519	99,589	113,577	126,536	141,478	150,247

Source: National Statistical Office, 2017

Table 2.7 Number of Legal Entities (by Sector)

Sector	2011/4	2012/4	2013/4	2014/4	2015/4	2016/4	2017/3
Agriculture, hunting and forestry	2,507	2,877	3,178	3,409	3,351	3,539	3,802
Mining	383	430	401	608	655	690	738
Processing plant	4,143	4,492	4,177	4,996	5,190	5,303	5,679
Electricity, gas, water supply	219	242	256	297	251	242	246
Construction	2,831	3,135	3,541	4,770	5,390	6,074	6,308
Wholesale and retail, home appliances, and maintenance	15,897	20,430	21,640	22,793	24,194	27,744	29,860
Hotel and restaurant	1,899	1,965	1,994	2,018	1,951	2,167	2,263
Transportation, warehouse business, communication	1,895	1,812	1,901	2,294	2,282	2,592	2,838
Financial transactions	1,564	896	927	915	1,037	1,065	1,155
Real estate, rent and business	5,092	5,609	5,899	6,045	6,121	6,944	7,398
Public administration, defense and social insurance	1,407	1,387	1,390	1,433	1,434	1,435	1,450
Education	2,790	2,528	2,553	2,659	2,973	3,344	3,490
Health and social welfare	2,569	2,525	2,659	2,900	3,122	3,271	3,364
Other services	4,873	3,597	4,404	4,681	6,326	7,748	8,470
Total	48,069	51,925	54,920	59,818	64,277	72,158	77,061

Source: National Statistical Office, 2017

The table shows that the legal entities operating in the wholesale and retail, home appliance maintenance, real estate, rent, construction and processing sectors are in overwhelming numbers compared to entities operating in other sectors. The table below shows the number of employees in legal entities.

Table 2.8 Number Employees in Legal Entities (by Sector)

Sector	2011	2012	2013	2014	2015	2016
Agriculture, hunting and forestry	342,768	369,961	329,057	310,719	327,560	348,487
Mining	45,116	46,696	50,274	40,927	42,641	38,203
Processing plant	65,781	64,895	80,988	85,497	81,279	86,105
Electricity, gas, ventilation	11,938	14,495	13,826	15,454	15,621	16,162
Water supply, treatment plant, waste	5,136	6,679	7,905	7,140	5,883	6,031
Construction	51,963	59,204	72,350	81,127	88,118	71,485
Wholesale and retail	152,468	131,341	155,980	170,234	178,239	172,668
Transportation, warehouse	75,833	56,092	65,891	69,815	72,679	65,931
Hotel and restaurant	26,386	30,235	31,714	36,552	37,805	32,141
Information and communication	11,532	14,741	16,750	17,796	15,974	18,132
Finance and insurance	16,580	17,373	20,907	22,914	23,815	21,863
Real estate	322	1,208	773	1,081	969	767
Science and technology	11,422	11,342	13,591	12,527	14,107	12,676
Public administration	9,208	13,335	15,019	12,010	15,990	15,042
Defense and social insurance	55,611	62,919	65,280	66,143	68,093	74,179
Education	85,478	86,271	89,820	89,552	89,091	94,989
Health	36,356	37,528	40,368	37,487	38,199	40,982
Arts and culture	7,810	7,357	9,247	10,602	12,333	10,090
Service	21,750	19,785	20,194	20,105	20,170	19,751
Other	1,812	1,318	1,457	1,407	950	1,059
Total	1,035,270	1,052,775	1,101,391	1,109,089	1,149,516	1,146,743

Source: National Statistical Office, 2017

The statistics above show that the agriculture, hunting and forestry, wholesale and retail, education and processing sectors employ the most employees. Especially, the agriculture, hunting and forestry, retail and education sectors have centralized most employees.

(2) Previously Conducted Surveys on Business Environment

1) Mongolian Business Environment Survey by the Mongolian National Chamber of Commerce and Industry

The MNCCI, as indicated in 2.3, one of the biggest economic organizations in the country, and the National University of Mongolia conducted a study among 1,573 entities nationwide to evaluate the country's current business environment in 2017, in order to define the necessary actions to improve the environment by analyzing the influencing factors. The business environment was assessed based on five main indicators: 1) infrastructure and technology, 2) operations of business entities, 3) economic environment, 4) society and culture, and 5) governance and law. The detailed assessment of factors influencing the business environment are classified according to two types: a) common problems encountered when running a business in Mongolia and b) common problems encountered during foreign trade and sales.

The survey results show that the Mongolian business environment was not performing well. The poor performance was directly related to governance and reinforcement of the rule of law. Financial market, tax and business environment performance was also poor. The biggest obstacles were defined as the source of financing and seed money for business. In order to alleviate these obstacles, the feasibility of business projects needs to be assessed and allocating low interest and long-term loans, which do not require collateral, were proposed. Regarding the tax environment, it was proposed to reconsider the stages of tax imposition and exempt new businesses from tax during their start-up years. Furthermore, transportation costs and time, as well as the process of acquiring a conclusion from the Specialized Inspection Office, were the biggest obstacles encountered when conducting foreign trade.

In order to overcome these obstacles, actions directed at reducing the tax burden, exemptions through optimal policies, reducing interest rates, offering flexible loans, facilitating the process of acquiring loans, increasing investments, eliminating corruption and red tape, ensuring fair competition and stable policy, and improving coordination between state organizations need to be taken. In addition, there is a need to create 80,000 jobs, which would constitute 57% of the total workforce and 17.8 of GDP, and implement a special policy to support 67,612 SMEs, which constitute 86% of the total number of legal entities.

2) Sampling Survey by the Bank of Mongolia

The BOM has been conducting a survey to assess the development and financial conditions of SMEs on an annual basis since 2014. The 2017 survey results show that a decline in economic activity has led to deficiencies in working capital and difficulties in maintaining and expanding business operations. Financial support from international organizations and government subsidy seem not to be at a sufficient level and inclusive; hence, most SMEs apply for financing from commercial banks. The amount requested by SMEs tends to be between MNT 10-50 million for a period of one to five years. The survey conclusion suggests that the biggest obstacles and difficulties for the business environment for SMEs are exchange rates and inflation as macroeconomic factors, poverty and unemployment as social factors, and the weak rule of law and government services.

The survey finds that, in order to improve SME business environment, actions such as the following are required: 1) ensuring public and private relations are in line with legislation, reinforcing the rule of law and pursuing stronger actions against corruption; 2) providing equal access, greater inclusion and transparency to government-subsidized financing, and promoting employment and economic diversification; 3) tax subsidies for new industries and start-ups until their maturity is reached; 4) targeting tax and other subsidies to non-export tradable goods and products; and 5) reducing exchange volatility.

3 Current Status and Issues of Credit Information Management

3.1 Current Status of the Financial System in Mongolia

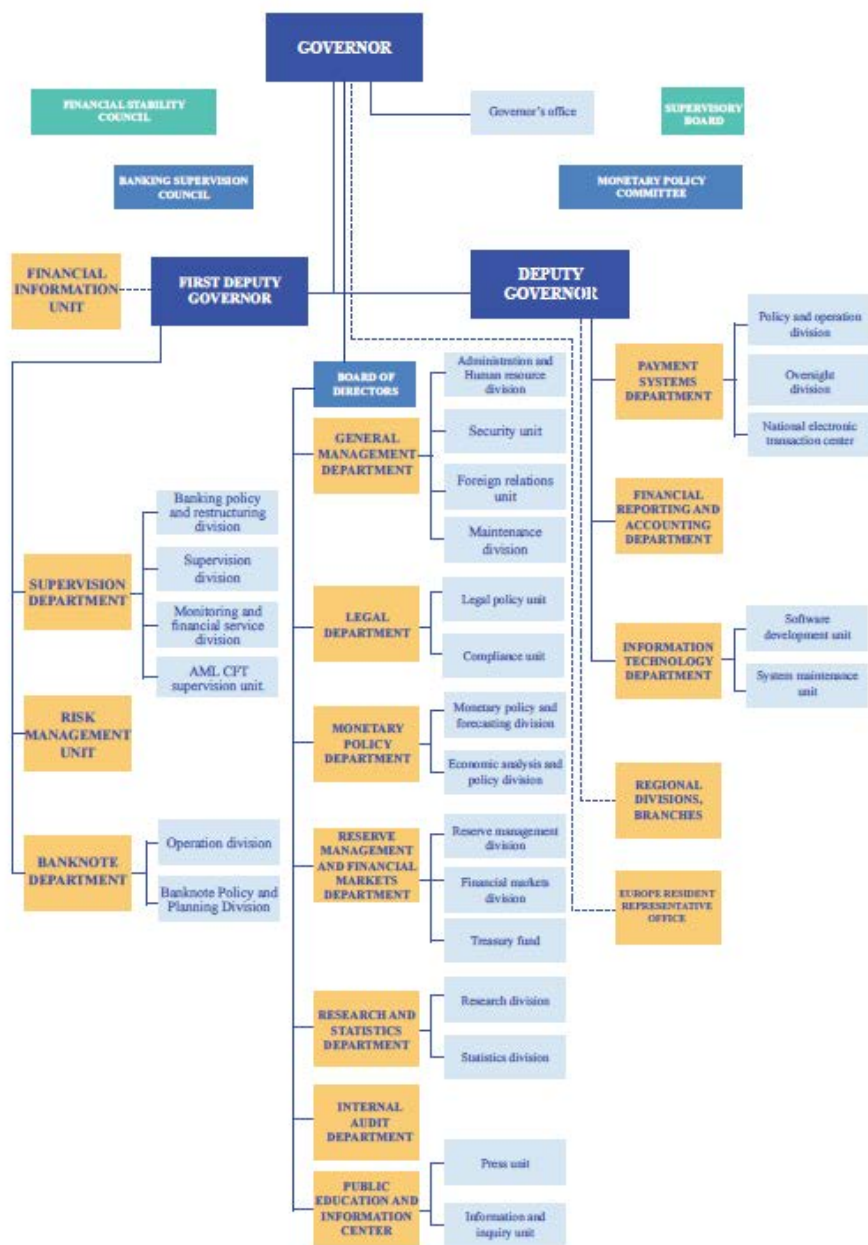
(1) Status of Organizations Related to Banking, Nonbanking and Other Lending Operations

1) Bank of Mongolia

The ultimate goal of the BOM is to ensure the stability of the local currency as well as other central banks. It is a legal entity established by the country and maintains the balanced and sustainable development of the national economy through stabilizing the currency, financial market and banking systems as part of its main purpose. Specifically, the BOM conducts the following activities to achieve its objectives, namely, to implement monetary policy and supervise the activities of commercial banks, as stipulated in the Law on the Central Bank of Mongolia (BOM).

- Issuing currencies into transactions
- Formulation and implementation of monetary policy by coordinating the money supply in the economy
- Acting as the Government of Mongolia's fiscal intermediary
- Supervision of banking activities
- Organization of interbank payments and settlements
- Holding and management of the state's reserves of foreign currencies

Figure 3.1 shows the organization chart of the BOM.



Source: BOM Annual Report, 2017

Figure 3.1 Organization Chart of the Bank of Mongolia

Departments related to credit information management include the Division of Monitoring and Financial Services, the Supervision Department, the Research Division, the Research and Statistics Department, and the Information Technology Department. The roles and functions of each department are as follows⁸.

(i) Division of Monitoring and Financial Services, Supervision Department

The Supervision Division is in charge of supervising financial institutions and conducting

⁸ Bank of Mongolia HP (<https://www.mongolbank.mn/>).

inspections based on banking legislation for the BOM. Therefore, improving financial systems, operations and various regulations is among its core roles. Specifically, it is responsible for the following duties.

- Inspections of compliance, based on bank regulations, monetary policy and procedures and instructions approved by bank supervisory authorities, and assessment of loans
- Issuance of licenses related to banking business for the control of banks and related organizations, and management including appropriate settlement and implementation of relevant measures
- Analysis of the organization of financial institutions, observations of economic and financial activities, and information provided by financial relations reports, economic analysis and surveillance based on data, reports and surveys provided by international institutions and related organizations such as the World Bank (WB)
- Receipt of the CIDB, confirmation of information and data submitted to related organizations, and improvement of operation, development of related proposals on software, hardware, and monitoring operations
- Improvement in the effectiveness and quality of monitoring work, and collaboration with relevant departments to timely release information on the results
- Internal checks to respond to client complaints regarding banking business, as well as police and law enforcement agencies, expert review, and enforcement of appropriate measures
- Cooperation with international banking organizations on issues related to supervision

(ii) Research Division, Research and Statistics Department

The Research and Statistics Department is in charge of statistics in the BOM and the entire financial sector. It also supports Mongolian policymaking by conducting research on the economic and financial sectors. Specifically, the roles of the Research Division are as follows.

- Develop policy bases and empirical studies to facilitate policymaking and monetary policy decisions of the BOM

- Conduct extensive research and analysis on the collection, storage and enrichment of research data on the foreign and domestic economic environment, monetary policy, exchange rate, payment systems, stability of the foreign sector, and financial stability
- Develop policy recommendations based on research findings and conduct research and develop recommendations for the effectiveness of the BOM's policy implementation
- Conduct a survey with the balance of payments calculations, including jointly with the Statistical Office
- Provide authorized research papers, present them at meetings and councils, and submit them to the relevant authorities as recommendations
- Cooperate with relevant foreign and domestic organizations on research

(iii) Information Technology Department

The following functions shall be implemented in order to define the information technology policy and directions of the BOM, to introduce advanced technology, to ensure reliable operation and to develop guidelines and advice aimed at reducing the risk of information technology in the banking system. These include:

- Determine the perspective of information technology in the banking system, recommendations, standards and requirements
- Identify and implement the information technology policy and perspectives of the BOM
- Develop software development, research and introduce new technology to meet the needs of the BOM
- Maintain reliable network operation, integrity, protection and security of the network used by the BOM
- Ordering, installing, testing and maintaining reliability and reliable maintenance of the BOM's computer hardware

Regarding the above three departments, the Supervision Department is in charge of the current CIDB system and the licensing and approval of the CIB, which may be outsourced to the private

sector in the future⁹. The Information Technology Department is responsible for the technical system operation related to the CIDB. In this study, the JST requested to organize a joint working team, while the BOM selected these three departments as departments relevant to the CRD. The joint-working team met on four occasions (see the latter part of this chapter for more details on the joint-working team).

2) Ministry of Food, Agriculture and Light Industry

The MOFALI performs a wide range of roles in various policy formulations related to food, agriculture and light industry, as well as implements policies and executes budgets through affiliated organizations. The MOFALI's Light Industry Department is responsible for general industries other than the mining and heavy industries, while its SME Department is responsible for SME policy, as well as formulating various SME policies, in which the role of supervising SME finance is noteworthy. Specifically, the SME Development Fund (SMEDF) and the Soum Development Fund are supervised by the MOFALI.

In terms of the study purpose, reference should be made to the SME database, given that the SME Department's role includes the confirmation of SMEs following requests from SMEs, while its data included in application documentation needs to be accumulated. With this database, the SME Department issues certificates to those companies that need to prove they are categorized as SMEs for funding purposes.

3) Small and Medium-sized Enterprises Development Fund

Established in 1993, the SMEDF was originally intended to provide SME support for agricultural production from the US and organized as a section of the MOFALI. In 2000, the restructuring of ministries and agencies created the basis for managing independent functions as the current SMEDF. Following the restructuring of ministries in 2009, it became autonomous as the SME Fund under the MOFALI¹⁰.

Currently, 25 officers operate across three departments: the Legal System Division, the Loan Project Division and the Financial Division. The MOFALI financially supports SMEs defined

⁹ In Section 3 of the Credit Information Law, the activities, rights and obligations of service providers of CIB are indicated. Specifically, there are stipulations about activities include collection of credit information, construction and operation of credit information database, rating of repayment ability of borrower, economic analysis and market research related to credit information. In addition, it is mentioned credit information should be based on permission of BOM.

¹⁰ SME Development Fund HP (<http://smefund.gov.mn/en/news/15/single/31>).

by the SME Law. Industries covered by this support include various other sectors than agriculture and fishery, such as the mining, liquor and tobacco industries and NGOs. The Soum Development Fund has financed up to MNT 20 million to SMEs that cannot receive loans due to the low valuation of collaterals. The character of this fund is similar to a microfinance fund. The capital equated to MNT 84 billion in 2011 and increased to MNT 140 billion by 2017.

4) Ministry of Finance (MOF)

The MOF stipulates its vision to ensure Mongolia's financial and fiscal stability, to continuously improve the living standards of its citizens and to meet the Millennium Development Goals (MDGs) and indicators, and to introduce average standards to developed countries. The mission of the MOF is to provide financial and fiscal environments aimed at improving the living standards of Mongolians and offering optimal financial management.

- Strengthen the capacity of financial and fiscal management and improve infrastructure and operations
- Conducting regulation and restructuring of the financial sector
- Providing finance, budget, taxation, customs, investment, insurance policy, management and coordination, consistent with the country's overall trends and strategies
- Strengthen the implementation of foreign-financed projects and programs, provide coordination, improve control over implementation, strengthen internal and external debt management, tighten controls and improve effectiveness
- Provide accounting, auditing and management policies
- Administer treasury activities
- Provide policy and management for internal financial control
- Improve government procurement policy, management and supervision
- Strengthen human resource capacity to provide leadership in public administration management through the establishment of an effective management, planning, reporting and accountability management system within the ministry
- Provide advice and services needed for the development and implementation of a policy on

financial and fiscal security, and provide all-round support to the minister and parliament for the effective and efficient operation of its activities

- Implement financial sector policy measures reflected in government priorities and actions of other ministries and agencies, and provide advice and services needed for financial planning and coordination to the highest level of professionalism

The organization chart of the MOF is shown in Figure 3.2

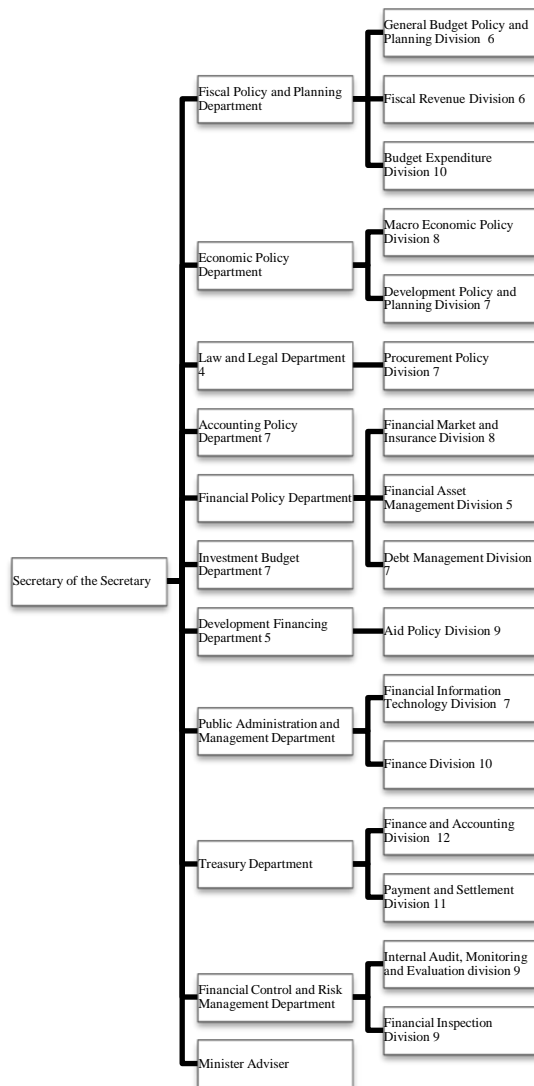


Figure 3.2 Organization Chart of the Ministry of Finance

Note: The numbers in the figure refer to the number of officers as of March 2018.

Focusing on the financial sector, the MOF is responsible for regulation and restructuring, and plays a major role in policy finance, particularly for the establishment of financial institutions and funds that are necessary for policy. In addition, the BOM oversees credit information

management and supervises financial agencies.

In Mongolia, as a custom going back to the 1960s until the present, all companies have to submit their financial statements to the MOF whose database relates to credit information management. A detailed explanation of this is given in the subsequent section.

5) Mongolian Bankers Association (MBA)

The MBA is an independent membership NGO established following BOM approval in 2000 as an industrial organization that voluntarily forms regional banks and other related financial institutions engaged in banking and financial operations in Mongolia. The role of the MBA is defined as representing the interests of the banking sector and acting as a sounding board to its members for policy dialogue discussions¹¹. In other words, it aims to develop the banking sector and the infrastructural development of the financial sector for that purpose. The MBA currently consists of 24 member organizations (14 commercial banks¹², the Development Bank of Japan, the Deposit Insurance Corporation, the Credit Guarantee Fund of Mongolia, the residential offices of three foreign banks, Union Pay International, CIB LLC., the Mongolian Mortgage Corporation, and the Banking and Finance Academy). In addition, the MBA has contributed to the development of the Mongolian banking sector and been involved in the establishment of the following institutions in cooperation with affiliates, in order to establish a supportive policy environment and financial infrastructure.

- Banking and Finance Academy
- Credit Guarantee Fund of Mongolia¹³
- CIB LLC
- Mongolian Mortgage Corporation

In Mongolia, the idea of “environmental and social (E&S) finance” is considered important, while the Mongolian Sustainable Finance (ToC) Principles, as introduced in 2015, have resulted

¹¹ <http://mba.mn/projects-and-initiatives/>; <http://mba.mn/mongolian-sustainable-finance-mongolia/>.

¹² Development Bank of Mongolia, Savings Insurance Corporation, Loan Guarantee Fund, SMBC Ulaanbaatar Office, BTMU Ulaanbaatar Office, Union Pay International, Loan Information Center, Financial Academy, Mongolia Mortgage Corporation etc.

¹³ According to a basic survey report on financial infrastructure in Mongolia, "In addition to CGFM, the Government, MNCCI, Mongolia Employers Association jointly established the Long Guarantee Fund (LGF) (November 2012)" is stated. However, according to an interview with CGFM, LGF refers to CGFM, which means that the Web address of CGFM is LGF.

in borrowers being treated in line with E&S finance when applying for credit. In relation to this principle, the MBA, together with the Ministry of Environment and Tourism, the MOF and relevant organizations, is preparing to establish Mongolia's first Green Credit Fund, which aiming to contributing to the state's Green Plan¹⁴.

Currently, Mr Ganzorig, CEO of Golomt Bank, is the chairman of the MBA and Mr Unenbat, ex-chairman of the Mongolian Central Bank, who acted as both a moderator and a panelist at the corporate governance workshop, is a secretary general of the MBA.

6) Credit Guarantee Fund of Mongolia (CGFM)

The CGFM was established in 2010 and the CGFM Law was approved in 2013¹⁵. Currently, the fund has 35 staff. It was established by the Mongolian government, the MNCCI and the Mongolian Employers Association (MEA) with the aim of supplementing SMEs' collateral shortage in terms of banks' SME financing. With MNT 5,000 million as capital and financial resources provided from the annual government budget, the CGFM has executed 536 warranties so far¹⁶. The administrative procedure of the CGFM is as follows: ① an SME applies to the CGFM when applying for a loan from a bank; ② the bank conducts a credit analysis based on the application documents including the MOFALI's SME certification (as well as confirming a 40% coverage in terms of collateral and repayment ability); ③ the bank sends the application, having passed the loan appraisal, to the CGFM for the guarantee (submission of all credit application documents); ④ the CGFM conducts a credit analysis based on its own risk analysis including financial status, business structure (a site visit is conducted to observe the actual operation), collateral (the bank checks the actual situation) and objective of the credit. The guarantee amount from the CGFM is limited to 60% of the total loan amount, while the remaining 40% must be prepared as collateral by the SME (as described in the CGFM Law). That said, a draft amendment bill is being prepared with the MOF and the MOFALI, in which the upper limit of 60% is to rise to 80%. The guarantee conditions are the same regardless of the proportion of collateral provided by the SME (even if it is 40% or 60%, for example) but the guarantee conditions are different depending on the scheme. According to the CGFM, the following points are cited as an obstacle to an SME's financial access (based on CGFM data).

¹⁴ <http://mba.mn/projects-and-initiatives/>, <http://mba.mn/mongolian-sustainable-finance-mongolia/>

¹⁵ The CGF law came into force on February 10, 2012, while the official establishment of the CGFM took place in November 2012; the text is based on an interview with the CGFM.

¹⁶ Based on an interview with the CGFM Guarantee Regulatory Department on March 15, 2018.

- Lack of pledgeable collateral of SMEs
- Lack of longer-term loans offered by banks at reasonable rates
- Liquidity constraints faced by banks in funding longer-term lending
- Inadequate credit information base
- Burdensome requirements when applying for credit
- SMEs' lack of financial knowledge
- Underdeveloped loan underwriting capabilities of banks

According to an interview survey with private banks in Ulaanbaatar, although there have been some changes recently, long after the economic crisis, commercial banks in Mongolia have maintained a cautious attitude towards lending and, other than loans to large enterprises such as OT banks, basically provide loans within the scope of collateral or guarantees. In addition, due to the inaccuracy and low reliability of SMEs' financial statements, banks are forced to spend time and money on clarifying and grasping actual financial content. It is also difficult for banks to finance long-term loans due to mismatched periods and interest rates in deposits and loans; thus it is difficult to finance in response to SMEs' needs while interest rates for loans tend to remain high.

The purpose of the technical assistance project and the loan, TA (9000-MON) and Loan (3338-MON), for the CGFM according to the ADB is to improve such SME finance. Prior to the TA with the ADB, there were numerous SMEs in the construction sector that received guarantees from the CGFM, as well as a problem where loans to other sectors did not proceed. Given that the original guarantees were simple issuances of warranty documents to the bank, the CGFM signed a contract with the ADB in 2015; however, it took more time for the IMF to adjust the outstanding debt balance on rescheduling and to sign contracts¹⁷, which delayed the start of operations in 2017.

The main objective of the TA and the Loan to the CGFM according to the ADB was to expand the guarantee operation to sectors other than the construction industry and to develop SME finance. The TA started its work with the Trade and Development Bank of Mongolia (TDB), the State Bank, the Xas Bank, the Khan Bank and the Capital Bank in September 2017. The total amount of TA equated to USD 60 million, while the guarantee came from the CGFM, before imposing a burden on the banks. In the new TA, the CGFM places deposits in the bank, whilst

¹⁷ The IMF's support plan for Mongolia, negotiations continued since the second half of 2016, was announced on February 19, 2017.

guaranteeing the same amount, and the country guarantees USD 6.6 million, that is, approximately 10%, in the affiliated bank beforehand.

Currently, there are two kinds of guarantees: the conventional type and the ADA TA type. The conventional type is used for the JICA's TSLs and funding SMEs. The ADB TA type has a period of five to 10 years and an annual interest rate of 12-15%, which is an advantageous condition compared with the conventional type. The scheme of guaranteeing up to 60% of the loan amount is the same as before. However, although it is supposed to execute the total amount of USD 60 million in five years, it is a little behind due to the relationship with the outstanding debt due to the IMF's rescheduling. So far, financing of MNT 32 billion has been made to 92 SMEs and guarantees worth MNT 16.7 billion have been made (60-70% for corporations and 78% for SMEs in Ulaanbaatar, with the remaining 22% for regional SMEs; the smallest loan amount is MNT 10 million with a guaranteed amount of MNT 5 million).

Regarding general guarantee business:

- Although it is true that there have been complaints from financial institutions that the execution of the CGFM guarantee tends to be delayed, in terms of the ADB TA type and the Loan, funds are transferred to the bank as a deposit in advance (all are in line with the ADB default procedure), so complaints do not arise.
- The CGFM provides a guarantee for the purpose of compensating for the shortage in collateral by SMEs and does not charge SMEs for collateral. However, management of the CGFM concerning collateral is strict in order to confirm that collateral is owned only by the borrower, with the mortgage provider having first priority.
- The MOFALI's draft was submitted to the Diet on May 4 (Friday) so as to prepare a bill to raise the guarantee limit from 60% to 80%, but there have been delays on the part of the MOF's working group. Although it is thought that the target SMEs will increase greatly if the guarantee frame expands to 80%, the extent to which the influence exists has still to be calculated. Incidentally, there was a total of 712 entries from November 2017, but two thirds of them were rejected because they did not meet the examination standards of banks.

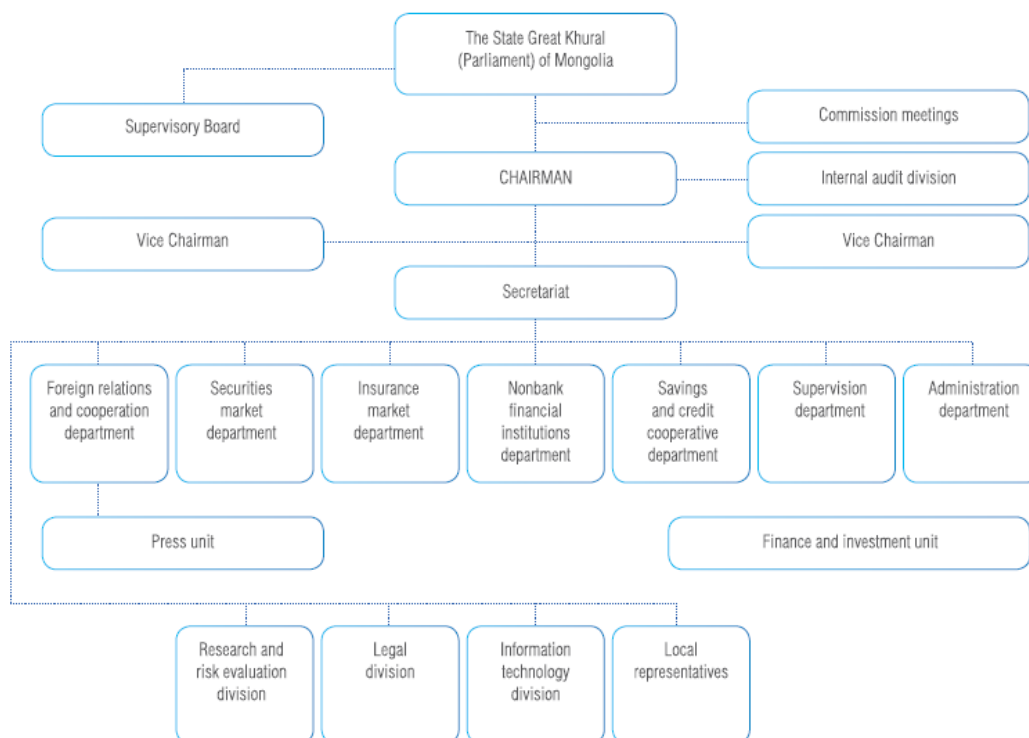
7) Financial Regulatory Commission (FRC)

The FRC was established in 2006 based on the FRC Law. It regulates and supervises all but the

commercial banks overseen by the BOM, subject to regulations, covering more than 1,000 companies including securities, insurance, nonbanks and others, as well as the MSE, the Mongolian Securities Depository Center (MCSD) and audit corporations. Main activities include

- Regulation of securities markets and the implementation of related laws and regulations
- Collection and analysis of financial statements of regulated members, such as listed companies and securities companies, and appropriateness screening
- Monitoring compliance status of securities markets (including implementation survey)
- Provision, suspension and deprivation of licenses
- Dispute settlement and prosecution
- Raising awareness to enhance corporate governance
- Training market participants in order to train individual investors

The organization chart of the FRC is as shown in Figure 3.3



Source: FRC of Mongolia

Figure 3.3 Organizational Chart of the Financial Regulatory Commission of Mongolia

The FRC issues 10 types of license and has issued 537 certificates granting special permission for credit activities to 480 companies performing such activities (factoring, currency change businesses etc.). It instructs the CIB to report to the nonbanks issued with an FRC permit. There are also cases where the information technology infrastructure is not in place in rural areas (Internet environment). Currently, about 80% have been reported; but, in line with the aim of 2018, all nonbanks aim to produce CIB reports and undertake promotion activities.

The FRC is also striving to strengthen the capacity of nonbanks by: (1) raising the minimum capital amount to MNT 2.5 billion (2016), (2) reducing interest rates and (3) strengthening competitiveness. Regarding the statistics from the FRC, these are also listed on other annual report websites.

8) Mongolian Association of Nonbank Financial Institutions

As an industrial association, this nonbank association aims to protect the legitimate rights and common authority of nonbanks, which are members of the association. This association was founded in 2002 and started full-scale operations in 2007. The FRC also covers insurance, savings associations, etc., but this nonbank association only covers nonbanks. Among the 534 companies registered as nonbanks in Mongolia, 230 such companies have joined the association.

For the FRC, a nonbank supervisory body, the association is in a position to exchange opinions as an industrial association, but the memorandum of understanding (MOU) with the FRC has been exchanged to improve the working environment/capabilities of affiliated organizations. Three activities by the nonbank association are commissioned by the FRC by the MOU: (1) formulation of nonbank strategic policy and submission to the FRC, (2) work to improve the legal environment, and (3) implementation of seminars.

Regarding the above three operations, no guidance has been given to individual nonbanks by the nonbank association concerning detailed guidance on financing methods. As for nonbank audits, the FRC conducts independent audits of nonbanks every year, but the association does not engage in this activity.

(2) Lending Institutions and Loan System

1) Organization

Concerning lending institutions in Mongolia, there are several types of organizations including private commercial banks, nonbanks, leasing companies and various funding bodies, all of which provide loan schemes. Regarding private commercial banks, business permission from the BOM is required; 11 banks are active as of June 2018. For nonbanks, the FRC requires business permission. As of June 2018, the FRC has issued permits to 537 organizations, with 480 organizations still active. Regarding the leasing company, although it is under the supervision of the FRC, licensing approval is not required, and the number of corporations is not known by the FRC.

In addition, the financial sector also includes industries such as securities companies, life insurance companies and Savings and Credit Co-operatives (SCCs).

2) Classification of Loans

For commercial banks and nonbanks, corporate loans and retail loans represent the basic categories of classification. This category aligns with product development, examination and credit management. In addition, this category is common among the requirements for submitting financial statements or statistical classification by the BOM. Regarding credit information management in this study, loans to corporations including SMEs fall within the main scope. Yet, in practice in Mongolia, it is often the case that, although loans to SMEs are corporate loan, loans to SME owners as retail loans are used. Hence, it is common for actual borrowers to be distinguished without clarity. This difficulty in terms of classification is described after presenting the nature of each loan.

- **Corporate Loan**

In terms of corporate loans, each bank has various loan products. Each bank offers them in accordance with the diverse needs of customers. When there is support from international donors, products are combined. For example, one of the four major banks offers corporate loan products: credit line loans, equipment loans, OT procurement business loans, microbusiness loans, business support loans, investment loans, working capital loans, employment support fund project loans, ADB agricultural development support project loans, ADB employment expansion project loans, KfW Bank project loans, JICA TSL loans, leather industry founder

loans, and OVERDATE loans.

Loan examination for corporate loans is when a loan is provided in the name of the corporation. In this case, it is essential for financial institutions to obtain financial statements for the past several years¹⁸. According to the statistics from the BOM, the loans to corporations are aggregated based on the amount of loans/number of cases in the corporate name of each bank.

- Retail Loan

Products for individuals (retail loans) are divided into around 10 types of loan products. Some products relate to the general life use, such as salary loans, nomadic loans, automobile loans or school loans, while others are used for business purposes such as business loans or loans for working capital.

The loan examination of a retail loan is applicable when the loan is disbursed in an individual's personal name. In this case, obtaining financial statements is not essential. However, depending on the application of the loan (the content of the product), the judgment of the lending personnel, etc., obtaining the financial statements of the company related to the individual is required by the bank¹⁹.

- Distinction Between Corporate Loans and Retail Loans

Regarding the categories of corporate loans and retail loans, even if loans are provided as retail loans, businesses and corporations are often involved in the background. Therefore, the difficulty in clearly distinguishing between them was highlighted with all interviewees from banks. This is not limited to business loans for individuals. For example, even if borrowers lend funds as a pension loan, the customer side may use it for business. Consequently, grasping the actual use of loans involves much effort.

The ratio of corporate loans to individual loans varies depending on the establishment of each bank, policy etc. This point also appears in BOM statistics. "Legal entity" and "individual/SME" are the largest categories in loan statistics. According to the "individual/SME" category, there are statistics about loan balances and the number of loans. This is considered to be concerned with substantive SME loans beyond the scope of individual loans, but their calculation depends

¹⁸ The required years depends on the policy of the bank in terms of what is necessary.

¹⁹ In this study, the JST survey clarified the ratio of requests for financial statements to individual financing, but commercial banks do not understand this. It is inferred that the person in charge has considerable discretion.

on the judgment of each bank in line with its policy. In this regard, there is no guideline or criteria from the BOM in order to judge whether SME loans are substantially retail loans.

- **Reasons Why Executives Prefer Borrowing as a Retail Loan**

Mongolian SMEs often receive loans, not as corporation but as individuals. When receiving a loan as a corporation, there are benefits such as the retroactive avoidance of personal assets due to the limited liability of management, as well as further advantages in terms of taxation. Nonetheless, borrowers prefer retail loans. In this regard, according to interviews with commercial banks, two aspects were highlighted: ① in the case of corporate loans, there are many documents to submit including financial statements for the past several years, while the procedures are also more complicated than in individual cases²⁰, so borrowers and bank staff seek to avoid a corporate loan; ② there are incentives to borrow retail loans for tax avoidance purposes²¹.

(3) Financing Results

Regarding the results related to banking sector financing, the BOM has compiled and announced these, based on reports from each bank. In the statistics, categorization is classified according to the entire financial institution, corporate loans and personal/SME loans²². The following section highlights the trends of loan-related results combined with FRC and National Statistical Office data.

1) Overall Transition in the Financial Sector

Regarding the trends of loan performance in the financial sector as a whole, as shown in Table 3.1, the loan amount remained flat between 2014 and 2016; but, between 2013 and 2017, it expanded by 140%. Loans by nonbanks increased by 300% in five years, contributing to the expansion of the scale.

²⁰ Regarding the documents to be submitted, in the case of loans to individuals, these differ for each product. There are simple cases like card loans, where only ID, income certification and an application form are required. On the other hand, retail loans for business may require the registered financial statements of the related corporations; but, in general, the number of documents is less for individual loans.

²¹ For example, consider the case of Corporate A and Manager B of a retail trade holding an operating license. In the store owned by Corporation A, Individual B borrows and purchases goods under his/her individual name and performs sales activities based on the license granted to Corporation A. In this transaction, the individual needs to submit the corporation's books for transactions from borrowing to selling and make income tax payments. However, since Corporate A does not have a trail from borrowing to revenue recognition, it is possible to avoid declaring corporate tax and other obligations by making an off-balance sheet transaction.

²² In terms of BOM statistics, in the category "individual/SME loan", SMEs mainly publish statistics about individuals, while the BOM identifies individuals who are considered as SMEs and publishes various numerical values.

Regarding the number of customers, one of the banks increased this from 2016 to 2017, and one of the nonbanks significantly increased this from 2016 to 2017.

Table 3.1 Lending Amount of the Whole Financial institution and Number of Customers

Units: credit balance (million MNT), the number of customers (real number)

		2013	2014	2015	2016	2017
Bank	Credit balance	10,715,632	12,440,921	11,633,571	12,337,509	13,506,463
	The number of customers	N/A	N/A	893,030	888,298	1,014,910
Nonbank	Credit balance	223,700	303,100	391,369	478,200	638,000
	Number of customers	2,050,590	663,098	636,341	592,461	1,471,099
Other financial institutions ²³	Credit balance	49,300	61,500	75,300	84,400	102,100
Total credit balance	Credit balance	10,988,633	12,805,526	12,100,243	12,900,109	14,246,563

Source: Compiled from data from the BOM, the FRC and the National Statistical Office

Along with the increase in the aggregated loan amount of the financial institution, bad debt in terms of loans has also increased. The last balance increased 230% over five years, which is a large increase compared with the fact that the loan amount increased 140%. In particular, for nonbanks, there was a 1,000% increase within five years, so it is supposed that loans are executed even for customers with a high credit risk.

Table 3.2 Total Amount of Defaults and the Number of Entities

Unit: credit balance (million MNT), the number of customers (real number)

	2013	2014	2015	2016	2017
Default amount in banks	565,956	625,699	869,840	1,051,680	1,152,951
The number of default entities	N/A	N/A	N/A	30.388	34.245
Default amount in nonbanks	8,014	17,825	38,325	59,455	84,712
Other financial institutions	1,545	1,563	3,467	4,621	4,475

Source: Compiled from data from the BOM, the FRC and the National Statistical Office

2) Corporate Loans

Regarding corporate loans, bank lending only saw about 10% growth in the five years from 2013 to 2017. However, as far as financing for SMEs is concerned, there was a growth of 60%.

²³ Leasing company, savings unions etc.

In terms of the number of corporates, the statistical data on the total number of corporate customers from 2013 to 2015 are missing, while the number of SME bank customers increased by nearly 150% between 2013 and 2017.

For nonbanks, this statistic shows the number registered on the CIDB by the BOM. Corporate loans by nonbanks have increased by nearly 70% and are growing rapidly. However, corporate loans from nonbanks equate to only about 0.5% of corporate loans by banks, so it is recognized that corporate loans are basically funded by banks.

Table 3.3 Corporate Loan Credit Balance and Number of Entities

Unit: credit balance (million MNT), the number of customers (real number)

		2013	2014	2015	2016	2017
Bank	Corporate credit balance	5,968,121	6,618,774	6,408,347	6,637,774	6,806,104
	The number of entities	N/A	N/A	N/A	6426	6688
	Among them, SME new lending	939,258	1,132,789	679,526	791,834	1,249,299
	Among them, SME credit balance ²⁴	971,079	1,270,619	1,270,097	1,282,229	1,661,516
	Among them, the number of SME entities	3,660	4,618	5,232	4,840	5,477
Nonbank	New lending	20,656	39,619	38,194	29,243	33,765
	Credit balance	641	3,028	5,099	7,948	11,782
	The number of entities	196	284	292	226	240

Source: Compiled from data issued by the BOM, the FRC and National Statistical Office

Regarding default data for corporations, only the results of banks are disclosed by the BOM. Information before 2016 is missing; but, considering the above number of corporations, bad debt ratios for 2016 and 2017 are high and calculated as 11.7% and 13.8%, respectively. The definition of bad debts and defaults in the financial sector is described in detail in Section 2 of this chapter.

²⁴ Regarding the credit balance, it shows the balance at the end of the fiscal year, adding the new loan amount of the current year to the credit balance at the end of the previous year and deducting the repayment amount. This calculation is applied in the following tables.

Table 3.4 Defaults on Corporate Loans

Unit: credit balance (million MNT), the number of customers (real number)

		2013	2014	2015	2016	2017
Bank	Credit balance	507,074.5	554,278.9	737,395	854,557.6	929,876.6
	The number of entities	N/A	N/A	N/A	754	921
Nonbank		N/A	N/A	N/A	N/A	N/A

Source: Compiled from data issued by the BOM, the FRC and National Statistical Office

3) Individual/Small and Medium-sized Enterprises

Regarding loans for individuals/SMEs by banks, it is important to this study to grasp a business entity that is financed as an individual, regardless of SME status, and whose customer base has been decreasing year by year since 2013. On the other hand, although there is an increase/decrease in the value basis, there is almost no change in the full term from 2013 to 2017, and the loan amount per customer who is financed as an individual rather than as an SME is increasing.

Table 3.5 Individual/Small and Medium-sized Enterprise Loan Credit Balance and the Number of Clients

Unit: credit balance (million MNT), the number of customers (real number)

		2013	2014	2015	2016	2017
Bank	Credit balance	4,640,385	5,648,914	4,963,948	5,605,062	6,608,506
	The number of borrowers	730,753	847,583	893,030	881,668	1,007,997
	New lending	1,052,127	826,718	580,238	532,113	1,101,562
	Credit balance	833,435	905,542	778,684	697,782	808,542
	The number of clients	52,947	57,220	49,945	40,465	40,532

Source: Compiled from data issued by the BOM, the FRC and National Statistical Office

The default amount of SMEs receiving loans as individuals is increasing year by year. In the period from 2013 to 2017, the amount increased nearly four times. Based on the fact that outstanding loans are almost flat, the default risk is increasing year by year.

Table 3.6 Individual/Small and Medium-sized Enterprises

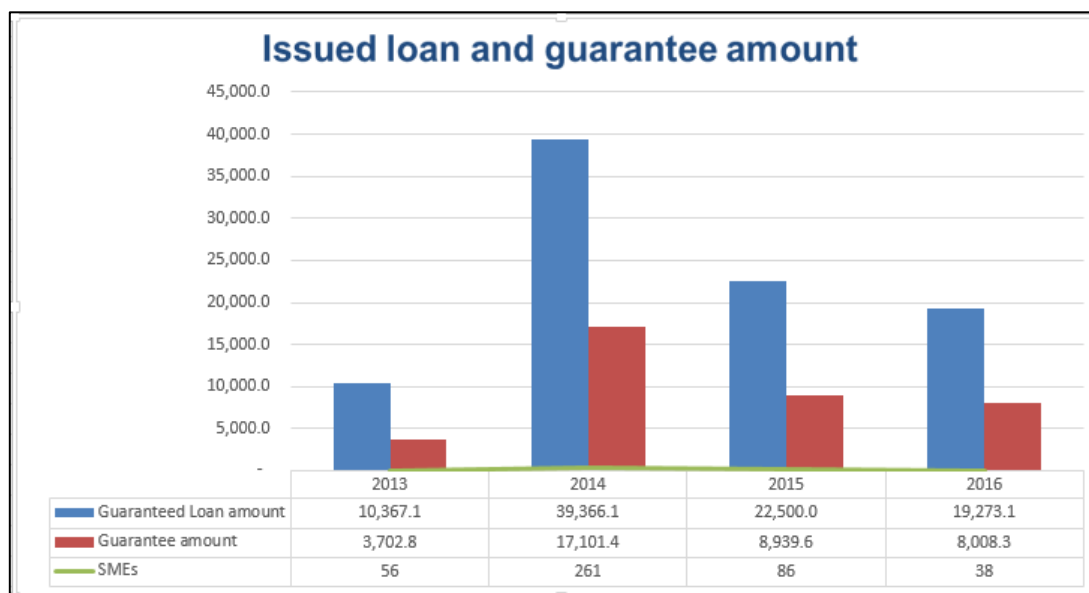
Unit: credit balance (million MNT)

	2013	2014	2015	2016	2017
Default amount	57,776.1	70,883.3	132,248	196,696.5	213,846.4

Source: Compiled from data issued by the BOM, the FRC and National Statistical Office

4) Guaranteed Balance by the Credit Guarantee Fund of Mongolia

In relation to loans, the CGFM balance in recent years has increased by about 400% from 2013 to 2014, but declined to about half later on. Changes over the four years from 2013 to 2016 are as shown in the graph below.



Source: Supporting the Credit Guarantee System for Economic Diversification and Employment Project, CGFM

Figure 3.4 Loan Balance of Credit Guarantee Fund of Mongolia Loans in Recent Years

(4) International Donor Organizations in the Credit Information Sector

1) International Monetary Fund (IMF)

The IMF's board of directors announced on May 24, 2017, a new annual expansion of SDR 314.55 million (USD 434.3 million, 435% of quota) to the country in order to support Mongolian economic reform with approved credit provision measures (EFF). The program, supported by extended credit provision measures, is aimed at stabilizing the economy, restoring trust and establishing a path to economic recovery. The main pillar of this program is financial and fiscal austerity, reducing the pressure on the country's financial markets, stabilizing external positions and regaining debt sustainability. In order to improve the foundation of sustainable and inclusive growth in the future, the program will also: (1) establish discipline in fiscal policy, (2) improve the Central Bank's focus on governance and core duties, 3) strengthen the financial sector, (4) promote economic diversification and foster inclusive growth, and (5) protect

vulnerable groups of society. Monetary policy is directed towards stabilizing inflation expectations, while the recently approved Mongolian Development Bank Law and the new bill on Mongolian banks will contribute to improving future fiscal and monetary management. Mongolian banks have a comprehensive strategy to restore vulnerable banking systems and strengthen their monitoring and regulatory capabilities, as well as anti-money laundering and the eradication of terrorist financing²⁵.

Financial and exchange policy: The New Mongolian Bank (BOM) Law is legislated to clarify the mission of the BOM and strengthen its governance and independence. The monetary policy stance should tighten for the time being, while the exchange system needs to demonstrate flexibility.

Financial sector reform: As a first step, authorities should undertake a comprehensive diagnosis of banking systems to analyze the financial soundness and toughness of each financial institution. Capital injection and business restructuring are implemented as necessary, while the framework of regulation and supervision is strengthened. Since 2018, technical assistance is focused on the registration of credit information, the evaluation of collateral and the strengthening financial supervisory capabilities through the “Strengthening Financial Supervision Project in Mongolia”.

2) World Bank (WB)

As a multisector TA project for the BOM, the World Bank has been implementing a TA in order to create a legal framework for anti-money laundering (AML) since 2010. Regarding the development of the private sector, Private Sector Development Credit (PSDC) has been in operation since 2000, mainly cooperating with financial sector support bodies. PSDC support has been given in two periods from 2000 to 2004 and 2006 to 2011, while a third term is being considered, but it is expected to cope with the improvement in the Mongolian government’s financial situation.

3) International Finance Corporation (IFFC)

The International Finance Corporation (IFC) mainly supports the private sector in relation to the following: ① improvement in SME financial access, ② support for industrial diversification

²⁵ IMF Press Release No.17 / 193,
<https://www.imf.org/ja/News/Articles/2017/05/24/17193-imf-executive-board-approves-financial-arrangement-for-mongolia>

such as agribusinesses, infrastructure improvement. Major projects since 2015 have been syndicated loans for the Khan Bank and the Xas Bank, as well as investments in hotel construction (Ibis Hotel), investments in commercial mall development (Shangri-La) and advisory services on water resource development. The IFC has also been involved in private equity investment and financing for more than 10 years and, in collaboration with the MBA, in establishing a private CIB, as well as discussing the establishment of a movable property collateral registration law with the MBA. The IFC continues to support improvements in the financial sector.

(i) Financial Infrastructure Development Program

Improving SMEs' financial access is facilitated by improving the registration procedures for movable collateral. With regard to real estate collateral, the IFC recognizes that there is a problem where claims are retained for up to seven years from two years when the obligor's plaintiffs appear in court. On the other hand, no action has been taken especially for procedures concerning movable collateral. Therefore, during the period from 2013 to 2018, the IFC promoted surveys and legislation concerning movable collateral security, including software-based procedures that are paper-based, the establishment of registry offices and public notices.

(ii) Insolvency (Bankruptcy)

With the MOJIA, the BOM and the MBA as the main counterparts, in addition to conducting legal reform and training, together with the ADB and the EBRD Cost Debt Reconstructing Committee, advise on liabilities and bankruptcy.

(iii) Credit Information Bureau (CIB)

Regarding credit information, the IFC began working on this in 2006 and has been involved in the establishment of the CIB Law. Whereas the BOM collects public credit information, it established the CIB as a private credit information center in cooperation with the MBA. However, this has neither been finalized yet and nor functionalized. Currently, the IFC does not provide any special support. However, regarding support from the CIB in the new stage, based on the recommendation from the IMF concerning economic crisis, the BOM requested assistance on improving the CIBD at the end of 2017 and made the following recommendations;

- a) Changing the software of the Credit Registry System (it is an outdated system, developed by a local company 10 years ago)
- b) Capacity of the staff responsible for credit registration: strengthening capacity of the BOM Supervision Department staff and increasing the number of employees (currently there are only three people but it is recommended that they should be at least 10 people)
- c) Data Submission (How to Collect and Deliver)

If these improvements proceed, we plan to start a new CIB project in June 2018.

4) Asian Development Bank (ADB)

Most of the support for and investment in the mining sector have come from international organizations and private companies, which have expressed concern about the industrial structure of the Mongolian mining industry. The ADB supports MSMEs, including micro-industries in other sectors, mainly the agriculture sector. Particularly in the Agricultural and Rural Development Project (ARDP), in addition to guaranteeing loans to agribusiness, the ADB also provides loans to the value chain and for capacity building of stakeholders. Among the numerous ADB Mongolian projects mentioned above, the “Supporting the Credit Guarantee System for Economic Diversification and Employment Project”, aimed at improving Mongolian financial markets through strengthening the CGFM, is closely related to this project. Details are described later.

5) European Bank for Reconstruction and Development (EBRD)

Support for MSMEs is a major activity field of the EBRD given that it is an important issue in private sector development in Mongolia. In doing so, the EBRD also provides direct assistance to MSMEs, most of which is in the form of private equity investments and various loans. The bank closely cooperates with the MOFALI’s SME Department, which is in charge of MSMEs. While a survey was conducted among 1,500 enterprises by the MOFALI from 2014 to 2017, survey data covering mainly corporate and financial information have not been collected. The EBRD does not directly engage with the SMEDF (affiliated with the MOFALI) (EBRD is to implement a sovereign loan to the recipient country government).

Advice for Small Business (ASB) is based on EU assistance and provides 50-60% of the funds necessary for supporting corporate management more effectively. The terms turnaround

management (TAM) and business advisory service (BAS), which previously existed, have not been used to date, but the same functions are still being implemented.

The Khan Bank project, “Internal Capacity Building for MSME Lending”, aims to support diversification of the Mongolian economy by strengthening financial access for SMEs. Meanwhile, since risk management and credit scoring experts for MSME loans²⁶ are being appointed, collaboration in the field of the CRD and information exchange will be important in the future²⁷.

3.2 Current Status and Issues of Credit Information Management in Banks

(1) Current Status and Issues of Loans in General (Including Risk Premiums and the Concept of Credit Enhancement)

1) Loan Category, Interest Rate and Credit Enhancement

Common loans made by commercial banks are classified into either corporate loans or retail loans. For corporate loans, banks do not provide interest rates calculated by credit ratings, except for one bank²⁸. The annual average interest rate of commercial banks in recent years is said to be around 18-20%. Based on interviews with SMEs, interest rates in the range 2-2.5% per month (24-26% at the annual rate) seem practical.

Real estate and movable property as collateral, rather than credit ratings, are used for credit supplements; but these are troublesome and time-consuming because it takes time and money for their liquidations. Therefore, even if there is collateral, it does not mean that collateral ensures a quick judgment and a positive response by banks. Furthermore, although it is possible for the CGFM to guarantee credit up to 60% of the loan amount, 40% of the loan amount must be covered by the company’s collaterals.

As an exception to secured loans, many banks offer cash flow loans and unsecured loans to companies that have contracts with large enterprises (OYUTORGOI: OT etc.). In addition, some banks provide value chain (supply chain) loans.

²⁶ <https://www.ebrd.com/work-with-us/procurement/p-pn70817.html>

²⁷ In an interview on May 3, 2018, the EBRD was supporting the strengthening of individual lending functions of private financial institutions, and it was said that they did not think about making a database like CRD. However, in other countries (Albania), EBRD is preparing a credit scoring system for promotion of MSME and supporting establishment of credit information office for that purpose.

²⁸ Even in this case, setting interest rate according the result of rating is applied only for the corporate loan.

2) Components of the Loan Interest Rate and the Reduction Method

Although there are several lending circumstances and institutional issues in Mongolia, one of the biggest concerns is the high interest rate in general. Although the level of the loan interest rate is described in detail in “Ratings and Interest Rates” in this section, typically, the loan rate is over 24% per annum. There are several factors to explain this. When focusing on the reduction method, by considering the components of the loan interest rate²⁹, the process is as follows.

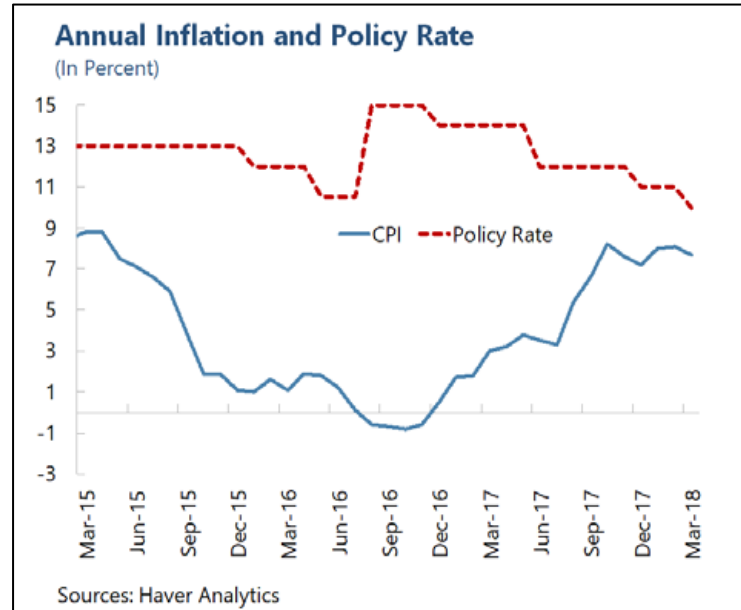
The loan interest rate consists of the cost and profit portions of the bank (margin). Costs include procurement interest rates (interest rates required by banks for financing), expense ratios (personnel expenses and property expenses related to financing operations etc.) and credit costs (reserves for losses incurred when borrowers are unable to repay). The profit portion is determined by the risk preference of each bank (expectation of gain); but, if it can be calculated, the risk premium of the borrower is included.

Among these components, the procurement interest rate is affected by macroeconomic factors, such as the inflation rate and the policy rate, while the IMF provides continuous monitoring and advice on both sides. According to the fourth review results, based on extended credit provision (EFF), as published in July 2018³⁰, a recent trend could be observed as shown in the following graph.

²⁹Japan Risk Database, 2010: “Risk pricing in bank loans”

(http://www.jsda.or.jp/katsudou/kaigi/chousa/shasai_kon/shasaikon_wg/files/100201s.pdf).

³⁰ IMF, 2018 “Country Report No. 18/204” (<https://www.imf.org/external/pubs/ft/wp/2012/wp12192.pdf>)



Source: Haver Analytics, IMF Country Report No. 18/204, p. 6

Figure 3.5 Inflation and Policy Interest Rate in Recent Years

Based on this trend, the policy interest rate³¹, as a guide for interest rates, offered to private financial institutions (PFIs) by the BOM has tended to decline recently, but it has ranged between 13% and 11% in recent years. However, this procurement interest rate is difficult to reduce by bank efforts.

Therefore, responses to high interest rates, which can be resolved by banks, are focused on reducing expenses rates, properly calculating credit costs and improving expected rates of return. In this respect, reducing the expense ratio depends on improving the efficiency of management in each bank. However, for the proper calculation of the credit cost, there is a possibility that it can be lowered by statistically measuring the default risk of the borrower from the database. As an improvement in the expected profit margin, currently, a uniform spread over cost is used, but it is also important to aim for an interest rate reduction by using the interest rate corresponding to the risk premium spread.

3) Reducing Interest Rates from an Economic Viewpoint

From an economic viewpoint, Yoshino Naoyuki, the Director of the Asian Development Bank Institute, has been developing a theory whereby the interest rate setting corresponding to the risk

³¹ The BOM targets repo transactions (sales transactions with conditions for selling back or buying bonds etc. at a certain price) (<https://www.mongolbank.mn/eng/dblistmongolbankrate.aspx>).

should work for the interest rate reduction³². With fixed interest rate loans that do not correspond to risks, the asymmetry of information between banks and customers may arise and reverse selection may occur, thus necessitating the need to set interest rates corresponding to risks that can be explained. That is, if fixed interest rates are applied in the case of low-risk customers, they will refuse to receive loans on account of their high interest rates compared with their circumstances. On the other hand, customers with a high-risk desire will want to receive inexpensive loans compared to their own risk. The worst result is that customers with low risk will not receive loans and only high-risk customers will remain, while the average interest rate across the bank will also have to be raised. In this regard, if banks can predict customers' default risk using a CRD etc., it will be possible to mitigate the asymmetry of information and set interest rates according to risk. As a result, high-quality customers will want loans with low interest rates from banks, while customers with high default risks will pay the corresponding interest rates, which can lead to an expansion of superior customers, with overall interest rates falling.

4) Issues with the Risk Complementary Method

In Mongolia, in addition to the above concerns about high lending interest rates, the issues of inefficiency with the collateral system and the credit guarantee system are also outstanding.

Regarding the collateral system, each bank has pointed out that the cost associated with the execution of collateral disposal is high. Even in Mongolia, where banks require collateral from borrowers in principle, when banks execute collateral disposal, it takes about two years, mainly during the trial period. During the trial period, banks cannot fund the collateral appropriately, meaning that collecting loan amounts and interest rates cannot take place during that period. Furthermore, judicial procedures are complicated in some cases, resulting in additional costs. Therefore, it has been highlighted that even banks want to avoid collecting funds through the execution of security interests, since this is a means of last resort. If the loan can be judged by referring to the database and statistically based credit risk without relying solely on collateral, the bank will broaden the options for a loan examination as well.

With regard to the credit guarantee system, credit enhancement provided by the CGFM is currently the main provision. Even in the CGFM, which sets a fixed guarantee fee, there is the

³² Naoyuki Yoshino, 2015, "Credit Guarantee System, Policy Finance and SMEs Database for SMEs" (<https://www.rieti.go.jp/jp/publications/pdp/15p003.pdf>).

above-mentioned counterselection risk. Therefore, in order to achieve the expansion of loans, which are without collateral but with low risk, in accordance with the objective of the CGFM, setting a guarantee fee according to financial risk would enable the fund to improve the soundness and reassure the guarantor. Ultimately, this will make it possible for banks to present low guarantee fees and low interest rates for healthy companies.

(2) Current Status and Issues for Loan Examinations (Including Credit Information, Collateral Valuation and In-line Setting Scoring)

1) Banks' Loan Examination Process

(i) Preparation of Documentation

In a loan examination, it is necessary for customers to prepare various documents and submit them to the banks. There are no particular guidelines etc. from the BOM regarding the required documents.

- **Essential Documents Released on the Websites of Banks**

Documents necessary for customers to apply for a loan are slightly different between banks, but basically it is necessary to submit several documents. For corporate loans, these are stated to the public on banks' websites. Specifically, in one of the four major banks, the approval of loan applications require the following: loan application/enterprise registration certificate (notary³³) /company internal regulation (notarized)/corporate overview/business license/shareholders meetings and minutes of meetings/executives ID (notarized)/certification photograph (within the last six months)/related document of collateral assets/certificate of financial statements from an audit and tax office/certificate of income and expenditure/use of loan documents to be certified, contract/documents from the last three years certifying the credit history of the company, credit contracts, and payment forms.

- **Documents Not Shown on the Websites of Banks**

Although not disclosed on the homepage of each bank, in practice, banks additionally require borrowers to submit other items, such as a written note, called a black note, which describes actual transaction content, various due dates etc., true financial statements, and a contract, which

³³ A copy of the company registration certificate and the submission of a copied version with the notary seal affixed to the financial institution are required. For any "notarized" documents, the same notary stamp is required.

serves as a basis for sales in the past. Although these cannot be requested, they are essential for creating correct financial statements (including confirmation of submitted financial statements) and future cash flows, which banks prepare for examination purposes.

In addition to the above, depending on the contents of the loan and the circumstances of the loan application company, as an optional additional document, the business plan/contents of the project etc. may be included with the application documents.

(ii) Loan Examination

· Documents for Examination

At each bank, if a loan application is made by a potential borrower, in order to conduct the loan examination, the examination documents are prepared, based on the materials created by the person in charge according to the loan application document. Although the examination documents differ depending on each bank, all the interviewed banks prepare future simulations (prediction of future cash flows) of potential borrowers in order to examine the repayment potential for loans. In preparing this forecast of cash flows, future contracts of potential borrowers, black notes, past financial statements, etc. are usually referred to. Furthermore, on the bank side, individual and corporate credit information using the CIDB of the BOM³⁴ is among the examination documents.

Information on various documents collected and created is used for input to various systems, such as the customer database system, rating system, review system, etc. Many documents submitted by customers are aggregated in examination documents.

· Authority to Approve

At each bank, based on the application documents from potential borrowers and examination documents prepared by the lending officials, a bank conducts an assessment to determine if it can finance the loan. Credit decisions are subject to approval by branches in charge of loan examinations, branch managers, branch office committees, or head offices (including committees). Whether the decision is made at a branch office or at the head office is determined by the monetary standard of the loan amount, which in turn depends on the policy of each bank.

³⁴ Regarding the BOM'S CIDB, details are given in Chapter 3.4. Concerning the CIDB, the evaluation of the credit situation in five stages from pass (no problem) to loss (requiring loss) is shown as the evaluation status of corporations and individuals, with financial institutions confirming this credit situation.

- Collateral Setting and Evaluation

Regarding collateral setting and evaluation, while there is no guidance especially from the BOM etc., basically each bank requires customers to provide collateral, so that 100% of the loan amount is covered. When real estate (land etc.) is insufficient, a supplement is made in the form of movable collateral. The collateral evaluation is determined by the method of each bank; but, basically, in the case of an apartment, the evaluation is made based on the location of the property, the number of floors, roads, services and so on. As Mongolia does not have a qualification similar to a real estate evaluator in Japan, the evaluation is performed by loan officers or specialized officers at each bank. The decision about whether to evaluate at the headquarters or branches is decided based on the loan amount. In the headquarters, the majority of banks assigned the matter to departments specialized in evaluation.

Although there are many banks that set the loan-to-value ratio as 70%, it may be different depending on the loan's financing products. For example, even for real estate, the LTV ration can be set at 70% for business loans and 60% for investments (so that investors can take risks).

In Mongolia, it is possible to set collateral that overlaps with others based on the Real Estate Collateral Law (Article 33) and the Movable Intangible Property Collateral Law (Article 13). However, in practice, two banks do not loan using one collateral³⁵, while a bank can provide additional loans for a collateralized asset from the same bank. It is also possible to transfer a bank loan with a security setting to another bank. In this case, all of the set collateral and agreement will be transferred to another bank.

In many banks, collateral is unnecessary for corporate loans in the case of high-quality large enterprises. Personal collateral is unnecessary in the case of credit cards, salaries, pension loans and so on.

(iii) System Used and Loan Decision

In loan processes, each bank registers and manages customer information including financial statements using a database system³⁶. Regarding the registration of financial statements, items equivalent to E-Balance are entered or registered by PDF. Regarding customer evaluation and

³⁵ For example, if the evaluation value of the property set as collateral is 100 and the loan amount is 70, other banks cannot finance the difference of 30.

³⁶ It was confirmed that several banks use a loan origination system.

loan content evaluation for loan decisions, scoring (0-100 points, etc.) or a rating system (rating of 1-10 or A-E) is used at many banks. For a rating/scoring system, only one of the four major banks uses a proprietary system developed by an information technology company in Mongolia, while two of the other banks use the Oracle Corporation system.

Regarding rating and scoring, a concrete practical example from one of the four biggest banks is as follows.

- A rating system is used for large clients while scoring is used for small clients; for the rating system, ratings are given on customer ratings and financing terms.
- As for the customer rating, there are input items as follows:
 - ① Business environment (sector/sector economic situation competition rate legal environment · business risk (stability of procurement) manufacturing risk sales risk (customer diversity) exchange rate risk)
 - ② Human resources (risk of executives, morals of executives, professional skills and experience)
 - ③ Financial risk (financial index (1-5) (five indicators based on financial statements) · reliability of financial statements)
- The evaluation result, when considering the comprehensive results of these items, is calculated as 1 (good) to 10 (bad).
- For the rating of the loan condition, items such as loan amount/period/repayment condition/collateral loan are entered, and finally A (good) to E (bad) ratings are given.
- About the customer rating and the rating of the loan contents, it is impossible to disclose the algorithm for connecting input items and rating results. All that is explained is what is developed based on its own data and structured so that various information including financial indicators can be comprehensively judged.

Apart from the above rating/scoring system, collateral certificates for (registration on) the bank's collateral registration system are attached, which are also entered onto the collateral's

historical database. This collateral-related information is also input to the rating/scoring system.

A comprehensive credit judgment is shown as a result of performing the above various system inputs. However, many banks do not make loan decisions merely by evaluation on the system, while the loan officer makes a survey visit to the client to complement the judgment on the system and in turn make a final judgment.

(iv) Rating and Interest Rate

Generally, in Mongolian commercial banks, fixed loan interest rates are set by almost all banks with the range from 16.8%/year (1.4%/month) to 36%/month (3%/month). There are different rates depending on the bank/product/borrowing period. An interest rate of 16.8%/year is the interest rate applied by institutional finance for various funds etc. In the case of general loans, it is confirmed that around 24% is the lowest lending interest rate.

Regarding the relationship between ratings/scoring and interest rates, at the time of this survey, there was only one bank that had adopted a system to determine the lending rate according to the in-row rating for corporate loans. In this bank, fixed interest rates are used for the first loan; but, in the second and subsequent loans, the average interest rate according to the risk assessment is calculated by the in-row database. Risk assessments are shown with a range of 1-9 and rates that can be offered are displayed. Regarding the authority to determine the reduction rate, the loan officer can decide the interest rate.

In the other banks, the result of rating is used only for the determination of loan provision. Even if the rating is being done, it is not reflected in loan interest rates. However, the loan discount system is adopted by most banks. That is, in the case of the initial loan, the interest rate is not lowered; but, in the second or later loan, it may be lowered through negotiations with the person in charge, based on the loan history, business experience, etc. This preferential rate is roughly 1% or less per month.

(v) Loan Examination Priority

In the loan examination process, there are variations in each bank as to what matters are prioritized. However, basically, the repayment ability (future cash flow) or the purpose and repayment method of funds are top priorities, while collateral is the third or below. This is because liquidation processes for collateral are time-consuming as they require a trial for

collateral disposition, meaning that collateral is the ultimate means of collection. In other words, banks emphasize recoverability.

(vi) Registration, Format and Quality of Financial Statements Submitted by Small and Medium-sized Enterprises

Many banks require financial statements by SMEs in the same format as E-Balance³⁷, which is the format submitted to the MOF. On the bank side, account subjects and amounts are registered in the system based on this information, with the adequacy of financial statements also confirmed. In the past, there were many paper-based documents, but it has been opined recently that there are many electronic documents including scanned PDFs for preservation purposes.

2) Challenges in the Loan Examination Process

The following points are challenges in the loan examination process.

- Without movable collateral, it is almost impossible to receive a loan; and, at the start of operations, companies with few assets cannot finance themselves, even if they have innovative ideas or skills.
- Banks clearly distinguish between financial statements submitted to the government (mainly to the MOF and the National Tax Agency) and true financial statements, while loans are provided on the premise that companies have two sets of books.
- On the bank side, based on financial statements for the government, real financial statements, black notes and various contracts, loan officers forecast future cash flows. Therefore, banks pay unnecessary costs, which does not occur if companies have submitted proper financial statements³⁸.
- As the business process is cumbersome, the number of days from loan application to execution is about twice as long as the period presented on the website.
- Since the government's collateral registration system has a time lag to registration, it is possible to receive multiple loans with the same collateral.

³⁷ The details of this system are described in Chapter 3.5 of this report.

³⁸ There are incentives if SMEs do not report real profits and losses in order to declare fewer corporate taxes, but accounting audits by independent auditors are not mandated (Auditing Law Article 8-10). Responses to SMEs' submission of appropriate financial statements to the government is detailed in Chapter 4.

- Bank headquarters adopt a conservative position for loans because they do not want to avoid risks as much as possible. On the other hand, opinions from loan officers in the field reflect the convenience of customers. Consequently, opinions differ in terms of requested documents etc.

(3) Current Situation and Issues of Credit Information and Data Management Methods (Including Management of Defaulting Credit Parties, Reporting Obligations and Content)

1) Credit Information Management Method

(i) Management of Borrowers

For borrower management, all banks' financial statements after financing are obtained, and interviews are conducted periodically by visits etc. As for the frequency of financial statements after financing, clients with a loan amount of MNT 300 million need to submit them once a year. For clients with a loan amount of MNT 300 million to 2 billion submit them once every six months. Clients with a loan amount of over MNT 2 million need to do this quarterly. Thus, the frequency relates to the reporting frequency of the MOF.

(ii) Default Definitions

For default definitions, the classification of loans based on the retention period for each type of asset such as loans and accounts receivable by the BOM is shown in the table below³⁹.

Table 3.7 Classification of Assets by the Bank of Mongolia

Classification	BY PAYMENT OVERDUE DAYS				
	Pass	Special mention	Substandard	Doubtful	Loss
	$\leq 15^{\dagger}; \leq 30^{\dagger}$	≤ 90	91-180	181-360	≥ 361
Loan *	≤ 15	15-90	91-180	181-270	≥ 271
Revolving facility**	-	≤ 30	31-60	61-90	≥ 91
Securities***	≤ 30	31-60	61-90	91-120	≥ 121

[†]- As stated in 2.1.5 of this regulation

* By loan principal and interest repayment

** By revolving facility principal and interest payment

*** By securities principal and interest payment

Source: Regulation on Asset Classification, Provisioning and Its Disbursements, BOM

³⁹ For the full text, see fn. 2.

Within this category, as for borrowers (creditors) whose loans are unpaid after 91 days, there is an obligation to report this matter to the BOM based on the Credit Information Database Guideline. Each bank also defines the default according to this regulation. In addition, the calculation of the default loan ratio published by the BOM also follows this definition.

(iii) Management Method and Report on Default Receivables

As a method for managing default receivables, the default receivables of 90 days or less are managed at the branch office; and, in the case of exceeding 90 days, they are managed at the head office.

Regarding the reporting of default information to the BOM, although reporting up to 10th of every month is a mandatory regulation for the Credit Information Database Guideline 2.1, the reporting date (monthly) of each bank to submit default information to the BOM is different among banks. Therefore, it is highlighted by financial institutions that it is also possible to make additional borrowings from other financial institutions, even if default occurs in one month. On the other hand, some banks automatically report to the BOM from the system about loans that were delayed even for one day.

(4) Related Operations (Including Loan Customer Service)

As a result of an interview-based survey of commercial banks, the major four banks provide additional customer services as part of loan management. This include seminars for preparing financial statements, advice to individual companies and events for SME managers. Meanwhile, other banks have not gone to such lengths. Specific examples of such efforts are as follows.

1) Advisory Service

- Advisory services for financial statements are presented on the company's website such as pages covering the CEO's network or business advisers. Banks provide business support including financial solutions and personnel relations.
- As an advisory service to customers, for example, if it involves a concrete factory, a bank advises what to pay attention to, or where to start a new road business. In providing such a service, a person known as a "customer care adviser" is assigned.

2) Seminars

- Banks have delivered accounting seminars for current and future customers. For example, one bank organized a 15-hour seminar along with two classes. There were no particular conditions for participation.
- A bank conducted joint training with an organization called the AFA Academy. The seminar, in which anyone could participate (40 to 50 people attended), was held over the past two years. Although the content of the training varied, it included basic contents such as defining finance.

3) Event

- As an event for SMEs, a plan called the “Next Champion” (to find the next big company) was carried out in 2018. For example, the MCS president and managers from large enterprises, such as Monnis, gave lectures on what kinds of issues they faced when their companies were SMEs. This highlighted how SMEs could deal with banks to solve issues. The main point of this event was that a bank not only lends money but also provides consultancy services to SMEs, which have been a bank strategy since 2016, among other signs of how banking is advancing.

(5) List of Loan Procedures, Credit Information Management etc.

In the previous sections, loan procedures, credit information management, services etc. were comprehensively discussed in order to describe the lending environment in Mongolia. While the practical affairs of each bank are basically the same in many ways, there are areas where each bank separately produces its own offer. Specific information on each of the four banks in the sample is summarized as follows.

Table 3.8 Loan Procedures, Credit Information Management, Service etc. in the Four Banks

	Bank 1	Bank 2
Type of loan/classification	Investment loan Working capital loan Agricultural loan OT procurement company business loan Credit line loan Emergency microloan Construction loan Financial lease Commercial loan Contract guarantee business loan Project loan Sustainable energy financing loan Project loan for additional financing of agricultural and rural development projects TSL loan Credit guarantee system to support economic diversification, employment expansion loan	Credit line loan Equipment loan OT procurement company business loan Microbusiness loan Business support loan Investment loan Working capital loan Employment Support Fund project loan ADB's agricultural development support project loan ADB employment expansion project loan KfW Bank's project loan TSL loan Loan for founders in the leather industry OVERDATE loan
Loan process	<ul style="list-style-type: none"> · In addition to the required documents, the loan officer consults the CIB and also considers the customer along with additional documents (black notes, new contracts, etc.). · The collected data are input into the customer system and the rating system in the bank. · Output documents from the system and part of documents from customers as review documents are summarized. · Regarding the review officer, according to the in-row policy, the decision authority at the branch office and the head office decide on the loan amount/product. 	<ul style="list-style-type: none"> · In addition to the required documents, the loan officer consults the CIB and also considers the customer with additional documents (black notes, new contracts, etc.). · The collected data is input to the customer system and the rating system in the bank. · Output documents from the system and part of documents from customers as review documents are summarized. · Regarding the review officer, according to the bank policy, the decision authority at the branch office and the head office decide on the loan amount/product.
Required documents for loan application	Loan application form Company registration certificate (notarized) Internal company regulations (notarized) company overview Business license Approval and minutes of loan application by shareholders meeting Executives' ID (notarized), Certification picture (within six months) Related documents of pledged assets Accredited financial statements of the audit and tax office Proof of income and expenses Application of loan Documents to be certified, contract Documents certifying credit history over the past three years, credit contracts, payment forms Other	Corporate loan application form Company registration certificate (notarized) Internal company regulations (notarized) Financial statements that are audited and certified by the tax office Certificate of transaction banks and tax offices company overview Manufacturing, service, commercial license Credit guarantee Collateral Copy of security registration certificate, certificate of non-coverage of other banks Execution ID (notarized), CV Loans received from other banks, loans to prove that they have repaid within the period, collateral agreements, payment forms Other certificates

Priority in loan examinations	(1) Repayment strength (future cash flow by business), (2) business content, (3) collateral	(SME loan) (1) financial statement, (2) business information, (3) income, (4) collateral
Collateral system	<ul style="list-style-type: none"> · Need collateral in accordance with bank rules. · There are cases where the CGFM guarantees. · All customers prepare collateral. · Although the main building is land building, depending on the type of business loan, products and goods may be collateralized. · It is also possible for 70% to be land etc. and the remaining 30% to be product collateral etc. 	<ul style="list-style-type: none"> · Requirement of collateral depends on business relations and customers. · Even when the bank does not need real estate collateral, customers often set up a pledge on accounts receivable or assign the designation of sales proceeds. · As an exception, loans based on contracts with OT and card loans need no collateral. · The bank also uses the CGFM and a specific department is in charge.
In-house rating	There are customer and loan contents ratings, but they are not reflected in interest rates.	The bank rates customer ratings and loan contents, but they are not reflected in interest rates. As a method of utilizing the ratings, the results of the examination are classified into scores 1 to 9, and when the result is high (closer to 1), the loan is decided only by the result. If the result is low, additional information is included in the score then examined and finalized.
Interest rate	While it is basically 2-2.1%/year, there is a case of lowering interest rates, such as a discount of 0.2% to the second-time customer.	There are rates such as 1.4-2%/month 8%/year, 2.5-3%/month etc., but interest rates are different depending on loan products, acquired collateral, review scores, etc.
Commission	1%	1%
Borrowers/default management	<ul style="list-style-type: none"> · Doubtful loans are automatically transferred to the CIB at the end of the month. Even if customers late one day, the information is transferred. The bank manages the claims exceeding 91 days at the headquarters and asks for dunning. · Obtain financial statements once a month/quarterly/semi-annually according to the amount of loans to customers. 	<ul style="list-style-type: none"> · Doubtful receivables are automatically transferred to the CIB. The headquarters will ask about doubt over 91 days. · Obtain financial statements once a month/quarterly/semi-annually according to the amount of loans to customers.
Customer service	In order to improve customer management and the collection rate of existing loan customers, special departments have been set up and seminars for executives are being implemented.	<ul style="list-style-type: none"> · Accounting seminar · SME management event · Providing various information through website
Major issues	<ul style="list-style-type: none"> · Since there are fluctuations in resource prices, etc. due to economic conditions in 2018, the bank expects that the risks to large enterprises will be high, and are planning to increase loans for SMEs. · Initiatives for lowering interest rates included creating a new department last year and dividing customers by segment. The bank wants to develop a new product, that is, a loan that fits the segment. 	N/A

	Bank 3	Bank 4
Type of loan/classification	Working capital loan Investment loan Import loan Equipment loan Mortgage loan OVERDATE loan Project loan CGFM loan by ADB fund source TSL loan ADB's agricultural and rural development support project loan KfW Bank's project loan Project loan of SME Development Fund CGFM loan Real estate loan	Working capital loan Capital loan Credit line loan Business loan for business reduction of greenhouse gas emissions CGFM loan from the ADB fund source TSL loan Project loan from Mongolian Business Incubator National Association IFAD Project Loan Organic Mongolian program loan (for agriculture) Investment loan from the EBRD (for agricultural company) Construction loan
Loan process	<ul style="list-style-type: none"> · In addition to the required documents, the loan officer consults the CIB and also considers the customer with additional documents (black notes, new contracts, etc.). · The collected data are input to the customer system and the rating system in the bank. · Output documents from the system and part of documents from customers as review documents are summarized. · Regarding the review officer, according to the in-row policy, the decision authority at the branch office and the head office decide on the loan amount/product. 	<ul style="list-style-type: none"> · In addition to the required documents, the loan officer consults the CIB and also considers the customer along with additional documents (black notes, new contracts, etc.). · The collected data are input to the customer system and the rating system in the bank. · Output documents from the system and part of documents from customers as review documents are summarized. · Regarding the review officer, according to the in-row policy, the decision authority at the branch office and the head office decided on the loan amount/product.
Required document for loan application	N/A	Loan application form Business introduction (business introduction) Company registration certificate (notarized) Internal company regulations (notarized) Financial statements one to three years' worth Business license, license, patent Credit history (financial institution) Contracts related to credit financing Related documents of collateral assets, certificate Other documents due to business features, certificate Certificate of transaction banks and tax offices
Priority in loan examinations	(1) profit from business operations, (2) what to use loans, (3) customer sales etc. (including CIB), (4) collateral	Cash Flow, president's individual creditworthiness, past financial information, collateral value is all important but has no priority
Collateral system	· It is regulated by internal rules, which is necessary for almost all loans.	· It is decided by policy and it is necessary for almost all loans, but it is unnecessary in the case of factoring. · In the case of land, the bank can finance up to 45-75% of the valuation amount by the product of the loan.
In-house rating	The bank rates customer ratings and loan contents; for second and subsequent loans, the rating is reflected in interest rates.	The bank rates the customer ratings and loan contents, but they are not reflected in interest rates.
Interest rate	1.6-19%/month	1.5.-1.7%/month

Commission	0.5%	1%
Borrowers/default management	<ul style="list-style-type: none"> · Doubtful receivables are automatically transferred to the CIB at the end of the month. The bank manages the claims exceeding 91 days at headquarters, makes visits and issues demands. · Financial statements are obtained once a month/quarterly/semi-annually according to the amount of loans to customers. 	<ul style="list-style-type: none"> · Doubtful receivables are automatically transferred to the CIB. · Financial statements are obtained once a month/quarterly/semi-annually according to the amount of loans to customers. · Payment notice is issued to the delayed party and a meeting is requested. · A special department will deal with it beyond 270 days.
Customer service	<ul style="list-style-type: none"> · The bank holds seminars for customers, and topics are wide ranging from management to finance. · The bank regularly hears from the borrower, and advice from the loan officer is given. 	<ul style="list-style-type: none"> · The bank holds an accounting seminar for clients in Ulaanbaatar.
Major issues	<ul style="list-style-type: none"> · The biggest challenge for SMEs is the lack of knowledge about financial statements among SME owners. Many owners do not understand the content of payment, such as making payment by paying money to an accounting person only when making FS. · The problem with institutional loans from national funds is managed by organizations without any knowledge of loans such as the MOF and the MOFALI. · As a problem for the BOM, medium-sized enterprises are particularly burdensome and countrywide support is limited. · Small businesses are separated by MNT 1.15 billion, but this standard is too small. · As for TSLs, there are too many documents to be submitted and the process is too long. It is necessary to simplify it according to the environment of Mongolia. The maximum amount is MNT 6 million, which is small. 	N/A

3.3 Current Status and Issues for Credit Information Management in Nonbanks

(1) Current Status and Issues for Loans in General (Including Risk Premium and Concept of Credit Enhancement)

Based on an interview with the nonbank association, as a representative of the nonbank industry, it is currently estimated that the number of customers in the entire nonbank sector is about 107,000, of which 3,000 are corporations⁴⁰. Companies such as TransCapital, BID, Gatsur Capital Partners and Vision are cited as large nonbanks. About 30 of the top companies are recognized as major nonbanks with a total financing amount of MNT 5 billion or more. In recent years, in order to mitigate the excessive level of establishment and competition in the nonbank industry, the capital required for registration with the FRC and the nonbank association has been raised. As a result, those that had been required to hold MNT 400 million or more in the past will be required to have MNT 1 billion until 2020 and MNT 2.5 billion after that.

Regarding the types of loans, in an interview with two major nonbank companies, there are fewer than 10 corporate loans, as basically nonbank funds are mostly for individuals. However, it has been considered by multiple nonbanks that 50% of loans in individuals' name are actually for business. In the interview with a medium-sized nonbank, as for the type of loans, about 60% are for living use and 40% are for business use, but the fact is that there are many cases where presidents receive business loans for other purposes.

There are various circumstances in which customers use nonbanks, but there are many cases where they are seeking speed of judgment. In other words, because loan examinations take a long time, there is a need for customers to use nonbanks to obtain near-term and short-term working capital, with customers also agreeing to pay high interest rates in nonbanks.

(2) Current Status and Issues for Loan Examinations in Nonbanks

1) Process of Loan Examinations in Nonbanks

(i) Preparation of Documents

- Required Documents

Regarding essential documents for receiving loans, while there is a large difference between

⁴⁰ This figure largely deviates from the BOM CIDB registrations (240 companies at the end of 2017). It is assumed that this is caused by the fact (1) that not all nonbanks are registered on the CIDB and (2) that the nonbank association estimates the loans to SMEs to include loans issued under individuals' name but counted as a corporation.

nonbanks, major nonbanks request documents that are not so different from banking retail loans. On the other hand, in small-scale nonbanks, there are nonbanks where customers can receive loans by providing only collateral; thus, in such cases, the documents to be submitted will be simple. In addition, it was explained by a nonbank that, in the case of a business loan, there are broadly three types of documents that are requested from all customers for submission: proof of income (depending on the type of loan), proof of address, and proof of collateral.

- Optional Documents

As a voluntarily submitted document, even if it is for a personal loan used for a business purpose, nonbanks also request the submission of financial statements.

(ii) Loan Examination

- Documents for Examination

For loan examinations, data on customer attributes, scores for loan judgment purposes and collateral details are submitted.

- Authority to Approve

The nonbanking sector basically involves small operations. At the branch level, there will be a branch manager, a person in charge of loans and a teller. Many nonbanks have a similar structure and consist of, at most, five people.

The nonbanks targeted for interview have multiple branches, with the method of examination differing depending on the amount of money for the loan examination, while the branch office has the authority to approve branches in the case of MNT 20 million or less. Cash flow may be calculated. This calculation method is a little different depending on the company.

- Collateral Setting and Evaluation

In major nonbanks, the range of LTV rates against real estate collateral varies widely, between 50% and 70% depending on the type of collateral and loan. As a regulation in nonbanking legislation, you can also finance up to 30% of available capital. There is a criterion to make it possible to finance up to one third of income as the maximum amount. Recently, there have been many cases of joint guarantees. Regarding elderly customers, a joint guarantee is required for

those living together with children or other family members.

In nonbanks that do not use the CIB, some companies loan only small amounts (from MNT 500,000 to MNT 7 million) as loans with precious metals, telephone numbers, etc. Furthermore, several nonbanks choose to provide loans based on a customer's balance statement for six months, with collateral not necessarily required for such nonbanks.

(iii) System Used and Loan Decision

Nonbanks have a database for customer management, but no system related to loan examinations is commonly used. In one big nonbank company, the scoring system based on Excel, which was developed with a German university and EBRD funds, was the most advanced effort based on its own development. In this system, financial statements are registered, but items to enter depend on the loan amount and include financial and non-financial information. In addition, these input items include the existence of fund resources from overseas and other detailed items, but the result is summarized on about two sheets of A4 paper when printed.

(iv) Rating and Interest Rates

According to interviews with individual nonbanks, there are companies that rate customers in nonbanks, but no company has set interest rates according to rating results. According to the nonbank association, interest rates are defined in each nonbank and interest rates are determined by what kinds of funds are used as resources for loans. For example, if government funds for SME loans are used, the loan rate for nonbanks would be 0.6%/month, while the lending interest rate of nonbanks for SME customers would be around 2%/month. Regarding the current loan interest rate, it ranges from 2.6 to 4.4%/month depending on nonbanks' policy and loan products. However, the interest rate is, overall, getting lower than before. Although not evaluated by the risk assessment system, as with many banks, there are also discounts based on historical results. For example, nonbanks provide loan with a fixed interest at the beginning, and lower it to about 0.5%/month after the second time.

(v) Priority in Loan Examinations

As with major banks, the repayment capacity of the project or company is a priority, with collateral in third position or below. Repayment ability is especially important to nonbanks that provide unsecured loans. On the other hand, in small nonbanks, it is assumed that there are cases

where loans are made only by providing collateral, such that it is assumed that collateral would be prioritized.

(3) Current Situation and Issues for Credit Information and Data Management Methods (Including Management of Defaulting Credit Parties, Reporting Obligation and Contents)

1) Management of Borrowers

For loan management, nonbanks obtain financial statements after financing, as well as banks. However, because nonbank financing is basically for individuals, management is mainly conducted through regular visits and similar activities. According to the nonbank association, the average default loan ratio in the industry is about 9.4%.

2) Default Definition

Basically, asset classification by the BOM also applies to nonbanks, so loans without repayment in more than 90 days are defined as default loans. As a practice in major nonbanks, while there are some nonbanks that defining the default as no repayment in more than 90 days, others see this as 30 days.

3) Management Methods and Reporting on Default Receivables

For default credits, each nonbank has a risk management manual or similar guidance. As an example of a major nonbank, the activity of each day is described such as in terms of when repayment is delayed. If this occurs before the 90th day, it will be managed at the branch; and, if it is an amount that exceed the remit of the branch, the loan is managed by the head office. In the event of a default, if it is collateral for liquid assets, the nonbank liquidates movables as written in the contract, and it is necessary to pursue a lawsuit if it is real estate.

(4) Related Operations (Including Loan Customer Service)

1) Advisory Service

In recent years, the competition between nonbanks has been severe; so, even in nonbanks, several companies have provided various advice services to customers at the time of financing.

2) Seminars

Regarding seminars, there are several cases where these have been organized for customers. For instance, a nonbank carries out three stages of training and holds seminars, lasting a few hours,

for individuals on how to generate revenue and profits. In addition, there are cases where nonbanks have collaborated with donors, such as the EBRD, and taught customers how to create a business plan.

Training for nonbank staff has also been held. For example, the FRC and the nonbank association jointly conducted training for loan economists from nonbanking financial institutions (NBFIs) from June 5 to 7, 2018. This training was aimed at nurturing loan experts who understand best practices, actual cases and the use of financing methods with ethics in banking sector.

3.4 Development of the Bank of Mongolia's CIDB, Current Situation and Issues

(1) Development of the Bank of Mongolia's CIDB

1) Necessity and Preparation of the CIDB

As Mongolia has adopted a two-stage banking system, reducing credit risk has become more important. Therefore, in 1995, the BOM's Resolution No. 11 ("Method for Creating a Credit Information System and Credit Reporting Procedures") was approved in order to reduce and mitigate the potential credit risk of commercial banks. Subsequently, as the starting phase of the public credit system, "public credit registration" was created by the BOM's Resolution No. 384, as issued in 1996. In addition, public credit registrations were officially launched in Mongolia after the adoption of the "Regulations on Credit Information" (January 1, 1999).

2) Improvement in Public Credit Registration

The Mongolian credit information system initiated by the above has been improved several times since then. First, according to Resolution No. 159 from 1997, all necessary credit information has to be created by the accounting program as part of the exchange (transfer) of credit information between public credit registration agencies and financial institutions. With this, the network was improved in terms of sending information automatically. In 1999, a regulation (Resolution No. 467) was approved to make it possible to use credit information from judicial agencies and investigative agencies. According to Resolution No. 565 from 2001, in addition to banks, other financial institutions could also start using credit information to exchange information. Furthermore, Resolution No. 131, as issued in 2005, provided criteria for ensuring software reliability and security. In 2011, in order to make substantial improvements

and improve credit information and financial discipline, the BOM prepared a law on credit information, which was approved by parliament.

In addition to a series of institutional improvements, measures to improve software have also been taken. Specifically, based on Resolution No. 159, issued in 1997, public credit record software was developed in cooperation with the JICA and this program was used from 2009 to 2017. The Information Technology Department of the BOM developed new public credit registration software and started using it after June 24, 2017.

(2) Bank of Mongolia's CIDB System

1) Use of the Bank of Mongolia's CIDB System

At the time of the study into the status of use of the BOM'S existing CIDB system, the access to CIDB registration was provided to 650 organizations including 14 commercial banks, one development bank, 407 nonbanks, and 94 savings and credit cooperatives, government mortgage companies, loan guarantee funds, lease companies, ministries, mobile phone operators, etc. About 9,753,387 pieces of credit information on approximately 1,722 thousand users (1,722,000 people) are held on the CIDB. Access to the CIDB is about 575,000 times on average per month, while 1,675,000 credit inquiries are made per month.

2) Input to the CIDB by Financial Institutions

According to the current system in Mongolia, banks and nonbanks should report the following information to the supervision department of the BOM regarding financing and repayment delay⁴¹.

- ① Information on the borrower, guarantor, issuer of credit letter (name, address, registration number, type of business etc.)
- ② Information on borrowing, guarantee, letter of credit (execution date, repayment date, usage, amount, final repayment date, etc.)
- ③ Information on the obligor who has appealed to the court due to delinquency
- ④ Credit card holders and debtors who have been paying over three months or more (name, balance, etc.)

⁴¹ Regulation on Credit Information (2005, No. 131). See Appendix 1.

- ⑤ Information on collateral (types of collateral assets, collateral coverage ratio, valuation of collateral assets, etc.)
- ⑥ Information received from institutions such as the Asset Registry Bureau, National Tax Agency, Customs Service Agency, National Personal Information Registry Information Center, Execution Agency, MSE
- ⑦ Other information

The Supervision Department of the BOM has the responsibility to process and store these collected data on the CIDB and appropriately manages the confidential handling of information. Regional branches of the BOM are also developing their own CIDBs in order to collect credit information on target companies within the branch office jurisdiction.


Banks and NBFIs are responsible for the accuracy of the information provided to the CIDB. If there is false or incorrect information, or information obtained from the CIDB is used other than for the prescribed purpose, penalties are imposed⁴².

3) Output from the CIDB to Each Financial Institution

Based on input from each financial institution, the BOM conducts a name identification check of debtors for the CIDB and maintains the data. The database is used by users who have signed a cooperation agreement concerning the CIDB, according to users' purpose of use. Users include banks, nonbanks, bank clearing houses⁴³, the Asset Registration Authority, the National Tax Agency, the Customs Bureau, the National Center for Personal Registration Information, the Judicial Decision Execution Executive Office and the MSE. In the case where there is an application for a loan from a customer, each bank makes an inquiry about the corporation and outputs the results in the following format.

⁴² The bank suspends the right to impose a fine equivalent to 40 times the minimum wage or receive information from the foundation covering a range of six months to one year.

⁴³ Established in 2008, in order to smoothly and stably perform fund settlements in the BOM, the MBA, banks, stock exchanges etc. For information on the National Council of the Payment and Settlement System, see: <https://www.mongolbank.mn/eng/listpaymentsystem.aspx?id=2>.



Credit Information Bureau
Borrowers INFORMATION

..... of the Mongolbank

Borrower's name:

May 16, 2018 (18:34)
Ulaanbaatar

.I/O	Registration number	The total amount of loans	Date of loan	The loan maturity Date	Currency name	Loan outstanding	Loan classification					Types of collateral		Number of Collateral	State registration number of collateral certificate	Name of Bank	Explanation	
							Pass	Overd	Substandard	Doubtful	Loss	Group	Subgroup					
1			2017-07-26	2018-12-10	MNT	0.00	+						Receivable, future income	Receivables from local organizations			Khas Bank (32)	
													Receivable, future income	Dividend income				
													Land	Right of ownership of land				
													Buildings	Apartment				
													Buildings	Apartment				
													Buildings	Apartment				
													Buildings	Apartment				
													Buildings	Industrial buildings and facilities				
													Machinery, transport and other equipment	Other vehicles				
2			2017-05-10	2017-12-18	MNT	0.00	+						Receivable, future income	Other fixed income			XAC (32)	

Source: BOM

Figure 3.6 CIDB Template for Corporate Customers

(3) Issues with the Current CIDB System

The BOM's current CIDB system has some range of points to be addressed. Specifically, the IFC investigated the current situation with the CIB in March 2018, pointing out the following items to be improved and making proposals for improvement.

- Credit information inquiries do not contain all the information necessary on borrowers' credit activities
- The CIDB's database and data processing are inadequate
- Software used in the CIDB does not meet international standards

These indications are not disclosed in the report included in the proposal from the IFC to the BOM, and detailed descriptions on each item are not disclosed. Currently, the BOM is preparing to start work on updating the IFC and CIB databases in June 2018.

There are several problems other than those highlighted by the IFC. For example, it is prescribed that credit information gathered in rural areas should be attached to business reports presented to

headquarters every quarter, as well as reports to the database office; however, in reality there is a need to quickly update information with the CIB, meaning that it is difficult to maintain the information with adequate quality and timely revision. This explains the trend of building uniquely corporate information databases in respective banks. In the financial industry, on the other hand, there is persistent hope that the CIB will collect information more comprehensively and share information with financial institutions and relevant ministries and agencies.

Another problem is that not all participants who need to engage with the CIB are doing so. Nonbanks have been obliged to join it since a 2015 regulation by signing a contract with the BOM within three months of acquiring licenses and using CIB information; however, despite the fact that CIB contract with BOM is without charge, not all of them have reached the CIDB.

3.5 Database Containing Credit Information Other Than the CIDB

Regarding the databases related to credit information, it is useful to classify them into two categories: ① identified information and ② anonymous information. For each database, the situation concerning database creation/possession other than the CIDB for the BOM is as follows.

(1) Identified Databases

As for the database with identified information, that is, tailored to credit information management, the CIDB is currently being operated by the BOM as described above. As for other databases, there are several databases including CIBs operated by private companies, corporate financial statements databases by the MOF, SME databases by the SME Bureau in the MOFALI, and NDA industry databases.

(i) Credit Information Databases Developed by Private Organizations

In 2009, with the cooperation of the US Agency for International Development (USAID) and the IFC, CIB LLC Mongolia was established by the MBA. In 2010, Dun & Bradstreet in the US and CIB LLC Mongolia agreed to establish a joint venture in the form of a center to provide private credit information services. In 2014, the construction of a credit information system was ordered from Interactive LLC in Mongolian, with the aim of introducing a scoring system.

In addition to CIB LLC Mongolia, attempts were made to create a new CIB by two companies

(private company names are not disclosed). However, at the time of this study, since no system in any company meets the permission conditions of a system administrative institution required by Article 23 of the Law on Credit Information, no operating licenses have been approved⁴⁴.

(ii) Database in the Ministry of Finance (E-Balance)

<Outline of the Ministry of Finance Database>

The database in the MOF is based on ministerial ordinances. Financial statements submitted by companies are sent to each prefecture and each district and transferred to the MOF. Among the companies recognized by the Statistics Agency, 78% (aggregated to 120,000 companies) have submitted their financial statements. Regarding the frequency of submission of financial statements, almost all companies including SMEs update on an annual basis and now do so using an electronic data (E-Balance) system. Four types of financial statements (balance sheet, income statement, cash flow statement, shareholder change statement) are among the documents to be submitted and items to be registered, while a further 25 items are registered. In terms of the content of financial statements, staff at the aimag and city level confirm it on receipt. After an online submission is made, the MOF can confirm whether it has been made in accordance with regulations, but the MOF cannot modify the content. Consistency with Tax Agency's tax filing amount is confirmed. However, no default relevant data are entered at all.

<Database Use by Government Agencies>

With regard to ministries and organizations that can use the MOF database, all government agencies including each university and research institute can use it. Regarding the scope of financial statements used by each agency, this is based on the application of each agency. For example, since applications to the MOFALI involves sales, sales data are available. However, no access to any of the databases in the MOF is given to each municipality. E-tax information is collated by the Revenue Agency and E-Balance.

(iii) Ministry of Food, Agriculture and Light Industry Database

As mentioned above, one of the roles of the SME Department in the MOFALI is to confirm

⁴⁴ At the third joint-working team meeting with the BOM held on May 24, 2018, the BOM said: "The BOM's credit information system survey by the IFC is being conducted, and it is proposed to update the CIBD system, which is old and does not meet international standards. It is planned to start the system update project in June this year, but it will be costly and take time to adjust. Therefore, for CIB LLC, it is hard to receive permission before 2020."

SMEs based on a request from SMEs. In order to receive SME development funds and financing from the CGFM etc., SMEs are required to prove that they are real SMEs (up to 200 employees and sales of up to MNT 1.5 billion/year). The SME Department is responsible for this proof role. In this work, SMEs also provide information on registrations, financial statements, types of sales, profit margins, etc. In addition, certification of the number of registered employees from the Social Insurance Agency and certification of tax payments from the Tax Agency are submitted. Therefore, the above data are accumulated in the MOFALI. As for the size of the database, 2,000 companies registered in the first year; and, so far, there are about 10,000 companies in total.

(iv) New Database in the Ministry of Food, Agriculture and Light Industry Database

The MOFALI is considering building a new database that is different from previous databases. This is because creating a database is one of the government's action plan goals for the period 2018-2021, whose approval is intended in June.

The content of this database will include companies' information about received loans through funding in the past. Specifically, the database will include evaluations based on sales, number of employees, etc. Regarding the time to start construction, the SME Law is currently being revised, and it is assumed that construction will be started after the revision is submitted to parliament and approved.

It was pointed out by the MOFALI that this database does not aim to collecting SMEs' credit history information like the CIDB. Instead, the MOFALI aims to aggregate SMEs' loan history involving various funds. Furthermore, the CIDB contains data from commercial banks and nonbanks; however, the previous system does not include loan histories involving various funds and other routes.

That said, this database is only at the discussion stage before being constructed, while the MOFALI has also received proposals for joint action with the MBA, but no decision has been made about where to manage the database and how to collect information etc. Furthermore, another idea including creating an SME Agency has been discussed.

(v) National Development Agency Industrial Database

In the NDA, there is a nationwide industrial database (data on 1,800 offices, equating to about

25% of the total number of operating establishments), which is used to support regional development and investment promotion. On this database, information on the scale of the enterprise, partial credit information, business plan etc. is updated and managed. Currently, with the support of the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), system updates and uploading information are being implemented.

(2) Anonymous Information

At the time of this study, there is no database that can be generally referred to as credit information management system, which includes anonymous financial statements, in Mongolia. There is also no plan to create one.

3.6 Prospect for CRD Introduction

(1) Explain and Discuss the Possibility of CRD Introduction in the Mongolian Financial Sector

Mongolian economic trends in the past 10 years are due to the expansion period, led by mineral resource development, from 2006 to 2013, followed by the subsequent decline in mineral resource prices and the emergence of political risks, the impact of slowing growth in the Chinese economy, etc. With the economic and financial crisis, as well as the economic revitalization period involving acceptance of international economic support through the application of extended credit provision by the IMF, Mongolia has experienced expansion and austerity in the financial sector.

Financial and financial access capabilities in the private sector originally reflected immature financial markets and mechanisms, but, despite receiving assistance from international organizations, overall lending rates such as total SME finance volume and portfolio ratio, albeit slight, could be said to be steadily improving (Table 3.9). However, the long-term ratio also varies from sector to sector, and still more than 13% of total loans with a term of over five years remain, as well as SME finance and retail loans far surpassing SME loan growth, especially consumer finance (Table 3.10). There are still many problems to be highlighted and further improvement is required. In 2017, SME loan / individual is about MNT 808 bil, SME loan / private is MNT 1,661 bil, and the total is about MNT 2,500 bil (Table 3.10). The balance of individual loans is MNT 6,608 bil (2017 actual results: Table 3.10). Therefore, if half of

individual loan is about MNT 3,000 bil for business purpose, the base of SME finance is estimated as 5,500 bil in 2017.

Table 3.9 Balance of Loans to the Private Sector

Unit: billion MNT

Sector	Year	Balance	Less than 1 year		1~5 years		Over 5 years	
Total	2008	1,336	583	44%	704	53%	48	3%
	2012	3,495	956	27%	2,260	65%	269	8%
	2017	5,179	1,004	19%	3,488	68%	686	13%
Mining	2008	113	63	56%	47	42%	3	2%
	2012	673	251	37%	422	63%	0	0
	2017	574	129	22%	442	77%	2	1%
Manufacturing	2008	312	85	27%	205	66%	22	7%
	2012	677	170	25%	415	61%	92	14%
	2017	975	182	19%	656	67%	137	14%
Public benefit • Construction	2008	294	133	45%	158	54%	3	1%
	2012	1,118	241	22%	762	68%	52	5%
	2017	823	81	10%	668	81%	74	9%
Service • Others	2008	617	304	49%	294	48%	20	3%
	2012	1,027	303	30%	661	64%	125	11%
	2017	1,321	432	33%	748	57%	140	10%

Source: BOM HP statistics, outstanding bank loans

Table 3.10 Balance of Loans to Individuals and Small and Medium-sized Enterprises

Unit: million MNT

Year	Retail loan	Mortgage loan	SME loan/ individual	Consumer loan	Salary loan	Pension loan	Other	SME loan/ private loan
2008	1,030,054	237,491	291,659	104,153	104,096	47,438	245,216	212,927
2009	919,949	244,003	255,637	58,816	120,356	55,331	185,806	227,431
2010	1,334,140	362,856	347,544	114,586	234,000	71,280	203,874	277,618
2011	2,439,603	710,583	568,859	159,554	559,104	116,979	324,525	473,698
2012	3,074,548	915,281	598,997	167,322	762,490	200,895	429,562	590,174
2013	4,640,385	1,620,345	833,435	223,984	1,220,096	260,756	481,769	971,079
2014	5,648,914	2,024,458	905,542	330,395	1,435,070	354,800	598,650	1,270,619
2015	4,963,948	1,425,420	778,684	303,101	1,393,206	433,918	629,620	1,270,097
2016	5,605,062	1,855,208	697,782	298,103	1,528,428	547,404	678,137	1,282,229
2017	6,608,506	1,699,186	808,542	679,760	2,131,634	695,163	594,102	1,661,516

Source: BOM HP statistics, outstanding bank loans

In this survey, we conducted a CRD seminar for government agencies and financial institutions immediately after the start of the survey, aimed at the recognition and understanding of CRD in Mongolia, with inviting lectures from the CRD Association in Japan. At the same time, we raised awareness of SME finance through individual interviews with related financial institutions and SME companies. In turn, we have grasped the situation and issues. According to individual interviews with related organizations, mainly seminar participants who attended the whole seminar, many agencies were actively interested in CRDs, despite their busy workload.

In the interviews with financial institutions in Mongolia with CRD, there were high expectations for the introduction of new tools in the present situation, along with a small number of business procedures related to examination procedures, other than in terms of collateral/guarantees, in order to support credit screening. There were also cases in which financial officials mistakenly explained it, due to the lack of understanding of CRDs and scoring models, especially in terms of providing anonymous financial information. Therefore, we held a second CRD seminar inviting experts from the CRD Association to explain the merits and disadvantages of CRD introduction in Mongolia, the purpose and significance of scoring model development and CRD construction to relevant organizations In order to disseminate it carefully.

(2) Comparison with Other Loan Examination Methods

According to individual interviews with financial institutions and SME companies in this survey, the barriers to SME financial access include: (1) high interest rates and short-term loans, (2) collateral problems, (3) weak financial structure of SMEs, and (4) the lack of ability to create business plans and financial statements among SME. These were not significantly different to those points highlighted in the “Basic Survey Report on Mongolian Financial Infrastructure” (March 2014). In particular, there is a continuing existence of collateral issues while the guarantee problem for the CGFM (as stated in (4), that is, donor support related to credit information) is also unresolved. This is an extremely high hurdle for financial institutions seeking to make unsecured guaranteed loans. Therefore, the introduction of a CRD is expected to lead to risk premium mitigation and a reduction in examination costs, which explains why there is high interest in both agencies.

In Mongolia, it is common practice that multiple types of SME financial statements are issued, as in other countries. Therefore, in addition to financial statements, the bank’s loan examination calls for the submission of contracts with business partners. The bank also creates real financial

statements and cash flows and conducts financial analysis. This affects the prolongation of the bank's appraisal time and the examination costs. In this study, the MOF accountants were found to be looking for an improvement to this situation.

Long-term, low interest loans to SMEs in Mongolia are limited to TSLs or CGFM loans under the ADB's TA scheme. In addition to collateral, guarantees and counterpart deposits, the tools to mitigate credit risk are poor. For that reason, there are no other tools than CRDs that can contribute to credit decisions and lead to a reduction in examination costs and time.

On the other hand, with regard to the introduction of a CRD, it is important to gather financial statements, including default information on a proper scale, corresponding to the regression analysis of information. Therefore, in terms of the Mongolian economy, the number of companies and the number of loans in each bank, remarks were made that careful consideration should be given as to whether CRDs work effectively⁴⁵. At the same time, the BOM showed interest in continuing to discuss the introduction of a CRD in parallel with the currently scheduled update of the CIDB by the IFC.

Currently, in the loan examination process of banks, each commercial bank independently develops and operates a scoring model. As for the CIB, which has become an important position on the scoring model, the BOM began to promote sophistication with the cooperation of the IFC. In this regard, reference to credit history is important, but more reliable information (indicators) that contributes to business evaluation as a material tool for loan judgments is necessary. In that sense, the possibility that the introduction of a CRD will be effective is extremely high, which is also evidenced by the heightened interest expressed in CRD seminars from each bank.

In Mongolia, since the population size and the number of companies are small, it is considered effective to build a shared CRD organization led by the BOM or other governmental organizations, instead of building a CRD at individual banks. In order to realize this, it is necessary for each bank to provide financial statements that have been checked on paying costs at the time of loan examination. However, when interviewing a bank loan practitioner about whether his CRD knowledge was correct, he said that he understood the safety of the CRD mechanism and the importance of information provided, and that a CRD should be pursued by his bank. This also indicates that continuing efforts to ensure a correct understanding at the

⁴⁵ As per the interview with Mr. Erdnebiereg, Deputy Governor of BOM on May 25, 2018.

management level in the bank are necessary.

Furthermore, the current scoring system in each bank is basically a point value of qualitative information due to the presence or absence of collateral of the company, which is used to determine whether to execute a loan. This is different from the risk ratings and scores generated by the analysis of financial aspects. It is also different from the output of CRDs, which is used to consider the interest rate level according to risk.

In addition to reviews mainly focused on collateral and CIDB information, the introduction of a CRD, which expands the possibility of interest rate setting according to risk and interest rate reduction, broadens the base of credit guarantees and contributes to the diversification of credit instruments, such as Collateralized Loan Obligation (CLOs). Consequently, it will be meaningful to promote understanding and investigate the further possibility of introducing a CRD on the initiative of the BOM in the future.

(3) Impact on Current Loan Examination

According to interviews with PFIs, it became clear that some major commercial banks have developed their own scoring models and are using them for loan examinations, but detailed scoring model with details of algorithms and scored samples were not available. As mentioned above, this is partly due to the fact that the correct understanding of CRDs and scoring models has only spread to personnel who are limited even within the bank as mentioned above. Even in an interview with the person in charge, promoting a proper understanding of the mechanism of CRDs at the managerial level is considered to lead to the acquisition of samples. This understanding includes the fact that a scoring model uses financial information including default information, related non-financial information and accompanying statistical methods. As for the BOM's leadership in this regard, agreement has been reached at the joint working team level established for the purpose of sharing and examining information on credit information management.

In addition, some unsecured and unguaranteed loans could be confirmed as loans based on the contracts with OT or other large enterprises. However, even in such cases, it seems that some kind of risk mitigation measure, such as designation of transfer, is taken instead of a complete credit loan. Moreover, this study covers SME finance, but does not investigate cases of methods such as project finance or project cash flow analysis in other methods. Therefore, other

financing methods than complete collateralized loans in consumer finance etc. should be considered.

Concerning the procedure of current loan examinations, parliament requires a reduction in the interest rates of banks. While banks recognize that they are setting interest rates for reasonable costs, they are seeking new judgment tools that will contribute to loan examinations. Furthermore, if a shared database across the country is established, it will be productively possible to statistically analyze a portion that cannot be sufficiently analyzed with data from a single bank. This will serve as a new objective indicator in the loan strategy and can contribute to the expansion of the loan field. It is also thought that this will lead to a reduction in appraisal time, cost reductions, the appropriate leveling of interest rates, etc.

(4) Implementation and Feedback from the CRD Seminars

In this study, two seminars to explain CRDs were held: one for government organizations (27 participants from the BOM, the MOFALI, the NDA etc.) on the morning of March 6, and another for financial institutions (24 participants from the MBA, the Khan Bank and Japanese banks). While the keynote content was the same for each seminar, the content of the exchanged opinions exchange was different. Two lecturers from Japan's CRD Association were invited to give keynotes including on the merits and disadvantages of introducing CRDs. Specifically, one lecturer presented the role of CRDs in SME promotion in Japan and the practice of CRD modelling. The other addressed the dissemination of CRD content in Asian countries.

In detail, the role of CRDs in the promotion of SMEs in Japan includes information asymmetry and risk distribution prediction, risk-based pricing and counterselection, by what is a CRD system? To answer this question, the following topics were discussed: credit information center, type of structure of a scoring model, historical background, the outline of the CRD Association, and the importance of verification.

In practice, the seminar on the CRD model and dissemination in Asian countries covered topics such as utilization in credit enhancement systems, utilization in the credit risk management of financial institutions, utilization in SME support, utilization in government agencies, and utilization in Collateralized Loan Obligation (CLO) schemes in Asian countries.

During opinion exchanges, confirmation of the understanding of CRDs themselves and the initiative taken by the BOM were raised at both seminars. On the other hand, at the seminar for

the private sector, there was also concern about whether CRDs could really collect data, while attendees agree with their implementation in general. In addition, as a point to be examined and solved in the future, there was a question about whether to adopt a system operated by the private sector, as in Japan, given the legal concerns etc. in that case.

According to the questionnaire results, almost all the participants understood the content and were impressed that they recognized the importance and necessity of CRDs.

(5) Discussions with the Joint-working Team

In this study, the JST study team organized a joint-working team in consultation with relevant departments of the BOM and the JST for the purpose of discussing and identifying an appropriate attitude towards risk management and supervision for financial institutions. As a member of the BOM, the Supervision Department and the Research and Statistics Department participated in the first working group round, and the Information Technology Department was added from the second round onwards. In the third round, the CRD Association of Japan participated by providing a lecturer. The joint-working team met four times by the end of June within the study period, and the outline of each meeting was as follows.

Table 3.11 Summary of the Joint-working Team

	Participants	Topics
1 st working group March 19, 2018	-Research and Statistics Department–1 person -Supervision Department–3 persons -JICA Mongolia Office as observers–2 persons -JICA consultants–2 persons	1. Financial statements in SMEs 2. Difference between a CRD and a CIB
2 nd working group April 26, 2018	-Research and Statistics Department–1 person -Supervision Department–3 persons -Information Technology Department–2 persons -JICA Mongolia Office as observers–2 persons -JICA consultants–3 persons	1. Importance of accurate understanding of CRDs 2. Utilization of CRDs 3. Necessity of a road map for introducing a CRD
3 rd working group May 24, 2018	-Research and Statistics Department–1 person -Supervision Department–3 persons -Information Technology Department–2 persons -JICA Mongolia Office as observers–2 persons -JICA consultants–3 persons -Lecturers–2 from the CRD Association	Detailed explanation of initial validation method for introducing a CRD
4 th working group June 22, 2018	-Research and Statistics Department–1 person -Supervision Department–3 persons -Information Technology Department–2 persons -JICA consultant–3 participants	1. Historical development of the CIB system and future plan for improvement 2. Procedure for the initial validation of a CRD 3. Explanation about improving FS in SMEs as another part of the project

Source: JICA Study Team

The major points of discussion, including members' recognition and understanding, points of information sharing etc., in the course of the four joint-working team meetings were as follows.

<Positioning and Understanding of CRD>

BOM members showed a strong interest in the significance and characteristics of CRDs and the difference with CIBs from the first to the last joint-working team meeting. Even at the CRD seminar prior to the joint-working team, these points were explained; however, there were BOM members who did not participate in the seminar. Therefore, in the first and second joint-working team meeting, knowledge about direct merits, the characteristics of a CRD, applicability in analysis, applications in other developing countries, comparison with a CIB, etc. was deepened through exchanges of opinion. Prior to the second meeting, a senior officer at the BOM, who had not been involved in the CRD previously, explained the erroneous understanding of a CRD in parliament, in turn emphasizing the importance of deepening the understanding of stakeholders' CRD knowledge both in and outside of the BOM. At the third meeting, BOM members mentioned: "In CIDB data, things related to individuals are almost in place, but things concerning companies are not sufficient. Especially for SMEs, a CRD is desirable because judging materials are insufficient. We expect the introduction of a CRD will also expand the financial sector, possibly lower interest rates, improve the loan system depending on excessive collateral and lead to a review of the importance of loan examinations."

In terms of the difference with a CIB, initially, the concept whereby a CRD provides the probability of default (PD) as a result of statistically analyzing anonymous information from a database had not been properly shared among BOM members except for some members, while it was obvious that a CIB provides the credit history of individuals by name. Following the explanation from the CRD Association at the third meeting, a common understanding about the input to a CRD was advanced. On the other hand, the technical part was often reviewed and confirmed repeatedly in the discussion. The major technological topics raised were: 1) that the target data are anonymous, 2) that it is not necessarily legally mandatory for data collection purposes if the cooperation of commercial banks is obtained, and 3) that each viewpoint is important, not only for individual credit history, but also for the PD of certain business patterns appearing in the course of financial analysis.

<Legal Aspect for Introducing a CRD>

Regarding information gathering as a legal aspect for the introduction of a CRD, at the first and second meetings, there were opinions expressed by BOM members. Based on the Credit Information Act (Article 6, Paragraph 1.13), the BOM can give guidance to commercial banks involved in collecting data. On the other hand, as for the full-scale introduction in the Mongolian environment, some considerations were pointed out: (1) no matter is raised with the government or the private sector without a law, (2) as CIBs and CRD play different roles, in the first place, a CRD should not be implemented via current Credit Information legislation. Thus, the opinion that another legal establishment, such as the CRD legislation, would be necessary is persistent.

Regarding the constraints on the introduction of a CRD according to the existing law, it would also be possible to deal with issues through the existing related legislation (company legislation, personal information protection legislation, banking legislation etc.) depending on the way in which the CRD is to be introduced. Consequently, arguments will continue to be expressed from a wide range of perspectives.

<Initial (Data) Quality Survey for the Introduction of a CRD>

In order to expand the discussion on the introduction of a CRD, the recognition that it is important to verify whether sufficient data quality and quantity for a CRD is actually available in Mongolia at present was formed. The expectation for CRD from the BOM member side was notable, especially at the second meeting when the further elaboration of CRD details were requested. Upon the request, at the third meeting, the CRD Association participated in the meeting and explained the specific CRD preparatory steps starting from the data collection process.

As a result, there was a discussion on the necessary approach to securing a certain amount of data and exploring the possibility of introducing a CRD in Mongolia. The conceptual direction was shared on collection and verification sample data of a certain size for initial analysis purposes.

Regarding the method of obtaining financial statements for the initial approach, there was discussion at the first meeting on this topic. From the BOM side, a cautiousness of commercial banks was pointed out towards information disclosure. For this reason, in the process of

discussion, there was an initial proposal from the BOM about the possibility of obtaining financial statements from SME funds, CGFM, or MOF, etc., which could be relatively realistic for the BOM to gather information; however, there discussed the uncertainty how to obtain reliable information linked with default information which is required for the analysis and so forth. Therefore, at the fourth meeting, the discussion was settled by considering the acquisition of financial statements from commercial banks where the default information should be available and linked with financial statements.

<Other Discussions on the Full-scale Introduction of a CRD>

Regarding the discussion on the assumption of the full-scale introduction of a CRD, in addition to the above-mentioned legal aspect, other issues were touched including the future management entity of CRD, the initial costs and an initial idea for introduction plan (a road map). As for the management entity, at the initial stage, a proposal from the BOM was made as to whether it would be possible to provide the newly installed CIB LLC with information on the CRD as well as CIB credit information. However, at the third meeting, it was possible for an organization to deal with this theoretically as a CRD managing entity, but it was recommended that this be set up as a separate and independent body from CIB. This is because operating both a CIB and a CRD will not generate any synergy effect; instead, the hazardous effects might be strong.

With regard to the introduction and operational costs, BOM members concerned about the initial costs as it was referred that a large amount of budget was needed to improve current CIDB.. To have rough idea, at the third meeting, the amount of expenses required for building a Japanese system was explained by the CRD Association.

< Other Donors' Assistances >

During the study period, information and opinions were shared, along with discussions on the introduction of a CRD about other donors' supports (including their proposals) for CIDB improvement which was based on recommendations by the IMF.

(6) CRD Introduction Environment (Legal Environment, Related Organizations, Needs and Limitations)

1) Legal Environment

When introducing a CRD, financial data of individual companies are required. The characteristics of these data are as follows: (a) financial statement data used for judgment on loans by financial institutions, (b) non-financial information, (c) obtaining default data anonymously from financial institutions. In order for a specific organization to obtain and manage such information, it is necessary for the process to be in line with the various laws and regulations concerning the handling of information. In this regard, the current laws of Mongolia have high relevance in terms of ①Banking Law, ②Enterprise Confidentiality Law, ③Personal Information Protection Law, ④ Central Bank Law, ⑤ Credit Information Law, and ⑥ Regulation on the CIDB. In addition, these can be roughly divided into information protection legislation from ① to ③, and legislation/regulations related to the CIDB from ④ to ⑥. The focus of the CRD introduction environment also differs according to this classification. In each area of legislation/regulation, the articles having relevance to the content of a CRD are as follows.

① Banking Law

Article 7. Prohibited activities for banks, their subsidiaries and affiliate companies

7.2. Shareholders, the chairman and members of the board of directors, the executive director and officers of a bank shall not release and disclose to others, or use any information that is considered by the bank, its customers, and/or third parties as confidential, except in the following cases⁴⁶.

Under the Banking Law, the disclosure requirements for the disclosure of customers' confidential information are prescribed, including the release requirements. Since the CRD is not included in the five release requirements, the argument would focus on whether anonymous financial statements can be included in the "information that is considered by the bank, its customers, and/or third parties as confidential".

② Enterprise Confidentiality Law

⁴⁶ There are five cases concerning the requirement to release information protection. Briefly, ① when the individual agrees in writing with the disclosure, ② when the BOM requests to comply with the supervision obligation, ③ investigation by the Public Prosecutor's Office in the lawsuit, anti-corruption institutions and police request, ④ requests by a foreign law enforcement agency or government, ⑤ requests according to the FRC's obligations under international treaties, etc.

Chapter 2 Defining and Protecting Company Confidentiality

Article 5 Company Security

2. Those who are in charge of the confidentiality of enterprises or those who encounter confidentiality through professional activities while on business are obliged to maintain confidentiality.

The third-party company is obliged to protect personal information gained through business activities as well as company confidentiality.

Article 7

2. A person who encounters the confidentiality of a company in accordance with duties, or who receives confidential information, is prohibited from disclosure of this confidentiality according to the law and rules.

Under the Enterprise Confidentiality Law, similar to the Banking Law, it is prohibited for companies to disclose information obtained in the course of their business to other companies.

③ Personal Information Protection Law

Article 4. Personal Information

1. Personal information shall have the following types:

1/ Letter or communication information

2/ Health information

3/ Individual property

4/ Family information

5/ Other confidential information set forth by law

1) Information, documents and physical items that are exchanged with correspondence, communications, communications and other means of communication such as letters of communication.

2) Information on illness other than infectious diseases shall remain secret.

3) Assets, intellectual property, the rights of the person, or his/her authorized persons, as well as information, documents, numbers, contracts and physical items found in accordance with the official duties of the authorities of the competent authority.

4) Information that contravenes the dignity, reputation and interests of the individual and his/her family, if disclosed to a person in the family, can remain secret.

5) Personal archives, deposits, notes, seals and their respective images and audio can be kept secret.

Article 5

1. Individuals protect personal information.

2. It is also possible for government agencies to protect personal information as required based on the rationale and rules stipulated by law.

3. The jurisdiction of a public agency permitted by law shall obtain personal information in accordance with the rationale and rules stipulated by law.

4. Prohibitors who have obtained and acquired personal information according to the law are prohibited from disclosing this to others.

In the Personal Information Protection Act, information on individuals to be protected is defined in detail. The prohibition of disclosing information to other companies by persons who have acquired that information is stipulated. However, regarding the information to be protected, there is no specific provision regarding handling when the information acquirer discloses to other companies in an anonymous manner.

With the above three laws, there is concern that banks will violate each law by disclosing information to others. In this respect, in Japan, the recent revision of the Personal Information Protection Act in 2017 stipulated that anonymous processing information does not correspond to personal information on the premise of complying with certain obligations. However, according to Mongolian current law, there is no provision directly prescribing anonymous information. Therefore, it is conceivable that anonymous information which cannot be specified from the analogy of Japanese legislation or the text of each provision of Mongolia is interpreted as data rather than information. Also, in this survey, there was no rebuttals from the BOM that this law is applicable to anonymous financial statements. In any case, future studies will be necessary in order to determine whether this is a matter of interpretation or whether a new provision is necessary.

④ Central Bank Law (Bank of Mongolia)

Article 19¹. Issuing license for credit information activity and oversight

1. Issuance, rejection, suspension, revocation of licenses for credit information business and its supervision shall be regulated by the relevant law with the purpose of maintaining financial sector stability.

Under the Central Bank Law, the BOM is authorized to issue licenses for credit information. Therefore, even in the case of newly establishing an organization to handle a CRD, whether the BOM can provide a license by applying this law has to be determined.

⑤ Credit Information Law

Since this law is highly relevant to this study, the full text is listed in Reference Material 2.

⑥ Regulation of the Credit Information Database

Since this law is highly relevant to this study, the related chapters are listed in Reference Material 3.

Since the Law on Credit Information and the database rules comprise regulations concerning the approval of the CIB and its system administration agency, the current content does not cover

anonymous information. Therefore, inherently, the CRD, which is anonymous, is not directly related to each stage of collection, analysis, system development and operation, and use of the data. However, regarding the CRD as well, whether it should be operated under the revision of this law is the focus here.

From the above, it is difficult to judge at present which laws/regulations are adequate for introducing the CRD into the legal environment or whether further regulations (law) are necessary. In the future, in the course of the full-scale introduction of a CRD, it will be necessary to sufficiently consider this matter, so that there will be no discrepancy between legal interpretation and legal operation in accordance with the method of introduction. It is also necessary to formulate regulatory legitimacy and operational rules. In addition, for a more rigorous interpretation, verification by legal experts and the MOJIA will be essential.

Furthermore, during the CRD seminars, the joint-working team meetings and the interviews with each bank, many people pointed out that, concerning the implementation of new policies in Mongolia, unless laws and regulations are not established, the activities of stakeholders will not progress. In the joint-working team meetings, it was also opined that there is a possibility that information might be collected by the BOM, in terms of asking commercial banks to submit financial statements, following a revision to the law on the CIDB. On the other hand, it was also considered that it is legally impossible to collect information on a CRD according to CIB-related laws/regulations. Depending on whether or not to establish a new agency as a management organization, the legal nature of the agency, the type of operation, and the necessity of legal provisions will differ. Rather than introducing a Japanese-style CRD, when reviewing the Mongolian type of CRD, rather than exclude the option to establish a new law, it is important to examine the possibility from a broad perspective.

2) Potential CRD Management Entities

When introducing the CRD, at present, it is considered realistic for the BOM to take the initiative for the time being with the government becoming the management entity. However, in consideration of the advantages of the current operation method from the CRD Association of Japan, at the initial stage, the BOM will function as the main body responsible for the introduction and create and manage the CRD. It will then be possible to transfer the function to an independent organization at the stage when the operational foundation is formed (including

professional human resources, information collection method/ICT system establishment, financial prospects, and etc.). (Besides the BOM, some opinions were expressed during the CRD seminars suggesting that the MOF should be in charge. However, general expectations were observed about the BOM's initiative in interviews with stakeholders.).

It is also necessary to consider the role of the FRC. This is because the FRC manages licensing etc. for financial institutions other than banks, such as nonbanks, savings and credit cooperatives and leasing companies. Especially in Mongolia, since the number of companies in the whole country is small, work to consider extending the base of the CRD will be carried out beforehand. The FRC's interest in introducing the CRD seems high, also because it indicated its interest in participation to the joint-working team at the time of interview.

For the private sector, the CGFM, commercial banks and nonbanks, which are supposed to be the main users of the CRD, will be important parties. In addition, it is possible for savings and credit cooperatives and other financial institutions to become users as well in the future. Furthermore, it is assumed that groups such as the MBA and the MNCCI (which has been working on the establishment of CIB LLC) will become important bodies in the announcement phase for bank users.

The above-mentioned related organizations can be summarized as follows.

Table 3.12 Major Stakeholders for Introducing a CRD System

Public sector	BOM, FRC, MOF, MOFALI, NDA, DBM, CGFM
Private sector	Commercial banks, nonbanks, MNCCI, MBA, other financial institutions
International organizations	JICA, ADB, IFC, EBRD

3) Needs of Stakeholders

There is a high need for the CRD among both government agencies and private sectors. Specifically, the BOM and each financial institution greatly expect that it will be possible to set interest rates according to risks and reduce the overall interest rate according to the evaluation information of the financial statements provided by the CRD system. This is supported by (1) questionnaire results from participants in the CRD seminars, (2) findings from the interviews with each institution, and (3) interest in the BOM's initial quality survey on the joint-working

team.

In particular, as a practical necessity for each financial institution, Mongolia has a small number of lending organizations in each bank, with corporate customers comprising at most 2,000 companies per bank. Furthermore, small banks and nonbanks with a few corporate clients may not be able to assess risk based on an own bespoke database. Therefore, the creation of a database for a whole country will enable Mongolia to establish a robust scoring model.

4) Challenges and Issues

There are two restrictions to the introduction of the CRD: (a) the number of financial statements in Mongolia is small and (b) there is limited cooperation between banks. In addition, there is a challenge, namely, (c) information management between the banks differs. Details of the constraints are as follows.

(a) Challenges Due to the Limited Number of Available Financial Statements

In Mongolia, the population is small, so the number of companies is not so large. As mentioned above, the total number of active companies is about 70,000 according to national statistics, the MOF database, etc. In addition, as detailed in Section 8 of this chapter, the number of companies borrowing in a corporate name from banks is about 6,000 to 7,000s, including banks and nonbanks. Even including the case of borrowing for SMEs in a personal name, the number of companies is about 40,000. Since the number of cases is calculated by multiplying the CRD by the number of years acquired, financial statements for the past several years, which are necessary for corporate loans, are available. Furthermore, at least annually, one financial statement is available after the loan. However, it is important to note that, if the total number of financial statements and default data are insufficient, the data necessary for building an appropriate model may not be accumulated.

(b) Challenges Due to the Competitive Environment Between Banks

In interviews, it was pointed out that, in Mongolia, it is rare for companies to build platforms etc. in collaboration with other companies. Particularly, because competition among banks is severe, there is the possibility of refusing cooperation with other banks, which may restrict the feasibility of model building.

However, concerning the lack of data in database creation for the whole country as mentioned

above, conversely, it shows that it is even more difficult for a single bank to build a database alone. Therefore, when creating a database under the leadership of government agencies, such as the BOM, it will be possible to encourage the active participation of more financial institutions by explaining this point to each financial institution.

Regarding the quantitative restrictions of these financial statements, it is necessary to increase the number of years of financial statements requiring submission, while, at the same time, seeking the submission of financial statements from retail loan customers who use loans for business purposes.

Details about the challenge are as follows.

(c) Different Information Management Systems among Banks

In order to introduce the CRD, it is necessary that each bank ultimately obtains data in the form of a CSV file data. In this regard, many banks confirmed that the financial statement submission from the customer to the bank is in the E-Balance format; but, it is unknown whether or not it will be a unified format when exporting it. Specifically, each bank requires customers to submit financial statements based on the E-Balance format for true financial statements. Still, because it cannot be submitted on the E-Balance system, it would be recorded in the financial institution's system with a PDF or handheld input. When saving as a PDF, it is necessary to convert it into the system readable data format.

(7) Summary of the CRD Introduction Environment

(i) Merits of Introducing the CRD in Mongolia

- Improvement in examination time and costs caused by the lack of corporate financial information
- Risk-based interest rate setting (possibility of improving high interest rate)
- Hierarchization of guarantee fee by CGFM
- Expanding SME finance target
- Possibility of unsecured loans
- Financial supervision of risk analysis through joint database construction and application to

securitization of loans

(ii) Disadvantages in Mongolia Raised by Introducing the CRD

Although this is not a clear demerit, it is necessary to verify whether the absolute number of companies and loan transactions currently in Mongolia is sufficient for analysis by the CRD. If sufficiency, such as a sufficient scale of data, is not ensured, it will be necessary to examine what kind of countermeasure is possible in a transient period. As for this transient measure, for example, it is conceivable that acquiring financial statements could be urged, even when an SME is currently financed as an individual. In addition, active participation in the CRD's establishment, from not only from banks but also from nonbanks, would be another option. As a result of such activities, the CRD is expected to become a significant form of soft infrastructure for Mongolia.

3.7 Economic Impact by the Introduction of the CRD

(1) The Content of Economic Influence and Its Calculation

When a system similar to the Japanese CRD system is appropriately introduced in Mongolia, various financial institutions can set interest rates corresponding to risks. Moreover, it is expected that SMEs' financial access will be improved by hierarchizing the guarantee fee by CGFM, as well as in applying for unsecured loans. This means that SMEs can receive realistic positive impacts in terms of declining interest rates and reducing the collateral provided. It is important to quantitatively measure the economic impact of the introduction of the CRD, in order to compare it with the introduction costs; but, since the form of introduction is not clear at this stage, it is difficult to make a quantitative estimate.

Therefore, as an impact concept of this study, we look at the number of present and future SMEs that CRD affects. Incidentally, in estimating the number of SMEs that will borrow in the future and are supposed to be subject to the CRD, practically speaking, corporate loans in the form of individual loans are included in the number of companies. In addition, the estimation of the number of SME companies that currently do not borrow, but may possibly do so in the future, will be performed.

(2) Number of Corporations (Including Small and Medium-sized Enterprises) Currently Borrowing

The number of SMEs/individuals currently borrowing in Mongolia as a whole can be estimated from several types of data. Specifically, these are: 1) bank statistics from the BOM, 2) the number of CIB registrations by the BOM, 3) statistical estimates from SMEs, and 4) estimates from the MOF database. This information is summarized as follows.

1) Statistics from the Bank of Mongolia and the Financial Regulatory Commission

As shown in Section 1 of this chapter, according to bank statistics from the BOM, the total number of companies borrowing from banks at the end of 2017 was 6,688, of which 5,477 were SME companies.

The BOM statistics only cover banks and do not include the number of loans made by nonbanks and other lending institutions; but, according to the data announced by the FRC, the number of loans to corporations was 240 at the end of 2017.

2) Registered Number of Companies on the Bank of Mongolia's CIDB

According to the BOM, a total of 1,722,000 (22,000 groups) loan users are registered on the BOM's CIDB. Among them, about 9,753,387 pieces of credit information has been provided and registered by financial institutions including nonbanks. However, this number of corporations is the total number of registrations since 2009 (after the start of using the database), so the number of credit balances cannot be grasped at any point in time.

However, since the total number of companies with loans since 2009 is 22,000, it can be understood that the number of outstanding loans does not exceed this number at most.

3) Estimation through the Interviews with Commercial Banks

For each commercial bank, credit outstanding is announced in annual reports, but the number of loans has not been disclosed. According to the interviews, the exact number of loans was regarded as nonpublic information. However, for three out of the four major banks, rough numbers were presented as follows: 1,500-2,000 (sensory approximate), 1,100 or over (real number) and 1,000 or less (almost real number).

4) Estimates from the Ministry of Finance Database

As for the database in the MOF, it is the largest existing financial statement database because of the high coverage rate of SMEs. Among the two types of financial statements (financial statements for government and revenue agencies, true financial statements), it is considered that those for government are registered. However, as an incentive for companies to prepare two kinds of financial statements, it is presumed that this is to alter the income statement and lower the tax payment amount, meaning that there is little incentive to tamper with the amount of liabilities. Therefore, regarding the financial statements on the MOF database, the debt amount is regarded as declaring the true amount. Then, if the number of companies with bank lending on this database is calculated, it will be possible to determine the number of companies receiving corporate loans. In this regard, the Accounting Department stated that aggregation was possible upon written request from a public institution such as the JICA. However, it could not be implemented during the study period.

(3) The Potential Number of Small and Medium-sized Enterprises that Will Become a Borrower as a Company

1) Estimation by Bank of Mongolia Statistics

According to the BOM, it also present statistics on the number of individual loans, which is supposed to be substantial for SMEs. Based on our interviews, for this type of loan, most cases require financial statements, including in the case of SMEs. Statistically, this number was 40,467 at the end of 2017. This number is about 660% that for corporate loans. However, according to interviews with the BOM and private commercial banks, the number of cases was expressed by several organizations, while emphasizing the strong possibility that accuracy is not high because the definition of an SME in each financial institution is different. In this regard, according to one of the four major banks, the number of substantial SME loans (business loans to individuals) has been disclosed, the number of which is about 5,000 before the name identification, and is about five times the number of corporate loans.

2) Estimation by Interviews with Commercial Banks

Regardless of the proportion of customers who are receiving retail loans, no bank gave a clear answer as to whether customers submitted financial statements as entities (SMEs). This means that requests for financial statement submissions made to individual loan customers are

determined by the type of loan, the situation of the customer, and the person in charge at the bank side. Furthermore, because counting the number is not advantageous on the bank side, it is not counted. Thus, there are no data on this.

(4) Summary of Impact Estimation of Introducing the CRD

From the results for (2), concerning the number of corporations (including SMEs) currently borrowing, the BOM statistics are considered to be reasonable as the number of companies receiving corporate loans do so as corporations. Since financial statements from the past several years are obtained when a bank decides upon a corporate loan application, if the CRD is introduced to all banks and ratings are reflected in interest rates, at least 5,000 companies will be involved in this system.

From the results for (3), concerning the potential number of SMEs that will become a borrower as a company, at least 40,000 out of approximately 75,000 companies in Mongolia might be affected with the introduction of the CRD.

The total credit outstanding, which corresponds to the corporations currently borrowing and the corporations that are likely to borrow as a corporation in the future, would have been approximately USD 3,000 million (MNT 7,614,646 million⁴⁷) at the end of 2017. In light of the fact that the nominal GDP of Mongolia in 2017 was about USD 11,135 million (statistics from the Mongolian Statistics Agency), it is understood that the size of the loans that may be affected by the CRD is quite large.

3.8 Challenges and Direction of Small and Medium-sized Enterprise Finance

In the above sections, the JST first investigated and organized the current situation and problems concerning the financial system in Mongolia, especially in terms of the loan examination system, and the content and management method of credit information. Next, the JST explored the merits and disadvantages of introducing the CRD in Mongolia and analyzed the impact it would have on the current loan examination system.

In particular, although various countermeasures have been taken to solve the current issues facing SME finance, expansion of SME loans and lending conditions (such as: 1) high interest

⁴⁷ The total amount of the balance of corporate loans in 2017 and outstanding SME loans in the name of an individual/SME in (3). Financing-related results can be found in Section 1 of this chapter.

rates and short-term loans, 2) collateral problems, 3) weak financial structure of SMEs, 4) lack of ability among SMEs to make business plans/financial statements), some improvements can be seen but the circumstances have not been improved. Regarding the alternative loan examination system, development efforts have been made at individual commercial banks, but fundamental institutional improvements to the financial industry as a whole are at the research and study stage. Against this backdrop, the Standing Committee on Economic Affairs of the Parliament of Mongolia pointed out that it is keen issue to enhance SME promotion and improve the financial system, especially in terms of reducing the interest rates of SME loans. In response to such movements, the BOM and the MOF are considering improving the CIBD, as well as corporate financial statement standards. Thus, the environment for CRD introduction is positively proceeding. At the joint working team meeting, and following the survey collaboration between the JST and the BOM, the BOM also showed its intention to further investigate concerns about CRD introduction. Table 3.13 sets out SME finance issues and countermeasures discussed by the joint-working team, with the CRD expected to be effective in relation to every issue.

**Table 3.13 Challenges of Small and Medium-sized Enterprise
Finance and Direction of Countermeasures**

	Challenges of SME finance	Direction of countermeasures
1) High interest rate · short-term loan	Loans with low interest rates that contribute to long-term loans, SME promotion	-Measures to reduce examination costs for SME finance, as in Tasks 2-4 -Clear long-term indicator for the development of a long-term financial market
2) Collateral/guarantee problem	-Under the existing legal system, there are also many risks whereby, even if they are registered as collateral, filing a lawsuit will result in suspension, effective for two years. -The CGFM guarantee system is based on the ADB's TA assumed financing with the principle of collateralism.	-Improvement in the collateral and guarantee system -Introduction of a mechanism to allow for risk premium lowering other than collateral/guarantees
3) Weak financial ability among SMEs	Since there are many SMEs with a weak financial standing, it is difficult to conduct an audit based on the cash flow of the business, and we have no choice but to rely on collateral/guarantee.	System of lending to entrepreneurs (clarification of examination criteria of the SMEDF etc.)

4) Lack of ability to prepare SME business plans and financial statements	In addition to the ability to prepare financial statements, it is necessary to grasp the true financial content of the customer, within the system where the submission of multiple current financial statements is overlooked (that is, making false financial statements is prevalent), while banks are collecting and analyzing incidental materials, such as forms and slips, which is time-consuming and costly.	-Establish easy-to-understand indicators and checklists for accurate preparation of financial statements -Efforts as a nation to create a reliable universal financial statement
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3.9 An Outline of Road Map for Introduction of CRD in Mongolia

One of the urgent tasks in Mongolia is to promote fiscal robustness and rebuild a sustainable economic infrastructure. Supporting SMEs, which account for 97% of the total number of establishments, is also important. In this regard, improvements in financial access for SMEs is crucial. From this point of view, it is important for financial institutions, such as commercial banks, to promote the rationalization and efficiency of credit analysis, in turn improving financing itself, optimizing interest rates, etc. in Mongolia.

As a matter of course, criteria for credit analysis are left to the judgment of each financial institution; however, at the same time, from the viewpoint of improving SMEs' access to finance, the financial sector as a whole should work towards rationalization and efficiency improvement. In that sense, the introduction of the CRD offer much potential, in terms of providing at least some new objective indicators (criteria) that contribute to the utilization of the entire financial sector, in which currently each commercial bank independently develops and operates a scoring model.

The credit history information of the borrowing entity provided by the CIB has already established itself an important criterion for financing or as an indicator of a scoring model among related financial institutions. The operation of a credit information management system by the BOM has also been established and incorporated into the financing decision procedure of each financial institution⁴⁸. It goes without saying that credit history is important in loan decisions, but it is not enough of an indicator by which to judge credit risk based on the company's physical strength, business potential and future potential of the borrower. It is important for the financial institution to fully understand the necessity of the indicators that complement these points. With regard to SMEs as borrowers, it is also important to gain an

⁴⁸ Cooperation by IFC has been started this year to improve the system which was not drastically updated for a long time.

understanding that not only collateral and credit history but also SMEs' efforts, such as business ability are subject to loan judgments. SMEs' effort to prepare correct financial statement will help to expand the financial environment including the operation of the CRD. (From the aspect of SME and industrial promotion, it is expected that SMEs' increased awareness of credit information will lead to an improvement in corporate governance and a desirable environment for investors.)

However, in order to obtain statistical significance for the CRD, based on a multiple regression system, it is necessary to ensure the information amount is on a certain scale. As seen in the US and the developed countries in Europe, if there are hundreds of thousands of corporate loan customers in a single banking institution, the latter can develop its own system for this purpose. But, in Mongolia, where the number of corporate customers is limited to 1,000 to 1,500, even in the top four banks, introducing a standalone system to each bank may be difficult from the perspective of statistical significance. In that sense, by introducing a Japanese-style CRD model in which commercial banks cooperate and share, this CRD will enable Mongolia to introduce a sophisticated common infrastructure for financing, equipped with a rating system with high statistical accuracy, in financial institutions. In the financial sector in Mongolia, while such a share system has not been operated so far, the procedures associated with the new common system, such as how to collect and manage data and information on operational aspects, the development of technology, such as information processing and management systems in each bank, and the review of the institutional environment including related laws are inevitable.

On the other hand, it is important to recognize the small size of the market, even when considering the share system, as the number of corporate borrowers in Mongolia as a whole is said to be 7,000 at most. In addition, since this survey was to clarify the actual situation, laws and ordinances etc. on the credit information management side in each area, it has not considered actual data (samples), while the real aspects of the system and operation need to be faced. Whether full-spec multiple regression systems can function effectively or not will have to be thoroughly studied, and, in that sense, verification and examination by empirical efforts are considered to be necessary⁴⁹.

⁴⁹ It has been pointed out on the BOM side that the consideration of a practical multiple regression system, in terms of data size, is also important.

(1) Efforts in the Financial Sector

1) Significance of CRD (and CIB)

At the present stage, the BOM, the MOF, NBFIs and many of the stakeholders are expressing the following: “For the time being, concerning the introduction and initial operation of the CRD, the BOM can take the initiative. Then, in terms of the subsequent system based on the actual results, further discussion will be held about the continuous operation of the system.”⁵⁰

Given this situation, in the meantime, under the BOM, a high-level committee in close liaison with the BOM, with members from a commercial bank, the MBA, the CGFM or the SMEDF, should be organized, and discussions about various studies can start on the committee and on the subcommittees on relevant issues.

When examining the introduction of the CRD, it will be important to consider technical issues in parallel with the positioning itself. These issues can be considered by the working group after receiving tasks from the high-level committee. Aiming to establish a sharing system among commercial banks under the initiative of the BOM, it will be necessary for each commercial bank to adjust at least to the following points.

- i) Standardization of data (data maintenance method, information item, data expression method, data format, etc.)
- ii) Standardization of data exchange method (including division or cooperation with the CIB)
- iii) Clarification of rights and obligations (location of responsibility, protection of information, etc.) for information management
- iv) Clarification of rights and obligations related to the system and system management

In addition, the MOF has the intention to formulate guidelines for financial statement preparation for SMEs in the near future, while it is expected for each bank to discuss how to use these operations as “standard” at the data development stage.

In the case of operating the CRD in the BOM, even though the section or system in charge is separated from the CIB, consideration is to be given to unifying the external contact point,

⁵⁰ This was clarified in the seminar and the various interviews in this survey. As for the BOM, even informally, it will be possible for it to start operations including immediate system development. However, in the future, after a certain period of operation, the BOM will consider transferring its responsibilities to a private or another public institution outside the BOM at an appropriate time.

which provides credit information. Currently, the renewal and upgrading of the CIB system, which is regarded as old, have been implemented since June this year. A working group on concrete system renewal/sophistication considerations has been established with the support of the IFC etc. and includes sessions at which each bank can voice its opinions. Until the establishment and start-up of the proposed committee, it will be conceivable that the joint working team and this CIB working group will continue to examine the activities in cooperation. Specifically, it can be said that the joint-working team members will participate on the CIB working group by focusing on information sharing and cooperation and considering how CIB and CRD criteria can be divided.

2) Improvement in the Efficiency of credit analysis and the Internal Structure of Financial Institutions to Optimize Loan Interest Rates

It can be confirmed that the introduction of the CRD will contribute to the efficiency of the loan examination procedure based on the experience of Japan or the present situation concerning the utilization of indicators in the scoring model, while the in-house CRD model is generally used in the Western financial community, including the US and European countries. (In Mongolia, it is observed that similar indicators (systems) have already been introduced in-house in the TDB⁵¹.)

As a financial sector-side development in response to this, on June 12, 2018, the “Loan Interest Rate Reduction Strategy 2018-2023” was agreed between the BOM, the FRC, the MOF and the Deposit Guarantee Corporation (DICOM). Among them, as a path towards the realization of a reduction in the loan interest rate, raising the sustainable development of the macroeconomic environment, and strengthening the financial sector and development of the capital market, are proposed. The objectives of improving risk management capabilities and increasing efficiency in banks have also been raised.

In order to reduce the loan interest rate, in addition to the promotion of efforts to increase the savings rate among households, develop the capital market, improve the interbank market and diversify procurement markets, as well as the various aggressive business activities of commercial banks, the efficiency of risk management also contributes.

Furthermore, by introducing objective statistical indicators, the CRD can theoretically

⁵¹ Regarding the TDB’s in-house model, although it was answered in the investigation interviews, it remains unconfirmed as to what level of model this is. Interviewees commented that expectations for the CRD, based on more data, are high and that it will be useful for comparing in-house indices.

contribute to interest rate setting according to risk, while, in the context of an interest rate reduction through streamlining risk management, the CRD can be used to optimize interest rates.

In this way, it is important to consider not only utilizing the information from the CRD for the scoring model of each bank, but also the possibility of increasing the sophistication of the financial sector and reducing interest rates. In addition to the above “committee” and “working group” on the technical side, consideration will be given to the establishment of a “working group” consisting of wider members, including nonbanks, as dealing with these issues will be important.

3) Guarantees and Collateral

As mentioned above, while depending on the positioning of the CRD, there is room for discussion on the efficiency improvement and optimization of the guarantee rate of the CGFM and the means of collateral required for loans following the CRD’s introduction. Based on Japan’s experience, where the guarantee rate of the Credit Guarantee Association is decided on the basis of the default rate provided by its CRD, the Mongolian version will be an effective index, which is one of the criteria for guarantee rate determination for the CGFM in Mongolia.

At present, the guarantee rate is a fixed rate system tailored to the form of bank loan after evaluating the financing examination result of the bank on the CGFM side. While reviewing the guarantee upper limit (reviewing the upper limit of the loan amount from 60% to 80%), consideration of the possibility of a more efficient and appropriate guarantee assessment and guarantee fee calculation in the future by introducing the CRD is important, especially from the perspective of mitigating SMEs’ financial access. To that end, in addition to examining technical evaluation methods when using information from CRD, it is also important to discuss institutionalization, such as review of the CGFM Act (“Law on the Credit Guarantee Fund of Mongolia of 2012”).

For the review system, it may be possible to set up a separate “working group” for discussions, while it is also conceivable to deal with this as part of the agenda of the working group, that is, raising the efficiency of the examination and optimizing interest rates.

(2) Legal System and Organizational Considerations

Regarding the methodology to consider, this should be studied in the future, either by setting up a working group on the legal system or by considering a review of the legal system with a comprehensive agenda performed by the above working group. In either case, at least it is necessary to consider the following viewpoints.

1) Organizing the Legal System Concerning the Introduction of the CRD

○ Information Management Aspect

On introducing the CRD, it will be necessary to clarify how to deal with sensitive information such as loan information or company information relating to commercial bank loans as original data, and debt delay/default information. In particular, in Mongolia, as described above, it is necessary to address the legislation concerning “corporate confidentiality”, “personal information protection, and “information transparency and rights for obtaining information”. In addition, legal confirmation will also be necessary for such information to be clearly separated from information regulated by the “State Confidentiality Act”.

For example, in Article 4, Paragraph 1, Item 3, of the “Personal Information Protection Law”, “trial calculation information” is defined as “personal information” to be protected, but it is not clear whether the original data used for CRD are subject to this or not. Otherwise, another question is prompted about whether the corporate information on the borrower managed by the bank might not correspond to the “individual” in the personal information. Regarding anonymous information, it is not obvious which laws protect and regulate this. At the present time, it is necessary to clarify each and every point that cannot be said to be both ‘yes’ and ‘no’.

○ Central Bank Law, Banking Law, Credit Information Bureau Law and Other Legislation Related to Institutional And Operational Aspects

When CIB LLC Mongolia was introduced and the CIB Law was enacted, along with various BOM decisions, including about the means of providing information from financial institutions, such as commercial banks, establishment standards, the role of the Central Bank and the relationship with banking legislation, confirmation of the interpretation of the provisions was made. If the CRD is installed and operated under the jurisdiction of the BOM for the time being, legal confirmation efforts similar to the CIB or similar will be necessary.

○ Credit Guarantee Fund of Mongolia Law and Other Laws Related to Relevant Organizations

Depending on the operation method/institution of the CRD, as described above, for example, in the case where relationships, in terms of operation, are emerging, such as in mutually applying the guarantee fee rate of the CGFM via the CRD, it will be necessary to confirm the related provisions of the CGFM Law, such as where alignment occurs. Even if necessary changes are made to institutional finance, such as to the collateral system and the SMEDF, it will be important to consider the examination of legal conformity.

2) Management Entity: System Consideration

In the case of newly establishing the management entity as a public organization or in the case of a new management entity, such as the private sector or the third sector, it will be necessary to consider what kind of institutional arrangement should be established in either case. At this stage, given the “management under the jurisdiction of the BOM for the moment”, which is seen as the major opinion on operational direction, it will be necessary to revise the Central Bank Law in order to accompany that authority to the BOM, even as a tentative operation. In this regard, as with the CIB, considering whether to apply the “supervising bank and other person specified by law” criterion of the Central Bank Law (Article 5, Paragraph 1, Item 4) or to create a new form of legal treatment for immediate action will be necessary.

3) Cooperation with Other International Organizations and Other Systems

Currently, the IFC is focusing on updating the BOM’s CIDB system. Regarding the CGFM, in addition to a funds injection of USD 60 million by the ADB, a technical assistance program on the operation side is in its advanced stages. Although there are no substantive activities taking place, the IFC has provided support for the establishment of CIB LLC and the MBA, among others, as well as support for system introduction in CIB LLC. Regarding the CRD itself, there is no sign of support from any institution other than from Japan; as for improving access in relation to financial institution credit information management and SME development, institutional improvements in the form of the CRD and the CIB, cooperation with the CGFM, the SMEDF etc., are important. In order to design an efficient and appropriate system, information sharing and collaboration with a view to seeking mutually complementary effects, while avoiding duplication with related international organizations, co-hosting is also important.

(3) Study on Collecting and Managing Original Data for CRD System Construction (Handling of Financial Statements and Corporate Information)

On introducing the CRD, financial statements (information), corporate information and loan information (including debt delinquency/default information) held by commercial banks are required. In the early stages of the introduction, the method for collecting such information becomes critical. In this survey, it was clear that such information is processed and managed by each bank in its own way. In addition, it was confirmed that a certain database and systemization are present at each bank. However, as these are related to the “personal confidentiality protection” of each bank, it has not been possible to confirm the specific management method, the details of the database and the system situation, as well as the overall situation itself. In other words, it is necessary to confirm in the future the extent of each processing and management method, and how the database and the system are unique to each bank in terms of contents and standardization, including procedure and format.

Even for financial statements alone, although most commercial banks apply the E-Balance format, the details are still unclear. This prompts the following areas of inquiry.

- Whether the subjects that cover the account item are standardized within the bank
- Whether the management period is prescribed as the minimum monthly or yearly information
- Whether minimum standards and procedures are prepared for the information collection method from black notes
- How often updates take place
- Whether there is standardization in updating etc.

In terms of the above, it is not possible to find out responses to the situation unless actual data and detailed procedures and provisions are stipulated in internal regulations. Regarding how to maintain information, the confirmation of various details is necessary. This include questions such as whether there is information on branch management and head office management, whether the management system for each branch office is standardized, whether the data format to be managed is digital or analog, or whether a standard format has been introduced or not. Above all, the questions must be clearly explained.

3.10 Summary of the Feasibility of Introducing the CRD

In the preceding paragraph, the JST explored considerations for a road map for introducing the CRD. Although the extent of this study only looked at issues such as options and directionality,

the road map itself has not completed. Regarding priority, the JST has only completed the conceptualization stage but has not agreed on a specific time axis. The reason for this is that it was quite difficult to confirm actual data, management systems and loan procedures with respect to the working template, as well as the management of original data including financial data and corporate information, which must be confirmed in order to establish the CRD. Furthermore, in terms of obstacles, this study needed to rely on summarized information in the explanations by each institution without seeing it in full. For commercial banks, such information falls under the protection arrangements for corporate confidentiality and personal information; at the same time, there was some element of closedness among companies in Mongolia⁵². In particular, there was a limit to the information that could be accessed by the JST as a third party.

Given these circumstances, it is necessary for the BOM to initiate another investigation in order to gather a certain amount of data and find out whether it is possible to establish a Mongolian CRD model.

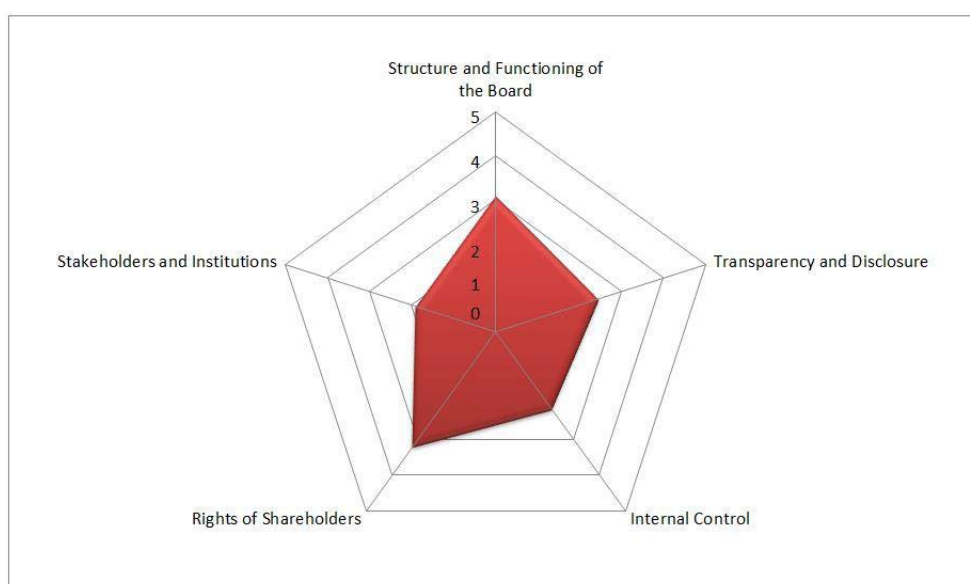
⁵² Currently, in Mongolia, the introduction of full-scale corporate governance, especially efforts to secure transparency in corporate activities, is still in its beginning phase. For this reason, there is one aspect where a passive corporate culture is deeply rooted in disclosing information on internal operations.

4 Current State of Corporate Governance and Issues

4.1 Corporate Governance in Mongolia

The primary sources of corporate governance legislation in Mongolia are the Company Law, the Banking Law and the Law on the Securities Market. As indicated in Chapter 2, the Company Law was approved in 1999 after Mongolia’s transition to democracy, in which general legal grounds concerning companies and corporate governance principles were stipulated. The Corporate Governance Code was adopted in 2007 by the FRC of Mongolia and revised in 2014. Meanwhile, the National Program on Corporate Governance was approved in 2011.

The EBRD conducted an assessment of Mongolia’s 10 largest listed companies, the MSE and law firms in December 2017, while corporate governance practice in Mongolia was assessed as below (Figure 4.1) in the EBRD’s “Corporate Governance in Transition Economies: Mongolia Country Report”. The assessment was conducted in five key areas: structure of the board, transparency and disclosure of company information, internal control, rights of shareholders, stakeholders and institutions. Out of these five areas, three were scored below “fair” and two were scored as “fair”. The assessment also showed that transparency of information and compliance with laws stipulated in the Corporate Governance Code are not fully in effect in the listed companies.



Rating: 1 – very weak, 2 – weak, 3 – fair, 4 – moderately strong, 5 – strong to very strong

Source: EBRD, Corporate Governance Assessment 2016

Figure 4.1 Corporate Governance Assessment of Mongolia

4.2 Current Status and Issues of Corporate Governance Development

(1) Policy of the Government and Related Implementing Organizations

1) Corporate Governance Development

With the enforcement of the Company Law in 1999, corporate governance principles were legislated and a working group in charge of corporate governance was established by the Standing Committee on Economic Affairs of the Parliament of Mongolia. The Securities Committee conducted an assessment of all registered joint-stock companies from October 2000 to 2002 at the direction of the Standing Committee on Economic Affairs. Among the 353 companies that took part in the assessment, 203 were functioning normally, while 124 companies' operations were inadequate and 59 companies had stopped operating altogether.

Mongolia's Corporate Governance Code, based on the OECD Principles of Corporate Governance, was approved in 2007 and revised in 2014. as shown in table 2.4, the basis for corporate governance, shareholders' rights, professional investors, shareholders meetings, the board of directors, executive management, financial reporting, information transparency, internal control system, risk management and stakeholders are comprehensively specified in the code.

2) National Program on Corporate Governance

As indicated in Chapter 2, the National Program on Corporate Governance, approved by a government resolution in 2011, consists of the following seven chapters that are aimed at developing national companies and entrepreneurs who operate according to an international-standard corporate governance code, business principles and ethics.

Table 4.1 Contents of the Program

No	Chapter	Subchapter
1	General principles	-
2	Purpose of the program	1
3	Targeted goals and framework	1
4	Implementation and implementing organizations	6
5	Implementation phases and funding	3
6	Outcome and indicators	2
7	Monitoring and evaluation	2

Source: Government Resolution No. 69, 2011

Within the framework of Chapter 3 of this program, four goals are expected to be achieved: 1) creating a favorable legal and economic environment for implementing the Corporate Governance Code and the Code of Business Ethics; 2) ensuring the leadership of government organizations to implement the Corporate Governance Code; 3) improving the management of companies to ensure the implementation of the Corporate Governance Code and the Code of Business Ethics; and 4) strengthening the capacity of stakeholders and their representatives who are involved in implementing the Corporate Governance Code and Code of Business Ethics. In addition, actions related to confirming shareholders' rights, conducting independent evaluations and supervision of governance practices in listed companies, and establishing a mechanism that ensures the removal of errors will be included in the framework of the third goal, while actions related to assessing corporate governance and creating a mechanism for information dissemination among the public, as shown in Chapter 4, will be included in the framework of the fourth goal. Moreover, one assessment item in Chapter 6 confirms that a corporate governance assessment index will be followed by listed companies, state-owned enterprises and relevant government authorities.

As implementing organizations for the program, the FRC and the MSE were responsible for listed companies, the Government Agency for Policy Coordination on State Property was responsible for state-owned enterprises, and Mongolian Employers Federation, the MNCCI and the CGDC were responsible for limited liability companies. Furthermore, the MOF, the BOM and the former Ministry of Industry were also included in the implementing organizations.

The program was implemented in three phases with funding from the state budget managed by the FRC. Phase I sought to embed corporate governance through the reform of the legal structure in 2011-2012, Phase II was planned to implement the corporate governance program by raising awareness among companies in 2013-2014, and Phase III was intended to conduct a corporate governance assessment and influence business activities after announcing the assessment results in 2015-2016.

According to the findings of a questionnaire survey organized by the National Corporate Governance Council, the achievement level of the program was 80%. A corporate governance assessment was conducted in 2013 among the top 20 companies listed on the MSE, where it was found that companies with good governance amounted to 27.5% of the total number of companies. This number reached 54% in 2016, with 51% of the surveyed companies having

established a board of directors, while 34% were state-owned enterprises.

Table 4.2 Phases for Implementing the National Program

Phase	Goals	Outcomes
Phase I (2011-2012)	Embedding corporate governance through a reform of the legal structure	The Company Law was revised and a legal environment for relevant laws such as the Law on Securities Market was created.
Phase II (2013-2014)	Implementing the corporate governance program by raising awareness among companies	The Corporate Governance Code was revised and 11 organizations started to organize corporate governance training, with the number of participants reaching 3,100. The number is expected to rise further.
Phase III (2015-2016)	Conducting a corporate governance assessment and influencing business activities following the announcement of the assessment results	Corporate governance assessment rules are approved, with assessment reports issued every two years.

Source: Prepared by the JICA Study Team based on interviews

During the implementation of Phase I and Phase II of the National Program on Corporate Governance, the legal environment for corporate governance was consolidated, shareholders meetings and boards of directors in joint-stock companies and state-owned enterprises were established, and the participation of management of companies in governance training was facilitated. The understanding of corporate governance was broadened and participation in training and seminars was increased as a result of developing the legal structure for corporate governance in the form of revising the Company Law and adopting the Corporate Governance Code.

Relevant rules:

- Corporate governance training
- Establishment of auditing, remuneration and nominating committees
- Listed company rules format
- Rules for invitations to shareholders meetings
- Rules for the board activities
- Rules for board secretary activities
- Rules format for shareholders meetings

During the implementation of Phase III of the program, corporate governance assessment rules,

the types of companies that are subject to assessment and assessment timing were defined.

An independent organization, such as the NCCG, can conduct an assessment following a request from a company in which shareholders have raised questions, such as on the remuneration structure of the board and company dividends.

However, Tier I and Tier II listed companies on the MSE are obliged to submit to an assessment every two years and disclose this to shareholders while voluntary assessment is also available for companies with capital raised from the public or organizations that concern the public interest, such as state-owned enterprises, commercial banks, insurance companies, savings and credit cooperatives, audit firms and NBFIs with a special license.

Even though the National Program was planned to be implemented by 2016, it will continue to be in effect following Resolution No. 444 of the FRC from December 2015

3) Industrial Database of the National Development Agency

As indicated in Chapter 3, the NDA is in charge of administrating an integrated industrial database and collecting information on businesses throughout the country. The database contains the following information: 1) year of establishment and history; 2) vision; 3) type of industry; 4) organization, and human resources planning; 5) SWOT analysis; 6) achievement; 7) environmental and social responsibility; 8) development of infrastructure; 9) corporate social responsibility (CSR); 10) business plan; and 11) contact.

The NDA has been working with the NCCG since April 2018 and started to collect corporate governance-related information on its database. Companies registered on the database will be ranked with a higher priority in public procurement and receive more opportunity to deal with large and foreign companies, such as Oyu Tolgoi LLC, which have an alliance with the NDA.

The importance and usefulness of information disclosure will be recognized by the public through the usage of the database along with dissemination activities.

4) Relevant Organizations: National Council on Corporate Governance

The NCCG was established by the FRC to implement the National Program on Corporate Governance. The NCCG is a professional institute with members, whose purpose is to contribute to economic development by improving the assessment of corporate governance, the

sustainable development of the finance and securities market, and the transparency of related information and reporting.

It was decided to continue the implementation of the program and that the NCCG should operate as a self-funding professional organization on the basis of a PPP at the Cabinet Meeting 24 of April 25, 2016.

Members of the NCCG include the president of the MNCCI, the director of the FRC, the vice president of the BOM, the head of division in the Financial Policy Department of the MOF, the head of division in the Government Agency for Policy Coordination on State Property, the head of the Monitoring Office of the MSE, the CEO of the Mongolian Institute of Certified Public Accountants, the secretary of Mongolian Association of Securities Dealers, and the director of the Mongolian National Broadcaster. Currently, there are 10 organizations delivering corporate governance training, staffed by 65 trainers and 15 researchers. The NCCG convenes once a year to approve its annual work plan. Its main activities are summarized below:

- To ensure the implementation of the Corporate Governance Code and relevant laws and to create a favorable business environment
- To promote state leadership in the implementation of the Corporate Governance Code (strengthening the corporate governance of state-owned enterprises)
- To strengthen the management capacity of companies through the Corporate Governance Code and business ethics (in order to support dispute resolution among shareholders and the board and conduct corporate governance assessments of listed companies)
- To strengthen the capacity of stakeholders and representatives of organizations (training, seminars, discussions and advice)
- To conduct the training of trainers in corporate governance and certify the trainers

In addition, according to FRC rules, the NCCG must conduct corporate governance assessments. Table 4.3 shows the levels used for the assessment.

Table 4.3 Corporate Governance Assessment Levels

Score	Assessment
Not less than 75	Good governance: normal operations
50-74	Moderate governance: management of the company could face challenges
25-49	Incompetent governance: monitoring and actions are required for the company
Not more than 24	Poor governance: structural change is necessary

Source: NCCG

The NCCG also promotes cooperation, in the form of training, holding seminars and sharing information, with organizations to which NCCG-certified trainers belong. In particular, internal training is organized in cooperation with the MNCCI whose members are representatives of the industrial sector.

On the other hand, since 2013, NCCG has issued statutory reports on mining and foreign companies in order to promote CSR. However, a small number of companies is also involved in issuing these reports due to their costs and voluntary nature. Besides, the NCCG frequently provides advice to state-owned enterprises; however, the management of those enterprises has frequently been replaced following regime changes, so the advice provided could not be implemented. Moreover, the *Good Governance* magazine on corporate governance is published once every two years in order to disseminate information on developing corporate governance. Up-to-date information is constantly delivered via the magazine's website as well as other media.

(2) Activities by the Private Sector and Relevant Organizations

In Mongolia, there are 11 organizations promoting corporate governance and delivering training in order to develop corporate governance, namely: 1) NCCG; 2) Business School of the National University of Mongolia; 3) Banking and Finance Academy; 4) De Jure Partners; 5) Corporate Governance Development Center (CGDC); 6) Mongolian Employers Federation; 7) Institute of Internal Auditors Mongolia; 8) Mongolian Institute of Certified Public Accountants (MONICPA); 9) Mongolian National Chamber of Commerce and Industry; 10) Mongolian Association of Securities Dealers (MASD); 11) National Academy of Governance.

Table 4.4 summarizes the activities of the organizations that deliver training on corporate governance.

Table 4.4 Organizations Delivering Training on Corporate Governance

Organizations	Activities
NCCG	Specified above in 4.2 (1) 4.
Business School of the National University of Mongolia	Corporate governance training is held in the Business Consulting Center of the Business School of the university. A curriculum, which is delivered by professors and teachers in the fields of business administration, finance and accounting, and law, applies.
Banking and Finance Academy	Established in 2011 after merging with the training center of BOM and the Financial Academy, the Banking and Finance Academy works to prepare personnel for the financial sector and to improve their professional capacity in cooperation with the Mongolian Bankers Association. It has been operating as an NGO since October 2017.
De Jure Partners	De Jure Partners LLC provides legal advice and organizes training on the law. It was established in September 2012.
CGDC	Established in April 2009 by the FRC and the University of Finance and Economics, it is a pioneer organization in corporate governance.
Mongolian Employers Federation	Established in 1990, the purpose of this NGO is to protect the interests of employers and support the private sector. It has branches in 21 provinces and representatives in 61 sums. The Mongolian Employers Federation is associated with 41 professional associations and has 8,100 members.
Institute of Internal Auditors Mongolia	Established in 2002, it offers specialized training for certified bookkeepers, certified accounting technicians, certified internal auditors, certified internal control auditor, certified management accountants, CGA, CCFO and CCEO. The institute delivers training in cooperation with the General Department of Taxation, the Social Insurance Office, the MOF and professional associations.
MONICPA	The MONICPA has 4,000 certified accountant members and 130 auditing firm members with 25 branches nationwide.
MNCCI	The MNCCI was established in 1960. It has 3,226 members, 70% of which are SMEs. One third of the members of the chamber operate in Ulaanbaatar. It has 31 business councils, 21 local branches and more than 60 representatives and honorary representative offices.
MASD	Established in 1995, the MASD has 47 organizational members. Its purpose is to consolidate the status of professional stakeholders in the securities market and to ensure professional involvement in decision-making.
Association of Independent Members of the Board at the National Academy of Governance	Established in 1924, this initially operated as a central school for preparing personnel of the Revolutionary Party of Mongolia, but became an Academy of Governance in 1994. It operated as the State Administration and Management Development Center for some time before becoming the National Academy of Governance again in 1999. The National Academy of Governance provides professional and methodological advice to public organizations, trains and re-trains their employees, and conducts research and analysis. The Association of Independent Members of the Board at the National Academy of Governance delivers training on corporate governance.

Source: JICA Study Team

1) Corporate Governance Development Center (CGDC)

The CGDC is an NGO, which was established in April 2009 by the FRC and the University of Finance and Economics. As a pioneering organization in the development of corporate governance, the CGDC actively delivers professional training, studies and assessments, and provides policy advocacy. The CGDC is one of the organizations that implements the National Program on Corporate Governance for Limited Liability Companies.

Members of the CGDC include the MSE, commercial banks, insurance companies and large foreign companies. The CGDC organizes various training, studies and assessments for legal entities, consulting services and the Annual Corporate Governance Forum. Since 2011, it has been delivering training on the following subjects:

2011 – Corporate governance and the stock market

2012 – Corporate governance in private companies

2013 – Governance in financial organizations

2014 – Governance in regulated organizations

2015 – Reporting and transparency

2016 – Outcomes of corporate governance, state and civil society organizations, and responsibilities of the company

2017 – (Not held)

2018 – Challenges for investors and coordinating organizations when running stable companies

The CGDC conducted a corporate governance assessment for the top 10 companies listed on the MSE with the IFC and the FRC in 2013. The CGDC is the first organization to have conducted a corporate governance assessment on the basis of the IFC handbook. Moreover, as indicated in the latter part (4.4(1) 3), the IFC Family Business Governance Handbook was translated into the Mongolian language by the CGDC.

In cooperation with the IFC, the CGDC has been providing advice to companies to improve the understanding of corporate governance and contribute to the development of the corporate governance system since 2015. In April 2017, the CGDC established the Corporate Secretary Club whose purpose is to develop good corporate governance.

The CGDC also took part in a working group for revising the Company Law and conducted promotional work in the form of seminars, discussions and forums for the revised Company Law in collaboration with the IFC and the FRC.

2) Mongolian Association of Securities Dealers (MASD)

The MASD was established in 1995 as an NGO. It currently has 47 corporate members. Its mission is to consolidate professional stakeholders in the capital market, increase their influence, and ensure professional involvement in decision-making in the capital market. Furthermore, the MASD communicates the opinions of securities dealers to the public. It works to build its members' capacity and protect investor interests by submitting comments on relevant laws and regulations.

The MASD also issues licenses for the security trade, provides continuing education for licensed representatives and organizes training on corporate governance. The trainings on corporate governance was organized once in 2015 with 15 participants, once in 2016 with 18 participants, and five times in 2017 with 75 participants.

3) Mongolian Institute of Certified Public Accountants (MONICPA)

The MONICPA has around 4,000 members comprising certified public accountants and 130 members of audit firms with 25 branches nationwide. In the past, the MONICPA supervised audit firms; however, the Department of Accounting Policy in the MOF is supervising them under the revised audit legislation. Regarding accounting for SMEs, the Accounting Law stipulates the adoption of the IFRS for SMEs. These were translated into Mongolian by the MONICPA, which works to implement them with the Department of Accounting Policy. The MONICPA also organizes trainings to members and non-members; however, corporate governance, risk management and business ethics are parts of the curriculum of training on accounting. The purpose of this training is to provide a better understanding of corporate governance through its members among their clients

(3) International Organizations

1) International Finance Corporation (IFC)

Since 2009, the IFC has supported and worked actively on the development of corporate governance in Mongolia. As of today, the IFC's corporate governance consulting services have

been provided to the Khan Bank, the Khas Bank, the Golomt Bank, the Capital Bank, the Max Group and Erdenes Mongol LLC, a state-owned enterprise. The IFC supported the FRC in revising the Corporate Governance Code in 2014. Furthermore, it conducted a corporate governance assessment (Table 4.5) of the top 20 companies on the MSE in cooperation with the CGDC in 2013.

Table 4.5 Corporate Governance Assessment

	Indicators	Score
A	Rights of shareholders	22
B	Equitable treatment of shareholders	19
C	Stakeholders' roles	14
D	Transparency and reporting of information	32
E	Responsibilities of the board	36

Source: Corporate Governance Score

Moreover, the IFC supported the establishment of the CGDC and has been a sponsor of the Corporate Governance Forum, organized by the CGDC, since 2009. The IFC also organizes the Annual Reporting Awards of Mongolia with the CGDC to improve annual reporting. Additionally, the IFC has issued number of reports on corporate governance research and handbooks in the Mongolian language.

2) US Agency for International Development (USAID)

Within the framework of the economic development support project, in 2011, the USAID organized training for the board members of state-owned companies to improve their corporate governance jointly with the MOF and the State Property Committee (now the Government Agency for Policy Coordination on State Property). In 2013, a self-assessment form for governance was formulated during the Business Plus Initiative Project. It has been used to introduce practice in the implementation of corporate governance-related legislative acts and regulations and notable international applications.

3) Asian Development Bank (ADB)

In 2013, the ADB, along with the CGDC, organized a training of corporate governance for the BOM and commercial banks in order to improve corporate governance and ensure stakeholders'

involvement in the finance sector. There were 52 officers from the BOM and 20 officers from commercial banks who took part in the training.

4) European Bank for Reconstruction and Development (EBRD)

In 2017, the EBRD conducted the “Corporate Governance Legislation Assessment Project” in Mongolia as well as issued survey reports including the “Corporate Governance in Transition Economies: Mongolia Country Report” as indicated in 4.1.

The EBRD’s roles in Mongolia include the implementation of corporate governance and supporting the SME sector. Its involvement in the SME sector comprises three main activities: improving the business environment, developing organizations that support SMEs and providing advice to new entrepreneurs. Organizations that support SMEs include the Mongolia Management Consulting Institute, the Banking and Finance Academy, the Mongolian Mining Association, the MNCCI and the University of Finance and Economics.

Within the framework of the project on supporting SMEs, 600 SMEs have been provided with consulting services and advice on corporate governance and management so far.

(4) Issues in Corporate Governance

A legal structure for governance, namely the Company Law, the Law on Securities Market, the National Program on Corporate Governance and the Corporate Governance Code, which mostly focuses on listed companies and state-owned enterprises, is properly established in Mongolia. NGOs and international organizations such as the NCCG, the CGDC, the IFC and the EBRD are working actively to develop/disseminate good corporate governance.

However, as demonstrated in the EBRD report, corporate governance practice has not been properly adopted, even among the top 10 listed companies. During interviews with representatives of the capital market, it was stated that: “There are some directors who prefer to convert to a private company by delisting from the MSE rather than remain as a listed company and follow the existing laws and regulations of corporate governance. Therefore, we still need some time to adopt proper practice of good corporate governance”.

Corporate governance should be introduced on a voluntary basis in accordance with the demands and needs of companies without forcing them to abide by laws and regulations. Assessments are conducted on a voluntary basis and companies make requests only when disputes arise. The benefits of good corporate governance are usually addressed in terms of

improvements in the management system; however, if good governance enables companies to improve their corporate value, they may receive more business opportunities, such as alliances with other companies, access to new technologies, the acceptance of new investment and the development of new sales channels. Therefore, more dissemination of corporate governance shall be required in order to promote a better understanding among companies.

However, since the boards of the state-owned enterprises are typically appointed by the Cabinet, the necessity to develop corporate governance practice in such enterprises is relatively higher. A mechanism by which to appoint an independent director with no conflicts of interest needs to be established. Although the management of state-owned enterprises is obliged to take part in corporate governance training according to the Company Law, there is still a failure to stabilize the situation due to the frequent replacement of board members.

On the other hand, SMEs are not subject to legal obligations in the same way as listed companies and state-owned enterprises are in other countries. In addition, they do not have any obligations in terms of being assessed in terms of their governance practices, as this can only be conducted on a voluntary basis. This means that no companies that submit to assessments being conducted. Even though an awareness of good corporate governance is relatively developed, as indicated in 4.3, due to the limited motivation caused by higher costs compared with expected benefits, corporate governance is not a high-priority management issue to be implemented by SMEs, which would rather put their efforts into surviving in an unfavorable environment. Therefore, government policy to promote corporate governance among SMEs should include specific incentives by reducing interest rates for borrowing from commercial banks and financial organizations and giving tax exemptions when a certain score on a corporate governance assessment is achieved. Furthermore, specific incentives such as easy access to finance, favorable conditions for export, the introduction of large or foreign companies with an opportunity to trade, making alliances and forming joint venture will be efficient ways to disseminate corporate governance practices.

4.3 Current Status and Issues for Corporate Governance Practices in Small and Medium-sized Enterprises and Microbusinesses (from the Survey Findings)

(1) Summary of the Survey

A survey was conducted in order to define the current status and issues for corporate governance. Industrial sectors (excluding mining, real estate, banking and finance) operating in Ulaanbaatar, which are expected to contribute to industrial diversification, were included in the survey. The survey was conducted in questionnaire form by considering the sector, size, type, activities and structures of the legal entities.

It was intended that the following two categories of legal entities would take part in the survey, comprising 3,400 members of the MNCCI (1,100 of them located in Ulaanbaatar): “legal entities that are expected to introduce corporate governance into their activities” and “legal entities that are expected to receive financial support from the JICA and other donor organizations for SMEs”.

- 1) Tier 1 and Tier 2 listed companies on the MSE (approximately 300 companies)
- 2) Companies that have participated in business training courses at the Mongolia-Japan Center for Human Resources Development (approximately 550 companies)
- 3) Companies that have received financing from the “Two-step Loan Project for Small and Medium-sized Enterprises’ Development and Environmental Protection” (JICA) in the past (approximately 700 companies)
- 4) SMEs that are members of the MNCCI (sole proprietors etc.)

However, the companies that mainly took part in the business course delivered by the Mongolia-Japan Center for Human Resources Development participated in the survey due to the limited time that was available for conducting the survey and issues related to confidentiality on the part of the companies. It was considered appropriate that the companies that had taken part in the business course were primarily SMEs, while the management bodies of the companies were willing to expand their businesses while ensuring business stability.

The survey was conducted from April 17 to May 25, 2018, via questionnaires issued to 554 legal entities. Among the legal entities participating in the survey, 12 companies were listed, 180 companies had taken part in the business course at the Mongolia-Japan Center for Human

Resources Development, and 16 companies were borrowers of TSLs from the JICA.

(2) Legal Entities Participating in the Survey

The population of the surveyed companies according to industrial sector may be similar to the distribution of industries in Mongolia. However, in this survey, the distribution of companies in the industrial and construction sectors may be a little more than the average distribution. On the other hand, the distribution of the agriculture sector, the largest sector in terms of total GDP, may be a little smaller than the average distribution. The reason why the agriculture sector is a little smaller is that the majority of the surveyed companies were located in Ulaanbaatar City.

When the number of staff of the surveyed companies is compared, 70% of companies were micro-enterprises with no more than 20 staff, and the remaining 30% were mostly of a medium size. According to the SME Law, an enterprise with no more than 19 staff is a micro-enterprise, an enterprise with 20-49 staff is of a small size, and an enterprise with no less than 50 but no more than 1,499 staff is a medium-sized enterprise. Micro-enterprises with no more than 20 staff constitute 90% of the total registered companies in Mongolia; therefore, the proportion of SMEs that took part in the survey is relatively higher. This may be explained by the fact that the majority of companies had taken part in the business course at the Mongolia-Japan Center for Human Resources Development. The survey findings suggest that there are companies with resources to introduce corporate governance practices into their operations, as well as SMEs with ambitions to expand their businesses; thus, the purpose of the survey was accomplished given that the surveyed companies are capable of introducing corporate governance practices and access to finance.

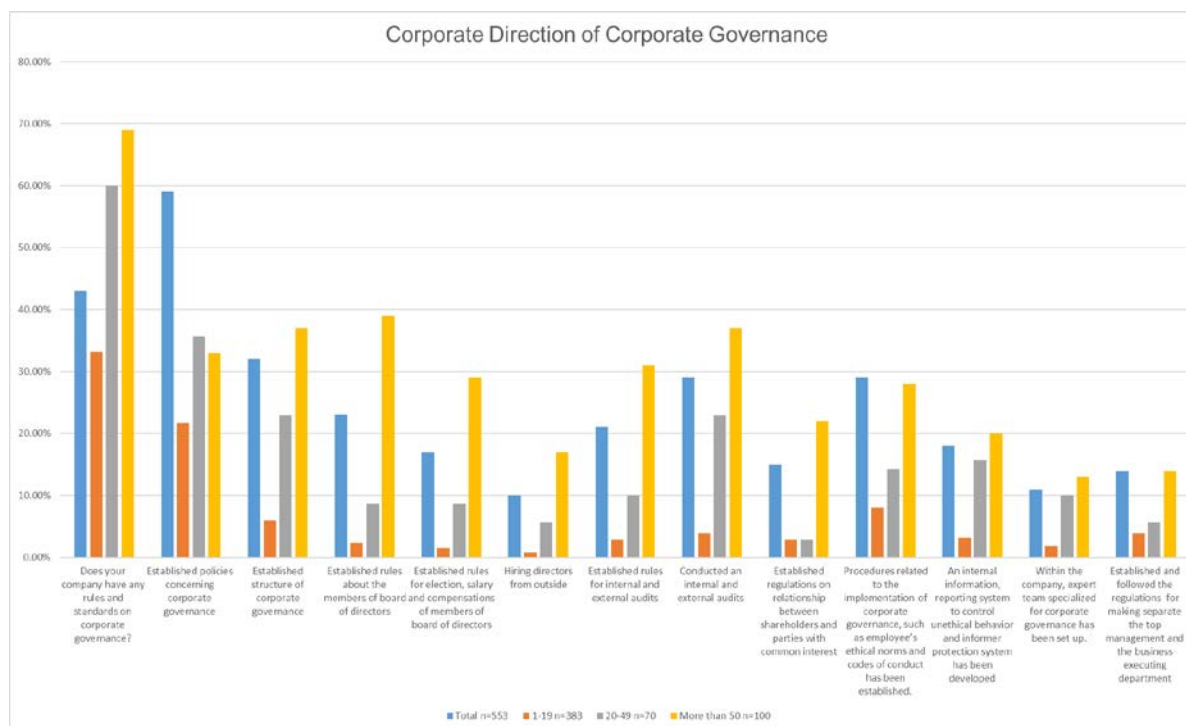
Regionally, 483 companies (87%) were registered in Ulaanbaatar and 70 companies (13%) were registered and operating in other aimags. Regarding the operating years, the majority of the companies had been in operation for more than 10 years on average.

(3) Corporate Governance Survey Findings

In order to clarify the actual situation concerning corporate governance practices through the survey, the questionnaire explored the existence of internal rules for corporate governance, the existence of boards of directors and shareholders meeting, the appointment of independent directors, transparency and disclosure of information, and decision-making processes.

43% of the surveyed companies responded that they have internal rules for corporate

governance. According to the survey findings, the majority of the companies responded that they have 1) established policies concerning corporate governance, 2) established rules and standards on corporate governance, 3) an established structure of corporate governance, 4) conducted internal and external audits, and 5) established rules about the members to board of directors (see Figure 4.2).



Source: JICA Study Team

Figure 4.2 Legal Entities with Rules for Corporate Governance

25% of the surveyed companies had a board of directors and 51% employed more than 50 staff. Regarding the structure of the board of directors and shareholders, 58% of the companies had a non-family member on the board of directors and 60% of the companies had shareholders from outside the family. Companies with separate decision-making and implementing functions constituted 6%.

Companies were inactive in terms of transparency and disclosure of information, while only one third of the surveyed companies made information available about themselves via their websites and on the Internet. In addition, only 47 companies, that is, less than 10% of the surveyed companies, made information regarding their investments available. Furthermore, just one joint-stock company and two companies engaged in trade with foreign companies uploaded

their corporate governance assessment report on their website. Two thirds (62%) of the surveyed companies responded that they question the accuracy of financial statements that made public. Transparency and disclosure of information are poorly demonstrated in practice, since the advantages are not evident and due to the existing practice of issuing double statements.

(4) Finance-related Issues

Finance related issues were surveyed on the basis of financial reports, the timely submission of reports to the relevant authorities, financial sources, credit analysis processes for loans and credit information. Moreover, since access to finance is a major issue for SMEs, loans from commercial banks and financial institutions and burdens during credit analyses conducted by them were also clarified.

58% of the surveyed companies submitted their annual reports to both the General Department of Taxation and the MOF, while 41% of companies submitted their reports only to the General Department of Taxation. Regarding loan issues, 445 companies (80%) responded that ‘interest rates are high’, 367 companies (66%) responded that the ‘appraisal value of collateral is lower than expected’, 294 companies (53%) responded ‘too many documents are required for loan applications’, and 238 companies (43%) responded that ‘repayment terms are short’ (see Table 4.6). 60% of the companies had loans from commercial banks and nonbanking financial institutions, 10% had loans from individuals, and 30% had never taken out a loan.

57% of the companies with more than 50 staff, 36% of companies with 20-49 staff and 20% of companies with one-19 staff had loans from commercial banks. The reason for the significant number of companies that had never borrowed a loan previously was due to high interest rates, short repayment periods and not being able to pass the credit analysis.

Table 4.6 Issues Related to Loans from Commercial Banks

No	Issues	No. of companies answered	% of total companies
1	High interest rates	445	80%
2	Low collateral valuations	367	66%
3	Too much documentation for applications	294	53%
4	Short repayment periods	238	43%

Source: JICA Study Team

(5) Assessment of Governance for Legal Entities Participating in the Survey

The IFC's SME corporate governance progression matrix was used to perform the following analysis given that most of the surveyed companies were SMEs.

1) Commitment to Good Corporate Governance

Commitment to good corporate governance is assessed in term of whether core divisions, such as accounting, legal and administration, are in place, basic operational and strategic planning is occurring, management has the ambition to develop corporate governance and commitment to good governance has been communicated to staff and stakeholders.

43% of the total surveyed companies had their own corporate governance code: in terms of company size, this concerned 33% of the companies with one-19 staff, 60% of the companies with 20-49 staff and 69% of the companies with more than 50 staff. The IFC's SMEs corporate governance progression matrix of the IFC was again used to perform the following analysis given that most of the surveyed companies were SMEs.

Among the 12 listed companies that were surveyed, 10 have developed their own corporate governance code. The survey findings show that even SMEs are taking relevant steps in relation to corporate governance. They also show that some small-sized enterprises with less than 19 staff had introduced an enterprise resource planning system and controlled the orders of customers, production control, stock control and financial management in an integrated manner. Furthermore, it also shows that one company has developed a written manual and guidance to communicate with customers, as well as treats complaints and requests from its customers during its meetings. There is also a number of companies whose staff have attended professional training courses, either held domestically or abroad, to improve the work environment.

The aforementioned examples show that an awareness of corporate governance is not always low among SMEs. It rather depends on the understanding and ambitions of management. Therefore, continuing efforts to raise awareness of and disseminate corporate governance principles towards SMEs are necessary.

2) Decision-making and Strategic Planning

Decision-making and strategic planning development are assessed in terms of whether a founder makes decisions on strategy, financing and staffing, informal external advisers are engaged,

executive decisions are made by key executives or the board and independent directors are hired.

24% of the surveyed companies had a board of directors, 17% had internal rules to regulate the selection of board members, their salaries and allowances, while 10% had recruited independent directors. Since 42% of the surveyed companies had a board consisting of family members and 40% had shareholders who were family members, 86% of the surveyed companies can be categorized as family businesses. Therefore, only the founder or general director made decisions without collecting or respecting others' opinions. While the majority of the surveyed companies were family businesses, succession planning remains necessary; however, only 17% of the companies had taken related actions for succession planning. The visit interviews showed that the opinion of the key decision maker would supersede any previous discussion with managers during the negotiation of foreign investment and transactions.

3) Internal Control

Internal control is assessed in terms of whether hiring accountants, performing external audits, controlling budgets, filing financial reports, declaring tax, establishing human resources and information technology divisions, and recruiting independent directors.

Regarding financial report filing and tax declarations, 58% of the companies submitted their financial reports to the General Department of Taxation and the MOF in a timely manner, 37% of the companies submitted their reports only to the General Department of Taxation, 4% of the companies submitted their reports only when they were reminded by the authorities, and 1% answered that they neither meet deadlines nor submit reports. 65% of the surveyed companies recruited accountants, 30% of the companies employed a part-time accountant, and 5% of the companies hired an accounting firm.

Even though it was legitimized by the Law on Accounting to follow the IFRS for SME reporting, it is inconvenient to implement these standards due to the lack of relevant handbooks and guidelines. The unavailability of integrated accounting software imposes more burdens. Furthermore, two sets of accounting books are known to be popular and the accuracy of financial statements are questioned.

Table 4.7 Financial Reporting of the Surveyed Companies

	2-8) Does your company have full time accountant?	2-9) If answered "No", Does your company have a Contract Accountant?	2-18) Do you think that Mongolian companies report their financial statements in a different ways?	2-20) Can you trust publicly available financial statements of Mongolian companies?
Total	Yes	374 68%	Contract Accountant 152 27%	Yes 254 46%
	No	179 32%	Full time Accountant 9 2%	No 340 61%
			Other(Exe.director etc.) 18 3%	
1 - 19	Yes	211 55%	Contract Accountant 146 38%	Yes 173 45%
			Full time Accountant 8 2%	
			Other(Exe.director etc.) 18 5%	
2 - 49	Yes	64 91%	Contract Accountant 5 7%	Yes 33 47%
			Full time Accountant 1 1%	
More than 50	Yes	99 99%	Contract Accountant 1 1%	Yes 48 48%
			Full time Accountant 0 0%	

Source: Survey findings

4) Transparency and Disclosure

Transparency and disclosure of company information are assessed in terms of whether a company's financial reporting is in accordance with the IFRS, its financial statements are audited by an audit firm, a company profile has been developed and it discloses company information on its website.

33% of the surveyed companies (180) make their information available on their website. Among these 180 companies, 47 make their information available to investors, 20 make their information available to shareholders, 10 make their corporate governance practices public, and six make their corporate governance reports available. There were 27 companies that make their profile, business plans and actions available to investors in order to attract investments.

Regarding financial reporting, there were 20 companies that submit their financial reports to the General Department of Taxation and the MOF in a timely manner or make information available on their website regarding their reports, while the reports of nine companies are prepared internally or by an accounting firm.

Table 4.8 Transparency of Information of the Surveyed Companies

2-12) If answered "Yes" for the question No 11, what kind of information is provided? (Multiple answers possible)	Financial statement		Financial statement reports done by the company's internal or professional accounting firms		Current activity reports for investors and shareholders		Company introduction and business plan for investors who are planning to invest		Action plan for investors (company introduction meeting, investment meeting, etc.)		Dividends and compensations paid to investors and shareholders		Directions of corporate governance		Corporate governance reports		Information to other investors	
Total	20	4%	9	2%	20	4%	16	3%	11	2%	12	2%	10	2%	6	1%	11	2%
1-19	3	1%	0	0%	3	1%	1	0%	0	0%	2	1%	2	1%	1	0%	6	2%
2-49	5	7%	3	4%	4	6%	2	3%	1	1%	2	3%	2	3%	0	0%	2	3%
More than 50	12	12%	6	6%	13	13%	13	13%	10	10%	8	8%	6	6%	5	5%	3	3%

Source: Survey findings

Concerning the survey findings on the transparency and disclosure of company information, it seems that Mongolian companies are not willing to implement these measures. Despite this issue being common in developing countries, it is a characteristic of Mongolian companies not to disclose detailed information about their activities in order to avoid losing their technology and trade know-how. Moreover, responses obtained during the visit interviews usually indicated that companies thought it was risky to disclose information.

Furthermore, one of the reasons why companies do not disclose their information may be that they do not trust the accuracy of financial reporting of other companies. It should be highlighted that transparent and accurate reporting can contribute to increasing the foreign customer base and attracting investments.

5) Founder and Family Members

In terms of the founder and family members, this aspect is assessed in terms of whether the role and responsibilities of the founder have been clearly determined with other family members, the distinction of the roles between family and non-family members, and holding annual shareholders meetings.

72% of the surveyed companies had a family member among their shareholders and the board of directors, 15% selected board members from among their own employees, and 7.8% selected the director from among non-family members. There are many cases where disputes had arisen between the company and non-family members due to the unclear separation of roles in decision-making and unclear definitions in contract terms. Regarding financial reporting, there

were 20 companies that submit their financial reports to the General Department of Taxation and the MOF in a timely manner or make information available on their website regarding their reports, while the reports of nine companies are prepared internally or by an accounting firm.

6) Conclusion of the Survey

The findings of the survey and the responses from the visit interviews show that the internal system within companies is not ready to accommodate good corporate governance. It is for this reason that the understanding and awareness of corporate governance are inadequate, while human resources are insufficient. However, in terms of the age and size of the company, there are numerous companies implementing good corporate governance depending on the understanding and aspiration of the management. On the other hand, companies with long operating experience and a large number of employees also face many issues, such as the lack of reporting and transparent operations, the issuance of duplicated reports, and non-involvement in decision-making except involving the family members.

There is a potential opportunity to introduce corporate governance practices in a favorable business environment where new businesses and ambitious young entrepreneurs are involved in taking appropriate measures. In other words, even though there is lack of implementation on corporate governance, a positive change could take place if SME participation is increased by taking advantage of the developed training system.

The findings of the survey show that Mongolia's entrepreneurs, company directors and executive officers are failing to take measures to implement corporate governance, despite understanding its importance.

If the resolution of these issues will enable companies to receive more financial arrangements and expand their business through cooperation with foreign companies, they may have more motivation to improve corporate governance and disclose more information. However according to the survey findings, the surveyed companies believe that such attempts may undermine their competitiveness and deny them such benefits. These companies do not value information disclosed by other companies since they do not consider disclosed information from others to be true.

Therefore, the promotion and dissemination of corporate governance should be addressed in

terms of the benefits linked to government policies and programs.

Although the benefits of good corporate governance are usually recognized only with regard to improvements in the management system, the higher corporate value achieved by good governance may enhance further business opportunities, such as alliances with large or foreign companies, access to new technologies, the acquisition of new investment and the development of new sales channels. Therefore, more dissemination of corporate governance will be required in order to increase understanding among companies.

4.4 Self-assessment Tool for Corporate Governance

Self-assessment tools, in general, are intended for managers to grasp the current state of corporate governance in their company, improve the points of strength and fix the weaknesses. However, in the case of SMEs, unlike listed companies, there are often lower-level incentives for introducing good corporate governance in order to increase the enterprise value of the firm. To deal with this point, as well as obtain external financing from financial institutions, deal with business partners and create potential partnerships and/or form joint ventures with large companies and foreign companies, using the outcomes from the self-assessment tool may help in learning about the required credibility.

In this section, we will: (1) examine existing materials on corporate governance (manuals, guidelines etc.); (2) examine existing self-assessment tools in other countries; (3) examine existing self-assessment tools in Mongolia (“Questionnaire for the Evaluation of Corporate Governance and the Code of Conduct for Companies Listed on the Mongolian Stock Exchange”). We will then: (4) analyze the feedback from the data collection survey; (5) analyze the feedback from Japanese firms; (6) introduce the self-assessment tool created using the above information; and (7) explain the feedback from the workshop where the self-assessment tool was tested.

(1) Existing Materials on Corporate Governance (Other Countries and International Organizations)

Many manuals and guidelines on corporate governance have been issued by international organizations, government agencies and NGOs. In general, most corporate governance materials focus on minority shareholder protection and effective decision-making structures

through boards of directors and general shareholders meetings for companies that raise capital from the capital market and have multiple external shareholders. However, some corporate governance materials on owner companies and SMEs do exist.

First, we will look at the G20/OECD Principles of Corporate Governance and the Corporate Governance Code of Japan as representative corporate governance principles for listed companies. Then we will review the IFC Family Business Guidelines for owner companies and the Guidelines on Corporate Governance for SMEs in Hong Kong.

1) G20/OECD Principles of Corporate Governance

The G20/OECD Principles of Corporate Governance were first issued in 1999 based on a statement that, “although there is no single model of good governance for each country, there are some common elements that can be modified to improve each country’s legal framework and the governance at company level”. The Principles were revised in 2004 and 2015 and are intended “to help policymakers evaluate and improve the legal, regulatory, and institutional framework for corporate governance with a view to support economic efficiency, sustainable growth, and financial stability”. They are considered to be “an international benchmark for policymakers, investors, corporates, and other stakeholders worldwide”.

In addition, the Principles focus “on publicly traded companies, both financial and non-financial. To the extent they are deemed applicable, they might also be a useful tool to improve corporate governance in companies whose shares are not publicly traded. While some of the Principles may be more appropriate for larger than for smaller companies, policymakers may wish to raise awareness of good corporate governance for all companies, including smaller and unlisted companies.” Therefore, it is intended that policymakers and market participants in each country should use the Principles to develop a corporate governance framework in their own country considering country-specific economic, legal and cultural differences.

The main content of the 2015 Principles of Corporate Governance is shown in Table 4.9.

Table 4.9 Contents of G20/OECD Principles of Corporate Governance

No	Principle	Outline of Principle	Descriptions
1	Ensuring the basis for an effective corporate governance framework	The significance of the framework of corporate governance, which promotes the efficient allocation of resources and a transparent and fair market, and that is consistent with the rule of law, supporting supervision and enforcement	<p>A: Perspective for developing a framework for corporate governance</p> <p>B: Legal and regulatory requirements that affect corporate governance practices</p> <p>C: Division of responsibilities among different authorities</p> <p>D: Stock market regulation</p> <p>E: Authority, integrity and resources of supervisory, regulatory and enforcement bodies, and the timeliness and transparency of their rulings</p> <p>F: International cooperation on cross-border transactions</p>
2	The rights and equitable treatment of shareholders and key ownership functions	Protection of shareholders' rights, promotion of exercise of rights, ensuring fair treatment of all shareholders, and measures to fix infringement of rights	<p>A: Basic shareholder rights</p> <p>B: Provision of information for decision-making by shareholders, and the right to give approval to decision-making or participate in decision-making</p> <p>C: Opportunities to exercise voting rights at general shareholders meetings and the provision of information regarding rules on general shareholders meetings</p> <p>D: Consultation with shareholders regarding shareholder's basic rights</p> <p>E: Equal treatment of all shareholders of the same series in a class.</p> <p>F: Approval and execution of related party transactions.</p> <p>G: Minority shareholders' rights and protection from abusive actions.</p> <p>H: Transparency of rules and procedures governing transactions, such as acquisitions, and the proper operation of anti-takeover measures</p>
3	Institutional investors, stock markets and other intermediaries	Impact of the investment chain on incentives to engage in good corporate governance	<p>A: Corporate governance and voting policies by institutional investors acting in a fiduciary capacity</p> <p>B: Votes in line with the directions of the beneficial owners of the shares</p> <p>C: Management of material conflicts of interest that must be disclosed</p> <p>D: The corporate governance framework should require intermediaries to provide analysis or advice relevant to decisions by investors, as well as disclose and minimize conflicts of interest that might compromise the integrity of their analysis or advice</p> <p>E: Prohibition of insider trading and market manipulation</p> <p>F: For companies that are listed in a jurisdiction other than their jurisdiction of incorporation, or for cross listing, the applicable corporate governance laws and regulations should be clearly disclosed</p> <p>G: Fair and efficient price discovery structure</p>

4	The role of stakeholders in corporate governance	Recognition of the rights of stakeholders and encouragement of cooperation between corporation and stakeholders	A:Respect for the rights of stakeholders B:Protection from violation of the rights of stakeholders C:Mechanism for employee participation D:Access to information by stakeholders when participating in corporate governance E:Communication by stakeholders to the board of directors and to public authorities F:Effective, efficient insolvency framework and effective enforcement of creditor rights
5	Disclosure and transparency	Timely and accurate disclosure of material matters regarding the corporation	A:Types of material information that must be disclosed B:Standards of accounting that regulate the quality of disclosed information C:Implementation of audits that can provide independent assurance on the disclosed information D:Duties and responsibilities of external auditors E:Channels for disseminating information and the rules of disclosure
6	The responsibilities of the board	The board's accountability to the company and the shareholders	A: The board's due diligence and care and its fiduciary duty B: Fair treatment of all shareholders by the board C: The board's ethical standards and consideration of the interests of stakeholders D: Key functions of the board E: Objectivity and independence of the board F: Access to internal company information by the board G:Duties, responsibilities, actions, access to information and independence of employees acting as directors

Source: G20/OECD Principles of Corporate Governance

2) Japan's Corporate Governance Code

Based on the “Corporate Governance Code Original Proposal” compiled by the Experts Meeting on the Formulation of the Corporate Governance Code in March 2015, the Corporate Governance Code was established as an appendix to the Securities Listing Regulations of the Tokyo Stock Exchange, when the related listing regulation was also improved. The background to this code is the Stewardship Code, the behavioral principle of “responsible institutional investors”, which was formulated and announced based on the measures in the “Japan Revitalization Strategy”, as approved by the Cabinet in 2013. Therefore, as the behavioral principle of companies, the Corporate Governance Code was formulated and promoted to support the sustainable growth of corporations and improvement of corporate value over the medium to long term based on measures in the “Japan Revitalization Strategy” (revised 2014), as approved by the Cabinet in 2014. After that, based on the recommended revision at a follow-up meeting concerning the Stewardship Code and the Corporate Governance Code, a

revision was made in June 2018 to the code.

In this way, the Japanese Corporate Governance Code was created for listed companies. It has the following two features: first of all, it adopts the so-called “principle-based approach” so that companies can realize effective corporate governance according to the circumstances of each company; next, unlike laws and regulations, the code does not comprise legally binding principles, but is rather based on a so-called “comply or explain” method (whether to implement the principles or to explain the reason).

As shown in Table 4.10, the Corporate Governance Code consists of five general principles, which are: (i) securing the rights and equal treatment of shareholders; (ii) appropriate cooperation with stakeholders other than shareholders; (iii) ensuring appropriate information disclosure and transparency; (iv) responsibilities of the board; (v) dialogue with shareholders. There are 31 principles and 42 supplementary principles within these general principles. In the June 2018 revision, the following additions were made to the general principles: (General Principle 1) expansion of description on share cross holding (strategic holding); (General Principle 2) description of the management of the corporate pension reserve fund; (General Principle 3) disclosure of the Environment Society Governance (ESG) elements as non-financial information; (General Principle 4) additions to the roles and responsibilities of the board of directors, advisory committees, the independence and diversity of members of the board of directors, qualification requirements of corporate auditors, formulation and disclosure of management strategies and management plans.

From the fact that most of the items are included in General Principles 1-4, it can be understood that the code is intended for publicly traded companies, where ownership and management are separated due to the large number of shareholders.

Table 4.10 Contents of Japan’s Corporate Governance Code

No	General principle	Number of principles	Number of supplementary principles
1	Securing the rights and equal treatment of shareholders	7	11
2	Appropriate cooperation with stakeholders other than shareholders	6	3
3	Ensuring appropriate information disclosure and transparency	2	4
4	Responsibilities of the board	14	21
5	Dialogue with shareholders	2	3

Source: Corporate Governance Code

According to the survey compiled by the Tokyo Stock Exchange on the status of compliance with the Corporate Governance Code, as of July 2017, 25.9% of the 2,540 companies listed on the First Section and the Second Section of the exchange had implemented all 73 items, while 63% of the companies had implemented 90% or more of the items.

3) International Finance Corporation's Family Business Governance Handbook

In order for IFC staff to understand the issues of corporate governance in the target companies when making investment decisions and giving advice, the IFC has issued numerous documents targeting seven types of companies: listed companies, family- or founder-owned enterprises, financial institutions, privatized transition economy companies, state enterprises, funds and SMEs. For analyzing the issues of corporate governance in these companies, toolkits including an instruction sheet, a progression matrix, a document request list and an information request list have also been prepared.

The Handbook for Family Business Governance, which was also issued in order to improving the governance of family-owned businesses, has been translated into multiple languages, including Mongolian. This is a unique document, which proposes governance issues and countermeasures focusing on family companies, whether large or small. The contents of the document are as follows:

(i) Strengths and Weaknesses of Family Businesses

Family companies show superior financial performance compared to their peers because of owners' strong commitment, knowledge transfer to the next generation, and the trust and pride. On the other hand, the following are considered weaknesses: complexity of ownership and employment of family members, informal activities especially at the beginning of operations, and a lack of attention on strategic planning and hiring a CEO, which are critical for long-term success.

(ii) The Roles of Family Members in Business Governance and Potential Conflicts of Interest

An individual in a family company usually has multiple roles and responsibilities, which makes matters complicated.

Owner: It is common for family members to assume multiple roles in the business, such as

owner and manager. However, as the family company grows, the owner and the manager will have different roles with different incentives, making the situation become complicated.

Manager: It is common for managers who are family members to be treated differently to those who are non-family members. Non-equal treatment is a barrier to attracting outstanding talent from outside.

Directors: Most of the members of the board of directors in a family company are family members. Conflict surfaces when determining whether a family member should be treated as a board director or a manager.

Family members: Asymmetry of information among family members can be a potential conflict.

(iii) How to Improve the Governance of Family Members

When the business is still at the founding stage, governance issues rarely arise because of the strong will of the founder and the strong family ties. As time goes on, however, the number of family members increases and governance problems occur. Therefore, it becomes necessary to establish a clear governance system to ensure discipline among family members. A good family governance system aims to:

- Communicate to all family members and convey the family value, mission and long-term vision
- Continually convey important business decisions and accomplishments to family members
- Establish rules on family members' employment, dividends and other benefits from the business
- Make available formal communication channels for family members
- Allow family members' participation and make any necessary decisions together

In practice, the governance system is established in the form of a family constitution and a family institution.

The Corporate Governance Scorecards also include a sample scorecard for IFC employees to use when making investment decisions in family businesses. The contents are shown in Table 4.11.

Table 4.11 Analysis of Corporate Governance in Family Businesses

No	Item	No. of questions
1	Commitment to corporate governance	4
2	Family governance	5
3	Rights of shareholders	3
4	Affairs of the board of directors	5
5	Control environment	6
6	Transparency and disclosure	4

Source: IFC Corporate Governance Scorecards

4) Guidelines on Corporate Governance for Small and Medium-sized Enterprises in Hong Kong

There are only a few documents and studies on SME corporate governance. The reason is that corporate governance is generally understood as a condition by which companies gain access to the capital market, while the merits and cost benefits for SMEs, which have no connection to the capital market, have been considered to be low. However, corporate governance can be used as a tool to improve the foundation for supporting company growth for SMEs. To this end, the Hong Kong Institute of Directors issued guidelines for corporate governance for SMEs in 2003 and provided them as a tool for the strategic direction of companies, business development and internal control setting. The main content of the second edition, revised in 2009, is as follows.

(i) The Concept of Corporate Governance and Its Importance

- Hong Kong follows the UK rather than the US model and concentrates on a combination of legal and self-regulation.
- Before this document was issued, most publications on corporate governance were targeted at listed companies.
- There is a link between corporate governance, investment and economic growth.
- According to various studies, companies with good governance attract more investors and outperform their peers on stock exchanges.

(ii) Governance Practices Needed for Hong Kong Small and Medium-sized Enterprises

- Regardless of their ownership structure, all companies need corporate governance

for management and supervision.

- Even microbusinesses can increase the possibility of business success by adopting and operating appropriate systems.
- Corporate governance practices have been developed for large enterprises, but many of them are useful for micro-enterprises even in simplified formats.
- Although differences in scale, ownership structure, tradition and personality can make a big difference in the management method of a company, there are common principles that are likely to increase the likelihood of survival and success for all companies.
- All companies should pursue the following as a minimum:
 - Follow laws and regulations
 - Obtain the respect of stakeholders
 - Reduce funding costs with good reputation
 - Identify and manage risks

(iii) Five Stages for Small and Medium-sized Enterprises and the Main Points of Each Stage

<Stage 1>: Small entities owned by single individuals. Operations may involve a few family members

- Document a simple business plan and a strategy plan, and determine the company's purpose and the direction of that purpose. A consistent and logical plan improves entrepreneurial decision-making and contributes to the credibility of the company in the eyes of banks.
- There is no need for full-time board directors, but part-time advisers such as a tax accountant adviser will help the owner see things objectively.

<Stage 2>: Larger entities than Stage 1 employing non-family members. Ownership is composed of a few family members or outsiders.

- In addition to Stage 1, more detailed plans and documents are necessary.

- As the company grows, the owner cannot oversee all the operations and needs a formal system to check activities that cannot be directly supervised by him/her.
- Risk monitoring and management systems are necessary.
- There is no need for full-time board directors, but owners should invite advisers to help with creating long-term plans.

<Stage 3>: Medium-sized companies with several shareholders or non-incorporated partnerships.

- As the stages progress, the number of stakeholders will increase, so more sophisticated corporate governance policies, such as a formal board of directors and annual accounting audits, need to be adopted.

<Stage 4>: Large private or public companies with a substantial number of shareholders and with representative boards.

<Stage 5>: Listed companies listed on the Hong Kong Stock Exchange.

(iv) Special Issues with Family Companies

The advantages of family businesses compared to companies with a large number of shareholders:

- a) Rational identification of target and other decisions
- b) Very strong individual incentives
- c) Loyalty of family members

How each of the five challenges faced by a family company is solved and how each task is carried out greatly affect the management method of the company:

1. Succession

If the owner decides not to sell the company but allow family members to succeed, a clear business succession plan needs to be formulated as early as possible.

2. Family interest and company interests

As the interests of families and companies might conflict, official documents such as the articles of incorporation should be prepared considering the following:

- Share distribution to family members working for the company (when, how many shares, etc.)
- Dividend: salary arrangements for family members working for the company
- Conditions of family members who work for the company
- Mechanisms to resolve disagreements

3. Attracting Non-family Executives

If non-family executives feel that priority is given to family members and that the distribution of power is not clear, they will not be attracted to family businesses. So, in order to invite competent executives, clear policies need to be formulated and implemented.

4. Providing Perspective

It is beneficial to have an independent board of directors to advise the owner because there is a risk that neither the board of directors nor executives can express their independent opinions when one owner dominates the company. Therefore, governance techniques should be adopted to facilitate the asking of constructive questions and expressions of opposing opinions.

5. Capital for Growth and Loss of Control

Rapid growth opportunities sometimes require family businesses to accept external capital at the expense of their ownership. This dilemma is likely to emerge early on if most of a company's resources are used to maintain the owner family's livelihood.

(2) Existing Self-assessment Tools (Examples from Other Countries)

While there are only a few self-assessment tools that have been created for companies to evaluate their own corporate governance, we will examine the Self-assessment Sheet for the Good Governance Contest from Thailand's Ministry of Commerce, a Self-inspection Check Sheet for taxation in Japan, and a self-assessment sheet based on FRC rules.

1) Self-assessment Sheet for the Good Governance Contest (Ministry of Commerce in Thailand)

The Department of Business Development under the Ministry of Commerce in Thailand has

held the Good Governance Contest every year since 2011. The purpose of the project is to grow interest in corporate governance among Thai enterprises when operating their businesses. To enhance the reliability of Thai enterprises on a global stage and compete with companies in other countries, the contest targets all Thailand prefectures in accordance with the “One Province, One Good Governance” policy. Specific objectives include: (1) enhancing corporate credibility among investors and the general public and competing with peers in the ASEAN region; (2) fostering honest and fair business and fulfilling CSR by showing fair towards consumers and the general public; (3) enabling companies to adapt to and implement corporate governance continuously; and (4) enhancing awareness of corporate governance by announcing the contest winners and highlighting good practice in corporate governance. As for the screening procedure, after the entry, a company first fills in the self-assessment sheet and submits it, experts review the contents and the review committee selects the winner. The self-assessment sheet for submission contains six topics as described in Table 4.12.

Table 4.12 Content of the Self-assessment Sheet for the Good Governance Contest

No	Item	No. of Questions
1	Rule of law	15
2	Corporate ethics and morality	15
3	Transparency	15
4	Engagement with stakeholders	15
5	Corporate responsibility	15
6	Value	15

Source: Self-declaration sheet for the Thai Ministry of Commerce’s Good Governance Contest application

The feature of this Self-assessment Sheet is that it is not targeted exclusively at listed companies and thus not focused mainly on subjects, such as general shareholders meetings, boards of directors, minority shareholder protection, and information disclosure. Therefore, this Self-assessment Sheet has been extremely useful in creating a self-assessment sheet for the purpose of this survey.

2) Self-inspection Check Sheet by Zenkoku Hojinkai Sorengo

The Self-inspection Check Sheet prepared by Zenkoku Hojinkai Sorengo, which is a federation of associations for companies to pursue tax compliance under the supervision of the Japan

Federation of Certified Public Tax Accountants Associations and supported by the National Tax Agency, is not for general corporate governance purposes. But it aims to “recommend voluntary inspections on internal control and accounting aspects of a company to improve its efforts on tax compliance”. There are 83 voluntary inspection check items on the sheet, but there are also 45 basic items in the introductory version for improving corporate governance.

The specific content includes documentation, storage status etc. for document management, accounting treatment and supporting documents for each account of financial statements, and finally items related to processing consumption tax and stamp duty.

(3) Consideration of the Corporate Governance Code in Mongolia

1) Corporate Governance Code

As mentioned earlier in this chapter, the Corporate Governance Code consisting of 10 principles was introduced in Mongolia in 2014, as shown in Table 2.4. It was created with reference to the 2004 version of the OECD Corporate Governance Principles, while taking into consideration the IFC’s proposal and advice, examples from other countries, the impact of a corporate governance framework on the economy, the positive influence on market participants, and the specific circumstances in Mongolia. Although this code was created for use by listed companies, private companies and other corporations can apply it with some adjustments.

2) Questionnaire for the Evaluation of Corporate Governance and the Code of Conduct for Companies Listed on the Mongolian Stock Exchange

Based on FRC Regulation No. 34 of January 29, 2016, the MSE created a Self-assessment Sheet for the evaluation of corporate governance and the Code of Conduct for listed companies, and asked companies on the Tier 1 and Tier 2 boards of the MSE to fill in the sheet and announce the results.

The content is as shown in Table 4.13 and covers corporate governance with 100 questionnaire items.

The scores are interpreted as follows: “good governance” for 75 points or above; “there are management problems” for 50 to 74 points; “governance is insufficient” for 25-49 points; and “there is a need for restructuring to improve governance” if the score is below 24 points.

Table 4.13 Content of the Self-assessment Sheet for Corporate Governance and the Code of Conduct

	Item	No. of Questions	Scores
A	Rights of shareholders and shareholders meetings	20	20%
B	Shareholders' equity	10	10%
C	Stakeholders	10	10%
D	Transparency	20	20%
E	Board of directors	30	30%
F	Executives	10	10%
Total		100	100%

Source: Self-assessment sheet for corporate governance and the Code of Conduct

(4) Feedback from the Data Collection Survey

Based on the results of the data collection survey as mentioned in 4.3, the following points, which were reflected in the Self-assessment Sheet, are stated with a view to attracting the attention of Mongolian SMEs:

- a) No board of directors is established, no independent directors, no separation of decision-making and business operation → decision-making
- b) No plan for business succession → family management (training of successor)
- c) Passive attitude toward information disclosure → disclosure and transparency
- d) Bribery of officers → ethics
- e) Lack of interest by management to financial data → planning and supervision

(5) Feedback from Japanese Firms and Investors

Large Japanese companies, including major trading companies and banks that are members of the Mongolia-Japan Chamber of Commerce and Industry, were interviewed. For major trading companies, it is common for them to start a business in Mongolia by setting up a representative office, in which case the business in Mongolia will involve a direct transaction between Mongolian companies and the headquarters in Japan. First of all, difficulties start when they begin searching for local business partners. Even though most Mongolian companies have a website, they do not disclose enough information for Japanese companies to decide whether or not they are suitable as local business partners, i.e., the name of directors and shareholders and

financial information. Therefore, it becomes necessary for them to contact the candidate companies directly to ask for more information. It is possible to obtain the necessary information to determine whether the local party is a large company, but this will take time to narrow down the candidates and may also create unnecessary high expectations on the Mongolian side. It is also difficult to explore the background in terms of how the company has grown to date, as well as necessary to communicate directly with the key person in a Mongolian company for negotiating transactions. If the key person is not directly negotiating, the story may change as the talks progress; and, even though the key person who is negotiating may stay the same, his/her opinions may change such that it takes time to close the deal. Further, even when a contract is signed, there are still many problems such as not respecting the contract and not making payments to follow the contract. Overall, in Mongolia, there is a general lack of awareness that the deal will not move forward unless Mongolian companies recognize that compliance is just the first step in starting actual negotiations.

Next, interviews were conducted with medium-sized enterprises from Hokkaido. For the past few years, there have been many such companies entering the Mongolian market in the agriculture and housing sectors for the reason that Hokkaido has similar weather conditions to Mongolia. The reason for this flow was that many companies received extra funds due to the economic boom during the period of rehabilitation from the damage caused by the Great Earthquake in Japan in 2011. However, only one company among the interviewees was still operating actively in Mongolia because most others have effectively exited Mongolia due to a lack of market research, high prices (even though there is a need for products) and poor selection of local partners. However, given the lack of manpower on the Japanese side, the demand to accept trainees from Mongolia is high, while Mongolia has become one of the popular suppliers of human resources to Japan. In the case of Hokkaido, although Mongolian partners have had issues such as fund shortages and contract breaches/compliance issues, the Japanese side has not carried out sufficient market research. Rather, it has trusted blindly in its personal relationships with Mongolian partners, not collected sufficient information and signed incomplete contracts without protecting sufficient interests etc.

Concern was also expressed by a legal counsellor at the Japanese Embassy about the awareness of compliance among some Japanese companies.

(6) Overview of the Self-assessment Sheet Created by the Current Project

As we have seen in (1) and (2), the existing documents on corporate governance and self-assessment tools are prepared for listed companies where ownership and management are separated and there are many shareholders. In the case of family businesses and SMEs, there are many cases where minority shareholders do not exist, there is no separation of ownership and management and, especially in the case of Mongolia, there are many companies that have problems with planning and monitoring.

A Self-assessment Sheet that is suitable for Mongolian SMEs was created by incorporating existing materials, interview results and the findings of an outsourced survey.

A draft of the Self-assessment Sheet consisting of 40 items was created by taking account of the problems faced by Mongolian companies as mentioned above and with reference to the Self-assessment Sheet for SMEs created by the Ministry of Commerce in Thailand. This was further narrowed down to 25 questions with the help of the CGDC. Now, although there was one item related to CSR in the draft, this was removed as it was pointed out that Mongolian SMEs cannot afford to perform social contribution activities at present, as they are still fighting to survive in business. Furthermore, although there was concern that only superficial answers would be given to questions on ethics and compliance with laws and regulations, these were included in the final Self-assessment Sheet for educational purposes.

In the development process, measures were taken: (1) to create 25 simple and easy questions, so that even companies without sufficient knowledge of corporate governance can perform a self-assessment; and (2) to enable companies to easily identify their own weaknesses in terms of corporate governance.

In addition, this Self-assessment Sheet is intended for use by financial institutions and large enterprises when doing business with SMEs, as well as make the transactions smoother due to the penetration of corporate governance.

As shown in Table 4.14, the Self-assessment Sheet created by the mission team is divided into the following 11 categories.

Table 4.14 Content of the Self-assessment Sheet Created for this Project

	Question	Category	Content	Scores
1	Our company has a vision, values and a mission in written form and employees acknowledge them	Vision and mission	Having a vision, values, and/or mission in written form helps management focus on the long-term goal and not be swayed by day-to-day short-term tasks.	4
2	Our company has a three- to five-years business plan	Planning and monitoring	SMEs, which are busy with day-to-day operations, can manage their operations from a long-term perspective if they document their plans on paper. By following up on results, it will also be possible to fill in the gap between plans and actual results.	28
3	Our company has a clear organizational chart			
4	Management understands the company's SWOT and the current situation in the industrial sector to which the company belongs			
5	We have backup personnel for our key management people			
6	A system to monitor and evaluate operational results by management			
7	Before borrowing from a bank, we plan the use of proceeds and build a repayment plan			
8	We use accounting software			
9	Decision-making is not concentrated in one person			
10	We have a clear division of authority between shareholders and key management			
11	Avoidance of bribery, corruption and other illegal activities	Compliance	Understanding and following all relevant laws and regulations will help the company to avoid any potential penalties. Furthermore, most big organizations or banks will not consider a partnership with a company that does not follow the law.	8
12	Filing of corporate income tax and social insurance fees on time			
13	Submission of financial statements, based on correct accounting information, to the Tax Authority and the MOF			
14	A written policy or rules on moral actions and ethical behavior and employees acknowledge them	Ethics	It is important to set high ethical standards internally for the purpose of CSR and to prevent corruption. If a company already has high ethical	4

			standards, then this should be declared to outside stakeholders on the company's website, brochures, etc., which will help attract investors and costumers.	
15	There is a clear plan for succession	Family business (Succession)	Most small companies are led by one strong leader or family members who made the business a success. However, as most entrepreneurs near their retirement age, it is important to start succession planning for the next generation of leaders. If a company does not start planning now, it may soon be too late. In addition, when family members constantly receive favorable treatment in terms of hiring and compensation, it may discourage skillful non-family employees and make them seek other employment opportunities.	12
16	The owner makes a clear distinction between the finances of his/her business and family			
17	Clear policy on the employment of family members of the owners and management			
18	Every employee is given a role and responsibility depending on his/her skills and position	Employees	Even though owner/managers are the key decision makers, employees are responsible for most day-to-day tasks in the company. So, it is beneficial for a company to treat its employees in a fair way, communicate key information and listen to their honest opinions related to various aspects of the business. After all, employees who are on the ground usually have some useful information and opinions that the managers may have missed.	12
19	The company has a system to collect opinions from employees via their managers regarding operations			
20	The company has work regulations and labor contracts with all employees			
21	The company's seeks to earn the understanding and satisfaction of its clients and other stakeholders	Stakeholders	For long-term success, it is important to treat all stakeholders in a fair way and earn their respect. Stakeholders are any entities that interact with a company in the course of its business: customers, suppliers, banks, government agencies, etc.	4
22	The company tries hard to predict various risks and mitigate them before they are realized	Risk management	Although it is good to have an optimistic view in business, it is always good to consider potential risks and mitigate them to the fullest extent possible before they are realized.	4

23	The company has disclosed company information on its website (or Facebook, Twitter, the National Industrial Database, etc.)	Transparency and disclosure	The benefits of disclosing information override the disadvantages. Companies can earn the trust of their stakeholders by disclosing information at the right time, even if there is no request. In our survey, there were many opinions about the challenge in finding joint-venture partners, as it is difficult to obtain information on the shareholders and financial situation of Mongolian companies.	8
24	The company discloses all data correctly and completely upon request from customers, suppliers, banks and/or government organizations			
25	The company tries to minimize the usage of energy and water, pollution and wastewater.	Environment	In recent years, investors and customers have placed higher requirements on companies regarding environmental impacts. By paying more attention to this, the company will not only help to save the environment but also attract foreign investment.	4
				100

Source: JICA Study Team

For SMEs, 66 or more points mean “good governance” (75 points or more for large companies), 33 to 65 points mean “partially deficient”, and 32 points or less mean “needs improvement”.

(7) Workshop and Feedback

The workshop on corporate governance, held on June 25, 2018, was co-organized with the NDA, which had planned a seminar on the theme of SME support, and was held during the Conference for Policy on Supporting Value Creators; the contents are shown in the Appendix. With help from the NDA, over 200 local companies, including from different regions, joined the conference, which allowed us to raise awareness about corporate governance and interest in the workshop.

As for the agenda, in the morning session, a presentation on the manufacturer support policy, the Mongolian export program and a panel discussion were followed by a presentation on this project and a panel discussion on SME corporate governance. This was conducted before the whole audience.

In the afternoon session, the conference was divided into two breakout sessions. On our side, as described in Table 4.15, we conducted a panel discussion about the corporate governance

workshop for SMEs, delivered as part of this survey, while the NDA side conducted a panel discussion on the NDA Industry Database System and SME development. There were 50-60 participants in our workshop; however, since these people were moving between sessions, only 34 participants eventually completed in the Self-assessment Sheet. At our session, we gave out a total of 56 certificates to the participants, which may mean there were multiple participants from one company filling in the Self-assessment Sheet together.

Participants in the workshop were mainly from the Greater Ulaanbaatar area, but there were some SMEs from other aimags, as well as a few NGOs and corporate governance organizations. There were also participants from Japanese companies.

Since the event was held with cooperation from the NDA, we were able to promote corporate governance to not only the participants in our session in the afternoon, but to all of the 200 participants, which included SMEs and commerce officials from aimags, and other organizations with an interest in corporate governance such as the IFC, GIZ and AmCham.

Table4. 15 Corporate Governance Workshop Agenda

Time	Content
12:10-12:30	Study on the Mongolian business environment and next steps in cooperation Masayuki Ishida, leader, JICA Survey Team
	Moderator: J. Unenbat, CEO, MBA Panelist: B. Bayarsaikhan, chairman, NDA Panelist: Masayuki Ishida, leader, JICA Survey Team Panelist: D. Ganbayar, director, NGGC Panelist: Bolormaa, senior officer, Accounting Policy Department, MOF Panelist: Tungalag, Association of Chartered Tax Advisers
13:00-14:00	Lunch break
The event was divided into two breakout session from here. Only our session agenda is shown below.	
14:00-14:10	Greeting Masayuki Ishida, leader, JICA Survey Team
14:10-14:20	Results of the survey on corporate governance G. Enkhjargal, JICA Survey Team
14:20-15:30	Corporate governance requirements for SMEs Moderator: Oyunbileg, CGDC Panelist: J. Unenbat, CEO, MBA Panelist: G. Batbaatar, manager, Procurement Policy and Strategy Department, Oyu Tolgoi LLC Panelist: Unenbat, CFO, Mobicom Corporation Panelist: Gantumur, CEO, MCS Holding LLC
15:30-15:50	Coffee break
15:50-16:50	Corporate governance Self-assessment Sheet Keita Inoue, JICA Survey Team

16:50-17:20	Improving SME corporate governance Oyunbileg, CGDC
17:20-17:30	Wrap-up and closing

Source: NDA

1) Panel Discussion

A panel discussion on corporate governance was conducted twice: in the morning session for the entire audience and in the afternoon session during our workshop.

(i) Panel Discussion in the Morning

Improving the Business Environment and Corporate Governance

- In order for Mongolian enterprises to enter the global supply chain, and to receive financing through initial public offerings and foreign capital, it is necessary for them to improve corporate governance. Businesses must also build a system to provide feedback to their stakeholders. Disclosure to customers will lead to CSR. The NDA is willing to support the realization of the above aims.

Improvement in Corporate Governance for SMEs:

- Most Mongolian SMEs are led by one or two people, while there are many corporate governance issues. However, if financial institutions including the CGFM encourage transparency of information and do not allow two sets of books, there is an opportunity for Mongolian SMEs to enter the international market.
- As for SMEs, the “who, what and how” are the most important points and no complicated framework is necessary. SMEs must always follow laws and regulations as well.
- Most Mongolian SMEs are getting closer to the timing of next-generation succession. Even SMEs need some kind of corporate governance. If they implement good governance, they can grow fast and expand their market share. Internal supervision, the human resources system, hiring experienced adviser, etc. all lead to corporate governance. SMEs are also poor at building trust between each other, while the costs of not trusting and not hiring professional consultants are extremely high.
- The fact that SMEs are reluctant to disclose information is not unique to Mongolia; the

situation is identical in Japan too. Companies are worried about losing competitiveness by disclosing information; but, in order for SMEs, to move onto the next stage, they should bring about transparency in their company and find new opportunities.

Two Sets of Accounting Books and Tax Compliance:

- The MOF has been working to eliminate the two-book problem without placing too much of a burden on SMEs. 95% of companies registered on the MOF's E-Balance system are SMEs. The MOF is encouraging these SMEs to use the simplified IFRS for SMEs accounting standards. While companies used to be required to submit their financial statements each quarter, they must now submit them twice a year online. In order to reduce the two-book problem, all stakeholders need to request financial statements from one source, and the MOF is working towards this end.
- SMEs need to be knowledgeable about taxes and declare them accurately, but this situation is inadequate at present. SMEs need to study and follow the related laws and regulations before starting a business.

(ii) Panel Discussion in the Afternoon

Desirables Regarding SME Corporate Governance:

- In terms of disclosing information to investors and banks, the business process is clear, a monitoring system has been established, and the owner can take responsibility. Standards required of listed companies, such as boards of directors, do not apply to SMEs.
- Currently, Mongolian commercial banks do not evaluate the corporate governance of all customers systematically; but, in many cases, the informal assessment of corporate governance is included in the credit review process. For long-term (more than one year) loans of more than a certain amount (MNT 50 million), independent corporate governance assessments are common.

Selection Criteria for Large Corporations When Procuring from SMEs:

- Is there an internal rule on safety and is it implemented? Business ethics, corruption, interests, and whether an SME can perform its contractual obligations are all items

that relate to corporate governance. Companies implementing good corporate governance are reliable. First of all, the above points need to be included in the internal rules of the company and then implemented.

- Emphasis on quality, cost, and financial strength: The procurement rules are published on the Internet and, if any company is dissatisfied with the bidding process, it can contact the Internal Audit Division or the parent company directly.
- Emphasis on quality, cost, and reliability: Reliability means quality of management, financial strength, respect for laws and regulations, etc. Further emphasis is placed on business ethics. Procurement rules, conditions required for subcontractors, a company's ethical standards, etc. are all disclosed on the Internet and the name of the winning bidder is also disclosed.
- Current status and issues for corporate governance in Mongolia.
- It is taking time for society to understand the necessity of governance, but the situation is improving slowly.
- We were able to expand quickly because we understood, from an early stage, the necessity to implement everything according to international standards.
- If everyone in the supply chain understands the necessity of corporate governance, the penetration of corporate governance among subcontractors will be quicker.
- Panelists frequently used the word "reliability" instead of corporate governance; but, if SMEs win the trust of large corporations, it will become easier for them to become these corporations' subcontractors.

2) Filling in the Self-assessment Sheet and Review

We asked the 34 participants to fill in the Self-assessment Sheet directly using a website for conducting surveys. We summarized the results and explained the purpose of the Self-assessment Sheet and the meaning of the 11 categories. The average score was 69 points, which is much higher than expected. However, there is a possibility that some answers do not necessarily reflect actual situations, as it is based on self-declaration. The responses to each question are given in the Appendix.

4.5 Dissemination and Strengthening of Corporate Governance in Micro-, Small and Medium-sized Enterprises

Based on the above results, we propose measures for promoting and strengthening corporate governance for SMEs. As explained in 4.4, the corporate governance of SMEs contributes not only to strengthening the internal management system, but also to enhancing reliability in terms of making finance arrangements, transactions with large/foreign companies, partnerships and joint ventures. The workshop on SME corporate governance held during this survey may have been the first such attempt in Mongolia. To this extent, further penetration of corporate governance should be made among SMEs in the future.

Meanwhile, as explained in 4.2, it is a reality that the penetration of corporate governance is not sufficient even among companies listed on the MSE. Therefore, as it seems it may take more than a decade to establish corporate governance in Mongolia, we propose that our future direction takes on a mid- to long-term perspective.

(1) Securing the Reliability of Financial Information from Small and Medium-sized Enterprises

During the interviews, we found that many SMEs create two sets of accounting books: one for the Tax Authority and the MOF, and another for internal management use. The problem is being resolved somewhat thanks to the 2016 Amnesty Law, a lottery award and the partial refund of value added tax paid by individuals following the Value Added Tax law, as well as potentially by new tax laws that are being discussed in parliament. However, keeping two sets of books is still prevalent, especially among micro-enterprises, with some SMEs not even filing their financial statements to the authorities.

Meanwhile, although Article 10 of the Accounting Law, as revised in 2010, mandates the application of the IFRS as accounting standards, there is no detailed regulation that establishes the criteria for classifying the application of the IFRS for SMEs, which has made the implementation of the IFRS slow in general. Furthermore, as the Audit Law requires only large-scale companies to have their financial statements audited, it cannot be verified as to whether SMEs are applying proper accounting standards.

Under such circumstances, in order to enhance the reliability of financial information made by SMEs, measures taken in other countries, as shown in Table 4.16, should be considered for implementation in Mongolia.

Table 4.16 Sample Measures for Improving the Reliability of Financial Information from Small and Medium-sized Enterprises

Measure	Examples of countries implementing measures
The MOF to publish all or parts of the financial statements submitted through the E-Balance system for the public to increase transparency	Singapore and Thailand
Restrict company accounting to those who satisfy the requirements in terms of academic qualifications and work experience and set up a registration system	China, Thailand and Vietnam
Register accounting firms that conduct non-audit work	Thailand, Vietnam and Myanmar
Register accounting software	Laos
Expand the target of statutory audits to SMEs	Thailand and Myanmar
Set simplified accounting standards applied to SMEs based on an acquisition cost basis rather than an IFRS basis	Japan and USA
Give tax benefits to taxpayers who maintain proper accounting books	Japan
Provide instructions to businesses on bookkeeping	Japan
Instruct financial institutions to conduct loan screening based only on financial statements submitted to the authorities	Thailand
Discount the loan interest rate from financial institution to companies that have a single financial statement	Thailand (under consideration)

Source: JICA Study Team

(2) Dissemination of Corporate Governance Other Than Disclosure of Financial Information

In addition to the preceding paragraph, it is necessary to improve corporate governance in terms of compliance with laws and regulations, disclosure of non-financial information, mission and vision, planning and monitoring, decision-making, risk management, ethics, environmental issues, etc.

Regarding compliance with laws and regulations, the Law on Violations, which was promulgated in 2017, made penalties for violations clear. Table 4.17 shows the contents of penalties based on the Law on Violations concerning tax. Since such penalties are prescribed in detail, it is now necessary to encourage business owners to follow the necessary laws and regulations and punish violations fairly without exceptions.

Table 4.17 Penalties Based on the Law on Violations

Clause	Content
<p>Article 11.18 Violation of accounting law</p>	<p>1. Corporate: In the following cases, a fine of MNT 400,000 is imposed on individuals and MNT 4 million is imposed on corporations.</p> <p>1.1 Do not comply with statutory accounting standards;</p> <p>1.2 Doing business in Mongolia but do not implement accounting books in the Mongolian language;</p> <p>1.3 Doing business in Mongolia but not booking and reporting transactions in Mongolian currency;</p> <p>1.4 When a corporation and a representative office book transaction in foreign currency under the approval of the Central Bank, they do not express and report the amounts of financial statements in MNT;</p> <p>1.5 Management and accountants do not sign the financial statements or certify with the company seal;</p> <p>1.6 A corporation does not perform the obligation to submit a financial report electronically to a competent financial authority within the statutory deadline;</p> <p>1.7 Jurisdictional financial authority (MOF), which electronically accepted the financial report, does not implement its legal obligation;</p> <p>1.8 The financial statements submitted electronically to the competent financial authority has not been electronically signed or certified by the management or chief accountant of the company;</p> <p>1.9 Do not calculate taxes, fees, charges for corporations based on electronic financial statements approved by the competent financial authority;</p> <p>1.10 A legal entity obliged to apply statutory accounting standards has not submitted quarterly and annual financial reports electronically to the competent financial authority within the statutory period;</p> <p>1.11 A corporation with an obligation to prepare consolidated financial statements does not submit an annual financial report electronically to the financial institution under the jurisdiction of the parent company within the statutory period;</p> <p>1.12 The accounting documents and financial statements are not kept for more than 10 years, unless otherwise specified in the archive law;</p> <p>1.13 Do not adhere to the general format of the accounting entry form, the methods, or not following the internal entry format as approved by the authorities;</p> <p>1.14 Management and accountants do not implement their obligation to electronically record and approve changes in each capital and capital source during production, service and business activities;</p> <p>1.15 The original slip is not signed or sealed by the person who issued it; electronic slips are not authenticated with electronic signs;</p> <p>1.16 Transactions without slips are entered on the books and the financials statement;</p> <p>1.17 Accounting books, financial statements are not prepared;</p> <p>1.18 Accounting records are not prepared using the double-entry bookkeeping method;</p> <p>1.19 Accounting information processing is not carried out in the statutory order or not recorded;</p> <p>1.20 Regardless of the country in which the transaction was carried out, do not fulfill the</p>

	<p>obligation to keep the related source documents and record formats as legally required;</p> <p>1.21 Errors in accounting records are not corrected based on the reasons, the documents and tables that show the way to correct them; persons who made the corrections and who approved the corrections did not certified with a signature; no correction of the accounts by way of reflecting the original financial statements;</p> <p>1.22 Do not provide accurate explanations and clarifications on financial statements requested by authorized persons in a timely manner;</p> <p>1.23 Management does not approve and implement accounting policy documents conforming to accounting statutes, standards, regulations and instructions;</p> <p>1.24 The accounting records and financial statements are not prepared by a certified professional accountant;</p> <p>1.25 The chief accountant does not implement statutory obligations.</p>
<p>Article 11.19 Violation of general tax law</p>	<p>1. If individuals and corporations avoid paying taxes as described below, a fine of 30% will be applied in addition to the original tax amount.</p> <p>1.1 Taxable income and other items are concealed, transferred objects without any basis to other individuals and corporations, or no entry in the accounting books, balance sheets and tax returns;</p> <p>1.2 Taxable income and other items are written down in numbers or prices in the books of accounts, balance sheets, tax returns, or expenses and deductible items are written up;</p> <p>1.3 Make it impossible to prepare a tax report by disposing of accounting, primitive records, tax reports and related documents;</p> <p>1.4 Name, address, seal, signature, account, state registration certificate, corporation's name, address, property registration, certificate, asset and documents are transferred or used by others;</p> <p>2. If tax is not paid within the due time, individuals and corporations are fined by an amount equivalent to 0.1% of the unpaid tax amount per day.</p> <p>3. If individuals and corporations with valued added tax payment obligations produce or sell goods, or provide services without a certificate, a penalty of an amount equivalent to 30% of the due tax will be imposed.</p> <p>4. If individuals and corporations responsible for withholding value added tax do not fulfill their obligations by not withholding tax or not paying the withheld tax, a penalty of an amount equivalent to 30% of the due tax will be imposed.</p> <p>5. If individuals and corporations are producing or selling goods, or providing services without registering as a value added taxpayer and are not paying the withheld amount collected from customers, a penalty of an amount equivalent to the due tax will be imposed.</p> <p>6. Individuals and corporations that are taxpayers shall be liable to a fine of MNT 150,000 and MNT 1.5 million, respectively, in the case of the following violations:</p> <p>6.1 Not submitted a statutory declaration to the tax office by the statutory deadline;</p> <p>6.2 Individuals and corporations with legal obligations to pay tax and withhold tax not registered at the tax office;</p> <p>6.3 Not registered with the local tax office within the statutory deadline;</p> <p>6.4 Owners or holders of taxable objects other than income that have not fulfilled their obligations to give notice during the statutory period;</p> <p>6.5 Not used a cash register machine, printer, ink, paper or point-of-sale terminal as approved by Mongolian country standards.</p> <p>7. Individuals and corporations that are taxpayers shall be liable to a fine of MNT 100,000 and</p>

	<p>MNT 1 million respectively, in the case of the following violations:</p> <p>7.1. Not notified the local tax office by the statutory deadline from the date of transfer of ownership of real estate by selling or giving;</p> <p>7.2. Every time there is a change to the information recorded in the corporate information or individual file, notify the tax office by the statutory deadline from the date of the change and do not change the registration or individual file;</p> <p>7.3. Not inserting the registration number issued according to tax law in reports submitted, information entry declarations, payments or other necessary documents.</p> <p>8. In the case of the following violations, individuals and corporations that are taxpayers will be respectively fined MNT 400,000 and MNT 4 million:</p> <p>8.1. Inaccurately submitting one's address where he/she normally or temporarily lives and conducts business;</p> <p>8.2. When called by the tax office, no appearance without justifiable reasons;</p> <p>8.3. When the court has not declared the taxpayer as missing, do not notify one's address and avoid paying taxes, late payments and fines.</p> <p>9. When persons authorized by a tax agency carry out the following acts regarding sealed assets used as collateral, damages shall be paid, with a fine of MNT 500,000 for individuals and MNT 5 million for corporations:</p> <p>9.1. Lost;</p> <p>9.2. Handed to others without authorization;</p> <p>9.3. Destroyed;</p> <p>9.4. Sold without permission.</p> <p>10. In the case of the following violations, individuals and corporations will be respectively fined MNT 100,000 and MNT 1 million.</p> <p>10.1. Do not submit required financial statements, balance sheets, tax data and related documents;</p> <p>10.2. Not providing the opportunity to enter buildings and warehouses;</p> <p>10.3. Not allowing counting;</p> <p>10.4. Interrupting the taking of pictures, inspections and seizure of collateral assets;</p> <p>11. Individuals, corporations, banks, nonbanks and stock exchanges shall be liable to a fine of MNT 400,000 for individuals and MNT 4 million for corporations in the case of the following violations:</p> <p>11.1. Not respecting the administrative norm established by enacting the same rules of compliance with the tax laws throughout the country;</p> <p>11.2. In the event that a taxpayer quits a job, the employer pays the withheld taxes by the statutory deadline, describing where the employee moved to;</p> <p>11.3 Not fulfilling obligations as stipulated by tax law;</p> <p>11.4. Violating statutory regulations on the preparation, recording and storage of tax documents;</p> <p>12. Individuals or corporations do not provide cash receipts to others who are users of the cash system, refuse to provide, or provide in the amount that is different from the correct amount;</p> <p>12.1. If a cash receipt (to a buyer) is not delivered, a fine to the amount of 2% of the income amount of the current month will be imposed;</p> <p>12.2. If a cash receipt is issued (to purchasers) to an amount that is different from that of sales, a fine to an amount equivalent to 20% of the monthly income will be imposed;</p>
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	<p>13. In cases that are not subject to criminal cases, or where systems are unlawfully used in ways other than defined by law or used for purposes other than those related to business policy, damages shall be indemnified and additional fines of MNT 1.5 million for individuals and MNT 15 million for corporations will be imposed.</p> <p>14. If vehicle tax is not paid during the statutory period, individuals will be fined to an amount equivalent to 10% of the original tax amount.</p> <p>Interpretation: For calculating penalties in the case of 1, 2, 3, 4, 5 of these articles, the amount of such overdue charges shall not exceed 50% of the original amount.</p> <p>The fine prescribed in 12 of these articles shall be paid in addition to the tax to be paid in the current term.</p>
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Source: JICA Study Team

Next, regarding the disclosure of non-financial information, it is desirable to introduce a commercial registration system, similar to those found in foreign countries including Japan, by revising the laws in order to disclose information registered on the government database to public. Alternatively, in order to maintain transparent government procurement, the database may be generated and made available to the public. Meanwhile, it is premature to introduce an integrated reporting system, as adopted in other countries, for Mongolian SMEs since even listed companies have not adopted one yet.

The timing is also not right for introducing mandatory disclosure of non-financial information. For this, it is appropriate to educate business owners as well as involve consultants who can advise not only on corporate governance issues but also on management issues.

For education purpose, it may be effective to hold seminars by sharing costs with financial institutions and large/foreign companies, in order to generate benefits from corporate governance development among SMEs. On the other hand, in terms of using consultants, although companies may not agree to hire consultants just for corporate governance issues, it may be more attractive to provide courses to train trainers, rather than involve professional consultants, such as certified public accountants, tax accountants and management consultants, and provide advice on corporate governance to clients.

(3) Provide Training Opportunities and Information on Corporate Governance (Institutional Finance, Investment Support etc.)

In order to allow SMEs to recognize the benefits of good corporate governance more specifically, the following incentives may be considered if companies reach a certain level of corporate governance: TSLs; subsidies from the Government of Mongolia and loans with subsidized

interest rates; export financial support from the World Bank Export Development Project. Such incentives for good corporate governance may encourage motivation to improve corporate governance among SMEs.

(4) Collaboration with Major Organizations (Industry Groups, Mongolia-Japan Human Resources Development Center, International Development Partners etc.)

The organizations related to corporate governance, other than those shown in Table 4.4, are presented in Table 4.18. It would be desirable to promote and disseminate corporate governance among these organizations in cooperation with their support programs.

Table 4.18 Groups Related to Corporate Governance Other Than Those in Table 4.4

Classification	Full Name	Short Name
Professional occupation	Mongolian Association of Certified Tax Consultants	TM3
	Association of Mongolian Advocates	AMA
	Mongolian Society of Financial Analysts	MSFA
	Mongolian Management Consultants' Institute	MMCI
Finance	Mongolian Bankers Association	MBA
	Mongolian Nonbank Financial Institutions Association	ABTS NBFII
Education and training organization	Mongolia-Japan Center for Human Resources	MJC
	The University of Finance and Economics, Mongolia	UFE
Chamber of commerce	Mongolia-Japan Chamber of Commerce	MJCC
	American Chamber of Commerce in Mongolia	AmCham Mongolia
International donor agencies	International Finance Corporation	IFC
	Asian Development Bank	ADB
	European Bank for Reconstruction and Development	EBRD

Source: JICA Study Team

5 Conclusion: Recommendations and Way Forward for Business Environment Reform in Mongolia

In the context of business environment reform, credit information management and corporate governance are an inseparable pair. Together, they contribute to the better access to finance and the wider development of business opportunities for MSMEs, as well as the reduction in investment risk via a more meaningful restoration of the business environment for investors. They also both provide a positive spiral whereby the credibility of one company is improved by good corporate governance, which will lead to the better recognition of its credit information. In order to improve the business environment and make it sustainable from the perspective of actual business activities, it is essential to improve the credibility of a company. To this end, the assistance measures from the authorities and development partners should play important roles in contributing to further investment promotion and industrial development. This scenario also contributes to the introduction of the CRD, which will add further strength to the credit information management environment. In this respect, the following chapter will conclude the outcomes of the study by making recommendations and offering a way forward for improving credit information management and corporate governance.

5.1 Future Direction for Credit Information Management

(1) Consideration of a Mongolian-type CRD

In the area of credit information management for this study, the JST started with a seminar to promote understanding of the CRD concept and clarified the actual state of laws and regulations related to the business environment, as well as conducted surveys mainly on the actual situation of corporate loans and screening exercises among financial institutions and related organizations. Through the study, it was confirmed that the CIB was fully incorporated into the whole financial sector and is widely used for general loan examinations involving companies and individuals. (The CIB was introduced in 1999, although the current system was introduced in 2009. It is based on the credit history information of organizations currently under the supervision of the BOM.) On the other hand, with regard to the CRD, it was observed that the credit risk-based model was in the initial stage of introduction according to individual banks' policies. Although it is not in the operational environment of the so-called Japanese-style CRD, which is shared with a range of stakeholders, when scoring in the case of loan examinations among individual commercial banks, each bank has prepared its own scoring process by utilizing individually calculated indicators, which, in some cases, are based on the risk-based approach. Those indicators are also used to substantiate the business operation of loan borrowing parties, as well as offer quantitative insights into the scoring process.

Through seminars and individual interviews, the JST observed that the financial sector in general including the BOM is positive and interested in introducing a CRD; however, there was

also a cautious view expressed by one board member of the BOM, who pointed out the following: “Mongolia is a small country and the number of companies is also small, and the absolute number depending on bank loans is also very limited compared with Japan. It is necessary to assess carefully whether a CRD using a multiple regression model would work effectively with limited data. It is also important to examine what kind of CRD is effectively applicable to the Mongolian situation in forming a Mongolian-type CRD. Consideration of how such a CRD can be introduced should also be important.” In fact, the number of corporate loans is in the region of 6,000 a year in Mongolia. Considering that the number of loans among the top four commercial banks is about 1,000 to 1,500 each year, it is also necessary to consider that there is a limitation concerning the in-house CRD-type model within individual banks where the amount of data is limited. Thus, it may be difficult to secure the amount of data effective for the multiple regression analysis of the CRD within only one bank, except for the four largest banks.

In that sense, the form of a Japanese-style CRD that shares data with multiple banks should be among the realistic options when introducing an ACRDS to Mongolia. On the other hand, if the amount of data related to approximately 300,000 cases (6,000 company cases × five years) in the banking sector equates to the upper limit and stable multiple regression analysis cannot be expected in this context, there is still room for the option to design and introduce a Mongolian-type CRD using other indicators, such as those derived from an indicator industry sector analysis. There is already a good number of reliable databases that could be the basis of industrial sector analysis, such as the SME-related data from the MOFALI, the industrial data of the NDA and the member company data of the MNCCI. Since these organizations are also interested in introduction of ACRDS, they will cooperate in discussing the CRD operational framework and future collaborative relationships. Above all, it is important to identify the most appropriate indicators for Mongolia, while reflecting on actual Mongolian corporate activities including loan and repayment activities, as well as considering and designing a Mongolian-type CRD.

(2) Consideration of a Mechanism to Contribute to the Optimization of Interest Rates for Corporate Loans

At the meeting of the Economic Standing Committee of the Parliament of Mongolia held in May this year, a request was issued to the BOM to reduce the interest rates for corporate loans of commercial banks. There is an urgent task to review the appropriateness of loan interest rates when the market interest rate remains relatively high at the level of 25-26% per annum. The issuance of interest rates in the market cannot necessarily solely rely on the efficiency and rationality of the loan examination process of commercial banks. It should certainly be solved by a combination of various factors, such as a reduction in the procurement costs of funds and the calculation of rational collateral value, while ensuring the effectiveness of collateral, improving the efficiency in the banking business in general and more. That said, it is still important to promote a wider understanding about the fact that the introduction of the CRD is not only a credit information management system but it can be utilized as one of the significant

contributions to reduce interest rates. Further discussion on how to proceed in a Mongolian way is recommended.

The CRD, which calculates the default probability, can rationally provide lending entities including commercial banks with the default risk of possible bad debts. Thus, it can secure stable profits on the banking side without incurring too much financial risk, as banks can determine their own loan interest rates, on extreme terms, simply by placing a certain spread on the calculated default probability. Actually, even if the CRD is introduced successfully, it is not such a simple matter; but at least if there is the possibility of optimizing the interest rate for each risk associated with the customer of a loan, this will surely help to reduce the interest rate. In addition to a loan examination using a scoring model based on the CIB and other indicators, as an additional objective indicator source, it is important that the utilization of the CRD should be further discussed in the context of reducing interest rates.

(3) Consideration of Required Legal Provisions and Legal Foundations of the Operation of the CRD

There are no obvious and explicitly restrictive legal provisions recognized as far as the introduction of the CRD is concerned; however, consideration of further detailed regulations and/or rules should be necessary in order to define the scope of a possible legal scheme that includes relevant data management, including the data collection process, personal information protection, the competence and obligations of the operational institution, and any essential components related to the CRD. In order to provide a solid foundation for a Mongolian-type CRD, further legal (and/or non-legal) frameworks may need to be introduced, where relevant, in terms of how the responsible entity should be set up to operate the CRD, what kind of contract is necessary for information/data management between what entities, the rights and obligations between private and public entities involved with the CRD, and the operational process requirements. While enhancing the legal environment, it is also important for the competent authority to further improve access to finance through the synergy with the CIB (for example, utilizing the CRD for guarantee rates issued by the CGFM while the CIB is used when applying the scoring model to individual financial institutions etc.)

(4) A Basic Step in the Preliminary Stage of the CRD Introduction (Preparatory Steps)

Although, in Chapter 3, this report elaborated on the bird's eye view of the road map for the introduction of the CRD, it may well be realistic to start with basic steps in the preliminary stage to consider the feasibility of data collection and the regression model based on a relevant scale of sample data.

As mentioned above, the JST confirmed that each commercial bank has already accumulated and maintained a database on corporate information, including financial statements, and utilized this in the scoring model developed in each bank for the loan examination process. However, there is still no specific clarification about the type and the level of information accumulated and in what form, as each bank has its own policy for information management, which is not

disclosable to the third parties. Thus, at first, the actual situation concerning data/information held by banks still needs to be identified in detail with actual samples, while the feasibility should be discussed with the actual sample data/information, combined with the loan default information, in terms of how they can be applied to the CRD model format. A further feasibility study should therefore be tested with applicable data/information, if the valid and stable variables can be derived from the regression analysis of the CRD. This stage will also contribute to the substantiation of legal arrangements mentioned in the previous section, as well as technical issues on data collection and regression analysis.

It is recommended, at this initial stage, that the BOM should take the initiative to tackle this pilot testing undertaking, as the authority responsible for financial supervision. It may be appropriate for the BOM to consult with and nominate relevant commercial bank(s) to cooperate with this undertaking to share outcomes, as well as invite views about the introduction of the CRD from the Mongolian financial sector as a whole.

5.2 Way Forward to Further Improve Corporate Governance Among Small and Medium-sized Enterprises

At the initial stage of introducing corporate governance (recognized as the mechanism for business management to realize long-term corporate value creation), the major focus is often on the “management mechanism”, which can include the enhancement of business management itself and the optimization of management with higher efficiency.

Therefore, in the case of SMEs with limited management resources, corporate governance is often regarded as the price of strengthening the management system within the company. It is undeniable that these companies tend to prioritize “business”, as businesses are directly linked to profit rather than costs. Most of the assistance from international organizations has been targeted at large companies. This is not only to say that SMEs are not large enough to consider introducing the full range of corporate governance, but that there seems to be some concerns as to whether assistance in the corporate governance area will be effective for SMEs whose recognition of corporate governance is mainly viewed in terms of the cost element. In this study, as a matter of fact, the following comments were often mentioned from the SME side: “What is the actual merit of business in introducing corporate governance?” and “Corporate governance does not seem to directly lead to an increase in company profits”.

Therefore, in this study, through actual surveys and the workshop in particular, the claim that corporate governance not only contributes to strengthening the internal control system but also contributes to external credit procurement and linkage to large companies and foreign investors (excluding partnerships and/or joint ventures) was challenged, well delivered and better understood. The activities of the study contributed to an increased awareness of the unnecessary loss of business opportunities among SMEs, where interested investors (such as investing Japanese companies) may have to give up their investment because parent companies do not

approve of further partnerships, on the basis that targeted SMEs do not have an adequate level of corporate governance.

In particular, it was a positive and major step that the study activities complement the above-mentioned outcomes in the case of not only SMEs but also the CGDC, the NCCG, the MNCCI etc., which can accept the initiative to disseminate the same concept in this area. It was also advantageous that the project activities, such as the workshop, were co-organized with the NDA, an investment promotion agency, which is already collaborating with the above-stated organizations in supporting SMEs in corporate governance, especially in terms of investing in SME promotion strategy.

As the direction of future discussion has already been elaborated in detail in the last section of Chapter 4, instead of repeating the details here, the overall key issues are highlighted as follows: “promotion of the soundness of financial statements”, “thorough information on laws and ordinances, supporting compliance with laws and regulations”, “promoting disclosure of company information”, “dissemination and promotion of awareness of the significance of corporate governance through cooperation with related organizations”, and “considering a mechanism whereby corporate governance can serve as a direct incentive for policy finance”.

In addition, the MOF is considering measures to transform multi-reported financial statements into one proper financial statement. This is important in improving corporate governance; at the same time, although this does not have a direct impact, it will also lead to necessary improvements from the viewpoint of credit information management. Future consideration is to be expected on both sides in terms of corporate governance and credit information management.

Direction of Promoting and Strengthening Corporate Governance (Highlights from Chapter 4)

- Securing transparency and ensuring reliability of financial statements through referring to good practices on sound systems in other countries
- Importance of dissemination awareness about compliance with laws
- Promotion of the disclosure of corporate information corresponding to administrative measures, such as the commercial registration system and government procurement qualification requirements
- Information sharing through promotion of cooperation with certified public accountants, tax accountants, consultants etc.
- Review of the significance of corporate governance in the context of incentives for policy finance, such as TSLs

APPENDIX

Appendix 1 Related Laws and Regulations

Appendix 2 Corporate Governance Related Documents

Appendix 1 Related Laws and Regulations

- 1. List of Related Laws and Regulations Concerning Bank Supervision by BOM**
- 2. Credit Information Law**
- 3. Regulation on Asset Classification, Provisioning and its Disbursements (unofficial translation, BOM)**

1. List of Related Laws and Regulations Concerning Bank Supervision by BOM

Type	Name
Laws	<ul style="list-style-type: none"> • Banking law of Mongolia • Credit Information • Law on deposits, loans and banking transactions • Conducting settlement in National Currency
Regulations	<ul style="list-style-type: none"> • Regulation on asset classification, provisioning and its disbursement • Preventive measures regulations on combating money laundering and terrorism financing • Regulation on Bank Unit • Regulation of the council board monitoring • The regulation on the implementation of the corporate governance principles for banks • The regulation on setting prudential ratios to commercial banks • Registration of immovable property regulations to a mortgagor • Regulation on mortgage lending process • Regulation on council on accounting and payment matters of the banks • Manual on internal control activities of the bank • Bank restructuring procedure • Regulation on imposing a conservatorship on a bank • Temporary regulation on issue of guarantees by banks
Guidance	<ul style="list-style-type: none"> • AML/CFT Risk Based Management Guidance Note • Medium term banking supervision strategy • General guidance for conducting on-site examination in bank by Supervision Department of Bank of Mongolia • Guideline on the operational risk estimation • Guideline on the market risk estimation • Guideline on the liquidity risk management • Guideline of interest rate risk management

<p>Decree of Governor of the Bank of Mongolia</p>	<p>2016.12.13: Regarding the amendments to the regulation No A-338</p> <p>2016.03.04: Regarding amendments to the regulation on setting and monitoring prudential ratios to banking operation</p> <p>2015.12.04: Regarding amendments to the Regulation on Asset Classification Provisioning and its Allocations</p> <p>2015.04.01: Regarding renewal of bank's minimum paid-in capital amount</p> <p>2014.03.31: Regarding amendments to the regulation on setting and monitoring prudential ratios to banking operation</p> <p>2013.06.25: Regarding amendments to the regulation on setting and monitoring prudential ratios to banking operation</p> <p>2012.06.07: Setting minimum paid-in capital requirement</p> <p>2011.12.30: Regarding amendments to the regulation on setting and monitoring prudential ratios to banking operation</p> <p>2011.11.25: Regarding the liquidity ratio</p> <p>2011.07.19: Regarding setting minimum paid-in capital requirement</p>
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2. Credit Information Law

CREDIT INFORMATION CHAPTER ONE GENERAL PROVISIONS

Article 1. Purpose of the Law

1.1. The purpose of this law is to regulate the relations concerning of build-up credit information database, processing, safety, protection and usage of the credit information, render credit information service, licensing of the legal entity which renders credit information service, the revocation of licenses and obtaining the control.

Article 2. Legislation on Credit Information

2.1. Legislation on credit information comprises Constitution of Mongolia¹, Civil code², Criminal code³, Law on Central Bank /the Bank of Mongolia/⁴, the Banking Law⁵, Personal Privacy Law⁶, Law on Organizational Secret⁷, this law and other relevant legislation, which is consistent with them.

2.2. If an international treaty to which Mongolia is a party is inconsistent with this law, then the provisions of the international treaty shall prevail.

Article 3. Scope of the Law

3.1. This law shall apply to bank, non-bank financial institutions, savings and credit cooperative, individual who stated in this law and contract in terms of building-up information database concerning on cash payment obligation arising from credit and settlement within state and private legal entities and its exploitation and monitoring.

Article 4. Terms and definitions

4.1. The terms used in this law shall have the following meaning:

4.1.1. "credit information" refers to information and data about credit and payment status which borrower undertakes under duly legislation and contract within lender;

"credit information database" refers to credit information of borrowers which possessed by BOM and other credit information provider-legal entity;

4.1.2. "borrower's permission" refers to document provided by borrower that permits to give the information stated in article 6 of this law to the credit information provider-legal entity;

1 The Constitution of Mongolia - Published in Issue No.1 of 'State information' magazine in 1992.

2 The Civil Code - Published in Issue No.7 of 'State information' magazine in 1992.

3 The Criminal Code - Published in Issue No.6 of 'State information' magazine in 1992.

4 Law on Central Bank /The Bank of Mongolia/ - Published in Issue No.11 of 'State information' magazine in 1996.

5 The Banking Law - Published in Issue No.7 of 'State information' magazine in 2010.

6 Personal Privacy Law - Published in Issue No.7 of 'State information' magazine in 1995.

7 Law on Organizational Secret - Published in Issue No.7 of 'State information' magazine in 1995.

- 4.1.1. "build-up credit information database" refers to processing of credit information by collecting, revising, updating and amending the database information on the basis of the law and contract;
- 4.1.2. "credit information provider legal entity" refers to for-profit legal entity that granted special permission by BOM to conduct credit information operation;
- 4.1.3. "borrower" refers to an individual or legal entity that has credit and payment obligation to state, entity, organization, individual and legal body according to law and effective contract;
- 4.1.4. "lender" refers to bank, non-bank financial institutions and savings& credit cooperatives. Furthermore, an individual or legal entity that entitled to require fulfillment of credit and payment obligation from borrower according to law and effective contract;
- 4.1.5. "information supplier" refers to particular lenders and state organizations that supply borrower's information about credit and payment obligation to credit information database according to contract made with credit information provider legal entity;
- 4.1.6. "user" refers to an information supplier, an individual, a legal body and borrowers who intends to receive the information in terms of contract made with credit information service provider-legal entity;
- 4.1.7. "contract to receive or provide information" refers to any contract made between information supplier, user and credit information provider concerning on (1) to supply information about credit and payment of the borrower to credit information database and/or (2) to receive information from this database;
- 4.1.8. "state organization" refers to BOM, Financial Regulation Committee, State Administration Organization which responsible for registration matter of individual, legal body and property, Taxation Department, Social Insurance Authority, Customs Administration, Power Authority, Court Judgment Execution Authority;
- 4.1.9. "credit inquiry" refers to credit information and credit history information that provided to users from credit information database in forms of electronic and writing;
- 4.1.10. "credit history" refers to systematic information about borrower concerning on obligation of any outstanding credit & payment and its fulfillment according to law and contract.

Article 5. Principle adhered for providing credit information service

- 5.1. Following principle shall be adopted/adhered for providing credit information service:
 - 5.1.1. to be independent;
 - 5.1.2. it's mandatory to obtain permission from borrowers;
 - 5.1.3. to exchange information on basis of law and contract;
 - 5.1.4. information shall be fair and on balance;
 - 5.1.5. to provide confidentiality.

CHAPTER TWO
CREDIT INFORMATION DATABASE, TO BUILD-UP
DATABASE AND ITS USE

Article 6. Credit information

6.1. Following information is included into Individual credit information:

- 6.1.1. surname, name of the father /mother/, given name, national ID and registration number;
- 6.1.2. residence address;
- 6.1.3. if taxpayer, the personal taxation number;
- 6.1.4. Employment situation, official address of the his/her workplace, telephone and e-mail address;
- 6.1.5. marital status;
- 6.1.6. date in when credit and payment contract, contract No, type, currency name of the payment;
- 6.1.7. term of the credit and payment, schedule, interest rate, outstanding amount of performing credit and payment;
- 6.1.8. outstanding amount of the credit and payment which has repaid overdue or defaulted at all;
- 6.1.9. amount of credit and payment that can be secured or will secure by pledge, collateral and guarantee;
- 6.1.10. Number of State registration and Certification of the property, date, holder, surname and father's /mother's/ name of the owner, given name, number of National ID and Registration, residence address, telephone number, e-mail address and other necessary information;
- 6.1.11. If ever rejected any obligation of credit and payment, reason for rejecting;
- 6.1.12. if credit & payment obligation and its entitlement to require has transferred into 3rd party; number and date of the document that perform transfer;
- 6.1.13. Information about classification of the credit and payment;
- 6.1.14. Conclusion on particular borrower's borrowing ability;
- 6.1.15. other information which BOM considers necessary to include into credit information related to obligation of the loan and payment.

6.2. Credit information of legal entity comprised from following information:

- 6.2.1. proper name, in Mongolian and English, its abbreviation;
- 6.2.2. number of state ID and registration;
- 6.2.3. domicile address, telephone number and e-mail address;
- 6.2.4. registration number of taxpayer;
- 6.2.5. surname, father's /mother's/ name, number of national ID and registration, address of residence, telephone number and e-mail address of the shareholder who owns more than 25 percent of the company stocks;
- 6.2.6. parent, associate, subsidiary and their related party as stated in article 3.1.2 of the Banking Law of Mongolia. Name of the joint interest entity as stated in article 99.1 of the Company Law, number of state identity and registration, domicile address, telephone number and e-mail address;
- 6.2.7. surname of the Executive Officer, given name, national ID number, registration number, residence address, telephone number and e-mail address;
- 6.2.8. Major operation of the business, conducting activities;
- 6.2.9. information stated in article 6.1.6-6.1.15 of this law.

6.3. Following information possessed by state organization shall be included in individual or legal entity credit information:

- 6.3.1. overdue paid or unpaid amount of the social insurance, tax and customs duties;
- 6.3.2. if credit and payment repaid under duress, amount of credit and payment which reimbursed under duress, execution date of the duress;
- 6.3.3. number and date of the effective judgment by the court that charged because of the criminal offence of fraudulent and waive intentionally from court judgment execution;
- 6.3.4. information, that is not legally prohibited to provide to others, from State Administration Organization that responsible for state registration, power management organization and Court Decision Execution Authority.
- 6.4. Credit information provider entity shall register following information that exchanged with credit information database:
 - 6.4.1. dates on which credit information submitted, updated or revised, information about supplier who has provided information or user who received credit enquiry;
 - 6.4.2. purpose and reason of receiving credit inquiry and its registration number.

Article 7. Source of the credit information

- 7.1. Following people shall be responsible/confirm that whether the credit information is fair or not:
 - 7.1.1. for information stated in article 6.1 and 6.2 of this law, borrower or information supplier;
 - 7.1.2. for information stated in article 6.3 of this law, relevant state authorities;
 - 7.1.3. for information stated in article 6.4 of this law, credit information provider.
- 7.2. It's prohibited for borrower, information supplier, state organization and credit information provider to supply, set up and inform unfair credit information intentionally.
- 7.3. If it considers source of the credit information unfair or incomplete, credit information service provider shall notify to the information supplier immediately and shall take actions to eliminate the offenses.

Article 8. Information that prohibited to be included in credit information

- 8.1. Following information are prohibited to be included in credit information, of which:
 - 8.1.1. race, ascription, religion, political party, membership of the non-government organization and information concerning on health of the borrower;
 - 8.1.2. information and research related to trade and business secret of borrowers.

Article 9. Build-up credit information database

- 9.1. Following rules shall be applied to building up credit information database:
 - 9.1.1. only legal entity which has obtained special permission on conducting credit information operation as building-up and exploiting credit information database is allowed to collect credit information;
 - 9.1.2. information supplier shall give any credit information to the credit information database on basis of borrower's approval;
 - 9.1.3. when supply credit information to credit information database, contract to give and receive information shall be made within information supplier and credit information service provider whereas they can exchange information upon it;
 - 9.1.4. only information stated in article 6 of this law can be collected as input to credit information database;
 - 9.1.5. credit information shall be collected occupying methods and ways which permitted by this law;
 - 9.1.6. credit information shall be enriched and updated timely;
 - 9.1.7. bank, non-bank financial institutions and savings and credit cooperative shall make contract

with credit information provider, which has special permission obtained by BOM, to receive or give necessary information and shall oblige to exchange information.

9.2. It's prohibited to neither acquire information from mass media and other person, other than information provider, nor insert them to the credit information.

9.3 It's forbidden to take out the information of credit information database or transfer it to foreign country without BOM permission.

Article 10. Use of credit information

10.1. User shall use credit information for following purposes:

10.1.1. state organization shall receive necessary information in order to execute its rights and duties in accordance with law and it shall used only for official use;

10.1.2. lender shall receive and use credit information in order to assess credit risk;

10.1.3. borrower shall receive and use credit information, which only concerned with borrower, in purpose of monitoring his/her/its credit and payment status and manage the finance effectively.

10.2. It's prohibited to use credit information for different purpose than as stated in article 10.1 of this law.

Article 11. Provide credit reference

11.1. Credit reference shall cover last 6 years of credit information for a particular borrower and it shall be provided only to user.

11.2. User shall apply to credit information provider according to approved application by expressing its request to receive credit reference.

11.3. Credit information provider shall give reference within the scope permitted by legislation and contract.

11.4. Credit information provider shall possess computer software that can provide the credit reference decently.

11.5. Rights to receive credit reference can be transferred only to registered user in accordance with proxy that can satisfy law requirement and otherwise it can't be transferred to the 3rd party.

11.6. Name of the information supplier who initially supplied the information to the credit information database, residence address, telephone, e-mail address, date on which give information and last updated date of the base shall be stated in the credit reference.

11.7. Whenever credit reference given to anybody from credit information database, name of the credit reference receiver and its purpose shall be added into database wherein it shall be enriched.

11.8. Regulation on providing credit reference from credit information service provider for its own authority person or shareholder, who stated in article 84.1 of the Company Law, shall be set by BOM.

Article 12. Service fee

12.1. Credit information service provider has right to receive service fee. When pricing service in compliance with operational cost, demand and supply, it shall base on stipulation stated in article 23.4 of this law.

12.2. Borrower is entitled to address to credit information service provider and to receive its own reference from credit information database once in a year and it is free of charge. In other circumstances borrower is required to pay service charge.

Article 13. Contract terms

13.1. Credit information service provider is mandatorily required to include following terms in the contract for giving and receiving information, which made with information supplier and users:

- 13.1.1. name of the information supplier or user, address, current account number in a bank;
- 13.1.2. contract duration, terms of making amendments, termination and revocation to contract;
- 13.1.3. whether permission obtained by borrower or not;
- 13.1.4. type of the credit information, volume, timing, procedure concerning on supplying and using credit information;
- 13.1.5. process of updating and revising credit information;
- 13.1.6. confidentiality of credit information, not leaking the secret to person who hasn't right to do so, how to compensate the damage which arisen from not fulfilling the obligation;
- 13.1.7. regulation on giving and receiving credit reference;
- 13.1.8. duties and responsibilities of the contract parties;
- 13.1.9. provision concerning on complain and dispute settlement.

CHAPTER THREE
CREDIT INFORMATION SERVICE PROVIDER'S ACTIVITIES TO BE CONDUCTED,
ITS RIGHTS AND RESPONSIBILITIES

Article 14. Contract terms

14.1. Credit information service provider shall conduct following activities:

14.1.1. to collect information stated in article 6 of this law, which is related to borrower, and to build-up credit information database;

14.1.2. process and digest credit information which collected in credit information database, develop and sale credit reference and other products in compliance with the customer's demand and necessity;

14.1.3. set ratings for the borrower's borrowing ability;

14.1.4. perform economic analysis and market research based on credit information;

14.1.5. other service related to credit information which permitted by BOM;

14.2. Credit information service provider is not allowed to conduct any other activities than stated in article 14.1 of this law and/or permitted by BOM.

Article 15. Forbidden activities for credit information service provider

15.1. Credit information service provider is forbidden to conduct following activities:

15.1.1. Credit information service provider, its shareholder and competent authority person and employees are to distribute, reveal and misuse the accumulated information in credit information database, except laws required otherwise;

15.1.2. Blast unfair advertisement about own activities or inform wrong information.

Article 16. Rights and duties of credit information service provider

16.1. Credit information service provider has below mentioned rights:

16.1.1. to build-up credit information database and process, save, protect and exploit credit information as stated in credit information legislation;

16.1.2. to provide credit information with any charge unless stated in article 22.1.1 of this law;

16.1.3. to review the content of the information which supplied by information supplier, verify the information that might be doubtful, uncertain and unfair, if it can't satisfy the requirement, refuse to receive and require them to resend;

16.1.4. to require and examine the proof or proxy that can prove whether the applying person is information supplier and user or not;

16.1.5. to monitor the contract implementation by receiving and reviewing the explanation letter from information supplier or user, who concluded the contract on receiving or giving the information, on how they exploit the credit information;

16.2. Credit information service provider has following duties:

16.2.1. to save and secure the credit information of the borrower soundly, to update and to process according to legislation;

16.2.2. to provide certification to individual or legal entity, who made contract with itself, concerning on entitlement of rights to receive information from credit information database and register it as user;

16.2.3. to provide credit reference to user in accordance with statement of this law only;

16.2.4. to do whatever it takes to prevent the leakage of the information to un-authorized person by improving the security and provide the safety to the credit information.

Article 17. To input credit information to credit information database

17.1. Information supplier shall consider following principle when inputting credit information to credit information database:

17.1.1. credit information shall be fair, accurate, certain, complete and feasible to understand;

17.1.2. information shall be permitted by legislation;

17.1.3. always update the credit information timely every time any change occurs;

17.1.4. information shall be only used in purpose of statement of this law;

17.1.5. to use computer software and hardware that can protect the credit information confidentiality to be supplied;

17.1.6. information supplier shall insert/merge credit information into credit information database based on borrower's permission.

17.2. unless it's permitted otherwise by legislation, information supplier is prohibited to insert credit information to credit information database.

17.3. Information supplier shall supply, using approved computer software, credit information to credit information service supplier in forms of electronic or writing according to contract for receiving or giving information.

17.4. Whenever credit information is supplied, both information supplier and credit information service provider shall execute electronic or written document mutually that can prove the information delivery and shall keep documentation.

Article 18. To revise, update and process the credit information

18.1. If any amendment made for credit information which already supplied into credit information database, information supplier shall deliver the particular amendment and revision to credit information service provider within 3 working days.

18.2. When credit information service provider receives amendments and revisions stated in article 18.1 of this law, they are required to add the amendments and revisions immediately and to update the whole database.

18.3. Credit information service provider shall take continual and systematic actions to classify the processed credit information, to arrange in order to sell it to the users as a credit reference and other products as well as to review fairness of the credit information.

Article 19. To save, secure and archive the credit information

19.1. Credit information service provider shall retain the credit information, which accumulated in credit information database, in this database for 10 years period from the date of receipt.

19.2. Credit information service provider shall provide and insure the confidentiality, safety and security of the information which is being saved in its credit information database.

19.3. Any damage occurred because of not providing the decent security and protection for the credit information according to the standards set by BOM shall be fall under the obligation of the credit information service provider.

19.4. Once period stated in article 19.1 of this law finishes, credit information shall be transferred to the BOM.

CHAPTER FOUR

RIGHTS AND DUTIES OF THE INFORMATION SUPPLIERS, USER AND BORROWER

Article 20. Rights and duties of information supplier

20.1. Information supplier has following rights:

20.1.1. to require from credit information service provider to ensure the safety and security of the credit information confidentiality;

20.1.2. to require from credit information service provider to reflect the amendments and revision made for particular credit information based on reference material whenever it occurs and to process and enrich the credit information timely;

20.1.3. to obtain control on not inserting any unfair and wrong additional information to the information already transferred into credit information database;

20.1.4. in case that it's required to clarify and examine certain information because of there is something doubtful exist in the information source for the supplied information, to enquiry to the borrower and other relevant authorities and to cooperate with;

20.2. Information supplier has following duties:

20.2.1. to verify the fairness of the credit information and to supply information, which is fair, certain and in compliance with the reference, to the credit information database;

20.2.2. when exchanging the credit information, fulfill the requirement set in this law;

20.2.3. in case of credit information supplied incomplete or omitted, to take immediate action to revise, finish and amend;

20.2.4. do not reveal any information, except for information stated in article 6 of this law, which involved to the borrower's secret.

Article 21. Rights and duties of user

21.1. User has following rights:

21.1.1. to require credit reference to include fair, accurate, certain and be in compliance with the particular source;

21.1.2. if the credit information is apparently wrong, to require from the borrower, information supplier or credit information service provider to revise and update immediately;

21.1.3. If any damage occurs because of providing wrong information intentionally, to require to compensate the damage;

21.2. User has following duties:

21.2.1. to exploit the credit reference just for the purpose that permitted by legislation and contract;

21.2.2. if it's know that information reflected in credit reference is wrong or incomplete, to inform to lender or credit information service provider immediately and to require from them to make necessary revision as soon as possible;

21.2.3. to preserve information privacy which reflected in credit reference and avoid to transfer information to third party;

21.2.4. If it's considered necessary to be examined because of information shown in credit reference is doubtful, it might be tampered or it's mandatorily required, to notify to the lender, information supplier, credit information service provider.

Article 22. Rights and duties of borrower

22.1. Borrower has following rights:

22.1.1. to receive its own credit reference from credit information database whenever it deemed necessary and review it, receive that credit reference free of charge once in a year;

22.1.2. in case that information in credit information database is unfair or incomplete, to require from information supplier or credit information service provider to revise/update the information;

22.2. Borrower has following duties:

22.2.1. to present/report the information stated in article 6 of this law, which involved into credit information, to lender;

22.2.2. if any amendment made into credit information in illegal way, notify to the legal authority immediately.

CHAPTER FIVE
TO GRANT, SUSPEND AND REVOKE SPECIAL PERMISSION TO CONDUCT
CREDIT INFORMATION OPERATION

Article 23. To grant special permission to conduct credit information operation

23.1. Special permission to conduct credit information operation shall be granted by BOM.

23.2. Applicant, who applies for special permission to conduct credit information, shall submit the documents stated in article 11.1.1 and 11.1.2 of the 'Law of Mongolia on Licensing⁸', outside than following documents:

23.2.1. name of the shareholder or key management personnel who is going to work in management of the credit information service provider, copy of the national identity, telephone and e-mail address;

23.2.2. for each shareholder who owns more than 5 percent of stocks of that legal body, percentage and volume of the their invested capital shall be disclosed;

23.2.3. for key personnel who is going to work in the upper management of the credit information service provider, their information concerning on major, education, working experience, document that can prove whether he/she ever engaged with any crime or not and he/she doesn't have any overdue credit or payment obligation shall be disclosed;

23.2.4. business plan;

23.2.5. document that can prove the applicant possesses is equipped with appropriate software and hardware that can satisfy all requirements to preserve the safety of the credit information database;

23.2.6. regulation on exchanging information with credit information database from user perspective, sample contract which stipulated their rights and duties precisely;

23.2.7. ethical code, including principle and responsibilities on internal and external activities of the organization;

23.2.8. document that can illustrate entity retains the minimum requirement on capital which set by BOM.

23.3. BOM is obliged to receive the application stated in article 23.2 of this law, along with relevant accompanying documents, whereas BOM shall do judgment on whether to grant special permission to conduct credit information operation or not and shall notify to applicant its decision in written form within 30 days from receipt date.

23.4. Regulations concerning on to grant special permission to conduct credit information operation, to build-up credit information database, to process/digest, retain, protect, transfer the credit information and pricing of the service shall be set by BOM.

23.5. Entity, which has not got special permission to conduct credit information operation, is forbidden to use the so-called name of 'credit information database.

Article 24. Basis for rejection to obtain special permission to conduct credit information operation

24.1. On below mentioned basis, BOM shall reject to obtain special permission to conduct credit information operation:

24.1.1. submitted application and accompanying documents can't meet the requirements stated in article 23 of this law;

24.1.2. its contract to establish (code for incorporating) and charter are inconsistent with legislation;

24.1.3. it could not equipped with merit hardware and software that can provide information privacy and safety at maximum in accordance with stated in this law, and/or management personnel are not qualified enough.

Article 25. To suspend the given special permission to conduct credit information operation

25.1. BOM may suspend the special permission to conduct credit information operation in terms of following basis, outside than basis stated in article 13 of the Law of Mongolia on Licensing of Economic Entity:

25.1.1. in case that credit information service provider is being restructured in forms of merge, divide and separation under stockholder's meeting decision, it shall be suspended until such restructuring procedure ended;

25.1.2. if it didn't take any dutiful actions which required by BOM in order to satisfy the requirements stated in this law, it shall be suspended until action to eliminate the offenses be taken.

Article 26. Basis for revocation of special permission to conduct credit information operation

26.1. BOM may revoke the special permission to conduct credit information operation in terms of following basis, outside than basis stated in article 14.1.1-14.1.5 of the Law of Mongolia on Licensing:

26.1.1. could not meet the requirement set by this law for preceding 3 months;

26.1.2. it's identified that its establishment and other documents, which serve as major basis to grant special permission, are fake or inconsistent with reality;

26.1.3. distributed wrong and incomplete information intentionally and make revision or amendments to credit information database in wrong way;

26.1.4. did not start or conduct any business for a year after special permission receipt;

26.1.5. violated this law and other relevant legislation severely by using the credit information illegally, and cause considerable damage to others;

26.2. Reason for revoking the special permission to conduct credit information operation shall be stated in the relevant resolution clearly.

26.3. In circumstance that BOM has revoked the special permission of the credit information service provider or has rejected to grant special permission once, BOM shall not accept any re-application to request special permission from that particular provider for succeeding 6 months.

Article 27. Restructure or liquidate the credit information service provider

27.1. Credit information service provider might be restructured or liquidated under stockholders' meeting decision, and in such case it shall be permitted by BOM.

27.2. To obtain permission to restructure or liquidate the credit information service provider, following documents shall be submitted to the BOM:

27.2.1. stockholders' meeting decision concerning on restructuring or liquidating;

27.2.2. document covering actions to be taken on how to settle credit information database in order to cease its operation properly, its implementation phases, initiative, form and timing to restructure or liquidate;

27.2.3. prediction on implication which arisen from restructuring, and if there is any entity to which rights and duties are transferring opening balance of the entity.

27.3. If BOM allows the restructuring process of the particular credit information service provider, BOM shall transfer the credit information to preceding credit information service provider which created as a result of restructuring.

27.4. In case of credit information service provider is liquidated, credit information database shall be transferred to the BOM.

**CHAPTER SIX
CREDIT INFORMATION DATABASE OF THE BOM**

Article 28. Exchange information with BOM database

28.1. BOM shall possess credit information database which comprised/collected from bank, non-bank financial institutions, other financial institutions which legally permitted to conduct credit operation, state organizations and other entities, in purpose of retain the stability of the financial sector.

28.2. Bank, non-bank financial institutions, savings and credit cooperative, financial leasing company and state organization shall detach the credit information to the BOM information database regularly regardless of individual or entity permission obtained or not.

28.3. Information of the BOM credit information database shall be exchanged with other credit information service provider on basis of its written and electronic inquiry, under law and effective contract.

28.4. Regulation on exchanging information from the BOM credit information database with credit information service provider shall be defined by BOM.

28.5. It's prohibited for BOM to use credit information database in purpose of generating profit.

**CHAPTER SEVEN
RESPONSIBILITIES**

Article 29. Responsibilities to be imposed on those who breach the credit information legislation

29.1. If the violation of the Credit Information Law does not constitute a criminal offense, then BOM supervisors shall impose following administrative sanctions against the violator:

29.1.1. Employee, who violates this law by inserting information forbidden by this law to the credit information as input, shall be imposed a fine of 10-20 times the monthly minimum wage;

29.1.2. If information supplier and credit information service provider violates the requirement stated in this law in process of collecting and supplying information, violator shall be imposed by a fine of 50-100 times the monthly minimum wage rate;

29.1.3. Violation of Article 7.2 of this Law shall result in a fine of 10-30 times the monthly minimum wage rate for an individual, a fine of 30-50 times the monthly minimum wage rate for the official and a fine of 50-70 times the monthly minimum wage rate for the business entity and organization;

29.1.4. If somebody violated the regulation to use credit information or exploited it for illegal purpose, violator shall be imposed by a fine of 50-100 times the monthly minimum wage rate;

29.1.5. If any damage occurred to others because of not providing the appropriate security and safety conditions for the information privacy; violator shall be imposed by a fine of 50-100 times the monthly minimum wage rate;

29.2. Credit information service provider and its staffs doesn't take any responsibilities for fairness of the information which initially supplied by the information supplier.

Article 30. Law effectiveness

30.1. This law shall come into force and be adopted starting from 1 January 2012.

LAW OF MONGOLIA

Date: Oct 26, 2011

State Palace, Capital of Ulaanbaatar

AMENDMENT TO LAW ON CENTRAL BANK /THE BANK OF MONGOLIA/

Article 1. Following items with below mentioned underlying meaning are being added to the Law on Central Bank /The Bank of Mongolia/:

1/ Article 19¹

“Article 19¹. To grant special permission to conduct credit information operation and do monitoring

1. Activities related to grant, reject, suspend and revoke special permission to conduct credit information operation and maintain supervision on it shall be regulated under legislation in purpose of retain stability of the financial sector. “

2/ Article 25³

“Article 25³. To obtain the supervision on legal entity who conduct credit information service

2. BOM shall obtain supervision on legal entity who conducts credit information service according to stated in article 24 of this law.

3. BOM shall examine any complaint presented in relevance to operation of the credit information database and shall charge with obligation to relevant person to revise the information as well as make it reliable.

4. BOM shall receive and review the independent auditor's report which conducted on operation of credit information service provider legal entity annually.

Article 2. This law shall come into force on same date as Credit Information Law effects.

D. DEMBEREL

SPEAKER OF PARLIAMENT

LAW OF MONGOLIA

Date: Oct 20, 2011

State Palace, Capital of Ulaanbaatar

AMENDMENT TO BANKING LAW

Article 1. Provision 7.2.6 with following specified meaning is being added to the article 7 of the Banking Law:

“7.2.6. give information to credit information database as stated in legislation”

Article 2. This law shall come into force on same date as Credit Information Law effects.

LAW OF MONGOLIA

Date: Oct 20, 2011

State Palace, Capital of Ulaanbaatar

AMENDMENT TO COOPERATIVE LAW

Article 1. Article 48⁵ with below mentioned meaning is being added to the Cooperative Law:

“ **Article 48⁵.** Credit information of the borrower

485.1. Cooperative may give its borrowers' credit information to credit information database or receive information from this database on basis of contract made in purpose of make lending responsible and minimize the risk inherent to its operation.”

Article 2. This law shall come into force on same date as Credit Information Law effects.

LAW OF MONGOLIA

Date: Oct 20, 2011

State Palace, Capital of Ulaanbaatar

AMENDMENT TO LAW ON STATE REGISTRY OF PROPERTY OWNERSHIP AND OTHER RELATED PROPERTY RIGHTS

Article 1. Provision 6.8 with below mentioned meaning is being added to the article 6 of the Law on State Registry of Property Ownership and Other Related Property Rights:

“ 6.8. If it's probable that there is a doubtful or unreliable information about borrower's property ownership inside the credit information in the credit information database and credit information service providing legal entity requests in order to ensure this information, detailed information concerning on state registry of rights can be provided free of charge”

Article 2. This law shall come into force on same date as Credit Information Law effects.

LAW OF MONGOLIA

Date: Oct 20, 2011

State Palace, Capital of Ulaanbaatar

AMENDMENT TO LAW OF MONGOLIA ON LICENSING OF BUSINESS ENTITY

Article 1. Provision 15.3.9 with below mentioned meaning/nature is being added to the article 15 of the Law of Mongolia on Licensing of Business Entity:

“15.3.9. Undertake/conduct credit information operation”

Article 2. This law shall come into force on same date as Credit Information Law effects.

3. Regulation on Asset Classification, Provisioning and its Disbursements (unofficial translation, BOM)

ONE. GENERAL PROVISIONS

- 1.1. The purpose of this regulation is to set the minimum requirements by the Bank of Mongolia (BOM) on classifying the loans defined in the Article 27.1 of Law on deposits, loans and banking transactions (DLBT) and other assets, as well as on establishing and disbursing loss provisioning on both loans and other assets stated in the Article 35.5 and Article 35.6 of The Banking law and to ensure regulated banks follow and comply with the set requirements.
- 1.2. This regulation shall be consistent with The Law on Central bank of Mongolia, DLBT, the Law on Credit information, the Administrative general law and other relevant legislations.
- 1.3. A bank shall comply with the minimum requirements set by the BOM to classify an asset with both quantitative and qualitative criteria in line with the provisions of Article 2 and the methodologies shown in Annex 1 and Annex 2 of this regulation and establish its corresponding loss provisioning in line with the provisions of Article 3 and the methodologies shown in the Annex 3 of this regulation.
- 1.4. A bank shall develop for management and accounting purposes its internal methodologies, guidelines and policies regarding its asset classification, loss provisioning and asset risk management taking into account its scope, complexity and operation and shall have the process to adequately follow them on a regular basis.
- 1.5. Provided there is a difference between the final asset classification, its corresponding provision by the bank and those by the BOM done in line with this regulation, a bank shall follow the classification and the provision set by the BOM.
- 1.6. A bank may classify its asset internally with the categories more than those stated in the Article 2.1.1 of this regulation and shall do so in such a way that they could be convertible into the basic categories stated in this regulation.
- 1.7. A bank shall submit its compliance status report of minimum requirements on the asset classification, loss provisioning along with its internal classifications and estimates stated in the Article 3.6.1 of this regulation to the BOM within set timeframe.
- 1.8. A bank is obliged to adequately set the class of a given asset and calculate the corresponding provision all while complying with the minimum requirements set by this regulation.
- 1.9. The BOM shall review and monitor if the asset class and its respective provision estimated by the bank were done in line with this regulation and shall require and enforce a bank to re-set the class and/or the provision in all those cases where the BOM and the bank have a different opinion.
- 1.10. Provided the class of an asset determined by a bank using its internal regulation, guideline or the methodology stated in the Article 1.4 of this regulation consists in a lower asset quality than determined by this regulation, the class based on the internal regulation, guideline or methodology shall be followed.

methodology stated in the Article 1.4 of this regulation is higher than that by this regulation, the provision based on the internal regulation, guideline or methodology shall be applied.

1.12. The terminologies below shall have the following meaning:

1.12.1. “**Asset**” means loans and other credit equivalent assets;

1.12.2. “**Loan**” means a financial asset that grants the right to demand the repayment on the sum of money from the obligor based on the contractual obligation;

1.12.3 “**Other assets**” means other on-balance credit equivalent assets; securities other than central bank bills and government bonds; off-balance sheet items that creates a potential right to demand, receivable and asset/credit risks for a bank arising from the operations and activities of a bank such as financial guarantees, warranties, letters of credit (LC), derivatives and other contractual financial contingent liabilities;

1.12.4. “**Securities**” means those stated in the Article 4.1.8 of Securities Market Law;

1.12.5. “**Multiple assets**” means the collection of assets or an asset that satisfies the conditions set forth in the Article 2.2.2 of this regulation;

1.12.6. “**Asset/Credit risk**” means likelihood which an obligor fails to repay on time his contracted principal along with its respective interest partially or in full in accordance with the provisions specified in the contract concluded between a bank and an obligor;

1.12.7. “**Final asset class**” is the final class of a given asset determined as the class of lowest quality derived from quantitative criteria shown in the Annex 1 of this regulation and qualitative criteria shown in the Annex 2 of this regulation;

1.12.8. “**Credit equivalent amount**” means the amount defined in the Article 3.2.1.2 and 3.2.1.7 of this regulation;

1.12.9. “**Risk profile**” means general overview or overall assessment of risks of an obligor formed by the bank using data and information on the obligor’s financial standing and the activities;

1.12.10. “**Pooled assets**” means assets that are grouped or pooled in accordance with article 2.7. of this regulation with the purpose of establishing the collective loss provisioning;

1.12.11. “**Unit asset**” means a specific asset included in the pooled assets;

1.12.12. “**Probability of default /PD/**” means PD parameter specified in the Annex 1 in Article D of the Accounting guideline estimated as the likelihood of default within next 12 month period of both principal or interest (payment for more than 90 days either in terms of loans or other assets);

1.12.13. “**Loss given default /LGD/**” means LGD parameter specified in the Article 4.3.D of the Accounting guideline estimated either in terms of loans or other assets;

1.12.14. “**Loss identification period /LIP/**” means LIP parameter specified in the Article 4.3.D of the Accounting guideline estimated either in terms of loans or other assets;

1.12.15. “**Asset/Credit risk parameter**” means any or all of the indicators stated in the Article 1.12.12, 1.12.13 and 1.12.14 of this regulation or other parameters used by a bank to estimate its asset/credit risks;

1.12.16. “**Specific provision**” means an amount of provision of a given asset, group of assets or pooled assets with the downgraded classification followed by multiplying them with the corresponding provisioning rates upon the review or conclusion on the deterioration in their quality using the criteria set forth in this regulation;

1.12.17. “**General provision**” means an overall amount of provision accumulated from and charged on both on- and off-balance sheet assets with predetermined provisioning rates based on the overall risks in the financial industry or in the banking activities.

1.12.18. “**Expected loss**” means the central estimate (through a simple average, weighted average, or other central statistics) of the amount of losses an asset is expected to generate within a given time horizon, as estimated by a bank using the long-term loss data and observations and subsequently applied to its internal methodology to determine the specific provision of a given asset;

1.12.19. “**Restructured asset**” means an asset that satisfies criteria set forth in the Article 2.4.1 of this regulation;

1.12.20. “**Downgraded asset**” means an asset that is downgraded due to the conclusion that the likelihood that its scheduled payment would be repaid in full or partially has lowered based on the evaluation using the factors and criteria specified in this regulation or an internal methodology by a bank;

1.12.21. A **default** shall be considered to have occurred with regard to a particular obligor when;

1.12.21.1. an obligor is more than 90 days past due on any material exposure to the bank Overdrafts will be considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than current outstanding; or

1.12.21.2. where the bank considers that the obligor is unlikely to repay its exposures fully to the bank based on the contractual terms, original or; when applicable, modified (e.g. repayment of principal and interest) without the bank’s realization of collateral, whether or not the exposure is current and regardless of the number of days the exposure is past due;

1.12.22. “**Revolving facility/asset**” means a given asset or pooled assets such as overdrafts, credit cards, credit lines and commitments where their specified amount, maturity, frequency of payments, maximum limits of drawing and other conditions have been set forth in such way that were more flexible, favorable to the obligor’s financial needs and may be granted to the obligor for continuous periods with longer frequency of payments relative to other regular assets;

1.12.23. “**Effective interest rate**” as defined in the Chapter 1 of Accounting guideline;

1.12.24. “**Repossessed asset**” means an item specified in the Article 4.5.b of the Accounting guideline;

1.12.25. “**Lower classification**” means the class of lowest quality assigned to a given asset;

1.12.26. “**Cross-collateralized**” means a single or multiple pledges of the assets granted to the obligor has/have been pledged to the assets granted to other obligors by that bank or other bank;

1.12.27. “**Cross-guaranteed**” means guarantor/guarantee of an asset granted to the obligor by a bank is also guarantor/guarantee of an asset to the other obligor by this bank or other bank;

1.12.28. “**Materiality**” means either:

1.12.28.1. an extent or a degree to which the stakeholders to that entity may change their investment or economic decision due to the information or evidence that were omitted or presented in an incomplete or false manner. (Materiality depends on the nature, context and the amount of information/materials that were falsely disclosed or omitted); or

1.12.28.2 an amount, level or the rate of change in regards to the adjustment to the asset valuation, if undertaken or taken place or omitted, could significantly affect the quality of the asset in question.

1.12.29 “Accounting Guideline” means the BOM Accounting batch material.

TWO. ASSET CLASSIFICATION REQUIREMENTS

2.1 General Provision

2.1.1. A bank, except the pooled assets specified in Article 2.7.1 of this regulation, shall classify its asset in terms of the classification categories stated in this regulation by simultaneously defining the asset class on both quantitative and qualitative criteria as shown in the Annex 1 and 2 of this regulation and consequently setting the final class as the one of lower quality between the two.

2.1.1.1. Performing;

2.1.1.2. Special mention;

2.1.1.3. Non-Performing; of which:

a. Substandard;

b. Doubtful;

c. Loss.

2.1.2. A bank can use additional categories and subcategories for internal purposes as long as all of them can be converted into the former categories of article 2.1.1.;

2.1.3. All bank assets except those of off-balance sheet shall be reported to the Credit information bureau with their class determined by the quantitative criteria;

2.1.4. Final class of off-balance sheet assets shall be reported to the Credit information bureau;

2.1.5. When the scheduled payment on the asset is past due but is classified performing by the qualitative criteria, a bank may classify such asset as performing by discretion if it views an obligor can repay, without financial support by the bank, his past due amount and return to the regular payment schedule within 15 days if the obligor is an individual and within 30 days if the obligor is a company since the date past due event. If past-due days of such asset exceed the number of days specified above, the asset shall be downgraded as specified in the regulation;

2.1.6. Qualitative classification of an asset shall be determined using results of the evaluation templates/forms specified in the Annex 5 and Annex 6 of this regulation;

2.1.7. Provided the classification of an asset determined by the internal methodology of a bank is of lower quality than determined by this regulation, a bank shall use classification of its internal estimate;

2.1.8. A bank shall timely adjust its evaluation on its assets⁵ quality whenever a change occurs in the quantitative and qualitative assessment whereas the asset classification shall be done once a month, within the end of last working day of the said month;

2.1.9. A bank may classify its assets with a frequency more than that specified in the Article 2.1.8 of this regulation;

2.1.10. If a bank decides to change the type of a given asset, the classification prior to the change shall remain and the subsequent classification shall be determined based on this regulation. Repossessed assets aimed at recovering the amount owed to the bank by an obligor or selling such assets shall not be deemed as type of asset being changed and classification and provisioning of repossessed assets shall be done as stated in this regulation;

2.1.11. A bank shall conduct analysis to determine the classes of its assets extended to companies to using the financial statements submitted by obligors on a quarterly basis and also require obligors to have their annual financial statements audited.

2.2 Multiple assets/facilities

2.2.1. All assets extended to the same borrower or risk group shall be classified in the same final category, except those where there are differences that imply significant different recovery likelihood. The amount of the assets with different recovery likelihood in given multiple assets shall not be higher than that of the 25% of the multiple assets.

2.2.2. Assets shall be collectively deemed as multiple assets, if their obligor or group of obligors satisfies the following conditions:

2.2.2.1. Obligors whose assets are cross-collateralized, cross-guaranteed to each other or whose financial activities are inherently interrelated;

2.2.2.2. Obligors the BOM or a bank concluded as having the ability to control or exert material influence on the ownership, products and services of other obligor or having linkages on a management level of obligors;

2.2.2.3. Other obligors that the BOM or a bank concluded that they could impose control on the operations and activities of other obligor based on the relevant documentations or evidences presented;

2.2.2.4. Suppliers or contractors, whose operations are inherently interrelated through their operations, activities, distribution channels based on the evidence in the forms of information, data and other source of documents collected by a bank;

2.2.2.5. Obligors other than those stated in the Articles 2.2.2.1-2.2.2.4 which the BOM or a bank concluded as having common or same risks.

2.2.3. Multiple assets specified in the article 2.2.2 of this regulation shall collectively be assigned a single classification, except for the following:

2.2.3.1. Assets of obligors are not cross-collateralized or cross-guaranteed;

2.2.3.2. Notwithstanding the assets were cross-collateralized or cross-guaranteed, in the event of default or payment interruption of principal or interest by the obligor, the BOM has concluded the overall amount owed to a bank could be recoverable by enforcing collateral and executing the guarantee, i.e. over-collateralized in which a bank is given on the security over other creditors;

2.2.4. When a material amount of multiple assets to a same obligor is considered non-performing, all exposures to that counterparty should be considered as non-performing, except for exposures to households, which can be categorised as non-performing on a transaction-by-transaction basis.

2.2.5. When an obligor belongs to a group of connected obligors, designating an asset to that one obligor belonging to a group as non-performing may not mandatorily lead to designating all assets to the other obligors from the same group as such. However, designating the asset to one of the group obligors as non-performing will be one of the inputs, along with the respective financial situation of other obligors from the same group, to determine the assets to the other obligors in the group as non-performing.

2.2.6. The relations and the linkages between multiple assets shall be defined based on the principles and the spirits of the definition of "Related party" specified in the article 3.1.2 of the Banking law.

2.2.7. The syndicated asset aimed to financing single project extended collectively by multiple banks and financial institution shall be deemed as one asset and subsequently, each contribution by a bank or financial institution to the syndicated asset shall be assigned the same or single final classification. The management or a due diligence of a syndicated asset may be assigned to one of the bank and the appropriate provisions shall be stated in the agreement between the institutions. Agreement shall clearly and adequately state the obligation and allocation of duties to each bank participating in the facility.

2.3 Other off-balance sheet assets

2.3.1. Other off-balance sheet assets, (contingent) liabilities shall be classified using the qualitative criteria specified in the Annex 2 of this regulation.

2.3.2. A classification of off-balance sheet items such as financial guarantees, warranties and other contingent liabilities which require a bank to pay out the liabilities on behalf of the natural person or a legal person in line with the agreement concluded between parties shall be downgraded if a bank or the BOM concludes that one or more of the following circumstances has occurred for a bank obligor. of which:

2.3.2.1. It is observed that the obligor's financial standing or the solvency status has deteriorated or continually being deteriorated or the economic sector or the industry in which the obligor operates is hit with distress or crisis which may result in client's inability to repay the asset when it is recorded on-balance after the obligation has been met on the part of a bank;

2.3.2.2. An obligor entitled to draw on an irrevocable loan commitment, credit line or other equivalent assets,

whose financial standing, creditworthiness or credit rating have deteriorated and as a result, it was concluded the likelihood him paying the scheduled amount has lowered;

2.3.2.3. A financial standing, solvency status of an obligor to a bank where the parties have concluded the derivative agreement has deteriorated, or a risk of deterioration has risen or his/its credit rating was downgraded by the respective rating agencies or determined by the international supervisor authorities and as a result, the obligor may not meet his obligation when the exercise date is due and a bank may not receive the specified amount in full or partially in due time.

2.3.3. Time-related characteristics of off-balance sheet items such as the exercise/transaction, time left to maturity shall be taken into account in order to classify the off-balance sheet items in accordance with the article 2.3.1 of this regulation.

2.3.4. When a bank meets the off-balance sheet obligations, the resulting amount owed by the obligor or an obligor shall be transferred on-balance and the corresponding classification and provisioning shall be determined in accordance with the Article 2.1.10 of this regulation.

2.4 Restructured assets

2.4.1. Restructured assets are the on-balance-sheet and off-balance-sheet assets for which some new preferable conditions have been provided either at the discretion of the bank and/or the obligor - due to the financial difficulties of obligor, irrespective of the assets being past due or not when restructured. These new preferable conditions include, but are not limited to, the following forms:

2.4.1.1. The periodic principal, interests, or fees payable on a monthly, quarterly, semi-annually, annually or payments with higher frequencies have been modified in new agreement from the original agreement e.g. grace periods, interest only payments, balloon payments, bullet payments;

2.4.1.2. Except due to the changes in general market conditions, the interest rate has been modified (e.g. postponed, deferred, forgiven) from initial set rate;

2.4.1.3. The accumulated interest receivables have been totally or partially discounted through the reduction or cancellation;

2.4.1.4. Interest payments receivables have been totally or partially added to the new principal balance i.e. interest payment or interest payment has been capitalized;

2.4.1.5. When postponing the repayment schedule (frequency of principal and interest payment), the interest rate for repayment has been set below the interest rate for newly issued assets with similar risk profiles;

2.4.1.6. The due date for repayment (frequency of principal and interest payment) has been extended for materially longer term than the due date of other assets with similar risk profiles;

2.4.1.7. Releasing collateral or LTV ratio deteriorated against the acceptable level;

2.4.1.8. Allowing the conversion of debt to equity of the obligor;

2.4.1.9. Deferring recovery collection actions for extended periods of time;

2.4.1.10. Easing of covenants.

2.4.2. Bank and obligor have to agree on new conditions and sign new contract to confirm the terms on the restructured assets.

2.4.3. Bank shall make a decision on whether to restructure assets or not at the management level or similar committee level based on its internal assessment of the obligors repayment effective capabilities. The bank shall restructure assets in terms of changing the lending conditions only in those cases where the bank justifies that the assets can be fully and duly repaid according to the new terms.

2.4.4. Due to an asset being defined as restructured asset, any derived present or future loss shall be immediately reflected in the financial statements.

2.4.5. If, as a result of the changes, the conditions attached to an asset are identical to the conditions applied to newly issued assets with similar risk profiles, and the changes are not caused by the financial difficulties of obligor, these assets shall not be considered restructured.

2.4.6. Without extending the repayment period, the assets except for the consumer financing, the repayment schedule of which has been modified or changed up to 12 months, may be exempt from being classified as

restructured, if an obligor with reliability in terms of credit rating, creditworthiness and liquidity, is experiencing a temporary financial difficulties due to the general market/industry conditions or its internal characteristics where a bank assessed internally the obligor is capable to recover from difficulties and pay the principal and interest payments fully within the due date. If, during this period, a bank observes no justifiable signs of improvement in solvency, financial standing or observes further payment delays, such asset shall be deemed restructured starting from the date of the contract amendment and its corresponding classification and provision shall be determined using the provisions related to the restructured asset stated in this regulation.

2.4.7. Restructuring may be granted on performing or non-performing exposures. When restructuring is applied to a non-performing exposure, the exposure should remain non-performing. When restructuring is applied to a performing exposure, the bank then needs to assess whether the exposure meets the non-performing criteria, even if the restructuring resulted in a new exposure. When the original exposure would have been categorized as non-performing at the time of granting restructuring, had the forbearance not been granted, the new exposure should be categorized as non-performing.

2.4.8. It is prohibited to reclassify assets and split one asset as the separate parts of performing and downgraded assets.

2.4.9. It is prohibited to restructure assets for the purpose of avoiding or postponing the repayment of required expenses, the classification as non-performing or the recognition of impairment provisions, or to conceal financial and liquidity difficulties of the obligor.

2.4.10. Bank may classify restructured assets as performing assets only if all the requirements in article 2.9.1 have been met.

2.4.11. Banks may discontinue to categorize exposures as restructured when both these criteria are met:

2.4.11.1. When all payments, as per the revised contractual terms, have been made in a timely manner over a continuous repayment period of not less than 6 months (probation period for reporting). The starting date of the probation period should be the scheduled start of payments under the revised terms, regardless of the performing or non-performing status of the exposure at the time that forbearance was granted; and

2.4.11.2. The obligor has resolved its financial difficulty

2.4.12. The modifications specified in article 2.9.1 of this regulation in regards to the restructured asset may be done only once.

2.4.13. Notwithstanding the application of qualitative criteria, the classification of restructured assets based on the quantitative criteria for assets that haven't met the prerequisites and conditions set out in article 2.9.1 of this regulation, at the time of restructuring or later on, shall be determined using the repayment schedule of the initial contract.

2.4.14. It is prohibited for bank to receive the principal and interest payment through issuing additional assets to the same or related obligor or allocating resources.

2.5 Repossessed assets- Assets acquired by for liability enforcement

2.5.1. According to the Accounting guideline the repossessed assets shall classified separately as assets held for sale, assets not for bank use (further called as immovable assets), movable assets and financial assets as securities.

2.5.2. Repossessed asset classification for immovable and movable assets shall be based only on quantitative criteria mentioned in annex 1b of this regulation.

2.5.3. Other repossessed assets, except the immovable and movable assets, shall be evaluated through the quantitative and qualitative criteria as shown in Annex 1a and Annex 2 respectively, and final classification be made as shown in Annex 3a.

2.5.4. If a bank intends to make use of repossessed assets, it must determine such intention at the time of those assets entering into bank's possession and obtain from the BoM the authorization to do so. Repossessed assets such as immovable property in use with no more than 5 years and movable assets in use with no more than 1 year since their production date may be upgraded by one notch from the final classification determined in accordance to the 2.5.2 article of this regulation, excluding the performing assets.

2.5.5. Provided a bank has not determined the intention of use of repossessed assets when acquiring them, the securities shall be classified as the other financial assets and immovable and movable assets shall be classified as the other non-financial assets.

2.5.6. According to this regulation the intention of the use of repossessed assets shall be determined within 1 month since its initial recognition as specified in the Article 2.5.5 of this regulation. Repossessed assets shall be transferred from other assets account into account related to use as stated in article 4.5 D of the Accounting guideline. If the bank considers it not possible to transfer assets into related accounts then the asset shall remain on the account of other assets.

2.5.7. Repossessed assets in form of securities shall be recognized as stated in articles 2.5.5-2.5.6 of this regulation and bank shall follow the regulation and treatment for securities classification and provisioning.

2.5.8. If a bank has been authorized to use the repossessed assets for bank operation, the repossessed assets shall be transferred, within no more than 3 months before the start of the operation, into Property account or Investment property account based on estimation of future economic benefit inflow and reliable cost measurement, and the provision for these assets shall not be built.

2.5.9. If the requirements for the particular classification of assets are no longer being met and the intention for use of assets has changed as specified in Article 2.5.8 of this regulation, the bank shall re-transfer the repossessed assets to the previous account and recognize the impairment provision and once re-transferred, it shall stay in the account permanently.

2.5.10. The amount of transfer from the repossessed assets into the Property account will be determined in compliance with the prudential ratio of assets as stated in "Regulation on setting prudential ratio to commercial banks".

2.5.11. Non-financial repossessed assets held for sale and non-financial repossessed assets with high probability to be sold shall be recognized as Assets held for sale. These assets are required to be sold under normal sale conditions within 1 year since recognition and the impairment provision shall be recognized according to the articles 4.5 and 4.6 of the Accounting guideline. The amount will be presented in the related line of the Comprehensive report on the allowance for specific provisions as shown in Annex 4.c.

2.5.12. If assets referred in the article 2.5.11 of this regulation have not been sold within 1 year since the asset is recognized as held-for-sale, a bank shall re-transfer assets back to the Non-financial assets section of the other repossessed assets account. A re-transferred asset shall be classified in accordance with the quantitative criteria shown in the Annex 1.b of this regulation, in which an past- due days of an immovable asset in the form of the mortgage specified in the Article 1.2.1 of "The regulation on mortgage operation" shall be counted from date of its initial possession and for other immovable assets the past-due days shall be counted from the date of its re-transferal into the other repossessed assets account and the corresponding provisions shall be calculated in accordance with the Annex 3.c of this regulation.

2.5.13. The assets transferred to the account of other repossessed assets as specified in Articles 2.5.9 and 2.5.12 of this regulation cannot be reversed or transferred back to the accounts of Assets held for sale or Investment property account.

2.5.14. Immovable and movable assets may be classified loss independent of the quantitative criteria if the assets incurred damages caused by the internal or external factors, or external professionals or bank itself have evaluated the assets as impossible to sale or use.

2.6 Securities

2.6.1. Securities shall be recognized based on bank⁵'s intention and policy on classification of securities which complies with the accounting guideline.

2.6.2. Although there is not impairment requirement on trading securities and securities at fair value through profit and loss as shown in Accounting guideline, the assets shall be classified and specific provision shall be recognized in the following cases during the on balance and off-balance period:

2.6.2.1. Principal and interest payment of debt securities have been overdue or not repaid;

2.6.2.2. The dividend amounts which have been declared but not distributed within a due date;

2.6.2.3. Bank and other authority have announced the insolvency of issuer of security or its termination;

2.6.2.4. Bank itself or BOM have made a conclusion that the related securities may cause risks on assets.

2.6.3. In case of occurrence of the condition referred in article 2.6.2.3 of this regulation to equity share, the final classification of the securities shall be done according to the qualitative criteria and specific provision shall be established with consideration that assets are classified as the performing assets based on the quantitative criteria.

2.6.4. The prerequisites set out in the article 2.6.2.1.-2.6.2.3, 2.6.3 of this regulation shall be followed when classifying the securities as the available for sale and estimate the specific provision.

2.6.5. Securities held to maturity and securities categorized as the loans and receivables shall be classified in accordance with the quantitative and qualitative criteria mentioned in this regulation and the related specific provision will be calculated as shown in Annex 3.

2.6.6. Banks⁵ investments in associates, subsidiary, and joint venture are not the subject for classifying, however, the impairment provision shall be recognized according to the article 4.2.2 of an accounting guideline.

2.6.7. If bank has no evidence to determine whether it has joint control or significant influence to investee as stated in article 4.2.2 of the accounting guideline, the investment in equity share to other entity shall be classified in compliance with the article 2.6.4 of this regulation and the specific provision shall be estimated.

2.6.8. Bank shall inform BOM in written form within 3 business days if bank sold securities held to maturity or it has no permission to classify assets in this category.

2.7 Pooled assets

2.7.1. Assets that meet following requirements can be pooled:

2.7.1.1. Share of a unit asset shall be no more than 2.0 percent of the pooled asset;

2.7.1.2. Quality, type, location, repayment period and risk profile, and other conditions of assets shall be similar;

2.7.1.3. Unit asset shall not be one of the 40 largest loans, or related asset;

2.7.1.4. Asset shall not be loan to the bank's related parties except for the mortgage loan and salary loan to the bank's employees;

2.7.1.5. Total outstanding amount of a pooled asset shall be no more than 20 percent of the bank's 40 largest loans.

2.7.2. Bank that meets the requirements specified in the article 2.7.1 of this regulation can pool small assets defined as assets to small and medium entrepreneurs or assets to individuals in terms of the bank's business.

2.7.3. Revolving assets may be pooled.

2.7.4. Final classification of each asset in the asset pool shall be done based on the quantitative criteria separately. Bank shall make specific provision on the whole of pooled assets according to the article 4.3.D of an

accounting guideline.

2.7.5. An asset that meets the requirement specified in the article 2.7.1 of this regulation can be added to the asset pool if any asset in the pool was repaid or removed from the pool and recorded off-balance.

2.7.6. If an asset in the asset pool did not meet homogeneity requirement, or lost or changed such homogeneity, the asset shall be removed from the asset pool, and final classification of the asset shall be separately done based on both quantitative and qualitative criteria.

2.8 Miscellaneous asset classification requirements to banks.

2.8.1. Bank's board of directors and executives are responsible for risk management and risk monitoring. Bank's internal policy, regulation, guidelines, procedures on asset classification and risk management as specified in the Article 1.4 of this regulation shall cover following issues:

2.8.1.1. Asset classification and provisioning policy, method, and monitoring procedures shall be consistent with bank's management, structure, operational development, operational scope and risk profile.

2.8.1.2. Duties and responsibilities of internal audit unit responsible for asset classification, specific provisioning and general provisioning shall be defined clearly in consistence with internal policy, accounting guideline, and BOM's requirement set in this regulation.

2.8.1.3. Operation of the asset risk management unit shall be updated in timely and proper manner considering credit risk, and other external and internal factors. Asset risk management policy and method shall be well documented and it shall cover at least the following issues:

- a. Asset quality monitoring,
- b. Assessment method and procedure of assets recorded in balance and off-balance,
- c. Risk assessment of obligor's business,
- d. Collateral assessment,
- e. Methodology to downgrade and write off assets when change in asset quality and probability of repayment occur,
- f. Validation of asset classification and loss provisioning assessment,
- g. Methodology to assess sufficiency of asset risk provisions for occurred and expected losses.
- h. Actions and enforcement measures applied to non-performing and risky assets to be repaid, and contractual obligations to be fulfilled.
- i. Banks shall apply methodologies capable to assess and confirm results and effects of asset risk models and methods.

2.8.1.4. Following factors can affect asset repayment:

- a. Solvency of obligor or guarantor
- b. Probability of agreement breach
- c. Probability of liquidation, bankruptcy of obligor (legal entity), management change possibility;
- d. Requirement and condition permitting structural and conditional changes in asset issued to obligor,
- e. Methodology to analyze pooled asset classification change and tendency of pooled asset to be classified as Non-performing if asset pool is being assessed.
- f. Collateral policy, collateral assessment, which have effect on asset qualitative assessment, on other parameters related to collateral type and collateral liquidity.
- g. Other events where obligor and guarantor may fail to fulfill contractual obligations, and

2.8.1.5. Conditions to what extend asset quantitative assessment and assessor's professional skill to be combined or to be limited shall be clearly defined.

2.8.2. Final classification of assets to insolvent or bankrupted obligor shall be no higher than Doubtful.

2.8.3. An asset being investigated at the law enforcement agencies due to suspicion that asset may be related to criminal activity, shall be finally classified as Loss.

2.9 Upgrading asset classification

2.9.1. Bank may upgrade the asset classification up to Performing if the non-performing asset (including restructured exposures) meets all of the following conditions:

2.9.1.1. the obligor does not have any material exposure more than 90 days past due;

- 2.9.1.2. regular, material and at least 3 repayments have been made when due over a continuous repayment period or at least 6 months;
- 2.9.1.3. the obligor's situation has improved so that the full repayment of the exposure is likely, according to the original or, when applicable, modified conditions;
- 2.9.1.4. the exposure is not "defaulted" according to this regulation or "impaired" according to the accounting regulation.
- 2.9.1.5. If during the onsite examination BOM concluded that the asset can be upgraded.
- 2.9.2. BOM or a bank concludes that assets classified according to the articles 2.9.1 were done with the intention to continually get the funding from a bank or to upgrade asset classification on the part of the obligor, or asset quality was not improved, asset class will not be upgraded.
- 2.9.3. Clauses mentioned in the articles 2.1.3, 2.9.1 and 2.4.10 of this regulation shall not be applied to assets mentioned in the articles 2.8.2 and 2.8.3.
- 2.9.4. Partial write-off of an existing non-performing exposure (i.e. when a bank writes off part of a non-performing exposure that it deems to be uncollectible) will not lead to the recategorization of a non-performing asset as performing.

THREE. PROVISIONING ON ASSETS AND THEIR DISBURSEMENT

3.1 Core requirements for establishing loss provision

- 3.1.1. Banks shall set Loss Provisions through expense as following categories:
- 3.1.1.1. General provision;
- 3.1.1.2. Specific provision.
- 3.1.2. Total loss provision shall be determined as the sum of a general provision and specific provision.
- 3.1.3. Bank shall set its total provision sufficient enough to cover over all loss which are both incurred and expected in the future due to uncertainty. The amount of Loss Provision reflected in the financial statements shall be the higher of that set out by this Regulation and those derived from the application of the internal methodologies considered in article 1.4. of this regulation
- 3.1.4. A Bank is prohibited from disbursing loss provision and any other risk reserves for any purposes other than those specified in the Regulation.
- 3.1.5. Taking into account its scope of operation and complexity of products and services, a bank may develop and implement internally, for management purposes, the methodology to calculate and recognize the provision for impairment differently than that specified in this regulation by incorporating them into the internal methodology specified in the article 1.4 of the regulation.
- 3.1.6. Bank shall report its established provision and its assessment both in line with this regulation and the internal methodology to the BOM within the timeframe specified in the article 3.6.1 of this regulation.
- 3.1.7. Bank shall ensure if the following are met when applying the internal methodology as specified in 1.4 of this regulation and before submitting a report of specific and general provision to the BOM:
- 3.1.7.1. Select factors which reflect effectively asset quality based on the economy and logical influence;
- 3.1.7.2. Statistical approach and method shall be based on accurate assessment; it shall be transparent and clear;
- 3.1.7.3. No material error or change in the estimation;
- 3.1.7.4. Significant factors shall be included which are affecting to adverse effect to the repayment of asset.
- 3.1.8. Provision of bank assets shall be established for a given asset and multiple assets or pooled assets.
- 3.1.9. A single provision shall be established from the sum of multiple assets that have been mentioned in

article 2.2.2 of the regulation. A different provision shall be built for the portion of multiple assets allowed to be separately classified meeting the conditions stated in the Article 2.2.3. of the regulation.

3.1.10. The amount shall be deducted by the specific provision from the assets except those recorded off-balance-sheet to estimate the risk weight specified in the “Regulation on setting prudential ratio to commercial banks”.

3.1.11. Off-balance assets shall be converted to their credit equivalent amount and their corresponding provision shall be estimated in accordance with this regulation and shall be recorded in the account “Reserves on Loans and its equivalent assets” as stated in the Accounting regulation.

3.1.12. In case the off-balance assets from which provision has been built in line with the article 3.1.11 of regulation are transferred and recorded to on-balance in line with 2.1.10 of this regulation, their provision shall be transferred from the account “Reserves on Loans and its equivalent assets” to corresponding provision account on balance.

3.1.13. A Bank shall set provision for immovable and movable assets specified as repossessed assets in line with the Annex 3.c whereas other financial assets shall be provisioned using Annex 3.a of this regulation. Off-balance sheet assets will be classified and provisioned according to Annex 3.b.

3.1.14. Book entries and recording of the transactions regarding setting, and canceling asset loss provision shall be done in accordance with the Accounting guideline approved by the BOM.

3.2 The Asset base to which the provision to be charged

3.2.1. General and Specific provision shall be charged from the following asset balance after making the below adjustments:

3.2.1.1. For the deposit-collateralized asset, the amount of deposit converted to MNT is deducted from the asset ;

3.2.1.2. For funded off-balance LC, guarantee or equivalent assets will be amortized by the corresponding funds;

3.2.1.3. Assets backed by the Central bank bill; it will be amortized as 100 percent by the bill;

3.2.1.4. Assets with guarantees by multilateral development banks and financial institutions which rated AAA from international rating agencies (Such as Asian Development Bank, European Bank for Reconstruction established development banks) will be amortized as 100 percent by the amount of guarantee;

3.2.1.5. Assets with guarantee issued by the Mongolian or Foreign government, government bonds and similar securities, asset-backed securities, shall be amortized by the amount of guarantee discounted by the percentages specified in the Annex 4.i. of this regulation;

3.2.1.6. Amount drawn by an obligor within the permitted limit in case of overdraft, in other cases of revolving facility, full amount shall be applied;

3.2.1.7. For off-balance sheet items or financial derivatives, the amount higher of the: credit equivalent amount specified by the method in accordance with “The regulation on setting prudential ratios to commercial banks” or mark-to-market value method in accordance with the article 4.4.C of the Accounting manual.

3.2.1.8. For some collateral uncorrelated with the direct activities of an obligor, liquid or there exists a liquid market for the collateral by which the market price can be determined where the BOM has determined that the collateral was eligible through its on-site inspection and specific directives and regulation, asset shall be deducted by 80 percent of its collateral value.

3.2.2. Except for pooled assets comprising loans, the article 3.2.1 of this regulation shall not be applied to assets where its specific provision is estimated using impairment method specified in the Accounting regulation.

3.2.3. The calculation of Risk weighted asset specified in the “Regulation on setting prudential ratio to commercial banks” shall be done in such way that only the specific provision shall be deducted from the corresponding asset whereas the general provision shall not be deducted.

3.2.4. Off-balance assets shall not be offset with its specific provision.

3.3 General Provision

3.3.1. General provision is charged with the purpose of withstanding against the potentially unexpected general risks posed to banks due to general distress, vulnerabilities in the economic and financial sector or specific bank activities and is charged by expense and is accumulated in the “Risk reserve account” in line with the Article 4.2.1.d, 6.7 of Accounting guideline.

3.3.2. General provision shall be built and disbursed accordingly from recorded date of the asset up until its repayment.

3.3.3. BOM shall put the minimum provisioning rate for general provision for the following asset base. Of which:

3.3.3.1. Loans outstanding;

3.3.3.2. Other assets, off-balance sheet items and contingent liabilities

3.3.4. A bank may set its general provisioning rate specified in the article 4.2 of this regulation through internal methodology higher than those specified in the article 3.3.3 in this regulation so as to more precisely incorporate its scope, complexity and financial sector.

3.3.5. Provided a unforeseen or unexpected loss is realized and recognized, the corresponding adjusted loss amount shall be offset by the reserve accumulated as general provision and subsequently be transferred to and recorded on their specific provision account.

3.4 Specific Provision

3.4.1. A Bank shall establish the minimum amount for specific provision according to the Annex 3.a, Annex 3.b and Annex 3.c of this regulation.

3.4.2. A Bank may estimate its specific provision based on its internal methodology, but the total amount reflected in the financial statements shall be no less than the minimum amount calculated according.

3.4.3. A specific provision for off-balance assets shall be calculated as shown in Annex 3.b of this regulation taking into account the maturity date specified in the contract (to honor the commitment) and if stated in contract, the repayment schedule after it is transferred on-balance and the amount shall be recorded on “The reserves on loans and its equivalent assets” account specified in the Accounting regulation.

3.4.4. A Specific provision for pooled assets shall be calculated according to the 4.3.D of an Accounting guideline and as the sum of impaired and non-impaired portions.

3.4.5. In case of upgrading or downgrading the assets other than off balance assets, securities using impaired methods and immovable and movable repossessed assets in line with articles 2.9 and 2.5.4 and other provisions of this regulation, the new classification shall set in such a way that it had the same qualitative and quantitative classification and provisioning is charged using the Annex 3.a. of this regulation.

3.5 Write-off of an asset

3.5.1. A bank shall write off following assets against existing and newly created provisions quarterly under following conditions:

3.5.1.1 The amount with an approval of Board of Directors, if obligor fails to repay whole asset amount within 180 days since court decision was made;

3.5.1.2. If court orders obligor to pay partial amount of assets, by residual amount under court decision;

3.5.1.3. The amount by judge’s decision and senior executors order to suspend execution process of court decision;

3.5.1.4. Bad assets with poor prospects of recovery with an approval of the Board of Directors;

3.5.1.5. Articles 3.5.1.1 and 3.5.1.4 of this regulation are not applicable to assets extended to shareholders, executives, officials and members of the Board of Directors of the Bank.

3.5.2. If shareholders of a bank is unable to repay their assets extended by a bank, at first a bank shall sell the collateral and use the proceeds to pay off the asset. If principal and interest of the asset exceeds collateral proceeds, shareholder's shares of the bank shall be sold to pay off residual asset amount in line with the provisions in enforcement measures stated of the banking law.

3.5.3. A bank shall report on the written-off assets based on Article 3.5.1, 3.5.6 of this regulation to Shareholders' Meeting and submit the report with Shareholders' Meeting Minutes to the BOM no later than April of each year.

3.5.4. The written off assets shall be recorded off-balance and a bank shall continue its recovery, work-out measures towards these assets.

3.5.5. In the event the written-off assets are fully or partially repaid, the recovered asset amount shall be recorded as other comprehensive income of a bank;

3.5.6. A bank may decide not to classify and provision the assets that are sold, transferred from its balance sheet, through securitization or other similar approaches based upon contract with third if they satisfy following conditions:

3.5.6.1. De-recognition conditions under IAS 39;

3.5.6.2. De-recognition conditions under IFRS;

3.5.6.3. Conditions stated in article 8.7.7 of accounting guidance.

3.5.7. Assets not satisfying condition stated in articles 3.5.6.1-3.5.6.3 of this regulation shall continually be recorded on balance sheet, classified and provisioned properly.

3.6 Reporting on Assets

3.6.1. Banks are required to submit on a monthly basis reports on asset classification, provisioning, written off assets, de-recognition, migration within assets and breakdown of provision in compliance with the template specified in tables of Annex 4 in both hard and soft copies to Supervision department of the BOM within no later than 5th day of following month. Of which:

3.6.1.1. Report on assets balance for provisioning according to Annex 4.a;

3.6.1.2. Consolidated report on assets outstanding, provisioning level according to Annex 4.b;

3.6.1.3. Comprehensive report on specific provisions by asset types according to Annex 4.c;

3.6.1.4. Report on migration of repossessed assets according to Annex 4.d;

3.6.1.5. Report on migration of restructured assets according to Annex 4.e;

3.6.1.6. Report on securities and breakdown of provision according to Annex 4.f;

3.6.1.7. Report on 20 largest multiple assets according to Annex 4.g;

3.6.1.8. Report on parameters of pooled assets according to Annex 4.h.

3.6.2. A bank shall submit written-off assets recorded off balance sheet to the Credit Information Bureau of the BOM in a timely manner.

3.7 Applying pooled assets methodology on calculating specific provision, criteria and requirements

3.7.1. Loss provisioning to the pooled asset may be done by one of the following methods or combination of them:

3.7.1.1. internal loss experience;

3.7.1.2. mapping to external data;

3.7.1.3. statistical loss model.

3.7.2. A bank may calculate specific provision using the methodologies specified in 3.7.1 of this regulation and whereas a bank decides to assess its specific provision on pooled assets with these methodologies in line with the minimum requirements of this regulation, it shall be in compliance with the general guidelines on estimating and validating Credit risk parameters set by international standards as well as the BOM.

3.7.3. BOM shall verify if the methodologies specified in 3.7.1 of this regulation adopted by a bank meets following requirements:

3.7.3.1. A bank shall have management information system capable of gathering and processing loss experience data;

3.7.3.2. Structure, characteristics, risk profile and other qualities of sample data shall be similar or comparable to the pooled asset;

3.7.3.3. Data used in the assessment shall be comparable, convertible and be mapped to the pool assets;

3.7.3.4. Sample data shall be proper enough to identify factors affecting pool asset quality, and shall be consistent with economic and market prospects;

3.7.3.5. Sample data scope and observation period shall be able to properly predict loss provisions and possible loss level of pool assets within predefined confidence level;

3.7.3.6. The methodology shall be consistent with the general requirements stated in 2.8 of this regulation;

3.7.3.7. Asset loss estimation and factors used in the method shall be flexible enough to be adjusted by outcome from the assessment specified in Annexes 2-6 of this regulation in terms of asset quality.

3.7.4. Adjustments mentioned in the article 3.7.4 of this regulation shall be done at least annually.

3.7.5. Sample data for bank asset risk assessment shall be at least 5 year-period no matter what method mentioned in the article 3.7.1 of this regulation was chosen. Sample data longer than 5 years of period shall be used for the risk assessment if such data is available.

FOUR. ENFORCEMENT, MONITORING AND ACCOUNTABILITY

4.1. Board of directors and senior management of a bank shall fairly estimate the classification of assets, expected loss from assets, the general and specific provisions, and report to BOM according to the time stated in the article 3.6.1 of this regulation.

4.2. The BOM may reset the general and specific provisioning rate of a particular bank stated in the article 3.1.1 of this regulation considering its risk profile and its risk management and control.

4.3. If necessary, BOM may set the upper or lower limit of risk parameters (PD, LGD, LIP and others), used banks to comply with them.

4.4. The provisions regarding classifications and provisioning can be modified via the BOM Governor's decree for particular assets based on their types, sizes or terms and condition of the contract.

4.5. In case that a bank evaluates that the quality of a particular asset, pooled assets or assets for financing a project, and all assets related to one specific obligor would soon deteriorate, having a negative impact on bank's solvency and prudential ratios, the bank shall inform BOM immediately.

4.6. A bank's internal audit unit shall monitor on how precisely bank assesses risk associated with assets, whether classification is being obtained fairly and completely, whether respective provisioning is being done and allocated, and be responsible for reporting to the Board of Directors. The scope of the internal audit unit includes both the application by banks of the rules of this regulation and the implementation of its internal methodologies for managerial purposes.

4.7. BOM shall maintain both on-site and off-site supervision simultaneously in order to clarify matters such as how banks assess risk associated to assets as well as classification of assets, whether mitigation actions against contingent risk are taken prudently, whether classification is being assigned fairly and completely, and whether provisioning is being done completely and allocated prudently. The scope of this supervision includes both the application by banks of the rules of this regulation and the implementation of its internal methodologies for managerial purposes.

4.8. Banks shall submit the information on asset classification to the Credit Information Bureau whenever any changes are made to the classification of assets or on a monthly basis.

4.9. In the course of BOM on-site or off-site supervision, if a supervisor of BOM reckons that a particular bank misclassified assets, did not do complete provisioning, or deducted from the provisioning without proper reasons, the supervisor has the right to require the banks to correct the classification of the assets and do additional provisioning according to the jurisdiction on its capacity.

4.10. In the course of BOM supervision obtained on bank management, Internal Audit Unit, Loan Committee and Treasure Committee operation if any case arises such as classification didn't performed in compliance with this regulation, didn't do provisioning according to relevant rate and misuse the provision, the BOM has right to charge responsibility for bank, its management and/or relevant staff according to jurisdiction on its capacity.

ANNEX

TABLE ON QUANTITATIVE CLASSIFICATION OF ASSET

Classification	BY PAY		MENT OVERDUE DAYS		
	Pass	Special mention	Substandard	Doubtful	Loss
Loan *	< 15 ^f ; < 30 ^f	<90	91-180	181-360	> 361
Revolving facility**	< 15	15-90	91-180	181-270	> 271
Securities***	-	<30	31-60	61-90	>91
Receivables and other assets	< 30	31-60	61-90	91-120	>121

f- As stated in 2.1.5 of this regulation

* By loan principal and interest repayment

** By revolving facility principal and interest payment

*** By securities principal and interest payment

ANNEX 1.b.

TABLE FOR CLASSIFICATION AND PROVISIONING OF REPOSSESSED ASSETS INCLUDING REAL ESTATES, MOVABLE ASSETS

Classification	UNSOLD DAYS AFTER RE]]			POSSESSION	
	Performing	Special mention	Substandard	Doubtful	Loss
Real estates	<60	61-100	101-160	161-220	>221
Movable assets	<30	31-60	61-90	91-120	>121

GENERAL TABLE FOR EVALUATING THE QUALITATIVE CRITERIA OF AN ASSET

Classification ¹	Qualitative Components			Bank's rationale of assigning a classification of an asset in question ⁵	For BOM use ⁶
	General standing of an obligor ²	General economic and obligor's Financial condition ³	Availability of information of financial or non-financial nature ⁴		
<i>Pass</i>	Obligor can honor the terms of the contract and there is no financial difficulty or lower or no risk to their ability to repay principal and interest of an asset in full and on a timely basis.	General condition of the economic sector in which an obligor operates and the financial standing of an obligor are both sound.	Information available allows for comprehensive and consistent evaluation of obligor's financial standings.		
<i>Special mention</i>	Although an obligor is honoring the terms of the contract by repaying principal and interest of an asset on time, there are some signs that an obligor may fail to meet his scheduled payments in the future.	One of the following has occurred: a) Borrowers mainly operating in an economic sector under stress or in a difficult situation b) Borrowers who are experiencing transitory difficulties so their financial and economic situation has deteriorated in the short term, but it is likely that the situation could improve afterwards in the mid- and long-term.	Bank does not have all the required minimum documentation, but the missing data are not material enough to impact negatively on the evaluation of the financial and economic condition of an obligor.		
<i>Substandard</i>	Doubts raised as to an obligor's ability to repay principal and interest of an asset as stated in the terms of the contract. Or the obligor has a history of having distressed assets. The existence, coverage and quality of collateral should not be a ground for not classifying an exposure in this category if the above condition is met.	Economic and financial condition of an obligor is in tangible distress and thus the core financial indicators are showing signs of deteriorations like: a) Reduced liquidity and cash-flow or has negative signs; b) High leverage or the ratio of debt to shareholders' equity is increasing c) Asset is inadequately secured or a collateral is illiquid and may be difficult to be sold to recover the asset value or is closely correlated with the industry in which the obligor operates d) Reduced or negative profitability indicators	Information material to determine the financial standing of an obligor is missing or unavailable or the authenticity/integrity cannot be verified.		

<i>Doubtful</i>	Obligor cannot fully and promptly repay principal and interest of an asset as stated in the terms of the contract.	Economic and financial condition of an obligor has deteriorated much severely than as described substandard classification.	Information essential to assess obligor's financial condition in inadequate or missing or the authenticity/integrity cannot be verified.		
<i>Loss</i>	Only a small portion of principal and interest payment of an asset may be recoverable.	Obligor's financial condition has deteriorated to the point that principal or the interest payment cannot be expected	No Information to determine the financial condition of an obligor is available or the available one is false		

NOTE:

1-Qualitative classification of an asset evaluated

2-Assessment is done taking into account all factors such as repayment schedule of an asset as well as the outcome of Component 1-3 of Annex 5, Annex 6 (Profile completeness, Financial indicators and others)

3-Assessed based on the outcomes of the second component (financial indicators) of Annex 5, Annex 6

4-Assessed based on the outcomes of the first (profile completeness) component of Annex 5, Annex 6

5-Bank shall provide justified rationale and explanation as its decision to assign a particular classification to an asset in question and if necessary, it shall enclose all essential information, data, reports and other researches to this evaluation form.

6-The BOM shall provide if it agrees to the explanation provided by a bank or not with its own explanation or decision. The BOM opinion shall prevail.

Basic guidance as to determine the qualitative classification of an asset: Using the table above, qualitative classification shall be usually determined **by the prevailing assessments of the three components**. However, exceptions can be made by providing convincing rationale and explanation as how the outcomes of the other components are material to the final classification. Accordingly, the corresponding documents, materials and evidences must be enclosed to this evaluation form.

**TABLE TO ASSIGN FINAL ASSETS CLASSIFICATION AND ITS CORRESPONDING
PROVISIONING RATES**

Quantitative	Performing	Special Mention	Substandard	Doubtful	Loss
Performing	Performing 0.5%	Special Mention 1%	Substandard 15%	Doubtful 35%	Loss 75%
Special Mention	Special Mention 1%	Special Mention 5%	Substandard 25%	Doubtful 35%	Loss 75%
Substandard	Substandard 5%	Substandard 15%	Substandard 25%	Doubtful 50%	Loss 100%
Doubtful	Doubtful 15%	Doubtful 25%	Doubtful 35%	Doubtful 50%	Loss 100%
Loss	Loss 50%	Loss 50%	Loss 75%	Loss 100%	Loss 100%

NOTE: Final asset classification is determined by assigning whichever lower of the quantitative and qualitative classification and charge with corresponding provisioning rates as shown in the table above. For instance: If a given asset was assigned “Special mention” by quantitative criteria, whereas by qualitative criteria it was assigned as “Doubtful”, then the final classification would be “Doubtful” and its corresponding provisioning rate is **25 percent** as shown in the table.

ANNEX 3.b.

**TABLE TO ASSIGN FINAL CLASSIFICATION AND ITS CORRESPONDING PROVISIONING
RATES OFF-BALANCE SHEET ITEMS AND OTHER CONTINGENT LIABILITIES**

Qualitative classification: <i>Period left to honor/finalize the contract</i>	Performing	Special Mention	Substandard	Doubtful	Loss
Within 1 year	0%	5%	25%	50%	100%
More than 1 year	0%	1%	15%	35%	75%

ANNEX 3.c.

TABLE TO APPLY PROVISIONING RATES TO NON-FINANCIAL REPOSSESSED ASSETS

CLASSIFICATION	Performing	Special Mention	Substandard	Doubtful	Loss
Minimum provisioning rates	0%	25%	50%	75%	100%

(Reporting template)

REPORT ON ASSET BALANCE FOR PROVISIONING

(thousand tugrugs)

No	Asset classification	Balance	The amount of discounting for collaterals and guarantees							Net balance	
			Deposit (100%)	CBB (100%)	IFDI (IMF, WB etc.) (100%)	Government guarantee (".%)	Foreign government guarantee (.".%)	Off-balance liabilities	Others		TOTAL
			(1)	(2)	(3)	(4)	(5)	(6)	(7)		(8)
1	Loans* (total)										
	Performing										
	Special mention										
	Non-performing										
	Substandard										
	Doubtful										
	Loss										
2	Guarantee, promissory note (total)										
	Bids										
	Performance guarantee										
	Refund for advances										
	Promissory note										
3	Letter of credit (LC)										
	Foreign trade LC										
	Stand by										
4	Credit line										
5	Receivables and others										
6	Total										

Note: * - includes the pooled assets, assets with flexible conditions and related assets; adjustments specified in Annex 4.i. of this regulation; (1)-Outstanding balance before collateral deduction; (2) -Adjustments stated in 3.2.1.1 of the regulation; (3) -Adjustments stated in 3.2.1.3 of the regulation; (4) -Adjustments stated in 3.2.1.4 of the regulation; (5), (6) -Adjustments stated in 3.2.1.5 of the regulation; (7) -Adjustments stated in 3.2.1.2 of the regulation; (8) -Adjustments stated in 3.2.1.8 of the regulation

CONSOLIDATED REPORT ON ASSETS OUTSTANDING, PROVISIONING LEVEL

(thousand tugrugs)

No	ASSETS CLASSIFICATION		Loans	Securities	Repossessed assets	Receivables and other assets	On balance risk bearing assets	Off balance liabilities	Total risk bearing assets
			(1)	(2)	(3)	(4)	(5)=(1)+...+(4)	(6)	(7)=(5)+(6)
1	Balance* (1.1+1.2)								
1.1.	Estimated as impairment **								
1.2.	Estimated as assets classification regulation								
2	Impairment of specific provision (2.1+2.2)								
2.1.	Estimated as impairment **								
2.2.	Estimated as assets classification regulation (2.2.1+2.2.1+2.2.3)								
2.2.1	Performing:						-		-
2.2.2	Specific mention						-		-
2.2.3	Non-performing								
	a/ Substandard								
	b/ Doubtful						-		-
	c/ Loss						-		-
3	Impairment for general provision (a+b+c)		-						
	Asset category	Provision rate***	=(1)*(3a)			=(4)*(3b)		=(6)*(3c)	
	a/ Loans	0%							
	b/ Off balance liabilities	0%					-	-	-
	c/ Other assets	0%					-		-
4	TOTAL IMPAIRMENT PROVISION [(2)+(3)]								
5	PROVISION RECOGNIZED BY BANK								
6	Excess (+)/ deficit (-)		-	-	-	-	-	-	-

ANNEX 4.c

COMPREHENSIVE REPORT ON SPECIFIC PROVISIONS BY ASSET TYPES

___ Loan _____ (thousand tugrugs)

No	Quantitative Qualitative	Performing	Specific mention	Substandard	Doubtful	Loss	Adjustments*	TOTAL OF SPECIFIC PROVISION
1	Performing							-
2	Specific mention							-
3	Non-performing							-
4	Substandard							-
5	Doubtful							-
6	Loss							-
7	TOTAL	-

Revolving facilities/assets

(thousand tugrugs)

No	Quantitative Qualitative	Performing	Specific mention	Substandard	Doubtful	Loss	Adjustments*	TOTAL OF SPECIFIC PROVISION
1	Performing							-
2	Specific mention							-
3	Non-performing							-
4	Substandard							-
5	Doubtful							-
6	Loss							-
7	TOTAL	-	-	-	-	-	-	-

Note: *- Adjustments stated in Articles 2.8.2, 2.8.3 Of this regulation.

ANNEX 4.c. - Continued

COMPREHENSIVE REPORT ON SPECIFIC PROVISIONS BY ASSET TYPES

Receivables and other assets

(thousand tugrugs)

No	Quantitative Qualitative	Performing	Specific mention	Substandard	Doubtful	Loss	Adjustments*	TOTAL OF SPECIFIC PROVISION
1	Performing							-
2	Specific mention							-
3	Non-performing							-
4	Substandard							-
5	Doubtful							-
6	Loss							-
7	TOTAL	-	-	-	-	-	-	-

Securities

(thousand tugrugs)

No	Quantitative Qualitative	Performing	Specific mention	Substandard	Doubtful	Loss	Adjustments*	TOTAL OF SPECIFIC PROVISION
1	Performing							-
2	Specific mention							-
3	Non-performing							-
4	Substandard							-
5	Doubtful							-
6	Loss							-
7	Estimated as impairment**							-
8	TOTAL	-	-	-	-	-	-	-

Note: *- Adjustments stated in Articles 2.8.2, 2.8.3 of this regulation.

** - Impairment amount stated in accounting guideline.

ANNEX 4.c. - Continued

(Reporting template)

OMPRESHENSIVE REPORT ON SPECIFIC PROVISIONS BY ASSET TYPES

Repossessed assets

(thousand tugrugs)

No	Classification	Balance	Performing	Specific mention	Substandard	Doubtful	Loss	TOTAL OF SPECIFIC PROVISION
	Minimum rate for provision		0%	25%	50%	75%	100%	
1	Balance of property (intangible assets)	-						
	Related provision		-	-	-	-	-	-
2	Tangible assets	-						
	Related provision		-	-	-	-	-	-
3	Balance of financial assets	-						
	Related provision	-	-	-	-	-	-	-
4	TOTAL		-	-	-	-	-	-
5	Property /intangible assets/ held for							
6	Estimated as impairment**							

Off balance sheet items

(thousand tugrugs)

No	Qualitative Contract expiry date	Amount equivalent to loans	Performing	Special mention	Substandard	Doubtful	Loss	TOTAL OF SPECIFIC PROVISION
1	Within 1 year		0%	5%	25%	50%	100%	
2	Balance	-						
3	Provision		-	-	-	-	-	
4	More than 1 year		0%	1%	15%	35%	75%	
5	Balance	-						
6	Provision		-	-	-	-	-	
7	TOTAL		-	-	-	-	-	0

Note: * -Asset specified in Accounting guideline, Impairment amount of immovable properties classified in Held for sale account.

COMPREHENSIVE REPORT ON SPECIFIC PROVISIONS BY ASSET TYPES

Pooled assets (thousand tugrugs)

No	Pooled assets category	Number of subcategory in total pooled assets	Number of total pooled assets	Number of member asset	Balance to estimate provision		Specific provision	
					Not impaired portion	Impaired portion	Non-impaired portion	Impaired portion
1	Loan							
2	Assets with flexible condition other than loan							
3	Receivables and other assets							
4	TOTAL	-	-	-	-	-	-	-
5								-

No	Repossessed assets	Previous month's outstanding	Of which assets moved to following classifications:					Returned from the transferred account****	Newly added	Outstanding of current period
			Fixed assets	REHFIP*	AHFS**	AFSS**	SHFIP***			
			(1)	(2)	(3)	(4)	(5)			
1	Non Financial assets (1.a+1.6)									
	a/ Immovable assets									
	a.1/ Mortgagef									
	a.2. Others									
	b/ Movable assets									
2	Financial assets (2.a+2.6)									
	a/ Securities									
	6/ Other									
3	Total (1+2)									

Note:

f- Immovable assets repossessed from the Mortgage loans specified under 1.2.1 of “The regulation on Mortgage operations

*-Real estate held for investment purpose

**-Asset held for sale

***-Available for sale securities

****-Adjustment stated in the article 2.5.6 of this regulation

REPORT ON MOVEMENT OF RESTRUCTURED ASSETS

Restructured assets

(thousand tugrugs)

No	Type of assets	Previous month's outstanding	repaid	Newly classified as restructured	Upgraded to or remained as Performing*	Other adjustments**	Current period's outstanding
		(1)	(2)	(3)	(4)	(5)	(7)=(1)-(2)+(3)-(4)+(5)
1	Loan (Total)						
	Pass:						
	Special mention						
	Non-performing (a+b+c)						
	a/ Substandard						
	b/ Doubtful						
	c/ Loss						
2	Securities						
3	Receivables and other assets						
4	Other						
5	TOTAL						

*For loan, write in the corresponding row of the previous classification (Particularly, if restructured loan previously classified as Substandard migrated to pass, write the outstanding amount of loan in the corresponding row of Substandard)

**Foreign currency exchange rate effect and other

REPORT ON BREAKDOWN OF OUTSTANDING SECURITIES AND ITS PROVISIONING

Breakdown of outstanding securities

(thousand tugrugs)

No	Type of securities	SMIFVOTAP*		Held to maturity	Available for sale	Loan, Receivables	Subsidiary, Controlled company, Investment in joint ownership	Total
		Trading	by fair value					
1	Outstanding amount (1.1+1.2)							
1.1.	Estimated according to the impairment**							
1.2.	Estimated according to regulation on asset classification							
2	Specific provision (2.1+2.2)							
2.1.	Estimated according to impairment							
2.2.	Estimated according to regulation on asset classification (2.2.1+2.2.1+2.2.3)							
2.2.1	Pass:							
2.2.2	Special mention							
2.2.3	Non-performing (a+b+c)							
	a/ Substandard							
	b/ Doubtful							
	c/ Loss							
3	Actual provisioning of the bank							
4	Excess (+)/ Deficit (-) [(2)-(3)]							

Note: *- Securities measured in fair value of trading and profit-loss; Amount of impairment estimated according to the accounting guidance

(thousand tugrugs)

No	Type of assets	Classification of assets	Number of assets*	Number of obligors*			Outstanding amount of multiple assets*	Evidence on classification of assets**			Of which: Portion of other classification***	Amount of collateral	Specific provision	Share of capital
				Total	Of which:			1	2	3				
					Legal entity	Individual								
1	Multiple assets1													
2	Multiple assets2													
3	Multiple assets3													
4	Multiple assets4													
5	Multiple assets5													
6	Multiple assets6													
7	Multiple assets7													
8	Multiple assets8													
9	Multiple assets9													
10	Multiple assets10													
11	Multiple assets11													
12	Multiple assets12													
13	Multiple assets13													
14	Multiple assets14													
15	Multiple assets15													
16	Multiple assets16													
17	Multiple assets17													
18	Multiple assets18													
19	Multiple assets19													
20	Multiple assets20													
21	Total													

Note: *- Assets estimated based on 2.2.2 of this regulation, To select from 3 main evidence for classifying as multiple assets: if 2.2.2.1 of regulation -1, 2.2.2.2 of regulation -2, 2.2.2.3. of regulation - 3, 2.2.2.4 of regulation - 4, 2.2.2.5 of regulation - 5 *** - As stated in 2.2.2 of the regulation.

No	Type of portfolio	Estimation of parameter*			Maximum - Minimum**						Estimation method***	Covering periods		Number of observations	Frequency of information**** (monthly, quarterly, semi-annually, annually etc.)
		PD	LGD	LIP	PD		LGD		LIP			Starting date	Ending date		
					max	min	max	min	max	min					
1	Housing														
2	Retail														
3	Payment card's														
4	Microfinance														
5	Consumer														
	And so on														

Note: *- Rounded to three decimal places

Maximum and minimum values of parameters for the period of the estimation

*** - To select from the methods stated in the this regulation (ILM-internal loss experience; MED - Mapping to external data; SLM - Statistical Loss Model)

**** _ Annually -1,semi-annually - 2, quarterly - 3, monthly - 4

THE REFERENCE TABLE ON ASSET HAIRCUT RATES BY GUARANTEES AND THE LIKE-SECURITIES

Long term

RATING*	Standard and Poor's	AAA / AA-	A+ / A-	BBB+ / BBB-	BB+ / B-	CCC+- or lower	No rating
	Fitch						
	Moody's	Aaa / Aa3	A1 / A3	Baa1 / Baa3	Ba1 / B3	Caal- or lower	80%
Outlook*							
Positive		100%	100%	90%	80%	0%	
Stable		100%	100%	90%	70%	0%	
Negative		90%	90%	80%	60%	0%	

Note:

*- If rated by two or more rating agency, lower rating and the outlook shall be applied

Short term

RATING	Standard and Poor's	A-1+	A-1	A-2 / A-3	B	C-or lower	No rating
	Fitch						
		Moody's	P-1	P-2	P-3	Prime-or lower	
Deduction percentage		100%	100%	80%	40%	0%	80%

Note:

*- If rated by two or more rating agency, lower rating shall be applied

QUALITATIVE ASSESSMENT OF ASSET ISSUED TO INDIVIDUAL

No	Assessment factors	Score	Explanation if criteria is assessed as unsatisfactory*	Materiality**
1.	Completeness of the asset file*	Yes/No		
1.1.	Whether decision made by authorized person in accordance with bank's internal regulation has been provided? Whether bank's assessment of obligor has been provided?			
1.2.	Asset application document			
1.3.	Asset agreement, and amendments to the agreement			
1.4.	Employer Reference on obligor			
1.5.	Evidence of other income, income source			
1.6.	Evidence of steady deposit and other savings for no less than 2 years			
1.7.	It is necessary; sources of family income.			
1.8.	Collateral			
	1.8.1.	Reference ⁴		
	1.8.2.	Valuation documents		
	1.8.3.	Certificate of state registration		
	1.8.4.	Examination document		
1.8.5.	External independent appraisal			
1.9.	Contracts for collateral and/or guarantee			
2.	Financial indicators of the obligor	Score/ Comparison***		Materiality**

		Value ¹	A% ²	Peer average ³	Comment or description of each indicator	
2.1.	Obligor's Debt/Income					
2.2.	Change in Debt/Income and last 3 months trend					
2.3.	Household Debt/Income					
2.4.	Change in Household Debt/Income and last 3 months trend					
2.5.	Asset/Value (LTV) -Mortgage and other collateralized asset					
3.	Other	Yes/No				Materiality**
3.1.	Collateral and Guarantee					
3.1.1.	Is market value of collateral sufficient to cover the asset's principal and interest payment?					
3.1.2.	Change of collateral value					
3.1.2.	Whether the right to sell the collateral and recovering assets has been fully transferred to the bank.					
3.1.3.	Sectoral conditions of sale of the collateral					
3.1.3.	Guarantee/ warranty from third- party.					
3.1.4.	Guarantor's financial condition if obligor is guaranteed or under guarantor assistance					
3.2.	Information obtained from Credit Information Bureau					
3.2.1.	Credit history of obligor					
3.2.2.	Whether there are any past due assets or other types of debt to Obligor					
3.2.3.	Whether there are any assets that was downgraded in recent period					
3.3.	Other Information					
3.3.1.	Condition of obligor employment / retention of work and self-employment /					

3.3.2.	There is no negative data of obligor payment inquiries from other government and law enforcement authorities and non-governmental institutions			
3.3.3.	Bank is assessing a financial situation of obligor without any difficulties			
3.3.4.	Economic situation, unemployment and the impact of payments situation of the sectors engaged in the obligor's payment of the obligor's financial situation and whether the expected positive impact in the future			
3.3.5.	Obligor is covered by an insurance, reducing asset risk associated with repayment			
3.3.6.	Bank internal data collected regarding the obligor do not suggest obligor's payment risk of negative impact			

Note:

*- Explanation shall be provided only to criteria assessed as 'unsatisfactory'⁵.

Evidence of materiality and other related documents shall be attached

*** - Obligor's financial indicators on monthly, quarterly and annual basis for 1-2 year period for longer period if such information is available shall be attached to this table and shall be updated on regular basis.

1- Financial indicators for the reporting period shall be recorded.

2- The latest trend of the financial indicators using current and the previous periods. Increase /I or / shall be marked If there is positive change, Decrease /D or / shall be marked if there is negative change, or Stable /S or ~/ shall be marked if there is no change.

3- Financial indicator value of last reporting period shall be compared to similar obligor group average or similar business sector average. Better /B or ↑/ shall be marked If the value is better, Worse /W or ↓/ shall be marked if the value is worse, or Similar /S or ~/ shall be marked if there are no substantial differences. Internal data or external data obtained from authorities can be used for group and business sector average calculation. Source for the data shall be provided and data used for group and business sector average shall be attached to this table.

4- References stated in the Articles 23.2.3, 23.4 of DLBT

Asset classification guideline: Bank shall provide explanation and conclusion if criteria have potential negative effect on asset quality assessment. Such explanation and conclusion shall be provided for criteria assessed as 'unsatisfactory'⁵ and criteria having material effect. Evidence, explanation, and other related documents shall be attached to this table if necessary.

QUALITATIVE CRITERIA OF ASSET ISSUED TO LEGAL ENTITY

No	Assessment criteria	Assessment	Explanation if criteria is assessed as unsatisfactory *	Materiality**
1.	Completeness of the asset file	Yes/No		
1.1.	Whether decision made by authorized person in accordance with bank's internal regulation has been provided? Whether bank's assessment of obligor has been provided?			
1.2.	Asset application			
1.3.	Asset agreement, and amendments to the agreement			
1.4.	Memorandum and Articles of Association, Registration certificate			
1.5.	Financial statement			
1.6.	Collateral			
	1.6.1. Collateral reference ⁴			
	1.6.2. Collateral assessment documents			
	1.6.3. State registration certificate if collateral is real estate			
	1.6.4. Examined documents			
	1.6.5. External independent appraisal			
1.7.	Guarantee and collateral contracts			
1.8.	Project financed by the asset			

	1.8.1.	Whether project has been approved by authority if necessary					
	1.8.2.	Documents related to project operations					
	1.8.3.	Financial arrangement of the project					
	1.8.4.	Project's accounting documents					
	1.8.5.	Project planning and execution					
	1.8.6.	Related contracts					
1.9.	Asset	Disbursement monitoring report/material					
1.10.		Statement from Credit Information Bureau and other authorities					
1.11.		Is information used for obligor's assessment sufficient? Have significant difficulties been observed during the assessment process?					
2.	Financial criteria of obligor		Criteria/comparison**			Explanation of each criteria	Materiality**
			Value ¹	A% ²	Group average value ³		
2.1.	Obligor's solvency						
	2.1.1.	Current asset /Short term liability, its change and trend					
	2.1.2.	(Cash assets+Short term investment +Receivables)/Short term liability, its change and trend					
	2.1.3.	Operating income /short term liability, its change and trend					
2.2.	Profitability						
	2.2.1.	Total profit / Total income, last 1-year trend (quarterly and monthly)					

	2.2.2.	Total expense/Total income, last 1-year trend (quarterly and monthly)					
	2.2.3.	ROA, last 3-year trend (yearly and half-yearly basis)					
	2.2.4.	ROE, last three year's trend (yearly and half yearly basis)					
2.3.	Asset management						
	2.3.1.	Receivables turnover /last 12-month average					
	2.3.2.	Receivables turnover /at the end of the period					
	2.3.3.	Inventory turnover / last 12-month average					
	2.3.4.	Inventory turnover /at the end of the period					
	2.3.5.	Capital goods turnover /at the end of the period					
	2.3.6.	Total asset turnover /at the end of the period					
2.4.	Leverage and debt service						
	2.4.1.	Earnings before interest and tax /Interest expense last 1-year trend (quarterly and monthly)					
	2.4.2.	Liability/ Earnings before interest, depreciation and tax, last 1-year trend (quarterly and monthly)					
	2.4.3.	Equity/Capital (leverage), change, last 1-year trend (quarterly and monthly)					
3.	Other		Yes/No				Materiality**
3.1.	Collateral and guarantee					Explanation of each criteria	

	3.1.1.	Can market value of collateral cover asset principal and interest payments?			
	3.1.2.	Has control of the collateral been transferred to bank?			
	3.1.3.	Collateral value change, last 3-month trend			
	3.1.4.	Has obligor been guaranteed by third party?			
	3.1.5.	Is guarantor solvent if asset is guaranteed?			
3.2.	Credit Information Bureau information				
	3.2.1.	Obligor's credit history			
	3.2.2.	Has obligor had non-performing Asset or overdue obligation?			
	3.2.3.	Has any asset issued to the obligor been downgraded in current month?			
3.3.	Other information				
	3.3.1.	Have warnings and negative watch regarding shares issued by obligor been recorded in current and previous credit rating reports?			
	3.3.2.	Has qualified audit opinion ever been issued? Do issues mentioned in the management letter have material effect on obligor?			
	3.3.3.	Do statements received from other state authorities, enforcement agencies, and non-government organizations have negative record on obligor?			
	3.3.4.	How economic condition, obligor's business sector can affect obligor's financial condition? And if future trend has positive effect on obligor?			

3.3.5.	Has any information ever been published that can negatively affect obligor's reputation, financial condition and solvency ?			
3.3.6.	Does obligor have insurance that can reduce asset related risk?			
3.3.7.	Do internal data on obligor collected by a bank on an obligor suggest the current and a potential credit risk?			

Explanatory note:

*- Explanation shall be provided only to criteria assessed as 'unsatisfactory'⁵. Evidence of materiality and other related documents shall be attached

*** - Obligor's financial indicators on monthly, quarterly and annual basis for 1-2 year period for longer period if such information is available shall be attached to this table and shall be updated on regular basis.

1. Financial indicators for the reporting period shall be recorded.

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4. References stated in the Articles 23.2.3, 23.4 of DLBT

Asset classification guideline: Bank shall provide explanation and conclusion if criteria have potential negative effect on asset quality assessment. Such explanation and conclusion shall be provided for criteria assessed as 'unsatisfactory'⁵ having material effect. Evidence, explanation, and other related documents shall be attached to this table if necessary.

Appendix 2 Reference Materials on Corporate Governance

- 1. Report on Survey for actual condition of corporate governance and corporate finance of Mongolian enterprises**
- 2. Responses to Self-assessment Sheet at the Workshop on Corporate Governance**
- 3. Shelf-assessment Sheet**

1. Report on Survey for Actual Condition of Corporate Governance and Corporate Finance of Mongolian Enterprises

July 24th, 2018

Survey for actual condition of corporate governance and
corporate finance of Mongolian enterprises

Final Report

Mongolia-Japan Center for Human Resources Development

Table of Contents

1 Survey Outline

- Survey status summary report
- Sample companies¹overview
- Family business condition of sample companies.

2 Corporate Governance

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- Financial condition of companies
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- Credit Guarantee Fund
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- Individual company visit survey record
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1. Survey Outline

=Purpose of the Survey=

The "Mongolian Corporate Finance and Corporate Governance" study aims to identify current state of corporate governance in credit information control and to provide with practical recommendations aimed at diversifying industries and improving business environment.

Survey Methodology:

An online survey has been conducted between 17th April 2018 and May 25th 2018. A total of more than ten thousand people, registered with Mongolian-Japan Center's business course graduates' database, were invited to participate the survey. Total of 586 companies participated in the survey on voluntary basis. A review revealed that, of the companies covered by the survey, 33 companies did not satisfy the survey criteria, thus have been removed from survey findings, and survey findings are based on 553 companies' information.

One of the targets of the survey was to distinguish companies, who obtained financing under JICA two-step loan program, however, no contact information of the companies have been

¹ Sample companies refer to all companies who responded to this questionnaire survey.

provided and difficulty of finding the contact information, this target was not met. However, there were 16 companies that were financed by JICA's two-step loan, among the surveyed companies. Please see the annex.

Also, we sampled 30 companies from the surveyed 553, and organized face to face meetings with them to gather information on Mongolian business environment and company's finance and governance, between May 25 and June 26. Minutes of these meeting are also in the annex.

= Sample companies overview =

According to the data of the Mongolian Bureau of Statistics, 158,800 companies are registered as of the first quarter of 2018 (January - March), of which 81,000 companies are actually doing business activity.

The proportion by scale of the number of employees:

Less than 10 employees: 85.5%

Number of employees 10 or more but less than 20: 6.4%

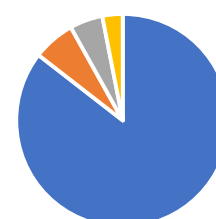
Number of employees 20 or more but less than 50: 5.0%

More than 50 employees: 3.1%

(Hereinafter referred to as comparison table)

Number of employees	Proportion	Survey response rate
Less than 20	91.9%	69%
20 or more and less than 50	5.0%	12%
More than 50	3.1%	19%

Business scale by number of employees 2018, 1st quarter



- Less than 10 employees
- Number of employees 10 or more but less than 20
- Number of employees 20 or more but less than 50
- More than 50 employees

The actual situation of Mongolia, in this survey within small businesses², with less than 20 employees accounted for more than 90%, nearly 70% is small scale business and the remaining 30% is small and medium scale (including 26 listed companies), and it is clear that the percentage of medium and small scale companies is somewhat higher.

One reason for this is that 1/3 of the respondents in this questionnaire are companies which are graduates of the business course of Mongolia-Japan Center for Human Resources Development, so it shows there are relatively many financially affordable companies, also many small to medium scale companies.

For this reason, the differences in consciousness between small businesses and SMEs have compared in this analysis.

Next, regarding the ratio of respondent companies by industry, the table below shows the percentage by industry of this sample companies and the ratio by industry by GDP.

² Enterprises with less than 20 employees are referred to as small businesses. More than 20 companies are referred to as SMEs or small and medium-sized companies.

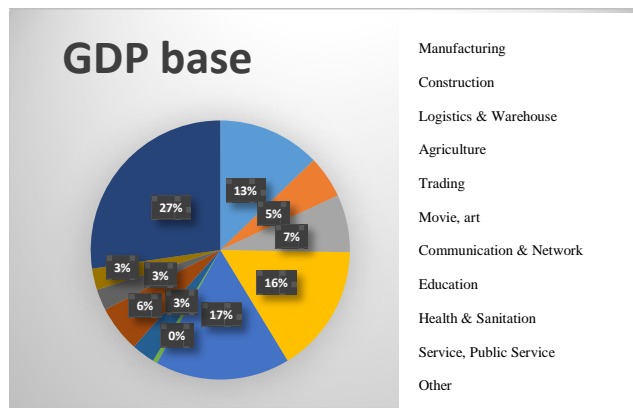
Although the ratio of manufacturing industry and construction industry is slightly higher in this sample, agriculture and fishery industry, the main industry of Mongolia, is slightly lower than the ratio based on GDP, but as a whole, it is largely out of proportion by industry by GDP and here it may be said that there is no big difference.

Therefore, although the answers to this questionnaire can be determined that it is not in any of the size rather biased answer of the Mongolian industry, It is thought that it cannot be said that it is inappropriate to estimate the overall situation of Mongolia from the questionnaire result.

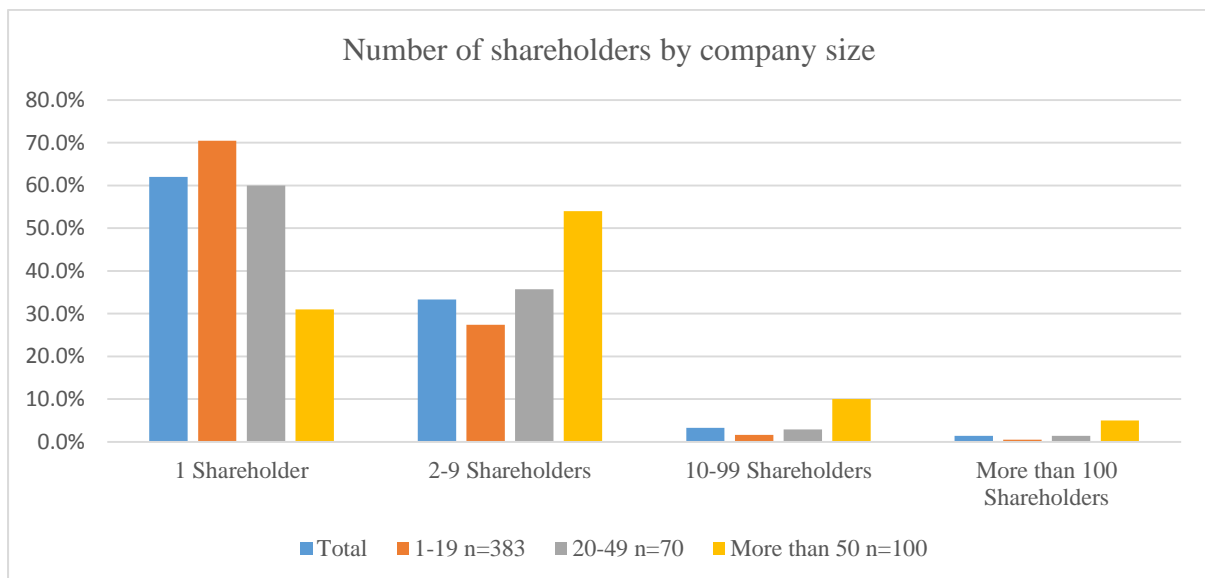
Survey sample (by industry)



Percentage by industry in Mongolia (GDP base)



=Family business condition of sample companies=



	1 Shareholder	2-9 Shareholders	10-99 Shareholders	More than 100 Shareholders
Total n=553	62.0%	33.3%	3.3%	1.4%
1-19 n=383	70.5%	27.4%	1.6%	0.5%
20-49 n=70	60.0%	35.7%	2.9%	1.4%
More than 50 n=100	31.0%	54.0%	10.0%	5.0%

For the question Part 2 No. 6, 21% answered that there are no shareholders in their companies. It seems that the respondents misunderstand the question, in fact, one founder,

equally owned equity shareholder³ in a situation and considered. In other words, 62% is considered to be a company with one investor and one shareholder. In addition, there are 26 companies with 10 or more shareholders, of which 12 are listed companies.

Even in companies that are not listed, those with more than ten shareholders are called major firms in Mongolia, such as “Nomin Holding LLC” and “Erdenet Carpet LLC”, but most of the limited liability companies can be said to be family owned businesses.

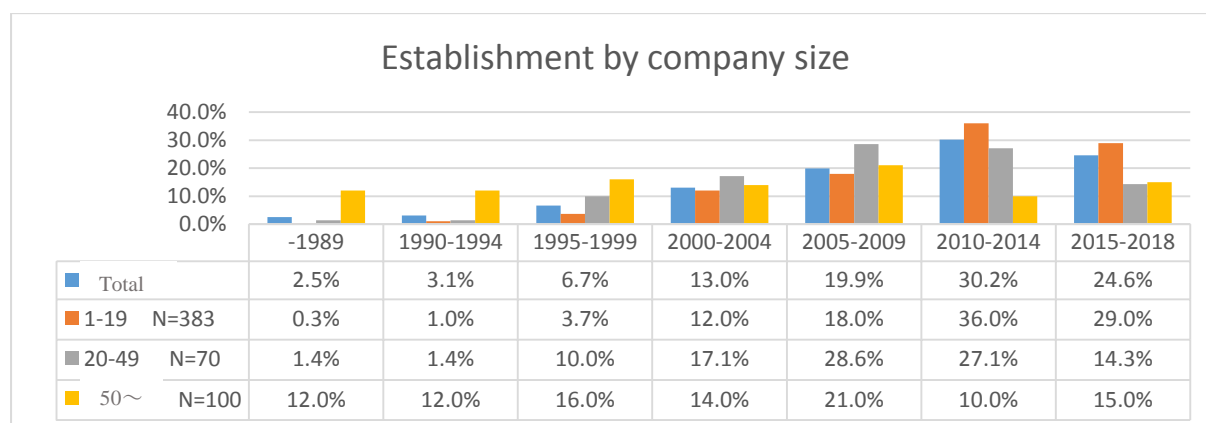
The figure on the previous page shows the number of shareholders by company scale. Most of the companies with 19 or less number of employees, responded to have starting from 1 shareholder, and those with size of shareholders of up to 9 are approximately 98%, whereas companies with more than 50 employees are 85%. However, the ratio of companies with more than ten shareholders is getting lower, regardless of their scale. Regarding the tendency to sudden change with the number of ten members as a boundary, it is conditional on the rules of the corporation to establish a board of nine or more members, and even it becomes larger and offer stocks publicly, it can be inferred that nine shareholders and nine directors are in charge of management has nothing to do with it at all.

In addition, according to the answer for question Part 2 No. 5, 76 companies (13.7 % of all respondents) have directors from other than family members in the Board of Directors among all the respondents.

From these results, approximately 86% of all responded companies is considered to be family owned companies.

From the table on page 68, there is a list of the establishment status of the Board of Directors for each year of establishment, but in companies with a company history of 18 years or less, the establishment status of the Board of Directors is 20% or less, The proportion of companies established before democratization has established a board of directors exceeds 70%.

Although this data suggests that it is a family company as the company's history is shorter, companies with a company history of 18 years or less have 95% or more of companies with 19 or fewer employees, Considering that no large bias is seen, It is thought that it is a big factor that the scale is small rather than the establishment years or industries, which is presumed to be a high percentage of family management.

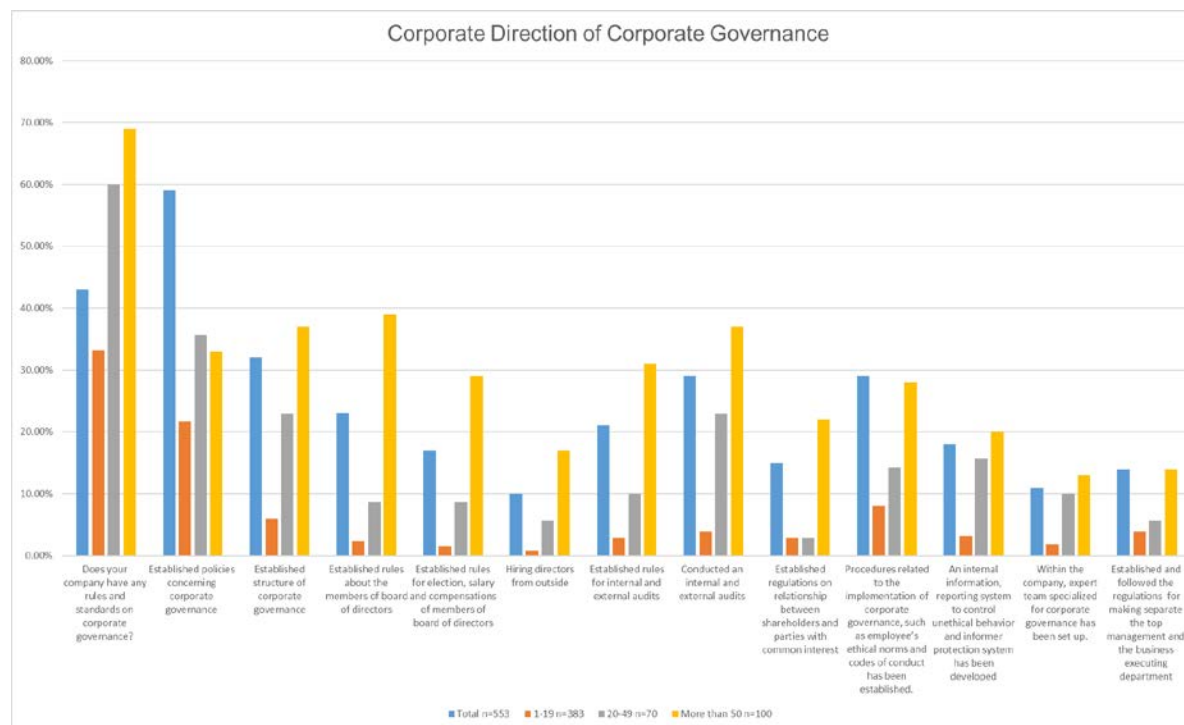


³ The shareholder referred to uses the word "Shareholder" in Mongolian as it is and its meaning is close to the meaning of investor in a limited liability company. A limited liability company that does not issue shares also uses the expression "shareholder" in accordance with the shareholding ratio.

2. Corporate Governance

=Company's attitude on corporate governance=

For the answer for question Part2 No2, there were 10 firms out of 12 companies that established rules or standards on corporate governance in listed companies and some companies did not have rules and standards even in listed companies.



	Does your company have any rules and standards on corporate governance?	Established policies concerning corporate governance	Established structure of corporate governance	Established rules about the members of board of directors	Established rules for election, salary and compensations of members of board of directors	Hiring directors from outside	Established rules for internal and external audits	Conducted an internal and external audits	Established regulations on relationship between shareholders and parties with common interest	Procedures related to the implementation of corporate governance, such as employee's ethical norms and codes of conduct has been established.	An internal information reporting system to control unethical behavior and informer protection system has been developed	Within the company, expert team specialized for corporate governance has been set up.	Established and followed the regulations for making separate the top management and the business-executing department
Total n=553	43.00%	59.00%	32.00%	23.00%	17.00%	10.00%	21.00%	29.00%	15.00%	29.00%	18.00%	11.00%	14.00%
1-19 n=383	33.16%	21.67%	6.01%	2.35%	1.57%	0.78%	2.87%	3.92%	2.87%	8.09%	3.13%	1.83%	3.92%
20-49 n=70	60.00%	35.71%	22.86%	8.57%	8.57%	5.71%	10.00%	22.86%	2.86%	14.29%	15.71%	10.00%	5.71%
More than 50 n=100	69.00%	33.00%	37.00%	39.00%	29.00%	17.00%	31.00%	37.00%	22.00%	28.00%	20.00%	13.00%	14%

Compared with listed companies, although the ratio is low, even small businesses and companies of small to medium-sized level that are taking some actions on corporate governance account for 43% of all the companies, and it is difficult to say that the necessity of corporate governance in Mongolia is not penetrated.

The figure on all pages is a graph showing what type of corporate governance measures are taken by scale.

As you can see from this figure, in companies with rules or standards for some type of corporate governance, in one company up to 19 people, one-third of the sample population and more than 20 companies have more than 60%. The ratio is low. Regarding companies with more than 50 people, they answered that measures are being taken at less than 13% in most of its options. On the other hand, even in companies with more than 50 people, the most of them are:

“Established policies concerning corporate governance (number of responses 140, 25% of the total)”

“Established a governance system within the company (number of responses 75, 14% of the total)”

“Conducting an internal audits and external audits (number of responses 69, 12% of the total)”

(Here mentioned total means all survey responded companies, 553 companies)

But there are many responses such as:

“Hiring directors from outside (number of responses 24, 4% of total)”

“Making separate the top management and the business executing department (number of responses 33, 6% of the total)”

Answers such as above are less and the most of the companies relating to the governance of management's side can be said that it is a real condition.

Also in Mongolia, as stated in the preceding paragraph, while there are many small family businesses, issues of business continuity are pointed out. From the answer result of question Part 2 No. 16, only 17% of companies take some measures in business accomplishment. This is because the average national company director's age of Japan is 61.19⁴ whereas in Mongolia, as it is not far from the transition into market economy, although clearly data not shown from the survey, company director's average age is lower than Japan. Although it can be cited as one factor, doubt on business continuity remains.

As for the question of Part 2, No. 4, 76% of companies have not been established as a board of directors, and even in question No. 6, the number of shareholders is 62%, which is two third, which also suggests that business continuity of a company is performed by some management team.

In Mongolia the Company law Article 75, under the same Article, Section 2, in the company, the installation of the Board of Directors is required. On the other hand, it is stipulated that there is no obligation to install in a limited liability company.

Among them, according to the provision of Article 75 Section 4, there is an obligation to set up a board of nine or more of the board of corporations, and of the directors making up the board of directors, at least 3 should be invited from outside the company are required.

Also, in the provisions of Article 75 Section 8, Board of Directors, who performs the director of the corporation and secretary general of the board of director's is obliged to receive training on corporate governance and to complete it. Comparing such circumstances, in the company with the board of directors in Japan, since the obligation to set up the directors is 3 or more, items related to corporate governance for the company are more severe than Japan due to laws and regulations.

Considering such a situation, concerning the problem of business continuity derived from corporate governance and corporate governance, the corporation has a certain degree of corporate governance and business continuity as guaranteed by laws and regulations, but for small scale businesses, legal development concerning corporate governance has a high degree of freedom, and at present it is not a property that is guaranteed by law.

On the other hand, with regard to small businesses, it is ideal to establish such a system of corporate governance and to disclose information, and for enterprises that want to receive entrepreneurship or domestic and foreign investment, such companies there are also a few companies with high consciousness or ambitious concerning the establishment of a governance system. However, in establishing such a system of corporate governance and

⁴ Tokyo Shoko Research Inc. Quoted from the age survey of the president nationwide (February 3, 2017 publication date) in 2016

disclosing information, it may be a case that contributing the cost exacerbates the financial situation of the company, and depending on the scale, establishing such a corporate governance system is a company we also have to consider the possibility that the sound business activities of the company will be restricted. For this reason, it is one of the options as stated above to establish corporate governance regulations step by step according to the scale, rather than prescribing so-called listed companies and other classifications.

=Disclosure of company information=

Generally, Mongolian companies are considered to be reluctant for the disclosure of their information.

As a result of this questionnaire, the number of companies that have opened the homepage has accounts one third of the total, among them IR⁵ Related information disclosure, about 47 companies that disclose information on website are less than 10% of the total. Among them, only “Gobi” from the listed companies to have created a report on corporate governance, and besides that the companies which has overseas counterparts, are “Nomin Holding LLC”, and “Everyday International LLC” have answered that they are making corporate governance report publicly on their website.

In such a background, as a characteristic of the Mongolian company, it can be inferred that the company attitude of Mongolia to be good to take a corporate defense measures that do not publish the details of the business to the outside to prevent the theft of their technology and business know-how.⁶

Even in daily life, there is a common sense of social attitude that it is not good to be taken photos without permission in any restaurant or retail shops and not to disclose useful information to outside, and such kind of useful information disclosure can be inferred as negative attitude.

Furthermore, in present Mongolia, as for the question Part 2, No 20, two-third of the companies answered “No” for the question of “Can you trust the financial statements published to society by Mongolian enterprises”, where you publish your information, it can also be presumed to be one of the factors of negative attitude with respect to such information public that you think not trustable or thought would not be trusted.

In response to the question of Part 3 No 16, in support of the question, “What the bank regards most for loan appraisal”, 46% of the companies responded as collateral value, 36% of the companies answered as company’s financial situation in general, in other words, tangible things such as assets, cash and securities are emphasized, responses concerning credit such as emphasis on credit history are only 12% of responses, which shows Mongolian financial institutions have a tendency to emphasize the tangible things than the intangible matter such as corporate governance situation and credit.

However, for the question Part 3 No 17, “Whether the bank evaluates or regards the situation of corporate governance at the time of financing”, 38% of the companies answered "Yes". It can be seen there are increased tendency to the awareness about corporate governance.

Therefore, it is possible to predict that demand will come out to learn the technique of how and what kind of corporate governance to be implemented in order to obtain credit from outside in the future.

⁵ IR refers to Investor relations

⁶ Some companies also commented on the risks of disclosing information in the visit questionnaire survey.

=Tendency of corporate ethics of Mongolian companies=

As mentioned in the preceding paragraph, as mentioned in the questionnaire in this survey, it seems that it is basically common for secretive information to be kept confidential, as two-thirds of companies responded that they are unable to trust information published in Mongolia which is a social philosophy, it is understood that the information widely publicized for society is not trusted.

Question Part 2 No 18, "Do you generally use financial statements appropriately according to the usage?": 254 companies (46%) answered "Yes"

Question Part 2, No 19, "Do you think that companies, in general are giving bribes to tax officials to lower taxes?", 157 companies (28%) answered "Yes"

Question Part 2, No 20, "Can you trust publicly available financial statements?", 341 companies (62%) answered "No"

As seen from above, the information that companies disclose publicly is not trusted. Also there are many corporate top management, who thinks that bribe is still exist now.

Regarding the credit investigation of the partner company at the start of trading between Mongolian companies, as seen from the question Part 3 No 23, 33% do not investigate and 16% unnecessary to investigate for cash transactions, and 31% are evaluating by credit evaluation based on the public reviews, results are obtained. As 49% thinks that investigation is not necessary, there are business practices such that there is no necessity or opportunity to create and submit reliable documents. While these Mongolian commercial environments remain unchanged, we cannot expect to raise corporate governance awareness and improve corporate ethics.

=Policy proposal for corporate governance=

What comes to be clear from the above answers and interview surveys is that Mongolian managers think that the necessity of corporate governance is necessary as knowledge but cannot deal with their implementation. In other words, ideally, when corporate governance and the commercial environment are improved:

- Smooth project implementation
- Simplified contract and transaction procedures
- Funding in favorable conditions
- Advantages in expanding business by improving corporate image
- Expand business by improving reliability from companies and institutions in other countries

Although it is motivated to strengthen corporate governance and to disclose information and to improve the consistency of information if above can be realized, but in reality, it is inferred that it is the actual condition of thinking unnecessary as it is not possible to get concrete and definite benefits by doing so.

Also in the Part 2, No 10 question, as 28% think that bribery and other injustices at the site of collection of tax, apart from actual condition, it is not even possible to relieve the distrust against Government organizations in a position to implement the matters stipulated by law.

Therefore, it is vital to implement measures to improve government organizations and administrative officials' evaluation from the public in general.

In order to improve this situation and to expand the business of the company in the future by means of foreign investment and funding methods approved by the public, it is thought that it is difficult to achieve by just one company's efforts, it is unlikely that results will become apparent unless public and private sectors tackle problems related to corporate governance at the same time.

In addition, as long as the reliability of the information on the evaluation of the governance system of such a company, the evaluation of corporate finance, and the financial statements of the company is disclosed, it is not generally available as far as seeing the document on page 46 of the attachment. However, 271 respondents say that they can trust the information publicly disclosed in Mongolia (49% of the total), of which 67% of the respondents who responded with “No”, 189 companies answered that they trust only when under the support of International organizations, such as UN, ADB, JICA, etc. and if we combine both, total 83% of the respondents said that they trust the information. Based on these results, international organizations from overseas and government organizations and enterprises in Mongolia collaborate to collect and publish information, and make Mongolian companies recognize the significance and effect of the information, and allows for example, to make advantageous to the enterprises in any business partnership and financing, and by making the profit solid, it can be inferred that the importance of such corporate governance and the accuracy of the public information is increased, and as a result, economic situation has been improved.

As seen from above, the following measures can be considered for improving the situation of corporate governance throughout Mongolia.

1. Addition, amendment, stricter on clauses of law related corporate governance
2. For a limited liability company, the application of the step-by-step defined by the business scale
3. Also, improve the expertise of government organizations and administrators, who are in a position to implement the contents according to the law and others stipulated by the preceding paragraph, improve the professional ethics, strengthen the execution system
4. Need and necessity for corporate governance and information disclosure, strengthening the administrative public relations to recover the trust.
5. Specific and clear measures⁷ obtained by the situation of the corporate governance.
6. Positive support by foreign companies and institutions for the realization of the above policies, establishment of administrative system, and establishment of agencies to provide reliable information.

End

⁷ The measure means matters such as lowering the interest rate on loans from commercial banks and corporate lending institutions, tax incentives, enterprises such as selection of top companies, introduction of corporate governance assessment at the time of award of a prize.

3. Corporate Finance

= Financial condition of companies =

Looking at the result of Question No. 9, 51% of the companies at this time said that the total assets were less than 200,000,000 MNT (about 83,000 US dollars).

Although about half of companies have collateralized assets, depending on the collateral valuation amount, the funding capability by providing collateral is estimated to be around tens of thousands of dollars, which is not on the scale capable of large capital investment. Under such circumstances, from the results of Part 3 No 16, banks that are the primary source of funds do not emphasize credit information such as credit history, but there are many responses emphasize the tangible things such as collateral.

From the results of this answer, it seems that small businesses have collateral that far exceeds the loan amount to make a large-scale investment, regardless of the poor performance of the business, or as it is required to secure equivalent amount of liquid assets for collateral, it is very difficult to conduct large-scale investment at the small business level.

= Accounting condition of companies =

Given the actual situation based on the answers of Parts 2, No 8 and 9, among the companies, the percentage of firms that have their accountants staying permanently is 68%, many companies which accounting services are carried out by their own, even companies that are not stationed permanently, there are many cases that they usually tend to hire accounting experts temporarily. (Among the companies answered "No", 153 companies are hiring temporary accountants which is 86%, 8 companies are appointed to audit firms which is 4%, others are 18 companies, 10%)

In the question of Part 3, No 5, "Whether you are getting explanation of financial data from an accountant, or if the respondent was in charge of accounting, did you explain the financial data to the top management?", the answer "No" is 43%, which is a notably large proportion.

From this data following can be read:

- Top management is less interested in the data that can read from financial statements
- Or the top management can read the financial data from the financial statements

Although it is said that it is either one of the above, by judging from the later answer, it seems that there is more in the sense that top management is less interested in financial data.

In answer to the question in Part 3, No 2, in response to the question as to which item of the income statement should be emphasized, in fact, 442 companies, which is 80% of the total, emphasize sales, and for the manufacturing cost as the next point, although the ratio drops sharply, 242 companies (44%) are emphasized. From this response, it is speculated that companies in Mongolia tend to focus on gross profit, in other words, gross margin. Slightly lower than this, responses for emphasis on operating profit is one third, 33%, and for ordinary profit 35%, shows that there is more emphasis on sales revenue rather than profit.

Also, as in the question of the Part 3, No 3, with respect to the question of "Whether there are any financial measure that emphasizes", accounted one fourth, and shows the low impact of the financial statements to the management.

Among the 147 companies, the most answer was that emphasizes ROA (51 companies, 35% of all responses, and 9% of the total). Regarding ROE, 41 companies responded, but there

were 2 companies with more than 100 shareholders, 1 company with more than 10 shareholders and 3 companies with many shareholders. The remaining 38 companies responded as ROE, but most of the companies have one or two shareholders.

ROE is originally, for shareholders is an indicator derived from the net assets in order to obtain the information of the dividend payout ratio, small and medium-sized or small-scale businesses, it is considered that mostly focus on ROA is common. From that, it can be seen that financial knowledge is not sufficient in the management of Mongolian companies.

From this, below can be inferred:

- Increasing top management's awareness and knowledge of financial statements will increase the accuracy, reliability, and usefulness of the financial statements.
- Improving top management's management on appropriate financial data and financial indicators, the soundness of corporate finance increases and the possibility that can lead to business expansion will increase.

= Problem of commercial bank loans =

From the answers to this questionnaire, items that Mongolian companies view as the biggest obstacles in commercial bank financing, received more than 40% of responses are as follows:

- High interest rate, 445 companies (80%)
 - Low collateral valuation, 367 companies (66%)
 - Much documents for application, 294 companies (53%)
 - Short repayment period, 238 companies (43%)
- (According to the answer result of Part 3 No. 20)

The result is as above. The answer "Short repayment period", includes the meaning of repayment period presented by the commercial bank is short and the repayment period has to be shortened because the interest is high. In fact, it is not possible to grasp only as a problem of the commercial bank side, and it is necessary to pay attention.

In this survey, we also investigated the borrowers.

As the answer of Part 3, No 8 and 10, allocation of business funds,

- Received funds from non-banking organization and pawn shops and others, 103 companies, 19% responded "Yes"
- Received funds from individuals, 191 companies 35% responded "Yes"

Regarding non-banking organizations and pawnshops, the loan interest rate is higher than banks. However, despite that 80% of companies feel dissatisfied with the high interest rate, the only reason for receiving funds mostly from these financial institutions other than banks is that "Simple". Also, financing from acquaintances and friends is because "low interest rate" and "ease of loan screening", but these are considered to be not good financing methods. As an obstacle to bank loans, "Interest is high" has an overwhelmingly high answer rate. Also, as for the question that the "Collateral evaluation is low", the majority of opinions, the two third has responded, so it is a big challenge for the following 3 points to solve the problems of commercial loans in Mongolia.

1. Reduction of interest rate
2. Appropriate collateral evaluation
3. Simplifying, optimizing and speed up loan screening and corporate evaluation

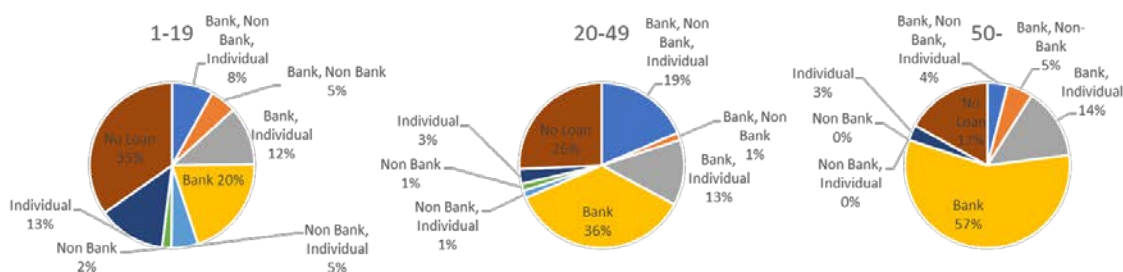
Regarding the problem of high interest rate on loans in Mongolia, fundamental solutions cannot be solved unless both problems at funding and risk control at the time of financing are solved.

Regarding the problem solving when funding, it is essential to resolve the following issues, and is a problem that cannot be solved in only self-help efforts by commercial banks and fund applying organization

1. Sovereign rating⁸ of Mongolia is B or B-, the cost of fund procurement from overseas is high.
2. It is inevitable to raise interest in order to avoid foreign exchange fluctuation risk and inflation risk for domestic money.

However, in terms of solving the problem at the time of financing, it is thought that it is possible to alleviate the problem even if each of the self-help efforts does not lead to a fundamental solution.

=Regarding the corporate financing=



Regarding companies' financing sources, it is remarkable to classify by company size. The figure above is a graph of the sources of financing by company size.

Small-scale companies, especially, within companies with up to 19 employees, only 20% choose banks as their only funding sources, whereas 57% in the case of companies with more than 50 employees, and depending on the scale, there are differences in financing condition.

Also, companies with a scale of up to 19 employees say that 35% of companies have never received loans, while in companies with more than 50 employees the proportion will decrease to 17%.

The reasons for this are presumed as follows:

- There is no choice to receive loans from banks or not able to receive loans as it is difficult for them a small scale companies, as they have less assets for collateral.
- Small-scale companies focus on time and performance of receiving funding, and have comparatively loose examination, but tend to receive high interest loans.
- In small-scale companies, as the amount required for financing is small, they often receive funds from individuals.

In this questionnaire survey, it is difficult to determine the reason, but in addition to the reasons mentioned above, it can be inferred that the difference in interest rates does not have

⁸ According to the sovereign rating list as of May 31, 2018 provided by S & P Global Rating Japan. B or B- is rated as B or B- in each of the four items of the short-term domestic currency and short-term in foreign currency. The rating of B or B- is generally high in clinical risks and is judged to be ineligible for investment.

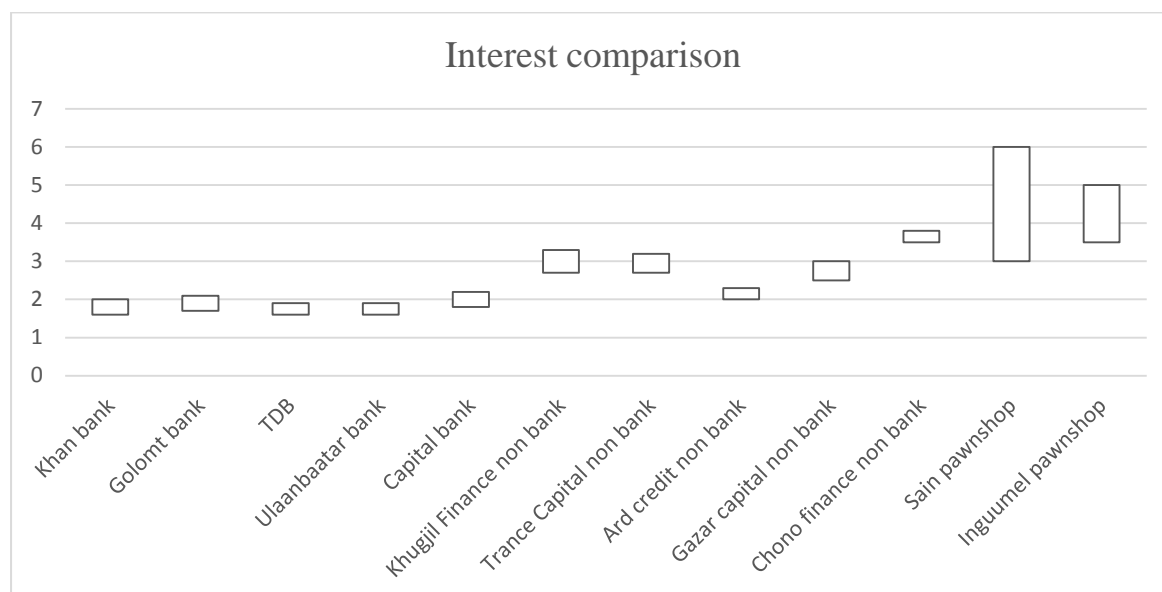
much influence on demand of short-term funding. Currently, the interest rates for funding in business in Mongolia (typical interest rates for pawnbrokers) are as follows ⁹

Banks: 1.6% to 2.2% (basically, research targeted business loans with liquid assets collateral)

Nonbank: 2% to 3.8%

Pawnbrokers: 3% to 6%

The difference in interest rates between bank and non-banks is about 1% per month, it is not big for the demand of short term funds, and for the demand of short term fund, if it is needed to pay some fees to banks, it would be an option to receive funds from non-banks easily.



On contrary, companies with relatively large scale of more than 50 employees think that relatively long-term fund demand also occurs more often than small-scale companies such as capital investment and tie-up funds until completion of construction. Therefore, it seems that responding by banks may be able to secure superiority to banks more.

= Credit Guarantee Fund =

According to the answer of Part 3, No 6, there are 301 companies that have received loans from banks until now. According to the answer of Part 3, No 9, only 20 companies, 6.6% out of 301 companies answered that Mongolian credit guarantee fund was used by loans from banks. In the Credit Guarantee Fund, it is possible to receive guaranteed loans up to 60% of the total loan amount and MNT 500 million. Despite such a situation, the reason of less user is:

- The credit guarantee fund service is unattractive
- It is appealing to the service of the credit guarantee fund, but it is not known
- There is some problem in the review process of credit guarantee fund (complications, examination period, examination ability etc.)
- The loan guarantee fee of the credit guarantee fund is high or the cost effectiveness against but the guarantee fee does not match. (The loan term is 1% up to 1 year, 1 year to 2 years 2%, 3 years or more 3%)
- Companies does not trust credit guarantee fund

⁹ Information cited from banks and non-bank financial institutions

By analyzing the previous two sections of questionnaire result, regarding the financing which is a driving force to promote the business expansion of companies leading to the improvement of the economic environment, guarantee of the accuracy of financial data submitted by companies, publicizing credit guarantee fund, simplification of the administrative process, commercial bank's review, and optimization, simplification of evaluation work can be assumed to be sought.

=Policy proposal for improving the corporate financing and funding=

The following items can be considered as measures to mitigate the problem.

1. By properly conducting financial evaluation of a company by commercial banks or finance-related companies or organizations, it becomes possible to set different interest rates by evaluating default risks
2. By appropriately conducting the value evaluation of collateral by commercial banks or financing companies and organizations, it becomes possible to eliminate the imbalance between the value of collateral and the amount of loan execution.
3. Publicizing credit history and credit information to business that are in the commercial area or companies specialize in investment allows to simplify enterprise-specific settings and procedures, and synergetic effect can be expected in a good way for both parties.
4. By taking measures to tighten and optimize the financial statements prepared by companies and increasing the credibility of financial statements released by companies, it becomes possible to reduce the risk at the time of lending and setting corporate interest rate and evaluating the value of collateral appropriately.
5. Based on financial data that can be read from the financial statements and financial indicators that are from the financial statements prepared by the management of the company, by the support of increasing the knowledge to measure the restoration of the financial situation, it becomes possible to improve the restoration of financial situation and accuracy of the publicly disclosed data.
6. By introducing a credit management system that simplifies the loan screening operation and simplifying and streamlining the in-line settlement system, it will be possible to reduce the cost associated with loan screening process.

(End)

4. Individual Company Visits

Individual company visit survey overview

For individual visit survey, questionnaires are in the appendix.

= Individual company visit survey summary =

Survey period: May 25 - June 18, 2018

Number of sample companies: 30 companies / 550 companies¹⁰

Company scale: From 4 to 1700 employees

Survey method: Company visit and interview directly

Interview content:

Regarding the content of interviews, each company interviewed according to the characteristics of the company and also asked common questions with the following contents:

1. Whether there is long-term mid-term business plan of the company, whether it is shared with employees or not
2. Seminars for staff, training, detailed contents
3. About the decision making process
4. Do you have a system that to listen opinions from staff and implement the idea?
5. Is there a resistance to disclosure of information? Is there homepage, SNS etc.? For example, is it possible to publish financial statements submitted to the National Tax Office etc.?
6. How do you think about the accuracy of financial statements, do you think it will be useful for loans from banks, soft loans from the government, preferential tax treatment, etc.?
7. Are there preparations to hand over to the next generation (to ask a question based on the age of the manager)

=Visit Survey Summary=

Many opinions mainly from young managers about corporate efforts that, “It should be done if able to do”, but due to the following reasons, efforts on corporate governance as a company is not well penetrated, except for some companies.

- There is no need to urgently optimize corporate governance.
- There are no expert people or knowledge exist to optimize corporate governance.
- I do not feel the merit of optimizing corporate governance

For these reasons, we cannot establish an in-house system to optimize corporate governance. For these reasons, we cannot establish an in-house system to optimize corporate governance. On the other hand, companies are implementing employee education, publicizing and sharing the vision of the company, and some companies disclose their financial situation and financial statements. By doing so, for establishing corporate governance in Mongolian

¹⁰ Here mentioned 550 is the total number of survey responded companies

companies, there is something that can be definitely benefited as a company, for the enterprise, it is hypothesized that a social system that clearly benefits must be established. What was impressive in the interview survey on corporate finance is that all the company has complains about business loans of commercial banks. The business loan currently presented by Mongolian commercial banks has interest rates of around 20% per annually and the longest period is five years. For this reason, it is impossible to borrow from the bank to operate the project stably, and generate profits. In addition, several companies have responded that they have dissatisfaction about the bank's procedures being complicated and not being able to process loans smoothly to fulfil fund demand. Therefore, it is said that they are receiving funds from funding sources such as non-banks with high interest rate. In addition, many companies emphasized that it is difficult to conduct business in foreign countries due to exchange rate fluctuations caused by Mongolian government's unstable policy. Therefore, as the credit information system that can be used by private financial institutions and registered entities does not exist, it is difficult to get funds in Mongolia. Some companies emphasized that the Mongolian government should introduce a credit guarantee system.

For getting investment from abroad:

- Stable exchange rate

(As exchange rate of MNT is not stable, foreign exchange risk involves a lot in order to receive funds in foreign currency, including banks)

- Protection of foreign investors
- Tax exemption for foreign investment

(In the current legal system, as non-residents receive dividends in Mongolia, 20% is taxed, it becomes considerably big burden in countries like Japan where a double taxation treaty is not yet concluded)

It seems that it is important to indirectly take measures to support industries like above.

(End)

2. Response to Self-assessment Sheet at the Workshop on Corporate Governance

Question	Category	Answer		
		Yes	No	will consider in the future
1	Vision and Mission	19	2	12
2	Planning and Monitoring	20	5	8
3		28	1	4
4		24	1	8
5		13	7	13
6		19	6	8
7		29	3	1
8		19	8	6
9	Decision Making	18	9	6
10		23	6	4
11	Compliance	28	2	3
12		24	3	6
13		27	4	2
14	Ethics	20	6	7
15	Family Business (Succession)	9	17	7
16		16	8	9
17		11	16	6
18	Employees	24	6	3
19		17	5	11
20		23	4	6
21	Stakeholders	26	0	7
22	Risk Management	17	4	12
23	Transparency and Disclosure	15	13	5
24		28	3	2
25	Environment	31	1	1

Source: JICA Survey Team

3. Shelf-assessment Sheet

	Corporate Governance Self Assessment Sheet	Yes	No	will consider in the future	Category
		(4 点)	(0 点)	(1 点)	
1	Our company has a written Vision, Values, and a Mission and employees acknowledge them.				Vision and Mission
2	Our company has a 3-5 years business plan.				Planning and Monitoring
3	Our company has a clear organizational chart.				
4	Management understands own company's SWOT and current situation of industries to which the company belongs.				
5	We have back up personnel for our key management people				
6	A system to monitor and evaluate operational results by management.				
7	Before borrowing from a bank, we plan the use of proceeds and build a repayment plan.				
8	We use an accounting software.				
9	Decision making is not concentrated in one person.				Decision Making
10	We have a clear division of authority among shareholders and key management				
11	Avoids bribery and corruption and other illegal activities				Compliance
12	Files corporate income tax, social insurance fees on time.				
13	Submits financial statements which are based on correct accounting information to the Tax Authority and the Ministry of Finance				
14	Has a written policy or rule on moral actions and ethical behavior and employees acknowledge them.				Ethics
15	There is a clear plan for succession				Family Business (Succession)
16	The owner has a clear distinction between the finances of his business and family.				
17	Clear policy on the employment of family members of the owners and management.				
18	Every employee is given a role and responsibility depending on their skills and position.				Employees
19	Company has a system to collect opinions from employees to their managers regarding operation.				
20	Company has work regulation and labour contract with all employees.				
21	We operate to earn the understanding and satisfaction of our clients and other stakeholders.				Stakeholders
22	We try hard to predict various risks and mitigate them before they realize.				Risk Management
23	We have disclosed company information on own Web page (or Facebook, Twitter, National Industrial Database, etc.)				Transparency and Disclosure
24	Company discloses all data correctly and completely upon request from customers, suppliers, banks and/or Government organizations				
25	We try to minimize the usage of energy and water, pollution, and waste water.				Environment

