The AMERICAN CHAMBER of Commerce in Mongolia

POSITION PAPER ON MAINTAINING ACCESS TO USD CLEARING

Ulaanbaatar 2018

AmCham Mongolia's Position Paper
Maintaining Access to USD Clearing

Through its Financial Services Committee, AmCham Mongolia has developed a policy paper on maintaining access to USD clearing. The policy paper outlines key challenges in regards to maintaining access to USD clearance, and suggests solutions to the government and regulators to address these issues in order to maintain, or even increase, access to USD clearing.

AmCham Mongolia, primarily through its Financial Services Committee, stands ready to discuss the challenges and suggested solutions with the authorities concerned to ensure that necessary actions are taken to minimize risks, avoid potential negative impacts, and to improve the situation.

The paper was prepared by AmCham Mongolia's Financial Services Committee, under the supervision of its chairman, AmCham Board Member Erik Versavel, and authored primarily by Torsten Kleine-Buening and Daniel Mahoney, members of the Financial Services Committee. The Financial Services Committee operates under the supervision of the AmCham Board of Directors.

Introduction

Mongolia's open and export-oriented economy, with a cumulative trade turnover of 10.5 billion USD (as of December 2017) and foreign trade surplus of 543 million USD paid in hard currency in the first four months of 2018, its capital flows and economic growth prospects depend on reliable access to USD clearing. While the issue is phrased in this paper as "USD clearing", in fact, the termination of clearing services provided to Mongolian banks also impacts the ability to clear (transfer in and out of Mongolia) euro, yen, and other international currencies.

Mongolian banks face increasing challenges maintaining access to USD clearing services due to the recent de-risking by international banks, which have pulled back from offering USD clearing services. On a global scale, Mongolian banks do not generate enough transaction fees to justify the compliance risks and potential fines.

Mongolia is perceived as a compliance risk by international banks due to the pending Asia/Pacific Group on Money Laundering report, which could result in a grey-listing of Mongolia, and due to the limitations Mongolian banks face when attempting to implement effective compliance controls and measures. This position paper outlines the key challenges and suggests solutions which would enable Mongolian banks to implement effective controls and measures, and by that, to maintain or even increase access to USD clearing.

The American Chamber of Commerce and its Financial Services Committee stands ready to discuss these suggested solutions with the relevant authorities, as the loss of USD clearing would not only affect banks, but would undermine the recent economic recovery and economic future of Mongolia.

Export-Oriented Economy and Trade Flows

Mongolia has extensive mineral deposits, e.g. copper, coal, gold, iron, and molybdenum, which account for a large part of Mongolia's industrial production. Mining is the principal industrial activity in Mongolia, making up 30% of all Mongolian industry. Another important industry is the production of cashmere, with Mongolia's cashmere output accounting for more than 1/5 of the global market.

The economy of Mongolia has been recovering since 2017, reflecting stronger international demand for commodities and improving confidence; key macro-economic quantitative targets, including the increase of net domestic and foreign assets, and foreign currency reserves (in USD), have been achieved. Fiscal and public debt metrics are on the way for further adjustments toward their programmed targets. The recent economic recovery to 5-6% GDP growth and the increase in business confidence will further expand capital flow prospects, and increase international transactions settled, especially, in USD.

While Mongolia benefits from the export of mineral products, at the same time it depends heavily on foreign direct investment, which is commonly provided in USD, and on the import of consumer goods, heavy machinery, and industrial input materials for local industry, which are usually billed in USD.

In the past 10 years, over 80-90% of total trade turnover was settled in USD. Mongolia's external financial account transactions directly affect its trade in goods and services, so issues affecting USD transactions through direct investment, portfolio investments and other investment can easily disrupt USD transactions via the import of goods and services.

As of now, Mongolian banks still have the ability to support trade flows with foreign partners through USD clearing, however, any interruption would adversely affect the economy, the state budget, and the overall economic wealth of Mongolia.

De-Risking

Since 2003, international standards and requirements for compliance, specifically Know Your Customer (KYC) and Anti-Money Laundering (AML), have significantly increased. International banks have paid material fines and, in some cases, even lost their license to clear USD after having been found to have violated these standards and requirements.

Therefore, international banks, especially U.S. banks, have pulled back from so-called correspondent banking, that is, to provide clearing services to third-party banks that do not by themselves have USD accounts in the U.S. This de-risking has left Mongolian banks with limited options. Mongolian banks have to route USD transactions through, for example, Chinese, Russian, or Korean banks.

It must be expected that even these banks will initiate de-risking if the Asia/Pacific Group on Money Laundering does not provide Mongolia with a clean bill of health in June 2019. Even if Mongolia is grey-listed, commercial banks can still keep their CBRs with Mongolian banks if they want, but the legal liability would be high.

Further, there is the real risk that those international banks would pull back completely from Mongolia even if Mongolia was not grey-listed, given the perceived weaknesses in Mongolia's compliance framework.

Know Your Customer and Anti-Money Laundering

Under Mongolian laws and regulations, banks must assess a customer's risk level and perform enhanced due diligence for high-risk customers.

This requires banks to gain information on the customer, the ultimate beneficial owner, the beneficiary of any transaction, and the underlying transaction itself. Under enhanced due diligence, banks are required to gain information related to the customer's business, source of funds, and the purpose of the intended transactions. Furthermore, banks shall take measures to verify such information.

In order to prevent money laundering, banks have the duty to deny banking services if the customer refuses to provide the required information, as well as to certain parties included in specified sanctions lists. Banks should further deny services, if the information received indicates criminal or illegal conduct.

Finally, banks are required to report any suspicious transactions to the authorities for further inspection without informing the customer, as that action would amount to tipping off the customer (which in itself is a crime).

Grey-Listing and Risk Indications

In 2016-17, the Asia/Pacific Group reviewed Mongolia and noted that Mongolia is exposed to a range of money laundering threats and vulnerabilities.

Higher-risk predicate offences are fraud, environmental crimes, tax evasion, and corruption. Moderate-risk threats include drug offenses, smuggling, organized crime, the violation of banking regulations, theft and burglary, and risk from foreign proceeds. The proceeds generated from these predicate crimes are mostly laundered in Mongolia, with some proceeds, particularly from corruption, being laundered offshore.

As a consequence, the Asia/Pacific Group indicated that, if the aforementioned issues were not addressed, Mongolia would be grey-listed along with countries like Nigeria, Cuba, and Sri Lanka. The Mongolian government and authorities have initiated a comprehensive action plan to address the concerns of the Asia/Pacific Group.
Despite the comprehensive action plan, key risk indications prevail, i.e.

- Limited legal clarity and comfort for banks to freeze and close accounts, thereby effectively denying services;
- Limited enforcement of corruption, bribery and money-laundering cases through the judiciary system;
- An unchanged, high level of corruption and bribery, as reflected in a Corruption Index score of 103 (out of 180) and a Corruption score of 36 (out of 100) as per Transparency International.

Challenges and Solutions

Banks and non-banking financial institutions face various challenges in the implementation of effective controls and measures to perform KYC and to prevent money-laundering.

Customers perceive measures as unjustified and unnecessarily intrusive, while banks face prosecution and, ultimately, fines and sanctions, if they fail to act on implementing effective controls and measures.

Moreover, different competent supervisory and regulatory bodies provide contradicting guidance and, in some cases, even undermine effective compliance controls and measures.

The list below provides an overview on the main challenges and potential solutions.

Challenge: Effective conduct of KYC procedures
Solution: Revision of relevant laws and regulations to mandate that banks request comprehensive information (especially on ultimate beneficial ownership, source of funds, and money laundering policies, where applicable) and to require that customers provide such information (or else lose access to the requested financial services).

In addition, to provide a list of specific items banks can or, even better, must require – the list should include, among other requirements, confirmation that clients are in line with tax requirements and full disclosure on their ownership structure to include determination of the ultimate beneficial owner.

Challenge: Effective conduct of KYC procedures
Solution: Revision of the AML Law and promulgation, if needed of related implementing regulations to clarify "denial of services" as an unilateral authority of banks to immediately freeze accounts and to close accounts with a lead-time of 30 days, without recourse for clients on account of compliance issues.

Challenge: Enhanced clarity and authority on the source of funds
Solution: Revision of relevant laws and regulations to provide banks with a strong mandate to acquire source of funds information and to require customers to provide such information (or else lose access to the requested financial services). Furthermore, to clarify what such information on source of funds should incorporate.

Challenge: Transparency on Politically Exposed Parties
Solution: The Anti-Corruption Agency should provide banks with transparency on the list of Politically Exposed Persons in Mongolia, consistent with the requirements stipulated under the AML Law and the Law of Mongolia on the Regulation of Public and Private Interests and Prevention of Conflicts of Interest in Public Office.

Challenge: Consistent guidance and effective enforcement
Solution: Specifically, the Bank of Mongolia, Financial Regulatory Commission, Anti-Corruption Agency and the court system need to demonstrate and implement a consistent approach. In addition, policy makers need to demonstrate clear support for effective controls and measures.

Central and Eastern European countries such as Bulgaria, Ukraine, and the Czech Republic have gone through similar transition periods, adopting sound standards and practices matching international best practices and requirements. The Mongolian authorities might be best guided to seek technical assistance from such countries specifically.

The above suggested solutions should be completed with measures to ensure effective enforcement and supervision, both for the financial sector and on the client side. Such measures would address a key concern of the Asia/Pacific Group and the U.S. authorities and banks.
The timely implementation of the above outlined solutions increase Mongolia's chance to maintain access to USD clearing services, thereby ensuring Mongolia's access to foreign investment, trade, and capital flows.

Summary

An export-oriented and foreign direct investment-driven economy like Mongolia depends on reliable access to USD clearing services. Continued risks in USD clearing threaten the country's export potential, investment outlook, and overall economic prospects. Therefore, it is of the utmost importance for financial institutions (and state bodies) to establish a reliable system of controls and measures, allowing them to identify unusual money flows and transactions even when criminal elements are, to the best of their ability, attempting to circumvent rules.

Recent incidents indicate that international banks will not await the final report and assessment by the Asia/Pacific Group, and there is concern that anything less than a clean letter of health will put access to USD clearing services at risk.

Even if Mongolia is able to meet the minimum standards established by the APG, as reflected through a clean letter of health in June 2019, international banks will continue to have concerns that they would be at risk of fines and sanctions, when dealing with Mongolian banks and non-banking financial institutions.

Ways Forward

AmCham Mongolia and its Financial Services Committee stands ready to discuss the solutions suggested above and urges policy makers and state authorities to address the identified challenges well before June 2019.

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