



Proposed Currency Regulation Act may lead to capital controls

The proposed Currency Regulation Act may lead to eventual introduction of capital controls in Mongolia

On 19 Oct 2018, the Mongolian Parliament have voted in favor of considering a new Currency Regulation Act. The proposed Act has been developed by Central Bank of Mongolia and is sponsored by several MPs. If adopted, the bill will replace the existing Currency Regulation Act adopted in 1994. The 1994 Act has effectively provided for a liberal regime for foreign exchange, including floating exchange rate, open conversion into any other currency and repatriation of any type of funds, profits, revenues, loan repayments, lease payments etc.¹

This advisory highlights two specific clauses of the proposed bill (the “**Bill**”).

1. Article 16.2:

Art. 16.2 of the Bill reads: “*The Central Bank may impose restrictions on [banking] transactions in foreign currency [between a resident and a non-resident] ... for definite time period in order to ensure financial stability and macroeconomic policy and to reduce dollarization [in the economy] and the Central Bank, to this end, shall adopt a relevant regulation”.*

The foregoing clause, if enacted, would appear to vest the Central Bank of Mongolia with a statutory power to restrict, via an administrative regulation, banking transactions involving a foreign currency. For instance, outgoing transfers in a foreign currency might be restricted under the forthcoming Central Bank regulation - e.g., limiting amount or frequency of, or deferring (rescheduling), a transaction.

Art.16.2 contains three qualifications to the restrictions that may be introduced by the Central Bank. In particular, the restriction must:

- 1) have the objective of reducing dollarization of the Mongolian economy, and
- 2) have the objective of safeguarding macroeconomic and financial stability, and
- 3) be temporary duration-wise.

According to the sponsors of the Bill, the restriction against foreign currency transactions under Art.16.2 would only be triggered by the Central Bank to intervene in

¹ We note that according to Art.11.2.2 of the existing Currency Regulation Act, a Mongolian commercial bank has an obligation to perform a “*transaction [e.g., repatriation] which might impact the rate of Mongolian national currency upon the Central Bank’s [prior] authorization”.* However, we note since the date of the Act (i.e., 1994), the Central Bank has not had to issue the authorization under the foregoing clause.

circumstances of short-term currency volatility or market distortion, leading to sharp devaluation of the national currency or to a drop in foreign reserves (which did occur in Mongolia in recent years).

Meanwhile, businesses and trade associations in Mongolia have voiced their concerns about the potential impact of the restrictions to be introduced under Art.16.2 of the Bill. According to them, Mongolia has had no capital controls under the existing regulatory regime, which has been an important feature of Mongolia's investment and business environment. If adopted, the restriction under Art.16.2 of the Bill might affect not only outgoing, but also incoming transfers of foreign currency by discouraging foreign investment.

If enacted as currently drafted, of the Bill the Central Bank of Mongolia would publish a regulation which would presumably contain details of restrictions under Art.16.2. Doubts have been expressed as to whether the Central Bank would wield its new statutory power on a weak basis or in a politically motivated way.

Finally, the Bill permits the Financial Regulatory Commission of Mongolia to “*impose restrictions on a transaction which will affect the exchange of [Mongolian national currency]*” (Art. 17.1.3 of the Bill). FYI, the Financial Regulatory Commission is the regulator of capital markets and non-bank financial institutions.

Overall, it is our observation that the foregoing Art.16.2 and Art.17.1.3 of the Bill may, if passed by the lawmakers, **lay the foundation for introducing capital controls in Mongolia.**

We note that the Bill is only under discussion by the Mongolian Parliament and has not been adopted yet. In our view, however, the Bill would eventually be enacted by the Parliament, likely within 2018. It is further possible that in the light of the concerns expressed by various stakeholders over Art.16.2, the restriction thereunder may be watered down or removed altogether as the legislature discusses the Bill.

2. Article 10.4:

Art. 10.4 of the Bill reads: “*The Central Bank may operate a foreign currency-denominated account as well as settle payments through that account, upon mutual accord with a non-resident strategic investor whose investment is critical to Mongolia's economy and budget revenues*”.

According to the sponsors of the Bill, the foregoing clause would require a mining company with foreign investment operating a so-called “*mineral deposit of strategic importance*” in Mongolia to open and maintain an account with the Central Bank.²

In particular, the foregoing requirement in Art.10.4 appears to directly target Oyu Tolgoi LLC, a copper and gold mining company in Mongolia and a joint venture of Rio Tinto and the Government of Mongolia. Oyu Tolgoi LLC owns and operates the Oyu Tolgoi Deposit, one of the largest high-grade copper deposits in the world and a “*mineral deposit of strategic importance*” for the Mongolian law purpose. Once fully operational, Oyu Tolgoi LLC would contribute up to a third of Mongolia’s GDP.

Oyu Tolgoi LLC (and other large foreign investment businesses in Mongolia) have long been called on by the Mongolian Government to channel their finances and sales revenues through local commercial banks in order to boost Mongolia’s foreign reserve. Understanding that the key reason for hesitancy of Oyu Tolgoi LLC (and other operators of “*mineral deposits with strategic important*”) to do so was the overall weak commercial banking system in Mongolia, the Bill attempts to introduce an acceptable solution to Oyu Tolgoi LLC (and other operators of “*mineral deposits with strategic important*”) - instead of a commercial bank, Oyu Tolgoi LLC would bank with the Central Bank of Mongolia by setting up an account with it.

Our observation is that the banking requirement under Art. 10.4 of the Bill may, if passed, contradict the very role of a central bank– that of overseeing the monetary system. In particular, the Bill would make the Central Bank to perform banking services of a commercial bank vis-à-vis Oyu Tolgoi LLC – such as holding foreign exchange, or carrying out cash transactions and settlements of a customer (Oyu Tolgoi LLC).

As noted above, the Bill is under discussion by the Parliament and is yet to be adopted. In our view, however, the Bill would eventually be enacted by the Parliament, likely within 2018.

KhanLex Partners will continue updating its clients on further developments with the Bill.

² FYI, “*a mineral deposit of strategic importance*” is defined in Mongolian law as a mineral concentration whose production has a potential impact on national security, economic and social development of Mongolia at national and regional levels or deposits which produce, or have potential of producing, above 5 (five) percent of total GDP of a given year. (Art. 4.1.11 of Minerals Law of Mongolia).

If you wish to receive further information about the proposed currency regulations in Mongolia, please contact Mr. Enkhbat Batsukh (Partner), tel: (+976) 9911 1061 (m), (+976) 7747 1122 (o), email: EnkhbatB@KhanLex.mn.

Our contact details:

KhanLex Partners LLP law firm
Suite 1404, Level 14, Ayud Tower
Olympic Street – 5, Sukhbaatar District
Ulaanbaatar 14240, Mongolia
Tel: (+976) 7747-1122
info@khanlex.mn
www.khanlex.mn (*under construction*)