

Mongolia Introduces a Mandatory Deposit Insurance Scheme March 2013

On 10 January 2013, the Parliament of Mongolia adopted the Law on Insurance for Bank Deposits ("**Deposit Insurance Law**") with effect on the same day.

The Deposit Insurance Law establishes a mandatory insurance scheme for the protection of bank deposits. The insurance programme replaces a blanket deposit guarantee issued by the Government of Mongolia under the Law of Mongolia on Issuing a Guarantee for Savings held at Banks dated 25 November 2008 ("**Deposit Guarantee Law**"). Such blanket guarantee had been issued for the purpose of banking stability and reassuring bank customers amidst the financial crisis in 2008. The Deposit Guarantee Law had been in effect for four years and expired on 25 November 2012. The blanket guarantee provided a generous insurance scheme at the state's cost and was intended to be replaced with a more market-based insurance scheme similar to that adopted in other jurisdictions.

Below is a brief summary of the main contents of the Deposit Insurance Law.

MANDATORY INSURANCE SCHEME AND ITS MANAGEMENT

The Deposit Insurance Law requires all Mongolian banks that are licensed to carry out activities for deposits and payment settlement services to join the deposit insurance scheme upon the payment of the applicable premiums.

Such mandatory insurance scheme will be operated by the so-called Deposit Insurance Corporation ("**Corporation**"), whose mandate is to carry out the compulsory deposit insurance activities set out in the Deposit Insurance Law and manage the Deposit Insurance Fund ("**Fund**"). The Corporation will be a non-profit state-owned company. The Deposit Insurance Law is silent on the capitalisation requirements and shareholding structure of the Corporation.

The highest governing body of the Corporation will be the National Committee ("**Committee**"), consisting of seven members. The National Committee has certain regulatory powers under the Deposit Insurance Law for issuing implementing regulations on matters such as of investments by the Fund, providing financial assistance to banks, exchange of information with banks, compensatory payments and the like.

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The main sources of Fund's revenue include:

- (i) commissions paid by the banks under the Deposit Guarantee Law;
- (ii) initial capital contributed from the state budget and the Bank of Mongolia;
- (iii) deposit insurance premiums;
- (iv) income from the sale of assets of liquidated banks; and
- (v) bonds issued by the Corporation.

Further, the law provides that the Fund's revenue can only be used for the following purposes:

- (i) compensation for depositors;
- (ii) financial assistance to banks receiving deposits from liquidated banks;
- (iii) the operational expenses of the Corporation; and
- (iv) payment of interest and fees on loans borrowed or bonds issued by the Corporation.

Further, the Deposit Insurance Law restricts the types of investment that may be made by the Corporation to reduce investment risk and ensure returns.

INSURANCE PREMIUMS

The principal source of the Fund's revenue are premiums payable by banks, which comprise the following:

- (i) an initial premium;
- (ii) a quarterly premium; and
- (iii) a special premium.

The initial premium is 1 percent of the share capital of the relevant bank.

The quarterly premium rate is to set by the National Committee for each bank depending on its risk level in the form of a percentage by reference to the average aggregate amount of deposits held at the relevant bank prior to the beginning of each quarter (excluding those deposits that are

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not covered by the deposit insurance scheme). The maximum rate for any bank will not exceed 0.125 percent of the deposited amount.

Furthermore, the National Committee may suspend the requirement to pay the quarterly premium if the total amount of the Fund reaches 10 per cent of the all deposits held with member banks.

The special premium can be called for when the Fund's reserves are not sufficient to cover all compensation payments declared by the National Committee. The special premium shall be calculated by multiplying the average amount of all deposits in a relevant bank by the special premium rate, which shall not exceed 0.5 percent.

PAYMENT OF COMPENSATION

A decision by the Bank of Mongolia to liquidate a bank constitutes an insurance event which triggers payment of compensation to depositors under the Deposit Insurance Law. Such compensation is payable by the Corporation in an amount up to MNT 20,000,000 (approximately US\$ 14,285) per person/entity, regardless of the total amount of deposits held by such person/entity. This constitutes a considerable reduction on the coverage afforded under the Deposit Guarantee Law which obliged the Government of Mongolia to compensate depositors for all losses.

EXCLUSIONS

The following deposits are excluded from the insurance programme:

- (i) deposits that are opened anonymously, using serial numbers or which are opened by persons specified in Article 4.1 of the Anti-Money Laundering and Terrorism Financing Law;
- (ii) bearer saving certificates or other bearer financial instruments; and
- (iii) deposits that will not be repaid at nominal value (non-nominative savings).

The Deposit Insurance Law sets out those persons whose deposits will not be covered by the insurance programme, which include:

- (i) banks and their related parties as specified under relevant legislation;
- (ii) central and local government; and
- (iii) health, pension or social insurance funds.

CONCLUSION

Whilst the Deposit Insurance Law provides a more limited deposit insurance scheme in comparison with the blanket deposit guarantee, the adoption of the Deposit Insurance Law is clearly a further step toward providing a market-based regulatory environment. At this stage, the Deposit Insurance Law has yet to be implemented and the Corporation is yet to be established. This will be achieved by forthcoming implementing regulations. Such mandatory insurance scheme will certainly be costly for the commercial banks and these costs will most likely be passed onto bank customers.

If you would like further information on any aspect of this note please contact a person mentioned below or the person with whom you usually deal:

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