MONGOLIA:

STRENGTHENING THE LEGAL FRAMEWORK FOR NON-PERFORMING LOANS RESOLUTION AND DEBT RESTRUCTURING -

GAPS IN MONGOLIAN LAWS

Prepared by KhanLex Partners LLP

Contents

GLOSSARY

- ADB – Asian Development Bank
- ADR –Alternative Dispute Resolution
- BoM – Bank of Mongolia
- CDRC - Corporate Debt Restructuring Committee
- Consultant - KhanLex Partners LLP of Mongolia
- CPC - Civil Procedure Code of Mongolia
- EBRD – European Bank for Reconstruction and Development
- LECD - Law on Enforcement of Court Decisions
- LCIP - Law on the Collateral of Immovable Property
- LDLP - Law on Deposits, Loans and Payment Transactions by Banks and Other Authorized Legal Entities
- LPMIP - Law on Pledge over Movable and Intangible Property
- LVA – Law on Valuation of Assets
- NBFI – Non Banking Financial Institution
- NPL – Non-Performing Loans
- Report - Findings and recommendations of the Consultant
- SRO - State Registration Office
- USD – United States Dollars
- WB – World Bank

BACKGROUND

In 2017 the BoM of Mongolia set up a working group (the "**Working Group**"), comprised of several key stakeholders, including the Ministry of Finance of Mongolia, the Ministry of Justice of Mongolia and the Mongolian Bankers' Association, tasked with the preparation of the NPL resolution strategy (the "**NPL Strategy**"). The implementation of the NPL Strategy will require a supportive legal and regulatory framework, particularly in the area of enforcement, restructuring and bankruptcy. According to the NPL Strategy, in the first quarter of 2018, the amount of NPLs in the Mongolian banking sector reached 1.1 trillion togrogs, which make up 3.7% of total assets and 7.6% of the outstanding balance of loan debts. Within this aggregate figure, there is a greater concern about the level of corporate NPLs, which is significantly higher than the level of retail NPLs.[1]

In addition, the BoM has been supporting the Mongolian Bankers' Association in the creation of a private-sector Corporate Debt Restructuring Committee (the "**CDRC**") to deal with the large debt burden of SMEs and other corporations. The CDRC will provide a platform for the companies and their lenders to work out feasible multi-creditor debt restructurings without resorting to legal proceedings or bankruptcy. The ADB has been assisting the BoM with the set-up of the CDRC.

In addition, the BoM is exploring the creation of an asset management company to take over significant amounts of NPLs from banks for ultimate disposal. ADB has drafted an initial draft law related to the asset management company, which is currently being considered by the Mongolian Government.

The EBRD has appointed KhanLex Partners LLP law firm (the "**Consultant**") to carry out the tasks set out in the Terms of Reference (the **"TORs"**).

Under the TORs, the general objective of the Consultant is to support the BoM and the Working Group in developing the necessary amendments to the existing legal and regulatory framework for the successful implementation of the NPL Strategy and the CDRC framework. In order to do this, the Consultant's assignment consist of three distinct yet related phases - (i) drafting and presenting the Report containing the proposed legislative amendments, (ii) making necessary revisions to the proposed legislative amendments *after* discussions with the Working Group, and (iii) engaging with stakeholders and active participation during the legislative process.[2]

[1] Analysis of NPL corporates to be discussed with BoM. According to the NPL Strategy, as of the end of December 2017, 7.2% of corporate loans and 3.3% of personal loans were classified bad loans, respectively.
[2] The detailed TORs are annexed to this Report (note: to be annexed).

INTRODUCTION

The Report for the Consultant is to support the BoM and the Working Group in developing the necessary amendments to the existing legal and regulatory framework in Mongolia for the successful implementation of the NPL Strategy and the CDRC framework. The amendments are largely aimed at corporate sector NPLs, which account for the majority of NPLs in banks' portfolios. We understand that the existing target date for adoption of legislative amendments to strengthen the enforcement of creditor rights is November 2018.

To prepare the Report, the Consultant has used the following methodology –

- Review of the existing literature on the subject matter. Such literature largely consists of the reports prepared with the support of development agencies. In particular, the following reports were reviewed - "*Final Report Mongolia: Reforms for Secured Credit and Debt Recovery*" (2011, WB), and (ii) "*Enforcement of Collateral and Reform of the Relevant Laws in Mongolia: Final Report*" (2012, ADB). Both reports conclude that the Mongolian legislation is inadequate for efficient NPL resolution.

- Meetings with Mongolian experts to discuss the matters covered in the Report. These include bankers, banks' in-house legal teams[3], as well as authorities, such as the judiciary, enforcement agents (bailiffs), the Constitutional Court of Mongolia and the Justice Ministry of Mongolia. The Consultant also met a representative of the International Finance Corporation ("**IFC**"), which is assisting the Government of Mongolia with preparation of a new Bankruptcy Law which is expected to come into force by March 2019[4].

- Review of international documents frequently referred to in connection with enforcement and restructuring including: (i) the World Bank's "*Principles for Effective Insolvency and Creditor/Debtor Regimes*" (last revised in 2015)[5], (ii) "*The UNCITRAL Legislative Guide on Secured Transactions*" (2010) by the UN Commission on International Trade Law[6], and (iii) "*Statement of Principles for a Global Approach to Multi-Creditor Workouts*" (2000) by INSOL International (a federation of national associations for accountants and lawyers who specialize in turnarounds and insolvency)[7].

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[3] Legal teams of Khan Bank, Golomt Bank, Trade and Development Bank, Xac Bank, National Investment Bank, Ulaanbaatar City Bank, State Bank, Credit Bank, Capitron Bank, Mongolian Mortgage Corporation and Deposit Insurance Corporation.

[4] We understand that the Bankruptcy Law will be redrafted in full and that a first draft is expected to be shared with the Ministry of Justice in September 2018.

[5] http://pubdocs.worldbank.org/en/919511468425523509/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2016.pdf.

[6] https://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf.

[7] https://www.insol.org/pdf/Lenders.pdf.

- Review of the Mongolian laws (statutes) pertaining to debt collection, creditor-debtor relations and collateral enforcement. The laws reviewed by the Consultant include, among other matters, the Civil Code, the CPC, the LECD (regulating the bailiff-led enforcement), the Law on Registration of Rights over Immovable Property, the LCIP and the existing Bankruptcy Law.[8] The Consultant has also sought expert tax advisory input on the Value Added Tax and Corporate Income Tax laws.

The Report consists of four chapters.

Chapter One analyses legal obstacles to successful judicial enforcement of NPLs in Mongolia. In doing so, Chapter One is divided into two sub-chapters – any judicial NPL resolution under Mongolian law consists of two distinct sequential phases:

1) obtaining a court judgment on debt recovery under civil procedure rules. Under Mongolian law, most NPL cases go to the judiciary for resolution, i.e., NPL resolution is mostly in-court[9].

2) enforcing the court judgment and any security interests over property. This state enforcement is carried out by a State bailiff agency, called the "General Department of Enforcement of Court Decisions of Mongolia". The General Department of Enforcement of Court Decisions is separate from the judiciary – it is considered to be part of the executive branch and operates as an executive agency under the Justice Ministry of Mongolia.

Therefore, Chapter One reviews the obstacles in the key laws which govern the above two stages - the CPC which governs the judicial process for enforcement and the LECD which governs the bailiff enforcement process.

Chapter Two discusses legal obstacles to the enforcement of collateral. In particular, it highlights gaps in the legal environment in conducting forced sale (auction) as well as voluntary auction of collateral. The concept of a negotiable instrument -"*baritsaalbar*" - is discussed, too. It also considers the interplay between secured creditors' enforcement rights and the Bankruptcy Law.

Chapter Three briefly focuses on the options for voluntary out-of-court resolution of NPLs available under Mongolian law. Specifically, legal obstacles to effective application of the two available options - arbitration and mediation – are discussed.

Finally, Chapter Four reviews gaps in Mongolian law hindering effective operation of CDRC.

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[8] To the extent possible, we propose to review the new Bankruptcy Law when it is available. In the meantime, we have shared some of our main areas of concern with the IFC team.

[9] Out-of-court resolution methods are available for certain types of security interest, but their use has so far been limited, as discussed further in the Report

Specific recommendations for legal amendments to deal with each of the main obstacles are contained in the executive summary and at the end of each Chapter. In addition, the end of Chapter Four highlights areas where extra-legislative reforms and support would be needed to tackle NPLs.

EXECUTIVE SUMMARY

№	RECOMMENDATION	REFERENCE
	Amendments To The Enforcement Framework	
1.	Introduce, in the CPC, expedited "summary court proceedings" for debt recovery. Under summary proceedings, the court would review, and base its decision, only on affidavit evidence and issue a decision on the claim within a certain date (e.g., fifteen days). The proposed summary proceeding is new and is different from the already existing simplified procedure under CPC. The summary process would be restricted to ["commercial debtors" and/or to loans below a certain threshold][10]. Therefore, the concept of a "commercial debtor" (vs. a consumer debtor) would need to be introduced, being a debtor, which is either a legal entity or individual, which/who procures credit for business purposes. Further changes within the court system to promote a core number of judges trained and specialised in different regions tasked with managing NPL cases should be considered in parallel.	Point 1 Page 12-13 Point 8 Page 17-18 Point 27 Page 70
2.	Introduce, in the CPC and in the Law on Misdemeanours, an express obligation of parties to a civil procedure, including specifically their counsel, not to file appeals which are frivolous, vexatious, or an abuse of process. Currently, there is no concept of "frivolous" or "vexatious" or similar appeal in Mongolia. "Frivolous" would be where the first instance court's decision is plainly and clearly correct so that there is really no appealable issue. Another criterion would be the appealing party's argument appears for the sole purpose of delay (or other inappropriate purpose such as harassment). The final criterion would be the intent – the appealing party must knowingly appeal, i.e., knowing the criteria above. Breach of such obligation would constitute an abuse of justice and a corresponding legal liability would be introduced in law. It is suggested that such liability be an economic sanction and training of judges be conducted to ensure that the sanction is applied in practice. Similarly, we recommend legislating for a right of the counterparty (suffering from an abuse of justice) to seek from the delaying party compensation for any damage suffered as a result of the delay.	Point 1, 5-7, Page 16-17
3.	Consider limiting the grounds for appeal in the CPC [for commercial parties][11] in order to reduce the significant delays caused by appeals in enforcement proceedings to the appellate court by either: (i) limiting by statute the grounds upon which a party can challenge an enforcement action (e.g. the enforcement title cannot be challenged if it meets certain requirements set forth by law); or (ii) requiring the	Point 2, 4, 12 Page 13-15, 22

[10] To be discussed with BoM. This procedure should also be broadly in line with any expedited recovery procedure under the proposed AMC Law.
[11] To be discussed with the Bank of Mongolia.

№	RECOMMENDATION	REFERENCE
	claimant to seek permission to appeal for enforcement-related claims where the value or the amount of the claim is below a certain amount[12] or where the only issue in the appeal relates to costs or fees for hearing dates. With respect to appeals to the Supreme Court consider requiring the appellant to demonstrate that any appeal to the Supreme Court is based on a question of law[13]. Generally the suspensive effects of certain appeals should be removed to ensure that enforcement will go forward (for example, an appeal to dispute the calculation of interests accrued cannot interrupt enforcement proceedings).	
4.	Introduce, in the CPC, a requirement for appellants to place supersedeas bond, also known as an appeal bond, when appealing[14]. The amount of bail would equal a certain percentage of the payment due under the judgment and would act to deter frivolous or vexatious appellants.	Point 6 Page 17
5.	Include, in the Civil Code, a provision specifying that interest will continue to accrue and be payable on monetary obligations such as loan facility notwithstanding any non-performance. Interest should continue to accrue at the policy rate determined by the BoM as the base rate (currently 10%).	Point 4 Page 14-15
6.	Shift the task of all valuation exercises (including resolving challenges of property valuations) in enforcement matters to professional appraisers authorised under the Law on Valuation of Assets and strip the bailiffs of the authority to conduct appraisal of (security) assets under the LECD and the Law on Valuation of Assets and similarly strip the courts of the authority to resolve challenges of bailiff valuations.	Point 12, 15 Page 22, 23
7.	• Specify in the LVA the role of appraisers in judicial enforcement proceedings as well as the review and resolution of challenges against a valuation by an appraiser set in such proceedings. • Couple the above amendment with further assistance to strengthen the regulation of independent appraisers and bailiffs by, for instance, strengthening the complaints and disciplining mechanism to reduce potential abuses. • Defer to the independent appraiser in the Civil Code in determining the price of a forced sale (auction) of a secured asset (i.e. sale following the debt judgment by court) and ensure that the auction is conducted pursuant to the procedures established in the LECD, not the Civil Code, i.e. to make it the responsibility of a licensed professional valuator appointed by the bailiff from a pool of valuators provided by the Mongolian Institute of Certified Appraisers NGO under the Law on Valuation of Assets to determine asset valuation in the event that the parties fail to reach a voluntary agreement on the value of the collateral within a specified time.	Point 13 Page 45 Point 15 Page 23 Annex I Page 85-87
8.	Remove the provisions in the Civil Code, the LECD and the LCIP that declare void any auction with a single bid, subject to compliance with certain conditions (for example, that the price offered by the single bidder is above the minimum bidding	Point 24 50-51 Annex I

[12] This is, for example, the case in Germany where an appeal from a first instance decision (Berufung) requires court permission if the value of the matter is 600 Euros or less. In France the right to appeal is automatic but is generally not opened when the value of the dispute is low (less than 4,000 Euros), or in specific matters.
[13] To be discussed with the Bank of Mongolia.
[14] To be discussed with the Bank of Mongolia.

№	RECOMMENDATION	REFERENCE
	price).	Page 85-87
9.	Designate the LCIP as the single source of law regulating enforcement of immovable property (and make appropriate changes to the Civil Code and/or the LECD). In particular, make the following amendments to the LCIP: o expand the LCIP to provide for detailed procedures and requirements for the direct extrajudicial sale of collateral. Currently, Art.45 of LCIP (*Direct Sales of Collateral*) that deals with direct sales of a secured asset contains just one short sentence as follows – *"45. Collateral may be directly sold if both pledgor and pledgee have mutually agreed so under Art.11.2 herein*". Lack of any further details into how direct extrajudicial sale would be conducted pushes the banks and practitioners to avoid direct sales and instead choose the auction or, more frequently, judicial enforcement. Lack of any clarity on the private sales (as an alternative to public auction) increases the risk of appeals at any time during such sale process. Examples of detailed steps would include content of the notice to the pledgor, its delivery method, what exactly constitute delivery, delivery deadline etc.; o clarify the mechanism of "*baritsaalbar*"[15] to fully operationalize its use as a negotiable instrument in line with the *baritsaalbar*'s original objective – to facilitate, as a negotiable instrument, out-of-court sale of debt, including NPLs and extend the application of *baritsaalbar* to financial institutions other than banks – NBFIs and factoring companies; o specify the requirements and procedures for delivering the mandatory notice to commence enforcement proceedings over immovable property (e.g. content of the notice, delivery method to the debtor, deadline upon which notice shall be given to the debtor, deadline to cure the default by the debtor, deadline to commence enforcement proceedings once notice is given, what would constitute delivery). In particular, delivery by any of certified mail, fax and/or telegram should constitute proper delivery. In addition, delivery may occur at the recipient's office address, fax number or telegram, if the recipient is an individual who is not available at his/ her home address; o allow intermediaries in real estate transactions to conduct auctions or out-of-court auctions of immovable property (instead of requiring "*legal entities … specializing in sale of real estate*" who do not exist in Mongolia).	Point 24 Page 50-51 Annex I Page 85-87
10.	Limit, in the LECD, the existing wide grounds for appeals against, and/or freezing, bailiff actions and ensure that any challenges against the valuator's appraisal must be filed with a party best equipped to review and resolve the appraisal in a professional and efficient manner i.e. the Professional Appraisers Association under the Law on Valuation of Assets. In particular, the following existing grounds for appeals need to be removed from the LECD: o valuation of the collateral, o dissolution/bankruptcy of a debtor, and o transfer of ownership title of the collateral (following the auction).	Point 8 Page 17-18 Point 12, 15, Page 22, 23 Point 20, 21 page 48-49

[15] "Baritsaalbar" is a new word in Mongolian language first used in the LCIP. It is roughly translated into English as "evidence of pledge", but functionally appears more akin to a negotiable instrument facilitating sale and other transfer of debt and/or security.

№	RECOMMENDATION	REFERENCE
11.	Further amend the LECD so as to make the enforcement proceedings more efficient by: o deeming notices successfully delivered to the debtor when delivered to the domicile indicated in the loan agreement/security agreement for enforcement purposes, unless the debtor proves that such domicile was amended in the loan. If the loan agreement does not foresee any domicile, courts/bailiffs should be allowed to send a certain number of notices to different addresses to start enforcement proceedings and the debtor should not be allowed to challenge the lack of notice at a later stage.	Point 10 Page 19-21
12.	Reconsider, in the Stamp Duty Law, the existing rates of stamp duties for subsequent amounts of judicial appeals so as to set a reasonable economic barrier against frivolous, vexatious and/or multiple judicial appeals. *NOTE: This recommendation, however, should be carefully weighed against potential risk to access of justice for citizens and other parties to the court procedure and should be considered by the Bank of Mongolia in light of the proposal to make frivolous and vexatious appeals subject to an economic sanction.*	Point 5 Page 15-17
13.	Remove in the LECD the current four-year statute of limitations on enforcement of a settlement agreement reached by parties in court as a result of simplified proceedings under the CPC – the current four-year statute of limitations likely prevents the creditor from appealing in the event the debtor breaches the settlement terms after the expiry of statute of limitations. Alternatively, expressly permit a party to a settlement agreement to appeal if the other party breaches the settlement terms after the expiry of the statute of limitations (as set by the CPC).	Point 9 Page 18-19
14.	Exclude, in the LCID, private residential property from out-of-court foreclosure. This way, assets of individual debtors who own, and generate income from leasing, multiple apartments and/or houses, as well as commercial immovable property, would be explicitly subject to the extrajudicial sale.	Point 8 Page 17-18
	Amendments relating to Insolvency And Restructuring	
15.	Explicitly carve out secured claims, both in civil enforcement proceedings (i.e. in the Civil Code) and in liquidation-type insolvency proceedings (i.e. in the Bankruptcy Law), from the estate of the judgment debtor to preserve and uphold the priority ranking of a secured creditor (vs. other types of creditors) in the legal proceedings.	Point 20, 21 Page 48-49
16.	Amend the Bankruptcy Law to allow the court to approve a "pre-packaged restructuring" so that a "pre-packaged restructuring" (which is an informal agreement) becomes a formal reorganization plan. The effect of the approval would be to bind the plan on minority creditors blocking a restructuring proposal favoured by the debtor and a majority of creditors, subject to satisfaction of any necessary tests such as the 'no creditor worse off' principle.	Point 33 Page 75
	Amendments To The Regulatory Framework For The Sale Of NPLs	
17.	Add, in the LDLP, which prescribes general provisions which should be included in any deposit, loan or payment settlement service agreement entered into by a commercial bank, a new chapter on "Out-of-court corporate debt restructuring" legislating the CDRC's key features such as cooperation between creditors and the borrower and a standstill period for the borrower and its creditors to assess the need for a restructuring..	Point 30 Page 72
18.	Amend the Company Law to exempt debt-to-equity swaps of NPLs foreseen in restructuring agreements from the pre-emptive rights of (other) existing	Point 33 Page 75-77

№	RECOMMENDATION	REFERENCE
	shareholders of the debtor.	
19.	Set out, in the Regulation on Asset Classification, Provisioning and its Disbursements (adopted jointly by BoM and Ministry of Finance of Mongolia), conditions and procedures for a non-judicial write-off by a bank, including partial write-off (i.e., without requiring court judgment or other legal proceedings in the context of an out-of-court restructuring), introduce special loan loss provisioning levels for a new loan category – "NPLs in restructuring mode".	Point 33 Page 75-77

CHAPTER ONE. LEGAL OBSTACLES TO JUDICIAL PROCESS

A. LEGAL OBSTACLES TO JUDICIAL PROCESS UNDER THE CIVIL PROCEDURE CODE

1. **The existing multiple appeals system contributes to lengthy delays of the civil procedure.** Pursuant to the CPC, a first instance court is to hear and resolve a civil case (such as an NPL) within sixty (60) calendar days from the day the court opened the case. In respect of an NPL case, jurisdiction is with the court of residence of the debtor. This deadline may be extended for another thirty (30) calendar days if the Judicial Conference decides to do so.[16] The 2nd instance (appellate court) and the cassation (Supreme Court) courts must each hear a civil case within thirty (30) calendar days.[17] These may similarly be extended for thirty (30) calendar days each.[18] Thus, in theory according to the CPC, an NPL collection matter must spend a maximum of ninety (90) days in the first instance court and a maximum of sixty (60) days in each of the appellate and cassation instance courts of Mongolia. While these time frames are typically respected by the courts, the CPC permits multiple appeal opportunities to debtors, who can slow the process down significantly[19].

   Such appeals under the CPC generally consist of – (i) appeals against a final (vs. interlocutory) judgment of the 1st or of the 2nd instance courts or (ii) procedural appeals.

   Appeals against final judgments are largely unrestricted, including all the way up to the Supreme Court of Mongolia. The only two limitations to such appeals are that an appeal (i) must be filed within a 14-day deadline[20] from the court decision has been received by the participants (claimant, respondent, third party and their representatives and lawyers) and (ii) it is not possible in the so-called "simplified proceedings"[21].

   In contrast, procedural appeals are challenges and requests of procedural nature made by the debtor to the same court. Examples of such procedural appeals include recusal of a judge

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[16] Art 71.2, CPC. Each court, irrespective of its instance and specialization, has "Judicial Conference". "Judicial Conference" is a conference of all sitting judges in that court which is vested with certain administrative tasks such as nominating Chief Justice candidate, determining the order of that court's judges to preside hearings, determining the rules of assigning cases to judges in that court (vs. judicial review).
[17] Art 71.1, 166.2, 174.1, CPC.
[18] Art 71.2, CPC.
[19] According to the judicial statistics as of the end of 2017, about 25% of the total civil cases in the first instance courts are postponed or suspended due to various reasons.
[20] Art 120.2, 167.5, CPC.
[21] Art 74.1. Under this article, "simplified proceedings" means a judge dismisses a case, by signing to his/her order, if the circumstances specified incurred during the period from the initiation of a case until the trial, which are as follows: 1) claimant has discarded his/her claim, 2) respondent recognized and agreed to satisfy the claim, 3) the parties conciliated, or 4) respondent satisfied the claim.
[21] Art 170.1, 171.1, CPC

from the trial or seeking (or challenging) a court injunction[22] [23]. A procedural challenge results in extension of the process by maximum twenty-four (24) days[24].

The right to appeal is a constitutional and legal right common to all advanced legal systems, a right that must be protected and be accessible by all natural and legal persons. But such right should be exercised reasonably.

Generally, debt recovery procedures are straightforward civil law matters (assuming the parties entered into valid loan and security agreements). Such issues as default, remedies, defences, notices, valuation etc. are usually articulated in the relevant agreements and/or law. Therefore, determining whether there has been a default and what remedies may be available should not require too many appeals.

Delays caused by frivolous or vexatious appeals in Mongolia have become so significant and prevalent that they amount, to an extent, to abuse of justice. Therefore, the debtor who resorts to such delaying tactics could accordingly be held liable for abuse of justice.

Case study

Bank "ABC" has filed a NPL recovery lawsuit with court. The debtor "XYZ" has appointed 4 (four) lawyers to represent itself. One of the lawyers was a well-known advocate and he privately said to Bank ABC "see you in court for the next 3 years". True to his word, the case, first started in March 2014, is still in the 1st instance court. Examples of delaying tactics deployed by the debtor and its lawyers included refusal of judges, absence of one of the 4 lawyers (due to sickness, travel overseas, conflict with another scheduled hearing).

2. **The Constitutional Court's past rulings have upheld a broad interpretation of the constitutional right to appeal.** Art.16.14 of the Constitution of Mongolia (1992) provides for the citizens' right to appeal to the courts and to a fair trial, among other matters.[25] This constitutional right of citizens is further enshrined in the CPC.[26]

[22] Art 170.1, 171.1, CPC.

[23] According to CPC, in particular art. 65.1.1-65.1.8, 65.1.10, 69.1.1.-69.1.5, 80.1.1-80.1.9, 80.4, 110.4, 156.1.1., procedural appeals are challenges and requests of procedural nature made by the debtor.

[24] Art 170.1, 171.1, CPC. Under Art 170.1, procedural challenge must be lodged to the same court within 10 days since the issuing date of such decision. Under Art 171.1, the court must review and resolve the challenge within 14 days. So, it requires max. 24 days for such challenge to be resolved.

[25] "*16.The citizens of Mongolia shall be guaranteed the privilege to enjoy the following rights and freedoms: …14) Right to appeal to the court to protect his/her right if he/she considers that the right of freedoms as spelt out by the Mongolian law or an international treaty have been violated; … to a fair trial…*", Art.16.14, Constitution of Mongolia (1992).

[26] For instance, Art.3.1 of the CPC reads: "*Any person, whose human rights, freedom, and legally protected interests specified in laws of Mongolia and international treaties to which Mongolia is a party, are considered to be breached, is entitled to appeal to the court for protection of the rights, in accordance with the procedures set by this Law and in the form of filing a claim, request or complaint*".

Furthermore, in 2005-2006, the Constitutional Court of Mongolia found some articles in the Law of Mongolia on Non-Judicial Foreclosure of Pledged Immovable Assets (2005) "unconstitutional". In particular, the articles of this Law restricting the right of the debtor to challenge actions of the creditor to foreclose the mortgage were ruled to be an infringement of a citizen's constitutional right to a court hearing or appeal and to a fair trial.

Following the Constitutional Court's ruling, the Mongolian legislature struck down in 2006 the above Law on Non-Judicial Foreclosure of Pledged Immovable Assets in its entirety, citing unconstitutionality of restrictions of this law on rights of appeals by pledgors.[27] Accordingly, provisions in the CPC restricting a party's ability to appeal court decisions are far and few between.

As a result, not only citizens, but also legal entities enjoy broad, absolute and unrestricted rights to appeal in NPL resolution cases heard under the rules of the CPC. This means that the Constitutional Court's ruling of defending a citizen's constitutional right to an appeal and to a fair trial applies, by extension, to legal entities.[28]

3. **Another delaying practice is seeking the postponement and rescheduling of court hearings.** The CPC allows for postponing a court hearing if at the hearing the debtor expresses its wish to replace its counsellor with a new one[29]. Also, if the debtor's counsel is unable to attend the scheduled hearing and such absence is due to a valid reason, then the hearing should be rescheduled to a later date.[30] Similarly, the court is permitted to adjourn its hearing if the debtor submits new evidence or new explanation prior to or at the hearing which require, in the opinion of a judge, additional time to review and assess.[31]

4. **Accrued interest on a loan is often not recognised from the date of filing the NPL claim with the court.** When rendering decisions on the enforcement of NPLs, most courts exclude from the final judgment any interest, except for accelerated interest, beyond the date upon which the claim seeking enforcement of the NPL was filed before the court. Such exclusion is upheld, if appealed against by the creditor, by superior appellate courts.

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[27] The Constitutional Court's ruling was widely interpreted as rendering it impossible to foreclose on real estate property out of court. Therefore, in 2009 the lawmaker passed the LCIP containing a short single clause permitting extrajudicial sale of collateral. No detailed regulations have been passed since governing extrajudicial sale of collateral, indicating that since the Constitutional Court's ruling the Government has in general been cautious in passing a legislation containing restrictions on the right of any party to appeal. The LCIP is discussed separately at section 24 of this Report.

[28] In Q1 2017, commercial loans (as opposed to consumer loans) make up about 70% of all NPLs in Mongolia (the remaining 30% consisting of consumer, pension and salary loans). The breakdown of the 70% of commercial loans is as follows – real estate 15.7%, retail 14.4%, manufacturing 10.6%, construction 9.6%, mining 6.0%, other industries 13.9%. Source: https://www.mongolbank.mn/documents/statistic/loanbank/2017/R01.pdf

[29] Art. 25.1.1, CPC.

[30] Art. 16.14, 55.2, Constitution of Mongolia.

[31] Art. 105.2, CPC.

No Mongolian law stipulates that interest should stop accruing from the date upon which the claim seeking enforcement of an NPL is filed before the competent court. On the other hand, the CPC does not contain provisions explicitly recognizing the accrual of interest on the NPL debt.[32]

The Consultant's discussions with the members of the Mongolian judiciary suggest the following reasoning behind the above practice: filing of a claim seeking debt recovery terminates the loan relationship between the debtor and the creditor. Such termination, by extension, triggers the termination of the accrual of any interest.[33]

However, this reasoning disregards another Mongolian law – the Law on Deposits, Loans and Payment Transactions by Banks and Other Authorized Legal Entities (LDLP) - which states that termination of a loan agreement does not relieve the borrower from its obligations under the loan agreement, including the payment of interests accrued.[34]

Such arbitrary position of Mongolian courts to interrupt accrual (and impede recovery) of interest until all creditors are satisfied in full, incentivizes the borrowers not to repay or pay less than they ought to and disincentivises the creditors to commence the judicial resolution process. Furthermore, such practice makes access to finance for borrowers more restrictive and expensive as the commercial banks will want to make up for the lost interest by increasing the rate. This effectively penalizes the performing borrowers by making them to subsidize non-performing ones.

5. **Level of stamp duties for judicial appeals is too low compared to overall workload of both judiciary and bailiff agency.** Pursuant to the Law on Stamp Duty, claims and appeals to courts are subject to payment of stamp duties. "Stamp duty" is a tax collected by the Government to fund various public services such as public registration services, permitting, licensing etc.

   Dispute adjudication by courts is a public service. Accordingly, a party who appeals to court (i.e., plaintiff or appellant) must pay the stamp duty.[35] The amount of stamp duty payable is calculated by applying a percentage to the amount disputed in the claim/appeal (where such amount is available), as follows:[36]

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[32] Art. 63.1.1, CPC (enumerating claims that a creditor can make against debtor).
[33] Banks are permitted by law to recover so-called "accelerated interest" not exceeding 20% of the principal interest. Art 452.2 of Civil Code, Art. 24.3 of the Law on Deposits, Loans and Payment Transactions by Banks and Other Authorized Legal Entities (1995)
[34] Art.22.3, of the Law on Deposits, Loans and Payment Transactions by Banks and Other Authorized Legal Entities ("*22.3.Expiry of the term of the loan agreement shall provide no basis for releasing the borrower from its obligations to pay the principal loan, interest and default interest if its obligations under the loan agreement have not been performed within the specified time*").
[35] Art.3.1 and Art.5.1, Stamp Duty Law.
[36] Art 7.1.1, Stamp Duty Law.

Amount claimed (in USD)	Rate of Stamp Duty (in USD)
0-53	1.85
53-265	1.85 plus 3% of amount exceeded USD53
265-530	8.21 plus 2.4% of amount exceeded USD 265
530-5297	14.57 plus 1.6% of amount exceeded USD 530
Over 5297	90.85 plus 0.5% of amount exceeded USD 5297

Where the amount is not available (i.e., claims/appeals of non-monetary nature), the stamp duty is flat MNT 70,200 (approx. USD 25). An appeal to court against a bailiff's enforcement action is considered as a non-monetary claim.[37]

The current level of stamp duties for judicial appeals appear to be too low in the light of the total volume of incoming appeals and the general workload of the judges and the bailiffs.

This view is illustrated through a hypothetical case below:

The debtor has borrowed from the bank USD 100,000. After successful repayment of USD 30,000, the loan is in default. The bank seeks payment in court of an amount of USD 100,000 (which combines the outstanding principal plus interests accrued). The stamp duty paid by the bank is approx. USD 560.[38] It is further assumed that the judge upholds the enforcement for an amount of USD 80,000 and dismisses the enforcement for the remaining USD 20,000.

Out of the USD 80,000 awarded within the judgment, the debtor challenges an amount of USD 30,000 and appeals before the appellate court. In appealing, the debtor pays a stamp duty for an amount of approx. USD 210. [39]

Once the judgment is rendered and the bailiff commences his/her enforcement actions, the debtor's appeal against such action is subject to the stamp duty of only USD 25.[40] In fact, there are debtors who hold up the enforcement proceedings for one or more years by filing repeated appeals. While the low level of the stamp duty is not a deciding factor for such debtors to appeal, it does not discourage them from filing frivolous or vexatious claims.

(To further illustrate the economic repercussions of the low stamp duties in Mongolia – it is assumed that the debtor in the above example manages to forestall the bailiff's enforcement

[37] Art 7.1.2, Stamp Duty Law.
[38] (100,000-5,297)*0.5/100=473.52 (USD 473.52 is 0.5 percent of exceeded amount)
473.52+90.85=564.37 (this is the stamp duty)
[39] (30,000-5,297)*0.5/100=123.52 (this is 0.5 percent of exceeded amount)
123.52+90.85=214.37 (this is stamp duty)
[40] An appeal against the bailiff's enforcement action is considered as a non-monetary claim. Thus, the appeal is subject to the flat stamp duty of USD 25.

work by resorting to appeals for two years before the debt is collected. During these two years, the debtor is further assumed to have lent USD 70,000[41] *to a third party at the Mongolian market rate. The debtor's windfall (or the creditor's lost income) is USD 42,000 for the price of USD 25 (if the debtor appeals just once) or USD 50 (if it appeals twice). In addition, as discussed above, the debtor does not have to pay any interest throughout the enforcement process. Similar to the non-accrual of interest, the existing levels of stamp duties facilitate delaying tactics of certain debtors).*

As discussed above in this Report, frivolous, groundless, appeals by debtors have become so ubiquitous that they have reached the level when they ought to be treated for what they are - abuse of justice. Raising stamp duties for certain appeals could deter, to an extent, the growth of frivolous or vexatious appeals. Alternatively, reliance could be placed on a fine for frivolous or vexatious appeals.

That said, any increase of stamp duties should be well researched and, if increased, such increase should be reasonable so as not become an obstacle to the right of access to justice.[42]

6. **Stamp duties aside, Mongolian law does not require, as necessary, from appellants the placement of a bail (bond).** While "stamp duty" under the Law on Stamp Duty is a state tax, the objective of supersedeas bond, also known as an appeal bond is primarily for the losing party to offset potential costs/damages to the other party, i.e., the defendant. The requirement for a bond is not provided for in Mongolian laws, such as the CPC, and therefore does not apply to protracted judicial proceedings, including NPL-related proceedings.

7. **The principle that costs follows the event is generally available under Mongolian law, but it is uncertain if the same principle applies to legal fees as well as, more importantly, to damages caused by delaying debtors.** Under the CPC, an award of costs does generally flow with the result of litigation. However, the CPC does not appear to permit an important cost item – legal fees – to be recovered. In addition, the CPC does not expressly permit or require courts to recover expenses and damages caused to the other party by delays in the civil proceedings resulting from frivolous or vexatious claims.

8. **Mongolian law does not distinguish consumer loans from business loans.** Consumer loans and business loans, while fundamentally the same legal relationship, have differences as to purpose and function. Many countries provide for special rules for either type of loan and have specific rules for protection of consumers in financial services. Oftentimes, these special rules touch on methods and restrictions in resolution and foreclosure with greater protection afforded to consumers. For example, the recent European Commission proposal for a directive on credit servicers, credit purchasers and the recovery of collateral excludes

[41] USD 100,000 was borrowed; the debtor paid USD 30,000 but defaulted on USD 70,000.
[42] The system of stamp duties has been heavily criticized in many other jurisdictions, including the EU, because of the reason explained above – the stamp duty levels represent a major obstacle to the right to access to justice.

consumers from the scope of the accelerated extrajudicial enforcement mechanism.[43] While Mongolia has Law on Protection of Consumer Rights (2003), it lacks a dedicated consumer credit law or consumer mortgage credit law. The provisions dealing with the protection of consumers of banking products and services lack clarity and detail. There are some general provisions regarding financial consumer protection in the LDLP (1995), Law on Protection of Consumer Rights (2003) as well as the Banking Law (2010). For example, the LDLP requires lenders to publicly disclose terms and conditions of loans, and states that the BoM shall determine methods for the calculation of loan interest. The Banking Law states that banks shall provide customers with true and fair information in accordance with the principles and standards set by the BoM. However, the rules lack detail and are not well developed. Nor they distinguish between business borrower and consumer borrowers. Absence of such special rules, to an extent, explain Mongolian constitutional disputes (Para.2 above) struggling with themes such as the right of appeal and equality. Finally, there is no general regulation of servicers in banking law. As a result, Mongolia in general lacks a well-developed servicing industry (which accompanies consumer NPLs to allow banks to focus on core business) as well as debt collection agencies.

9. **The four-year statute of limitations for settlements under the CPC is not long enough for settlements of large NPLs.** Settlement agreements are reached if any of the following occurs during the civil procedure: (i) the plaintiff withdraws its claim, or (ii) the defendant accepts and agrees to the claim, or (iii) the defendant has satisfied the plaintiff's claim. If any of the foregoing occurs, the court conducts so-called "simplified proceedings" of the CPC which conclude with the judge issuing the settlement decision. The settlement decision contains terms of the settlement, if any. Thus, a settlement agreement may or may not involve restructuring.

   It is not uncommon in Mongolian practice for commercial banks to enter into a settlement agreement under the CPC with a defaulting borrower, usually extending the repayment schedule, reducing the principal and/or collecting assets in consideration for certain part of the debt.

   The issue is following the court's settlement approval, the debtor may after the expiry of statute of limitations (i.e., after 4 years) cease repaying the debt.[44]According to Mongolian lenders, this does occur in practice, which leaves the creditor unable to ask the bailiff to enforce the court-approved settlement agreement. This is due to Art.18.1.1 of the LECD. Thus, if the debtor halts repayments starting from the 5th year of the settlement agreement, the creditor faces the legal risk that the bailiff would deny enforcement of the settlement. The

[43] Brussels, 14.3.2018 COM (2018) 135 final 2018/0063 (COD)
[44] Art.18.1.1 of LECD.

CPC provisions are such, as discussed above, that the creditor is likely unable to appeal to court either.[45]

The four-year cap on the statute of limitations on settlements (which in case of substantial NPLs would oftentimes exceed this cap) is incompatible with the CPC principle that a court decision, once rendered, must be implemented, and enforced, if not implemented voluntarily - Art.11.1 of CPC: "Citizen or legal entity must abide by the effective court decision".

B. LEGAL OBSTACLES TO JUDICIAL PROCESS UNDER LAW ON ENFORCEMENT OF COURT DECISIONS

10. **Similar to the CPC, the LECD allows multiple appeals leading to significant delays in the process to enforce judgments.** The LECD is the most problematic of the laws discussed in this Report. The case study (on the next pages) is illustrative of some of the many issues that the LECD represents for creditors and bailiffs.

Once the court has issued a debt judgment, the bailiff is the State enforcement agent to foreclose the collateral and arrange for its sale.[46] The LECD grants bailiffs a broad range of powers to enforce a debt judgment, including seizure of collateral. A bailiff has been vested with specific powers under the LECD in order to enforce the debt. These powers are broad ranging from confiscation and/or sale of the debtor's assets[47] to transfer of the debtor's immovable asset under the creditor's administration[48] [49].

However, the LECD simultaneously provides for numerous appeals under which the debtor may challenge the exercise by the bailiff of any of its powers, during the process to enforce the judgment.

The immediate impact of those appeals is the suspension of the enforcement process until the appeal has been decided. For instance, if the debtor disagrees with an action of the bailiff assigned to the case the debtor may appeal to that bailiff's superior (so-called "senior bailiff"). If the debtor disagrees with the decision of the senior bailiff, it may appeal again before the senior bailiff's superior (so-called "general bailiff").[50] If the debtor still disagrees with the decision of the general bailiff, it may further appeal the decision before the court.

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45 Commercial banks' in-house counsel has identified these provisions of the CPC and of the LECD as an impediment to mediation, especially for NPLs which are likely to take longer than four years to repay (Source: meeting with the in-house counsel of the commercial banks of 20 Sept 2017).

46 In 2017, about 50 (fifty) percent of the total judicial awards filed with the bailiff's department for enforcement [as of end of 2017] have been actually implemented (through the bailiff-led enforcement procedure). Out of this 50%, the rate of successful monetary recovery (i.e., successful collection of the award by bailiffs) is 20%.

47 Art. 44.2.8, LECD.

48 Art. 44.2.15, LECD.

49 Please see Overview of the LECD in Annex I of this Report (*Overview of Mongolian Laws*) for description of each of the 17 powers.

50 Art. 44, LECD.

The filing of each of these appeals entails the suspension of the enforcement proceedings until the appeal has been decided by the official (who the appeal has been filed with).[51] Resolution of the appeal includes appeal to and resolution by the 2nd (appellate) instance court and by the cassation court (Supreme Court), if necessary.

In addition, there exist inconsistencies between various provisions of the LECD. For example, Art.27.2.5 of the LECD permits a senior bailiff to suspend (freeze) enforcement proceedings undertaken by a junior bailiff if an appeal has been lodged with the court or with the senior bailiff against the enforcement actions. The suspension lasts until the appeal has been resolved by the court or by the senior bailiff.

On the other hand, Art. 44.5 of the LECD says that lodging of an appeal against enforcement actions undertaken by a bailiff does not serve as a basis to, and subsequently will not, suspend, or rescind enforcement actions.

Therefore, in order to support implementation of Art. 44.5, the Consultant proposes to amend Art.27.2.5 to remove the ability of the senior bailiff to freeze enforcement proceedings. The proposed amendment would leave the power to freeze enforcement proceedings only to the court.

Subsequently, this will clear a gap between these articles and remove possible risk of prolonging enforcement.

The below case study is illustrative of issues that the LECD presents to the creditors and to the bailiffs.

Case study

Under a two-year term Loan Agreement a company "ABC" borrowed a significant amount from Bank "XYZ". The proceeds of the loan were to purchase 2 mine excavators from China. Company "ABC" paid 10% of purchase payment for the excavators in advance and pledged them to Bank "XYZ" as security. The ownership of excavators was held by Bank "XYZ". Company A has not performed its duty for three years. Court decision was in favour of Bank "XYZ".

Bank "XYZ" has staff debt collectors who tried to follow up on the court decision, but failed. Therefore, Bank "XYZ" approached the Court Decision Enforcement Authority.

Bank "XYZ" located the collateral, which was found in a remote area of Mongolia. A team of bailiffs and representatives of Bank "XYZ" drove to the area to confiscate the collateral. However, there they found one excavator with other assets unavailable – there was a leak from the Court Decision Enforcement Authority prior to their departure. Bailiffs were unable to confiscate the only excavator as Company "ABC" had hired security services that openly prevented bailiffs from doing their job.

[51] Art. 27.2.5, LECD.

Later, Bank "XYZ" located second excavator in another remote part of Mongolia. This time, Bank "XYZ" had two police officers as well as private security men with them. In order to have such powerful team, Bank "XYZ" had some talks with the higher level officers in police. At the place, however the team were welcomed by Company "XYZ"s own one hundred security men. Bank "ZYX" thinks there was leak within the police this time. Confrontation ensued between the two parties involving pushing and shoving. However, all of a sudden, two police officers left the place because they were called back. During the face-off, Bank "XYZ"'s debt collectors managed to pull out the excavator's computer, disabling its operations. The bailiffs sealed the collateral and left. Later, however, the sealed property disappeared.

Next time, Bank "XYZ" checked place alone and to a photo showing how the bailiff's seal was broken illegally. Parts of the excavators were dissembled and used up as spare parts. Bank "XYZ" requested the local area's police to open criminal case and investigate. But for some unknown reasons the case was dismissed.

As for the Company "XYZ"s other assets, confiscation was unsuccessful. Company "XYZ" had over 100 security guards in place. They resisted the bailiffs, and parked four heavy mining trucks surrounding the excavator. Unfortunately, as the bailiffs do not have power to access and/or utilize heavy machines and special equipment, the confiscation failed again.

11. **A search for an absent debtor suspends the enforcement procedure as well.** In addition to the above referenced system of appeals, the LECD allows the bailiff's office to freeze its enforcement proceedings *ex officio*.

    A common cause for such suspension by the bailiff itself is the inability to serve the debtor with the claim seeking to enforce a judgment in its domicile – such inability would be due to the debtor travelling (outside or inside Mongolia) or having its residence or centre of main interests somewhere else[52].

    The LECD provides that the judgment debtor must be formally notified of a court decision. Methods of such notification are prescribed by law – telephone, fax, telegram, or mass media.[53] In addition, actual enforcement measures (e.g., confiscation of the assets or sale of the collateral) must be carried out in the presence of the debtor.[54]

    Often, however, the debtor's domicile cannot be determined by the bailiff in practice because of various factors – the debtor's domicile would often be out-dated or wrong or even be outright missing in the loan documents. The state database of civil registry would be not up-to-date, either, with the information in the database not updated and maintained properly. In these circumstances, the bailiff's office must suspend the enforcement process. This allows recalcitrant debtors to slow down or even avoid enforcement by wilfully conceiving or changing their domicile.

[52] Art 27.2.6, LECD.
[53] Art 14, LECD.
[54] Art. 48.5, 48.6, 54.4, LECD.

If the debtor is a legal entity, a legal representative of that entity (such as a founder or managing director) must be notified as well.[55] Similar to citizen debtors, it is not uncommon in practice for legal entities to manipulate the bailiff's enforcement efforts by changing the domicile, using a fake domicile or even leaving their domicile altogether and continuing their operations from an unregistered domicile such as home.

12. **Appeals against the valuation of the collateral are another common tactic to delay the enforcement of judgments.** Under the LECD, if the debtor challenges the valuation of the collateral to be foreclosed, the enforcement is suspended pending the final review and resolution of the appeal by the competent court.[56]

    The valuation of an asset such as collateral is a professional activity carried out by licensed independent appraisers in accordance with the Law on Valuation of Assets. However, the LECD disregards the Law on Valuation of Assets. Instead, it entrusts the bailiff to come up with the valuation of an asset. In doing so, the LECD lacks any guidance as how to a bailiff is to perform his/her appraisal of the asset. This leads to a confusion as to who (bailiff vs. valuator) and how should conduct valuation of an asset in judicial proceedings. Not surprisingly, valuations by bailiffs are a popular target for scheming debtors to challenge leading to delays of the enforcement proceedings.

13. **The bailiff office's current powers are not adequate to ensure an effective and efficient enforcement of judgments.** In order to identify hidden assets, a bailiff must be able to access various public registries in Mongolia (e.g., registry of immovable property, registry of secured transactions, land registry, registry of citizens, credit registry, registry of mining licenses, registry of corporates and other legal entities, registry of vehicles and registry of intellectual property). Pursuant to the LECD, a bailiff has the power to "*procure from … legal entities necessary documentation, references and statements necessary for implementation of a [civil court decision]*".[57] However, in order to exercise this power, the bailiff must send written letters to the registries (i.e., like private organizations and citizens). Most registries are only accessible in paper form, even though there have been attempts by the Government of Mongolia to digitalize some of these registries. For example, the registry of secured transactions has been made available online. Moreover following the new Law on General State Registration the data of these registries is expected to be merged into one comprehensive database, although this will take some time to complete.

14. For the time being Mongolian bailiffs are unable to access public registries in order to ensure timely identification and seizure of the concealed assets. According to the estimate of the General Office of Court Decision Enforcement, the bailiffs need to send out up to 40 (forty)

[55] Art. 14, 27.2.6, LECD.
[56] Art. 27.1.4, LECD.
[57] Art. 44.2.2, LECD.

request letters to different public and/or private organizations for just one enforcement case.[58] While most registries are required to answer to any such request within three to five business days, this still requires considerable effort and not only affects timing, but also results in higher cost of administration for bailiff enforcement of court decisions.

Another set of powers for the bailiffs under the LECD relate to bank accounts. For instance, a bailiff may freeze a bank account of the debtor or restrict his/her control over, or access to, its bank accounts etc.[59] However, in order to exercise this power, the bailiff must first send a formal written letter to the commercial bank in which the debtor maintains bank accounts. The banks are expected to act on the bailiff's letter only upon the receipt of it which means in practice that moneys on the account can be withdrawn before the account is frozen.

15. **Valuation of assets which are under enforcement is not administered by appraisal professionals whose capacity and regulation, in turn, need improving.** As discussed in the above paragraph, the Law on Valuation of Assets (2010) introduces a new professional activity - the valuation of an asset (such as collateral) – of appraisers. However, the LECD disregards the LVA. Instead, the LECD appoints the bailiffs to valuate an asset. Moreover, the LECD appoints the court, which would similarly lack professional background, to resolve challenges to bailiff-produced valuations.

    Legislative framework of asset appraisers consists of the LVA itself as well as of the regulations passed by the regulator, the Ministry of Finance. In addition, a self-governing professional association established under the LVA and called the "Mongolian Institute of Certified Appraisers NGO" has adopted in the past a few regulations for its member appraisers.

    The LVA and the rest of the legal framework lack clear provisions as to the role of appraisers in the judicial enforcement proceedings and to the review and resolution of challenges against a valuation by an appraiser set in a judicial enforcement process.

    Overall, the professional capacity of appraisers and of Mongolian Institute of Certified Appraisers NGO is largely viewed as weak, however the bailiffs are not better placed to conduct the valuation process. Sufficient knowledge of market economy, professional training and retraining, adoption of best international standards and practices for appraisers probably need improving. The same can be said with regard to legislative framework, too – the LVA focuses on asset valuation only, leaving business valuation out of its remit. In addition, new provisions are needed in respect of professional liability, code of conduct, status of the professional association, interaction between the regulator and the professional

[58] (Source: Meeting with Mr. B.Batbold, Senior Officer of Ministry of Justice, and Ms.Unurtsetseg, Head, Professional Administration Division, General Office of Court Decision Enforcement on 2 Oct 2017).
[59] Art. 44.2.13, LECD.

association, stricter terms and conditions of professional licenses, annual determination of professional fees etc.

16. **The civil law principle that security interest "follows", and remains enforceable against, the collateral is yet to be fully recognized in Mongolian law and practice.** The Constitutional Court of Mongolia has described this principle as follows: "*The owner of an immovable asset pledged [in favour of an obligee] has the absolute right to sell, rent, lease, pledge, transfer the said asset to third parties, whether temporarily or permanently… Despite such movement of the said asset and regardless of who has become the owner or possessor of the same, the pledgee's first-ranking right in the asset shall remain valid and enforceable. If the same asset has been pledged in favour of a second pledgee, such pledge shall not affect the first-ranking priority of the first pledgee…*".[60]

    The foregoing principle is not always honoured in Mongolian laws. For example, Art.170.6 of the Civil Code provides the following:- "*if the owner of an immovable asset pledged in favour of the obligee wishes to pass the ownership title to a third party, the owner must obtain [in advance] the consent from the obligee*".[61]

17. **Creation and registration of security interests in movable property has now become possible, but there are issues about the lack of coordination amongst various public registries**. Until recently, the absence of a legal framework for the creation and registration of security interests in movable property was a major gap. With the adoption of the new Law on Pledge over Movable and Intangible Property (in force since March 2017), it has now become possible to register security interests over movable assets, as well as to publish relevant notices.

    The Law is based on various international standards.[62] For instance, the Law makes it possible for secured creditors to obtain possession of, or sell an encumbered asset. Or a secured creditor may propose to acquire an encumbered asset in total or partial satisfaction of the secured obligation. Overall, the Law is expected to improve access to finance in Mongolia. However, the absence of any interaction of the pledge registry with other public registries in Mongolia has already created risks for banks. Below are two examples of the lack of coordination and communications between various public registries in Mongolia:

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[60] Constitutional Court of Mongolia Ruling No. 13, dated 7 Oct 2015.

[61] During the drafting of this Report, the Constitutional Court has considered a case related to this clause and ruled that it was a breach of the Constitution. The Constitutional Court's rationale is that ownership is a fundamental right; as such, the owner's absolute right to freely enjoy, and exercise, its ownership must be preserved and protected. The Court has also noted that the exercise by the owner of its ownership right would not infringe in any way the creditor's/pledgee's rights anyway.

[62] In particular, the UNCITRAL Legislative Guide on Secured Transactions (2010) prepared by the UN Commission on International Trade Law (UNCITRAL) (https://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf)

18. **The pledge registry and the vehicle registry do not "speak" to each other.** Under the LPMIP, security interests in most types of movable property (including motor vehicles and mine cars) are registered with the SRO. At the same time, ownership of cars (including, mine cars) is registered with the Transportation Department of Mongolia.[63]

    However, the pledge registry of the SRO and the vehicle registry at the Transportation Department are stand-alone registries and do not "speak" to each other. As a result, ownership of an encumbered vehicle could get transferred to a 3rd party without knowledge of everyone else – the pledgee (i.e. the bank), the SRO, the Transportation Department, or the new owner of the vehicle. While the pledgor's security interest in the encumbered car remains enforceable (at least, theoretically) despite the change in ownership of the vehicle, as previously stated in Para.11 above, practical application remains to be an issue.

    Furthermore, banks in Mongolia attempt to control the potential ownership changes of encumbered vehicles by way of entering into "fiduciary transfer agreements" (in addition to, and/or instead of, the pledge agreement).[64] However, the ownership status of the bank creates other issues: once the bank is the owner on record of the motor vehicle or mine car, it becomes exposed to the owner's typical risks (e.g., insurance claims or traffic violations).

    Similar to registration of vehicles, the "fiduciary transfer" of vehicles is registered with the Transportation Department of Mongolia but not with SRO.[65] The existence of two separate registries – registry of pledges of vehicles with the SRO and the registry of fiduciary transfers of the same with the Transportation Department – often drives banks to enter into both agreements (pledge and fiduciary), an option that increases banks' costs.

19. **The pledge registry and the corporate registry do not "speak" to each other, either.** In a similar vein, the newly established pledge registry does not interact with the corporate registry. The LPMIP has made the possible creation and registration of security over shares in Mongolian companies (except for publicly listed companies).[66] The corporate registry functions as the public registry for legal entities. The registration comprises different information, such as the corporation's address, the identity of its shareholders, the composition of its management body, its charter (i.e. articles of association), but not the existing security over the shares of the company.

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[63] Art. 17^1.1, Law on Auto Vehicles.
[64] In "fiduciary transfer" mechanism, an obligor transfers the ownership title in a movable property (usually, a vehicle) to the obligee to secure its obligation to make payments to the obligee. Once the obligation of the obligor has been performed in full, the obligee then transfers the ownership title back to the obligor. Thus, "fiduciary transfer" is a security method different from pledge. It is commonly used in Mongolian practice in respect of vehicles. (Art. 231, Civil Code).
[65] Art. 17.1, Law on Auto Vehicles.
[66] Art. 2.3, LPMIP.

Since the two registries operate separately from each other, it is possible for the pledgor to dispose of its shares and get such disposal registered in the corporate registry despite an existing pledge over the same shares registered in the pledge registry. This is possible even though both registries – the pledge and the corporate - are administered by the SRO.

Recommendations

Existing Law	Proposed Change	Explanation
Civil Procedure Code		
Chapter VII. Simplified Civil Procedure 74.1. The case shall be resolved through simplified procedures in case of plaintiff's withdrawal from his/her claim, acceptance by a defendant of a claim, conclusion of friendly settlement by litigants, or satisfaction by the defendant of the claim for the period between initiating a case and the court session. 74.2 If it is considered possible resolving a case through simplified procedures, a judge shall issue an order confirming plaintiff's withdrawal from his/her claim, defendant's acceptance of the claim, friendly settlement of the litigants and satisfaction of claim's demand by the defendant. 74.3 The litigants shall conclude an agreement, in writing, on plaintiff's withdrawal from his/her claim, defendant's acceptance of the claim, friendly settlement of the litigants and satisfaction of claim's demand by the defendant and shall certify this agreement by their signatures.	Introduce the following key changes to CPC: • Enable "summary proceeding" for debt collection and enforcement to shorten procedures for claims. The proposed summary proceeding is new and is different from the existing simplified procedure under the CPC. In particular, some of the specific changes proposed to the CPC are: • Summary proceeding must be expressly agreed in loan documentation between the lender and the borrower, possibly in a notarised format. • The borrower must be notified in writing by the creditor of: o the creditor's intention to realise the assets through this summary proceeding to satisfy the obligations of the debt, o the type of enforcement measure – public auction or private sale, o the time period for the execution of payment before the use of summary proceeding, and o the default amount of the debt due.	An appeal right must be available, whether to citizens or to legal entities. On the other hand, such right must be exercised reasonably. Debt recovery is in general a straightforward civil law matter (assuming clear valid loan agreement and security agreement). Such issues as default, remedies, defences, notices, valuation etc. are usually articulated in the relevant agreements and/or law. Therefore, determining whether there has been a default and what remedies may be available should not require too many appeals. The CPC does not currently recognize affidavit evidence mechanism – an important feature of summary proceedings. With regard to consumer loans, with exponential growth of consumer credit in Mongolia over the recent years, a separate dedicated law should be adopted (regulating, among other matters, purpose, general and particular terms and conditions, threshold requirements, formula for interest and default interest, payment sequence, default notice

Existing Law	Proposed Change	Explanation
	• Summary proceeding shall apply, among others, to the commercial debtor (vs. consumer), i.e., a commercial borrower is the debtor, usually a legal entity who procured loan for business purposes; • In addition, summary proceedings shall apply to all NPLs whose amount is below a certain threshold(s), for instance, below MNT 50m (approx. USD 20,000). • The court shall review, and base its decision, only on the affidavit evidence and shall issue a decision on the claim within [15] days; • In addition, consideration should be given to introducing a "preliminary hearing", prior to the court hearing (above), at which the parties or their counsel are to disclose all of their evidence, and file motions, if any. The purpose of "preliminary hearing" is to ensure full disclosure and avoid claims/evidences/motions once the court hearing (above) commences; • The affidavit evidence mechanism shall be expressly permitted in the CPC. Other key elements of such mechanism would be: o a written/sworn statement of fact voluntarily made by each party; o court would base its judgment on the affidavit evidence presented to it by the parties within the specified time;	procedures, treatment and foreclosure of collateral, disclosure requirements etc.)

Existing Law	Proposed Change	Explanation
	○ court may resolve the case without presence of the parties.	
Article 25. Rights and duties of a party to a case 25.2 A party to a case shall have the following duties during case proceedings:	• Add the following new obligation to the list of obligations of the parties (participants) to the civil procedure: "*25.2.7. shall refrain from filing multiple appeals, claims or complaints with the purpose of intentionally delaying the court proceedings or appeals, claims or complaints which are based on unreliable or false evidence*".	It is suggested to deter dilatory practices by making it an express obligation of parties to the civil court procedure not to file frivolous, vexatious and/or multiple appeals. Legislating such obligation would result in ability to impose legal liability on such behaviour for abuse of justice.
Article 53. Reimbursable court expenses 53.1. The following expenses incurred by a Court shall be reimbursed by the litigants:	• Add the following new category of court expenses payable by the delaying party to the civil procedure: "*53.1.6. expenses for [prolonged] [delayed] civil proceedings. If a party to the civil dispute has been determined by the court to have intentionally [prolonged] [delayed] civil proceedings by way of filling frivolous, vexatious and/or multiple claims, appeals or complaints, the judge shall order that party to pay the expenses of [prolonged] [delayed] civil proceedings to the other party*."	
Article 54. Determining amount of reimbursable court expenses 54.1 Reimbursable court expenses shall be determined according to the following procedures:	• Add the following guideline for the court to determine the amount of the court expenses payable by the delaying party for [prolonged] [delayed] civil proceedings: "*54.1.4. the judges shall fix the total amount of the expenses payable by the delaying party for [prolonged] [delayed] civil proceedings based on evidence of the losses incurred by*	

Existing Law	Proposed Change	Explanation
	the other party due to such [prolongation] [delay]". *If either party appeals the amount of the expenses fixed by the judge, such appeal shall not prevent or postpone the civil procedure.* • Accordingly, update the numbering of the affected CPC clauses – in particular, change "*54.1.4*" to "*54.1.5*".	
N/a	• Add new Art. 60^1 to the Chapter V of CPC (*Court Expenses and Stamp Duty*) ***Art. 60^1. Compensation for lost time*** *The court may charge, at its discretion, compensation for lost time against a litigant who has brought vexatious claims with regard to the principal claim to the court or has systematically obstructed the proper and timely court procedure of a case, in favour of the other Party. The amount of such compensation shall be determined by the court within reasonable limits and taking into account specific circumstances.*	
Article 56. Division of reimbursable court expenses	• Add the following new clause to make it the delaying party's obligation to pay to the other party the expenses for [prolonged] [delayed] civil proceedings: "*56.6. the party who has been found by the court as having unjustifiably [delayed] [prolonged] the civil proceedings shall pay to the other party the expenses set out in Art.53.1.6 of this Law*".	The Consultant suggests removing 55.1 as well - insolvency debtors should be ordered to bear court expenses (as is the case in other jurisdictions).
Article 55. Exemption from compensating court expenses	• Add the following new clause denying the delaying party the right to seek	

Existing Law	Proposed Change	Explanation
55.1 A litigant may be exempted from compensating court expenses if it is established by his/her explanation and other evidences that he/she is insolvent, or based on other grounds provided by law. 55.2 The Court or a judge may reduce the court expenses to be compensated, defer their payment or allow instalments considering the financial and other positions of the parties.	exemption from payment of the expenses: "*55.3. Articles 55.1 and 55.2 of this Law shall not apply to the expenses set out in Art.53.1.6 of this Law*". *"55.1. A litigant may be exempted from compensating court expenses ~~if it is established by his/her explanation and other evidences that he/she is insolvent, or~~ based on ~~other~~ grounds provided by law.*	
Art. 12. Grounds for opening a civil case 12.1 Court may open a civil case based on the following grounds: 12.1.1 a claim brought by a party to the legal relation regarding violation of their rights related to material and non-material wealth; 12.1.2 a claim brought by a person authorized to apply to Court under the law to defend rights, freedom and interests of other persons; 12.1.3 a request submitted by an interested person to resolve matters specified by law through special procedures; 12.1.4 a complaint against activities of administrative organization or official or a legal act; and/or 12.1.5 other grounds provided by law.	• Add new para. 12.2 to Art. 12 of CPC as follows: *"12.2. The court may deny a claim/complaint if it deems the claim/complaint as vexatious or unmeritorious and as an abuse of civil procedure. The court may issue an injunction restricting the party's ability to continue with further claims/complaints"*	
Article 25. Rights and duties of a party to a case 25.1 A party to a case shall have the following rights in the case proceedings:	• Add the corresponding right to enable to the party who has suffered from the delayed proceedings to seek compensation for loss of time: "*25.1.8. claim compensation for any losses*	An example of determined "losses" would be "lost income/revenue" (over the lost time) which is already acknowledged under Mongolian. Another example would be actual expenses, such as court expenses.

Existing Law	Proposed Change	Explanation
	suffered as a result of an unjustifiable delay from the delaying party". • Accordingly, update the numbering of the affected CPC clauses – in particular, change "*25.1.8*" to "*25.1.9*".	
57.4. The party who appeals a decision of either first instance court or appellate court shall pay stamp duty for an amount that he/she challenges (i.e., appeals).	• Amend Art.57.4 as follows: "*The party who appeals the first instance court decision without merit [more than [ ] times] shall pay a stamp duty [3] times the amount set out in Art.7.1.1 of the Law on Stamp Duty. The party who appeals the appellate instance court decision without merit [more than [ ] times] shall pay a stamp duty [2] times the amount set out in in Art.7.1.1 of the Law on Stamp Duty*".[67]	The current levels of stamp duties for judicial appeals are too low in the light of the total volume of incoming appeals and the general workload of the judges and the bailiffs. Thus, it is recommended to introduce higher rates of stamp duties for subsequent amounts of appeals to deter frivolous appeals. This recommendation, however, requires further discussion, such as careful weighing of benefits vs. potential risk to access of justice for citizens and other parties to the court procedure.
Article 6. Adversarial principle 6.5. Litigants shall be obliged to submit only realistic explanations and present important evidences for case proceedings.	• Amend Art.6.5 as follows: "Litigants *and their counsel* shall be obliged to submit only realistic explanations and *promptly* present important evidences for case proceedings". • Add a new Art.6.7 as follows: "*6.7. If a litigant has appointed a new lawyer more than 3 (three) times or has appointed more than one lawyer since the opening of the case, the court shall deem that the*	Please see Case Study in Para.1. Currently, a litigant has the obligation to provide true depositions and evidence. A litigant's lawyer technically does not have such obligation. It is thus recommended to extend such obligation to the counsel, too. It is also suggested to require prompt submission of evidence in an effort to curtail late production of evidence. It would also

[67] Please refer to the table in Para.6 herein for the amounts of stamp duties under Art.7.1.1 of the Law on Stamp Duty.

Existing Law	Proposed Change	Explanation
	adversarial principle has been complied with and shall not reschedule a court hearing if a litigant or its lawyer request changes in the composition of the appointed lawyers". • Add new provision 34.5 to CPC: "*34.5. Either litigant may appoint more than one lawyer to represent him/her/it. If, however, only one of the appointed lawyers is present at the hearing and the other appointed lawyers are absent irrespective of reasons, such absence shall not constitute a ground to reschedule the hearing"*.	contribute to full application of Art.105.2 of the CPC ("*105.2. If the court considers the reason for presenting of additional explanations and new evidence significant to the case resolution during the court session to be adequate, although it may have been presented or proposed earlier, the court shall accept it and if it is necessary to analyse it, the court may adjourn the court session once*"). In addition, the proposed changes would serve as the legal basis for imposing liability on delaying acts of lawyers where such delays are without reasonable grounds. While provisions of the Code of Conduct for Lawyers e.g. Art. 4.2(2) and 4.5 (2.6) should restrict unscrupulous behaviour by lawyers, these are not enforced in practice.
Article 34. Participation of advocates in case proceedings, their rights and duties	Add a new Art.34.5 as follows: "34.5.An advocate shall not engage in any action or inaction which delays, or may delay, court proceedings save where he/she can demonstrate that this was unavoidable and/or necessary in the circumstances."	
Civil Code		
N/a	• Add the following new article in the Civil Code's Chapter on Obligations: *Article 218[1]. Liability for non-performance of monetary obligations* *1. In cases of improper deduction of monetary funds, evasion from their return, or other delay in their payment, interest shall be payable on the amount of the debt due. The amount of such interest shall be determined*	The matter of interest accrual is a substantive law matter as well as a procedural law matter. Thus, instead of CPC, it is recommended to add the proposed provisions to the Civil Code of Mongolia. As the interest rates of Mongolian commercial banks are among the highest in the world – annually 22%-27%., accrual at such rates would simply bankrupt the borrower and thus would probably be viewed as impractical. Hence, using the Bank of Mongolia policy rate

	by the policy rate of the Bank of Mongolia, in effect at the time of non-performance, unless a different rate of interest is established by law or by contract. *2. If losses caused to the creditor by improper use of its funds exceed the amount of interest due to the creditor under paragraph 1 above, the creditor is entitled to demand damages from the debtor for the part exceeding this amount.* *3. Interest for the use of creditor's funds shall be levied through the day of the actual payment of the full funds to the creditor, unless a law or a contract establishes a shorter period for calculating interest.* *4. If the contract between the creditor and the debtor provides for a penalty for failure to perform or for improper performance of the monetary obligation thereunder, the interest provided for in this article shall not be recoverable unless otherwise provided by a law or a contract.* *5. Accrual of interest on interest (compound interest) is not allowed, unless otherwise provided by law. For obligations to be performed when parties carry out entrepreneurial activities, the use of compound interest is not permitted, unless otherwise provided by a law or by a contract.*	(which is currently 10%) is recommended.

	6. If the amount of interest payable is clearly disproportionate to the consequences of a breach of an obligation, the court, upon application of the debtor, has the right to reduce the interest provided by the contract, but not less than the amount determined based on the rate specified in paragraph 1 above. *7. Default interest shall be calculated by applying the end-of-period simple interest calculation on the matured principal amount without adding default interest to the principal upon expiry of the accounting period, by using the mathematical formula prescribed by a BoM regulation. Default interest shall be calculated for the entire period of delay from the first day following the maturity date (without calculating the compound interest). If not stipulated otherwise, the calculation shall be made on a monthly basis, at the end of month.*	
Article 453. The debtor's obligations 453.1. The borrower shall pay interest and, if so provided by the contract, additional interest in case of its failure to repay the loan on time. 453.2. In case the borrower fails to fulfil its	• Add the following new paragraph in the Civil Code's chapter on bank lending: *453.3. Unless otherwise provided by law, the creditor's right to file a claim to the court against the debtor may be exercised starting from the 91st day after the debtor's breach of its obligations under a business loan*	A loan becomes "non-performing" upon expiry of 91 days since a due date.[68] By allowing the bank to commence a court action three months after the debtor's breach, it is intended to further promote the use of new "summary proceedings" proposed in Page 24.

[68] The Regulation on Asset Classification, Provisioning and its Disbursements determines minimum provisioning levels for the various loan categories. Minimum provisioning levels increase with the day-past due status of the loans. (Annex I.A, Regulation on asset classification, provisioning and its disbursements adopted by Joint Decree A-193/228 of Governor of Bank of Mongolia and Finance Minister of Mongolia dated 30 June 2017).

obligations under the loan contract and if the contract provides for an undisputed transfer of the collateral to the creditor, the creditor shall exercise the right of disposal of the pledged item starting on the end date of the contract. This paragraph shall apply to movable assets only.	*contract.*	
Law on Enforcement of Court Decisions:		
Art.18.1.1. Statute of limitations for enforcement of settlement agreements is 4 (four) years since the date of court approval of the settlement.	Exempt enforcement of settlement agreements from the four-year statute of limitations by including the following sentence in Art. 18.1: "*Art.18.1.1 shall not apply to the court decision approving the settlement between the parties and closing the case*". or: *"In case of a court-approved settlement agreement, the statute of limitations for enforcement thereof shall be [4] years since the end date of the settlement agreement."* • Alternatively consider the following changes to Art 74 of CPC: o Amend Art.74.4 of CPC as follows: "*74.4. Parties to the litigation shall not appeal to either appellate or cassation court in regards to all cases resolved by an*	Following the settlement if the debtor has after the expiry of statute of limitations of four years ceases repaying the debt, the creditor is prevented from asking the bailiff to enforce the court-approved settlement agreement. This is due to Art.18.1.1 of LECD. Thus, if the debtor halts repayments starting from the fifth year of the settlement agreement, the creditor faces the legal risk that the bailiff would deny enforcement of the settlement. The CPC provisions are such, as discussed above, that the creditor is likely unable to appeal to court either.[69] The 4-year cap on the statute of limitations on settlements (which in case of substantial NPLs would oftentimes exceed this cap) would be incompatible with the CPC principle that a court decision, once rendered, must be implemented, and enforced, if not implemented voluntarily. (Art.11.1 of CPC: "Citizen or legal entity must abide by the effective court decision.")

[69] The commercial banks' in-house counsel have indeed identified these provisions of the CPC and of the LECD as an impediment to mediation, especially of NPLs which are likely to take longer than 4 years to repay (Source: meeting with the in-house counsel of the commercial banks of 20 Sept 2017).

	expedited procedure, except for the cases settled under the simplified procedure". ○ Add Art. 74[1].9 to CPC as follows: *"74[1].9. If the parties to the litigation settled the case under the simplified procedure, but later either party breaches the settlement terms, then the other party shall be entitled to appeal through to either appellate court."*	
Article 55. Valuation of assets *(provisions governing valuation of asset and appealing it)*	• With the amendment, the bailiffs would no longer conduct the valuations. Instead, the valuation tasks would be transferred to and done by licensed appraisers only. Accordingly, appraisal fees of the valuator would be introduced and considered as an expense of the judicial process, the valuation would be performed under the LVA and a specific reference would be included in the LECD to this effect. • In addition, the LVA would include new provisions governing review and resolution of challenges, including timelines, brought to the Mongolian Institute of Certified Appraisers NGO against a valuation set by a licensed appraiser in a judicial process. • If the appraisals by appointed appraiser(s) have significant differences (for example 5-10%) the court shall appoint the professional body of appraisers (expert) from a pool of valuators provided by the Mongolian Institute of Certified	Valuation of an asset is a professional activity by independent licensed appraisers conducted under the LVA (2010). However, Art. 55.1 of the LECD "ignores" the appraisal under the Law on Valuation of Assets. Instead, it entrusts the bailiff with valuing the collateral. The bailiff cannot and should not replace a professional appraiser – he/she would lack basic prerequisites (e.g., market data, valuation techniques, professional license, experience, liability insurance etc.) to valuate collateral asset in a professional and efficient manner. Hence, incorrect valuations have been a major source of appeals and challenges delaying judicial enforcement. Any challenges against the valuator's appraisal must be filed with a party best equipped to review and resolve the appraisal in a professional and efficient manner – i.e., the Mongolian Institute of Certified Appraisers NGO – under the LVA.

	Appraisers under the LVA to review and determine the appraisal which shall be treated as final by court. • In addition, amendment to Article 55 shall prevent the parties from challenging the appraisal's valuation (value of collateral) before the court. Parties wishing to challenge a valuation shall bring the challenge to the Mongolian Institute of Certified Appraisers. Complaints regarding only to the procedural issues shall be brought to court.	
Art 27.1.4. *(provision permitting "freezing" of judicial enforcement procedure if there has been an appeal of a valuation amount or a valuation procedure to court)*	This provision shall be void.	Since the task of valuation of collateral is to be shifted from the bailiff to an independent appraiser, lodging judicial appeals (and ensuing suspension of the judicial enforcement process) would be removed from the LECD.
Art 44.2.9. *(provision granting a bailiff a power to (i) appraise an asset during a judicial process or (ii) appoint, at his/her discretion, an appraiser to valuate an asset during a judicial process)*	With the amendment: • the bailiffs would no longer conduct the valuation, • instead, the valuation tasks would be transferred to and done by licensed appraisers only	
Art 64.2. 64.2. Initial price at the auction shall not be less than the price set by the bailiff.	• Amend Art.64.2 as follows: *"The initial price at the auction shall not be less than the price determined by the duly appointed licensed appraiser."*	
Art 55. Valuation of assets *(article granting a bailiff a power to appraise forfeited, pledged or confiscated assets*	Amend Art 55 as follows: • bailiffs would no longer conduct the valuation and instead, the valuation tasks	

except intangible assets, precious metals, gemstones, all types of collections, antiques with historic, cultural characteristics, assets that bailiff appraise independently and assets the parties could not agree on the value)	would be transferred to and done by licensed appraisers only; • Art 55.4 shall be void (article providing guidance), • Art 55.6 shall be void (expenses) • Art 55.7 shall be void (right to challenge bailiff's appraisals)	
Art.78. Filing a request to take the asset unsold by the payor in consideration of debt 78.2. If the payee has made a request in Art.78.1 of this Law, the payor has not managed to sell the asset within the time period set out in this Law and if there have been made no complaints against the asset valuation, the asset shall be transferred to the ownership of the payee in consideration of the debt due at the price set by the bailiff.	As the bailiffs would no longer conduct the valuation and instead the valuation tasks would be transferred to and done by licensed appraisers only the provision shall be amended to specify that the value of the asset shall be determined according to the appraisal of appraiser.	
Art 62.1 *(provision allowing the judgment debtor to propose to the bailiff to sell the asset at the price no lower than the valuation if it (debtor) does not wish to appeal the valuation set pursuant to the LEC*D).	Consistent with the above changes, the following amendment would be made to Art 62.1: (*provision allowing the judgment debtor to propose to the bailiff to sell the asset at the price no lower than the valuation ~~if it (debtor) does not wish to appeal the valuation set pursuant to the LECD~~*).	Challenge against collateral valuation would be resolved by the professional body of appraisers under the Law on Valuation of Assets. Filing of such challenge with the professional body of appraisers would not result any more in suspension of the judicial enforcement process. The two processes – (i) review of the challenge by the professional body of appraisers and (ii) judicial enforcement process, including sale – would go in parallel.
Art 63.4. *(provision allowing the judgment debtor to appeal the valuation, among others, to court)*	Consistent with the above changes, the reference to appeal would be removed from Art 63.4.	
Art 44.3. 44.3 A party to a judicial enforcement proceeding may appeal to the senior bailiff	To limit the possibility of objection, the following amendment would be made to Art.44.3:	Judicial enforcement by definition infringes on the debtor's property rights. It cannot and should not be restricted by the judgment

actions or decisions by the [junior] bailiff within 7 days if it disagrees with such action or decision.	"44.3 Parties to a judicial enforcement proceeding may appeal to the senior bailiff actions and decisions of the [junior] bailiff within 7 days upon learning of such action ~~if it disagrees with such action or decision~~ *only if such action is deemed to have [expressly breached the procedures established by this Law]*."	debtor's objection. Wilful and frivolous objections presently distort the justice system by effectively restraining the judicial branch. Most alleged breaches of procedures by bailiffs relate to notice deliveries and appraising assets. Due to the extremely high workload on the one hand, and the low salary rate of the bailiffs on the other hand, bailiff staff are not always properly qualified or trained. In addition, the State bailiff enforcement agency's HR turnover is high. These factors result in the bailiffs breaching various procedures and rules. Therefore, capacity building of bailiffs is necessary.
Chapter 26. (*Procedure for Bailiffs to use force, special devices and firearms*)	• Update Chapter 26 of LECD (*Procedures and Requirements in Application of Force, Enforcement Devices and Firearms*) to allow for, and regulate, the bailiff's use of vehicles and heavy machinery in judicial enforcement. • Particularly, "vehicles and heavy machinery" shall be added to Art. 290 of LECD to set power for bailiffs to use vehicles and heavy machinery. • Also, new Art.294[1] will be added to set up legal grounds and required permissions that need to be obtained prior to usage of such vehicles.	Please refer to the Case Study in Para. 8 In this case, the bailiff could not seize the collateral as the judgment debtor blocked the bailiffs' access to the collateral by lining up heavy trucks and heavy machinery around the collateral. Although the bailiffs have the power to seize, seal and confiscate assets, this power can oftentimes not be realized as the bailiffs do not have an express power to access and/use heavy trucks and machinery, if necessary.
Chapter 26. (*Procedure for Bailiffs to use force, special devices and firearms*)	Expand the circumstances when the bailiffs may apply so-called "individual"	

Article 294 Use of individual enforcement equipment 294.1.Individual enforcement equipment may be used [by bailiff] in the following circumstances: …. 294.1.2. in order to detain a criminal suspect or a prisoner who is armed or who may resist by using weaponry;	enforcement devices (e.g., handcuffs, bats, straightjackets, tear gases etc.) as follows: • add "*the debtor or the pledgor*" to 294.1.2; • add the new clause "*294.1.8. if the bailiff's actions to seal, arrest, confiscate or sell the collateral or other assets have been resisted by the debtor or other person(s) with force or special devices or firearms";* • add the new clause "*271.1.16. apply enforcement devices set out in Art.293.1 of this Law in accordance with procedures and requirements set by law*".	
Art 48. Access to Premises, Examination and Search *(provision granting a bailiff a power to (i) access (enter) premises , (ii) conduct examination of that facility and (iii) conduct search in that premise)*	Split current Art 48 into the following three separate articles: • Art.48. Access to Premises • Art 48[1]. Examination • Art 48[2]. Search	The procedures for (i) *accessing* (entering) a facility such as debtor's residence or a legal entity's office and (ii) *examining* and *searching* that facility must be treated and regulated separately. Currently, these two procedures are prescribed in a single clause of the LECD in a short and general manner. Thus, to enable full and efficient exercise of the bailiff's power to access the debtor's facilities, to examine and, if and as necessary, search and confiscate collateral and other assets, proper and detailed regulation of these enforcement techniques must be included in the LECD. Access to a facility must further be regulated in detail by distinguishing the type of judgment debtor – individual debtor or legal entity debtor.

		The same applies to examining and searching the facility.[70]
Art.44. *(provision relating to the enforcement powers of the bailiff)* "Art. 44.2.11. [bailiff shall have the power to] approach, and receive references and statements from, the property registration authorities regarding assets of the debtor;"	• Amend Art.44.2.11 as follows: • "*Art. 44.2.11. [senior bailiffs shall have the power to]* obtain *information regarding the payor's registered property and property rights from the Data Center in accordance with rules set out in Article 9.9 of Law on General State Registration subject to the following:* o *If electronic access is not feasible and paper-based access is feasible, within ordinary office hours;* o *Strict protection of data and confidentiality.*	The bailiff's powers to access and use information are not sufficient and automatic. To exercise these powers, the bailiffs must apply to the holders of the respective registries just like any other interested (private) party – by filing a formal written letter. Such inefficiency is not acceptable for the type of enforcement work carried out by the bailiffs.
Art.44. *(provision relating to the enforcement powers of the bailiff)* 44.2.13. [bailiff shall have the power to] withhold funds from the debtor's bank accounts, freeze withdrawals, restrict the account-opening or account-maintaining ability, or monitor revenues and expenditures of a bank account.	Add a new Art.31[2] as follows: "*Art. 31[2]. Duty of commercial banks to comply with the bailiff's instructions* *A commercial bank shall have the duty to comply with the bailiff's lawful instruction to withhold funds from the account balance, freeze the account movement, deny account-opening, account-maintaining or account-closing ability to the judgment debtor, institute monitoring over revenues and*	Similar to its power of access to information, this power of the bailiff is not exercised efficiently, either – he/she must first filing a formal written letter to the bank in order to freeze a bank account by which point funds in the account may be depleted. It is, therefore, suggested to introduce an obligation by the bank to comply promptly with any instruction by the bailiff to freeze the account or monitor revenues and expenditures on the account

[70] FYI, difference between "examination" and "search" in Mongolian enforcement laws is as follows: "Examination" of a facility is aimed at revealing traces of assets and clarifying other circumstances of importance for the enforcement procedure. "Search" of a facility is aimed to locating and confiscating assets, such as collateral.

	expenditures of the account without delay and in any event within [] business hours[71] *after receiving the written instruction from the bailiff. if such instruction is received by the bank during non-business hours, the instruction shall be complied within business hours after the resumption of the business next day".*	
Art.14. (*provision related to notice delivery*)	To make the following changes to Art.14: • Amend Art.14.4 as follows: *"14.4. if necessary, the notice set out in Art.14.1 herein may be delivered via, fax, telegram and email."* • Add new Art.14.5 as follows: *"14.5 [first sentence]. Notice addressed to legal entities shall be delivered to the employee of that legal entity who must sign the delivery slip and clearly indicate position, date and time of delivery."* • Add new Art.14.7, 14.8 and 14.9 as follows: *"14.7. It shall be deemed that the notice has been delivered to the payer or payee, including any of their representatives notwithstanding the following circumstances:* *14.7.1 the relevant party has refused to*	Methods of notification of the judgment debtor of the judicial enforcement are prescribed in Art.14.4 of the LECD. However, the actual wording of Art.14.4 is ambiguous – it does not clarify whether the notification by the means set out therein must be actually received or seen by the debtor (before the judicial process can be enforcement) and if, accordingly, the notification is final.

[71] To be discussed with Bank of Mongolia.

	accept the delivery; *14.7.2 the relevant party has failed to present himself/ herself/itself to the relevant authority's offices as requested although the notice has been delivered to the last known address;* *14.7.3 a notice sent to the last known residential address of payee or payer, or to the address disclosed in writing by payer or payee to the bailiffs (including email address) or sent through other means directed by payer or payee has not been received;* *14.7.4 a notice in form of electronic document, stamped by digital signature and sent to payer or payee through ICT sites.* *14.8. Any notice transmitted by fax, telegram or other form of electronic communication shall be deemed to have been given and received on the date of its transmission provided that if such day is not a Business Day or if it is received after the end of normal business hours on the date of its transmission at the place of receipt, then it shall be deemed to have been given and received at the opening of business in the office of the recipient on the first Business Day next following the transmission thereof.* *14.9 If the contact details of payer or payee change, they shall be obliged to promptly inform the court and the enforcement authority/bailiffs of the new address. If the*	

	payer or payee fails to do so and the notice is delivered to the former address, it shall be deemed as properly delivered.	
Art. 27.2. A senior bailiff shall suspend enforcement proceedings, whether fully or partially, undertaken by a [junior] bailiff as set out below: Art.27.2.5 if an appeal has been lodged with the court or with the senior bailiff against the enforcement actions and if the appeal has been deemed by the court or the senior bailiff as substantiated, [the proceedings shall be suspended] until the appeal has been resolved by the court or by the senior bailiff. 44.5 Lodging of an appeal against enforcement actions undertaken by a bailiff does not serve as a basis to, and subsequently will not, suspend, or rescind enforcement actions.	There exists inconsistency between Art.27.2.5 and Art.44.5 of the LECD. It is recommended to amend Art.27.2.5 as follows: "Art.27.2 if an appeal has been lodged with the court ~~or with the senior bailiff~~ against the enforcement actions and if the appeal has been deemed by the court ~~or the senior bailiff~~ as substantiated, [the proceedings shall be suspended] until the appeal has been resolved by the court or by a senior bailiff."	The purpose of the proposed amendment is to eliminate the inconsistency between Art.27.2.5 and Art. 44.5 of the LECD. Art.27.2.5 permits a senior bailiff to freeze enforcement proceedings undertaken by a junior bailiff if an appeal has been lodged with the court or with the senior bailiff against the enforcement actions. Under Art. 44.5, however, lodging of an appeal against enforcement actions undertaken by a bailiff does not serve as a basis to, and subsequently will not, suspend, or rescind enforcement actions.
Law on Misdemeanours		
Article 15.7 *(provisions imposing administrative liability on infringements of law enforcement proceedings)*	Add a new provision making it an administrative offense (misdemeanour) to lodge multiple frivolous appeals and claims: "*15.7.3. If a party to a legal proceeding lodges, on numerous occasions, claims and appeals within the same proceeding or connected proceedings which are based on knowingly groundless or false evidence with the intention of frustrating the proceedings, such party shall be imposed monetary penalty in the amount of […] (if the party is an individual) or in the amount of […] (if the party is a legal entity).*"	It is suggested to introduce legal liability for abuse of justice by making it an express obligation of parties to the civil court procedure not to file frivolous and/or multiple appeals.

Article 15.2 *(provisions imposing administrative liability for failure to comply with, or for obstructing, the actions of public officials without using force).*	It is proposed to increase the maximum level of liability (which is a monetary penalty) for non-compliance with actions of public officials such as bailiffs or for obstructing their actions without use of force. In particular, it is suggested to at least triple the maximum level of the monetary fine.	Currently, the Misdemeanours Law provides a relatively low penalty for a legal entity (maximum approx. USD1000) and for individual (maximum approx. USD100). In practice, obstruction of enforcement actions of bailiffs without using force is frequent. Please refer to the Case Study in Para. 8. In this case, the bailiff could not seize the collateral as the judgment debtor blocked the bailiffs' access to the collateral by lining up heavy trucks and heavy machinery around the collateral.
Law on Valuation of Assets		
N/a	• Add the following new Paragraphs to Art.26 (*Power of the professional appraisal organization*): *26.1.9. Publish and maintain a list (pool) of qualified appraisers,* *26.1.10. Receive and resolve challenges brought by a party to court proceedings, including proceedings of enforcement of a court decision, against valuation of assets by an appraiser [appointed by the General Department of Court Decision Enforcement],* *26.2. The professional appraisal organization shall resolve the challenge made under Para.26.1.10 herein in the following manner:*	Any challenges to the valuator's appraisal must be filed with the party which is best equipped to review and resolve the appraisal in a professional and efficient manner i.e. the professional appraisal association under the LVA. The recommendations herein specify the resolution procedure of challenges against a valuation by an appraiser set in enforcement proceedings. A critical recommendation is to grant finality to the decision of the appraisers' panel. In addition, we understand that the Ministry of Finance of Mongolia has recently started working on revising the LVA. For coordination purposes, it is recommended to communicate with the Ministry and the Ministry's team as

	26.2.1. after the challenge has been filed, the professional appraisal organization shall inform, in writing, the General Department of Court Decision Enforcement within 3 days receiving the challenge, *26.2.2. within 7 days of receiving the challenge, the head of the professional appraisal organization shall appoint a panel of no less […] consisting of the members of the Professional Committee of the professional appraisal organization in order to review the challenge and set the date for the review hearing of the challenge,* *26.2.3. the head of the professional appraisal organization shall similarly inform the General Department of Court Decision Enforcement of the appointment of the panel and the date of the challenge review,* *26.2.4. each of the appointed panel members shall sign the statement confirming his/her lack of conflict of interests,* *26.2.4. prior to the review hearing, the panel members [shall] [may] have a preliminary hearing for the purpose of hearing the reasons and evidences of the*	soon as possible.

	person who has brought the challenge, *26.2.5. the panel's decision and the proceedings on the day of the review hearing shall be documented and signed by all the panel members, copy of which shall be delivered, within 3 days since the date of the decision, to the General Department of Court Decision Enforcement.* *26.2.6. the panel's decision shall be final and unappealable.* *26.3. Detailed regulations of reviewing and resolving the challenges made under Para.26.1.10 herein shall be adopted and published by the professional appraisal organization in accordance with this Law.*	

CHAPTER TWO. LEGAL OBSTACLES TO ENFORCEMENT OF COLLATERAL

20. Mongolian law falls short of clearly upholding the priority ranking of a secured claim over unsecured claims. The Civil Code of Mongolia in general recognizes the principle that a secured creditor has a priority ranking over unsecured creditors in respect of the encumbered asset.[72] However, there exist legislative provisions – both within the Civil Code itself and in others laws - which fail to confirm, or even appear to contradict, the foregoing principle.

For instance, the same Civil Code sets out the order in which creditor claims are to be paid out of the proceeds of the company's liquidation or bankruptcy.

Specifically, the Civil Code sets the following sequence of claims:

1) payments to eliminate harm done to the life and health of others and other payments ruled by Court;
2) payments of the cost of activities carried out by the executor/ administrator in insolvency proceedings or Liquidation Commission, and other persons designated similarly;
3) claims arising from contracts and transactions concluded in the process of re-capitalization of the plaintiff during its bankruptcy;
4) indemnity of mandatory deposit insurance;
5) money assets of depositors;
6) wages of workers under labour contracts;
7) payments to other claimants in accordance with law.[73]

There are no limitations on any of the above categories. Moreover, it is only after the full payment of all the claims of the higher category creditors that those of the next category may be repaid[74].

21. Secured creditors' claims do not show up in the above sequence. This raises doubts as to the status of secured claims in bankruptcy or liquidation of a debtor. There have even been instances when a secured creditor was treated by the court *pari passu* with unsecured creditors. For instance, the Consultant itself recently represented a foreign-based client in Mongolian court, who was a secured creditor, in an insolvency case. The court refused to recognize the secured creditor's status and treated that creditor as *pari passu* with unsecured creditors. The case was lost even though the secured creditor appealed all the way to the Mongolia's Supreme Court and ultimately the creditor could not enforce its secured claim. The Mongolian court reasoned that the secured creditor's dealings with the insolvent

[72] Art. 153.1, Civil Code.
[73] Art. 32.5, Civil Code.
[74] Art. 32.6, Civil Code.

company in its capacity of a shareholder of the insolvent company (e.g., shareholder loans) justified denial of the secured claim's status.

In addition, the LECD provides for a suspension of the enforcement procedure if the debtor has been liquidated.[75] However, neither the LECD nor any other law contains explicit exclusion of security from this suspension. As a result, the suspension is open to interpretation of being a blanket suspension, i.e., covering recovery of collateral. Similarly, the Bankruptcy Law of Mongolia does not contain clauses dealing with secured claims and their status. It includes a broadly-worded language which says that any asset in the ownership of the debtor at the time of commencement of insolvency proceedings will belong to the debtor's estate for distribution.[76] There is no suggestion in the Bankruptcy Law that an encumbered asset is separate from the rest of the debtor's estate or that the secured claim's ranking will be respected. This leads to confusion about the status of a secured claim which may have an adverse effect on the security practice.

22. **Mongolian laws in general allow for out-of-court enforcement of collateral**. According to Art.174.4 of the Civil Code, the procedure for out-of-court enforcement of mortgages is to be established by law[77]. Pursuant to Art. 11.2 of the Law on the Collateral of Immovable Property, parties may agree to satisfy the secured obligation from the proceeds of the encumbered asset through an out-of-court process.[78] This out-of-court process can take place either as (i) an auction or (ii) a direct sale. [79] Thus, Mongolian law does in principle recognize out-of-court enforcement of all types of collateral, except for (i) land and (ii) items of cultural and historical significance.[80]

23. **Due to lack of clarity and detail in the applicable laws, practical application of out-of-court enforcement is limited**. At the same time, the law lacks detail as to the procedure for out-of-court enforcement. For example, direct sale of collateral is an option under Mongolian law[81]. However, the procedures for such direct sale are not defined in law. Instead, the parties themselves – debtor and secured creditor – must set the rules and procedures for direct sales in the loan agreement.[82]

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[75] Art. 27.2.1, LECD.
[76] Art. 17.1, Bancruptcy Law.
[77] Art. 174.4, Civil Code ("*The procedures for sale of properties under hypothec though a non-judicial proceeding shall be established by law*").
[78] Art. 11.2, LCIP.
[79] Art. 44.2, LCIP.
[80] Art.44.4, LCIP.
[81] Art. 44.2, LCIP.
[82] Art.45, LCIP.

In addition, out-of-court enforcement is prone to judicial appeals (which seem to be unrestricted under Mongolian law). Such legal uncertainty combined with the risk of appeals at any time during an out-of-court procedure, agreed by the parties whether pre-default or post-default, has limited the use of direct sales.

Instead, because of the legal regulation available, banks frequently choose auctions or, even more, judicial enforcement as their preferred methods to enforce collateral (even if in case of auction, it will likely involve judicial participation down the road).[83] In other words, judicial enforcement usually ends up with an auction sale.

Another example is so-called "*baritsaalbar*" set out in the LCIP and roughly translated into English as "evidence of pledge". "*Baritsaalbar*" is a type of negotiable instrument which (i) evidences the right of pledge and (ii) serves as the means of selling and transferring the debt, together with the pledge, out-of-court. However, unclear provisions in other laws (as described above) and litigious nature of most debtors have led the banks to use the mechanism of "*baritsaalbar*" only tentatively.

24. **Provisions related to auction, while extensively covered in three separate laws, are oftentimes contradictory and lack clarity.** Analysis of provisions of the key three laws relating to auction is annexed to this Report.

At present online auctions are not allowed in Mongolia and all auctions are physical. A judicial auction is regulated by Civil Code. This type of auction usually consists of the two steps. A person appointed by court (e.g. a bailiff) conducts the auction within 30 (thirty) days upon the issuance of the court's decision. This person informs the public about the auction via mass media 14 (fourteen) days prior to the auction. If no person submits a bid which matches or exceeds the initial price of the first auction or if no or just one person participates in the auction, a second auction will be organized after 30 (thirty) days of the date of the first auction. Announcement of the second auction must be run through the same procedure.

The minimum (starting) auction price of the first auction must be set as agreed to by the obligee, the obligor, and the owner of the asset (as applicable). If they fail to agree on such price, then the auction price will be set at 70 (seventy) percent of the market price determined by the appraiser. The appraiser is appointed by the bailiff.

As for the second auction, a mininum auction price of the second auction is set by either mutual consent of the parties or at 50 (fifty) percent of market price determined by the appraiser. Under the LECD if the collateral is unsold at initial action, the creditor/pledgee has a right, not an obligation, to take the unsold collateral (in satisfaction of the secured obligation). At the same time, Mongolian law (LCIP) contains another, self-contradictory

[83] Meeting with the in-house counsel of the commercial banks of 20 Sept 2017.

clause which states that if the creditor/pledgee fails to exercise its right, it will lose its secured right to the collateral. This effectively forces the creditor/pledgee to take the collateral onto the balance sheet in all circumstances.

While Mongolian law contains an extensive regulation of judicial auctions (albeit disparately – in three separate laws), rules and requirements of out-of-court auctions are not sufficieintly spelled out. Thus, it is not widely practiced. Nevertheless, according to law, extrajudicial collateral enforcement shall be conducted, under the contract, by an independent real estate agent, appointed by mutual consent of the pledgee and the pledgor and the sale mechanism for enforcement is a public auction on similar terms to the auction run by the court appointed bailiff i.e. private sales are excluded. The starting price of the auction is to be determined upon mutual agreement of the parties, in absence of which the price is set at 70% of the market price as determined by the appraiser. If the first auction is unsuccessful, the pledgee and the pledgor may enter into a contract enabling the pledgee to take collateral at the value equal to the starting price of the auction. If the pledgee and the pledgor, however, fail to reach such agreement, the second auction should take place within a month since the date of the first auction. At the second auction, the minimum asking price is set mutually by the parties, in absence of which the price is set at 50% of the market price determined by the appraiser. If the second auction fails, too, due to lack of bids (no bidder) or if no bid matched the minimum asking price, the pledgee has a right to take the collateral at the price reduced by no more than 40% off the price set for the first auction.

In the past, bailiffs in court enforcement proceedings used to take a 10% reward from realisation of the asset. This practice, which was allowed by the then law, has been discontinued after the recent legislative changes so that there is no longer a set percentage reward.

Recommendations

Existing Law	Proposed Change	Explanation
Civil Code		
Art.32. Dissolution of legal persons 32.5. Claims against a legal person in liquidation shall be satisfied in the following order: • payments to eliminate harm done to the life and health of others and other payments ruled by Court; • payments of the cost of activities carried out, within the rights and obligations, by the executor or Liquidation Commission, and other persons designated similarly; • claims arising from contracts and transactions concluded in the process of re-capitalization of the plaintiff during its bankruptcy; • indemnity of mandatory deposit insurance; • money assets of depositors; • wages of workers under labour contracts; • payments to other claimants according to law	Add the following sentence to Art.32.5 "*The foregoing sequence of distribution shall not apply to any asset which is subject to a validly-created security interest and shall not affect the priority ranking of a secured creditor's claim set out in Art.153.1 of this Code*".	A secured claim is not explicitly carved out in Art.32.5 of Civil Code from the estate of the debtor to be distributed to creditors (such as bankruptcy estate). This creates confusion and even inconsistent treatment of secured creditors in bankruptcy and other liquidation proceedings. Therefore, the proposal is to make it clear that a secured claim's priority ranking (as prescribed in Art. 153.1 of Civil Code) is not affected by the order of distribution set out in Art 32.5 of Civil Code.[84]
Art.175. Forced sale of pledge based on court ruling 175.1. In case the obligation performer failed to fulfil obligations when demanded as provided by Article 174 of this Law, immovable property	Make the following changes to Art.175: • Amend 175.1 as follows: "*Forced sale of immovable collateral shall be conducted in accordance with the procedures established by the Law on Collateral of Immovable Property*".	The Civil Code and the LECD are inconsistent as to the auction of collateral. For example, Art.175.2 of Civil Code permits the courts to establish a different disposal

[84] FYI, Art.153.1 of Civil Code: "If debtor fails to fulfill legal or contractual obligation secured by a pledge, then the creditor-pledgee shall be entitled to have her/his needs satisfied first from the value of the pledged property before other creditors ".

Existing Law	Proposed Change	Explanation
serving as hypothec shall be subject to forced sales at the decision of Court, unless otherwise provided by law. 175.2. Court may determine other forms of sales of immovable property based on the claims from owner of the immovable property and creditor, and considering proposals made by authorized parties. 175.3. Creditor, debtor and owner shall be entitled to take part in the auction. 175.4. Debtor shall lose his/her rights to keep the benefit from the property by issuance of decision on sales of immovable property at auction. 175.5. If debtor lives with his/her family members in a house or in a room of the house, that serves hypothec, s/he shall become lessee by the moment of issuance of Court decision on forced sales of immovable property and shall be obligated to pay the rent to creditor at the current rate. 175.6. Person, who assigned by Court to lead the auction, shall carry out the auction within 30 days from issuance of Court decision. 175.7. Person assigned by Court to lead the auction shall notify the public of the event through the mass media 14 days prior to it.	• Remove 175.2- 175.7 entirely in order to harmonise the Civil Code with the LCIP	procedure. This not only allows the courts to interfere with the powers of the bailiffs, but also, importantly, creates confusion. It is thus recommended to bring clarity in Art.175. Further, Art.175.6 of Civil Code contradicts Art.63.1 of the LECD – the former requires the conduct of auction within 30 days, whereas the latter – within 2 months (on certain occasions). Another contradiction between these two clauses is that the LECD mandates the bailiff only to conduct a judicial auction. Finally, it is in our view inappropriate for the Civil Code to contain procedural provisions since the Civil Code is first and foremost a substantive law.
Art 176. Terminating or rescheduling an auction	*176.1 Auction shall be terminated or rescheduled in accordance with the procedure established by the Law on Collateral of Immovable Property*". Remaining provisions in Art. 176 will be deleted.	
Art.177. Auction price 177.1. Minimum price of auction shall be mutually agreed by obligation performer, obligation assigner and owner prior to the auction, but if no such agreement was reached, such price shall be equal to	• Amend Art.177.1 as follows: "*177.1.Auction prices shall be determined in accordance with the procedure established by the Law Collateral of Immovable property.*	A licensed professional valuator determines asset valuation (under Art.9 of Law on Valuation of Assets). Therefore, it is proposed to bring Art.177.1 of Civil Code in line.

Existing Law	Proposed Change	Explanation
70% of the market price determined by appraiser. The appraiser shall be nominated by the auctioneer. 177.2. If no price offer was up to the level of the price offered at the initial auction, or no one participated in the auction, the second auction shall be conducted. 177.3. Second auction shall be organized within 30 days after the first one. Second auction shall be publicly announced as provided by law. Art.177.4. The minimum price of the second auction shall be set as 50% of the price mutually agreed to by the parties or 50% of the market value determined by the independent valuator. 177.5. Expenses of auction shall be borne by obligation performer.	• Remaining provisions will be deleted. •	Also, the minimum price of the first auction of 70% per current Art.177. of Civil Code is generally too unfavourable for the pledgor. Instead, it is suggested to apply the price agreed to by the parties themselves or, failing such agreement, by the independent valuator.
	•	
Art 451. Loan Agreement 451.3 Loans by banks shall be regulated by law.	• Amend Art 451.3 as follows: *451.3. **Consumer or business** loans by banks shall be regulated by law.*	The purpose of this amendment is to differentiate consumer loans and business loans. Currently, under Mongolian laws, no such distinction is made.

Existing Law	Proposed Change	Explanation
Bankruptcy Law		
17.1. The respondent's assets to be distributed shall comprise items owned by the respondent at the time of starting the bankruptcy case, or newly acquired during the period until the respondent's liquidation and removal from the state register as well as revenues and profits generated by such items. 21.1. The following activities shall be suspended by starting a bankruptcy case in order to ensure equal rights of claimants: 21.1.1. providing services or making payments out of the respondent's assets to be distributed;	Add the following sentence to Art.35.5 "*The priority ranking of a secured creditor's claim set out in Art.153.1 of Civil Code shall not be diminished or otherwise affected by this Law*".	Similar to Civil Code, a secured claim is not explicitly carved out in the Bankruptcy Law. As a result, the Bankruptcy Law is prone to varying interpretation and inconsistent application, even by courts. Hence, the need to clarify that a security's priority ranking (as prescribed in Art. 153.1 of Civil Code) is not affected by the Bankruptcy Law, namely, its Art. 17.1 and 21.1.
Law on Collateral of Immovable Property /Law on Deposits, Loans and Payment Transactions by Banks and Other Authorized Legal Entities		
LCIP: Art. 11.2. "*Collateral may be enforced out-of-court if parties agree so and if provided for by law*". Art. 14.2. "*Baritsaalbar shall be issued only if prescribed by law*". **LDLP:** Art.29.5 *"[banks and other authorized bodies] may execute baritsaalbar in accordance with the LCIP subject to entry into an immovable pledge agreement*"). Art.29.6 "*[banks and other authorized bodies] may sell the collateral evidenced by baritsaalbar in an extrajudicial manner … if prescribed so by law*".	To add the following provisions to the LCIP and the LDLP: • designate, and expand, the LCIP as the single source of law regulating out-of-court judicial enforcement, • conceptually, confirm that "*baritsaalbar*" is a negotiable instrument designed for banks and financial institutions only – for instance, amend Art.14.2 of LCIP as follows: "*Baritsaalbar shall be issued by banks and other authorized financial institutions*". • all other parties (non-banks) may still enforce collateral through out-of-court without "*baritsaalbar*" under the LCIP, • make the corresponding changes to the LDLP such as	The mechanism of "*baritsaalbar*" must be clarified and fully operationalized in line with its original objective – to serve, as a negotiable instrument, as facilitator of out-of-court sale of the debt, including NPLs.

Existing Law	Proposed Change	Explanation
	removing the overlapping and/or conflicting provisions from the LDLP.	
LDLP: **Art 20. Issuing loans by bank or other authorized legal bodies**	• Add the following new provisions: *20.2 "Consumer loan" means a loan to an individual for personal household, or family purposes, but not for business purposes.* *20.3 Consumer loans shall be regulated by the law.*	
Law on Collateral of Immovable Property		
Art.42 (Delivery of Notice to Pledgor) (*provision requiring delivery of a notice to pledgor prior to commencement of enforcement*)	• Make the following changes to Art.42: *42.4. if necessary, the notice set out in Art.42.1 herein may be delivered via, fax, telegram and email.* • Add new Art.42.5 as follows: *"42.5 [first sentence]. Notice addressed to legal entities shall be delivered to the employee of that legal entity who must sign the delivery slip and clearly indicate position, date and time of delivery."* • Add new Art.42.6, 42.7 and 42.8 as follows: *"42.6. It shall be deemed that the notice has been delivered to the payer, payee, suspect or other person notwithstanding the following circumstances:* *42.6.1 payer, payee, suspect has refused to accept the delivery;* *42.6.2 payer, payee, suspect has failed to*	The LCIP requires the creditor (i) to submit a mandatory notice to the debtor, and (ii) then to approach the court if the notice is not acted on by the debtor. However, the LCIP does not provide clear rules for notice procedures. This creates risks which provide an opportunity for debtors and their lawyers to challenge whether the notice has been delivered or not, and also may result in inconsistent interpretation and application of the law by judges.

Existing Law	Proposed Change	Explanation
	turn up in the authority offices although the notice has been delivered to the stated address; *42.6.3 a notice sent to the last known residential address of payee, payer, suspect or to the address disclosed in writing by payer, payee, suspect to the bailiffs (including email address) or sent through other means directed by payer, payee, suspect, has not been received;* *42.6.4 a notice in form of electronic document, stamped by digital signature and sent to payer, payee, suspect through ICT sites* *42.7. <u>Any notice transmitted by fax, telegram or other form of electronic communication shall be deemed to have been given and received on the date of its transmission provided that if such day is not a Business Day or if it is received after the end of normal business hours on the date of its transmission at the place of receipt, then it shall be deemed to have been given and received at the opening of business in the office of the recipient on the first Business Day next following the transmission thereof.</u>* *42.8 In case if the contact details of payer, payee, suspect are changed, they shall be obliged to promptly inform court decision enforcement authority/bailiffs of the new address. If the payer, payee, suspect fails to do so and the notice is delivered to the former address, it shall be deemed as properly delivered.*	

Existing Law	Proposed Change	Explanation
Art.44 Out-of-court sale of collateral 44. The following pledged items shall not be sold through extrajudicial (out-of-court) procedure: 44.1. land; 44.2. cultural and historical immovable property or the artefacts which has been, or must be, registered with the state.	• Amend Articles 44-47 as follows ***Article 44. Accelerated Extrajudicial Collateral*** *44.1.Accelerated extrajudicial collateral enforcement shall be exercised by a pledgee where all of the following conditions are fulfilled:* *44.1.1.Accelerated extrajudicial collateral enforcement has been agreed in writing by the pledgee and pledgor and that agreement specifies the enforcement event and the period of time in which the pledgor may execute payment following that event in order to avert the execution of this accelerated extrajudicial collateral enforcement;* *44.1.2.the pledgor has been clearly informed about the application and consequences of this accelerated extrajudicial collateral enforcement prior to the conclusion of the agreement referred to in Art.44.1.1;* *44.1.3.within 4 weeks of the enforcement event, or such later point in time where so negotiated by the pledgee and pledgor, the pledgee has notified the pledgor, in writing, of all*	Lack of provisions governing direct extrajudicial sale combined with the risk of appeals at any time during such sale pushes the banks and practitioners to avoid direct sales and instead choose the auction or, even more, the judicial enforcement
Art.45 (Direct Sales of Collateral) 45. Collateral may be directly sold if both pledgor and pledgee have mutually agreed so under Art.11.2 herein.		
Art.46 (Out-of-court Auction of Collateral) 46.1. The extrajudicial auction of collateral shall be conducted by a party mutually appointed by both pledgor and pledgee or, if pledgor and pledgee fail to agree, by an independent legal entity chosen and contracted by the pledgee and specializing in sale		

Existing Law	Proposed Change	Explanation
of real estate.	*of the following:*	
Art.46 (Out-of-court Auction of Collateral) 46.4. The minutes [of the auction] prescribed in Art.197.20 of Civil Code as well as the agreement [with the winner of the auction] prescribed in Art.197.23 of the same shall serve as the basis for registering the new owner [of the auctioned collateral].	*44.1.3.1.the pledgee's intention to realise the assets through this accelerated extrajudicial collateral enforcement to satisfy the contractual obligations of the secured credit agreement;*	
Art.46 (Out-of-court Auction of Collateral) 46.5. An auction shall be deemed void if the following circumstances are present: 46.5.1. there was no competition in the auction; 46.5.2. the winner has failed to fully pay the price indicated in the agreement.	*44.1.3.2.the type of enforcement measure to be applied as referred to in Articles 46 and **46[1]**;*	
Art.46 (Out-of-court Auction of Collateral) 46.9. If the auction is re-held due to Art. 46.5.1 (absence of competition during the first auction), the price set out in Art.46.2 herein shall be reduced by up to 20%. 46.10. if the auction is re-held due to Art. 46.5.2 (due to failure by the winner to pay the price on time), the price set out in Art.46.2 herein shall remain the same. (*Note: Art. 46.2 of the LCIP says that the starting auction price shall be determined in accordance with Art.177.1 of Civil Code*).	*44.1.3.3.the time period for the execution of payment before the use of the accelerated extrajudicial collateral enforcement referred to in 44.1.1;* *44.1.3.4.the default amount of the secured credit agreement due pursuant to the contractual obligations of the secured credit agreement;* *44.1.4.the pledgor has not executed the full payment as stipulated in the pledgee's notification referred to in Article 44.1.3. For the purposes of Article 44.1, the agreement referred to in Article 44.1.1 shall include a directly enforceable title.* *44.2.For the purposes of Article 44.1, in the cases where pledgor has paid at least 85 percent of the amount of the secured credit agreement, the period referred to therein may be extended by at*	
Art.46 (Out-of-court Auction of Collateral) 46.12. If the repeat auction under Art. 46.9 and Art. 46.10 was unsuccessful, the pledgee shall have the right to acquire the collateral for a price not exceeding 40% of the price set out in Art.46.2 herein.		
Art.46 (Out-of-court Auction of Collateral) 46.13. Provisions of the Civil Code relating to sales		

Existing Law	Proposed Change	Explanation
and purchase contract shall apply when selling a pledged asset [through an auction] or when the pledgee takes the asset in consideration of its claim under Articles 46.3, 46.7, 46.8, 46.12 herein.	*least six months.* *44.3. Pledgor is not permitted to dispose of the assets pledged as collateral as of receipt of the notification referred to in Article 44.1.3 and is subject to a general duty to cooperate and to furnish all relevant information where this accelerated extrajudicial collateral enforcement is exercisable in accordance with Article 44.1.*	
Art.47 (Judicial sale of Collateral) 47. If the court has satisfied the claim of the obligee to sell the collateral, the collateral shall be sold through auction in accordance with procedures established by Civil Code and the LECD.	*44.4. Pledgee affords the pledgor a reasonable period of time for execution of payment and makes reasonable efforts to avoid the use of this accelerated extrajudicial collateral enforcement.* *44.5.In case if conditions and procedures for out-of-court enforcement established by this Law have been met by the parties, the court shall not accept or satisfy any complaint challenging the out-of-court procedure"* ***Article 45.Enforcement*** *45.1.Collateral shall be realized pursuant to this accelerated extrajudicial enforcement.* *45.2. Parties shall be provided for at least one or both of the following means to realize the collateral as referred to in Article 45.1 for each type of security right and collateral:* *45.2.1.public auction;*	

Existing Law	Proposed Change	Explanation
	45.2.2.private sale. *45.3.For each of these means, a notary, bailiff or other public official is appointed where appropriate to ensure an efficient and expedited distribution of sale proceeds and transfer of the collateral to an acquirer, or safeguard the pledgor's rights.* *45.4.Where the extrajudicial enforcement is established by means of appropriation, the right of the pledgee to retain the asset in or towards satisfaction of pledgor's liability shall be governed by the applicable laws. In the case of appropriation, the positive difference to be paid out to the pledgor shall be the difference between sum outstanding of the secured credit agreement and the valuation of the asset.* *45.5.For the purposes of the realisation referred to in Article 45.2, the pledgee organizes a valuation of the assets, in order to determine the reserve price in cases of public auction and private sale, and that the following conditions are met:* *45.5.1. the pledgee and pledgor agree on the valuer to be appointed;* *45.5.2. the valuation is conducted by an independent valuer;*	

Existing Law	Proposed Change	Explanation
	45.5.3. the valuation is fair and realistic; *45.5.4. the valuation is conducted specifically for the purposes of the realization of the collateral after the enforcement event;* *45.5.5. the pledgor has the right to challenge the valuation in accordance with Law on Property Valuation.* *45.6. For the purposes of Article 45.5.1, where the parties cannot agree upon the appointment of a valuer for the purposes of realizing the collateral referred to in Article 45.2, a valuer shall be appointed by a decision of a judicial court, in accordance with the applicable laws.* ***Article 46. Public auction*** *46.1.The realization of collateral by means of public auction is conducted in accordance with the following elements:* *46.1.1.the pledgee has publicly communicated the time and place of the public auction at least 10 days prior to that auction;* *46.1.2.the pledgee has made reasonable efforts to attract the highest number of potential buyers; 46.1.3.the pledgee has notified the pledgor, and any third party with an interest in or right to the asset, of the public auction, including its time and place, at least 10 days prior to that*	

Existing Law	Proposed Change	Explanation
	auction; *46.1.4. a valuation of the asset has been conducted prior to the public auction;* *46.1.5.the reserve price of the asset is at least equal to the valuation amount determined prior to the public auction;* *46.1.6. the asset may be sold at a reduction of no more than 20% of the valuation amount where both of the following apply:* *46.1.6.1.no buyer has made an offer in line with the requirements referred to in Article 46.1.5 and 46.1.6 at the public auction;* *46.1.6.2. there is a threat of imminent deterioration of the asset.* *46.2. Where the asset has not been sold by public auction, the realization of the collateral by private sale.* *46.3. Where a second public auction takes place, Article 46.1.1-46.1.6 shall apply, but the asset may be sold at a further reduction [TBD].* ***Article 47. Private sale*** ***47**.1.The realization of collateral by means of private sale is conducted in accordance with the*	

Existing Law	Proposed Change	Explanation
	following elements: ***47**.1.1.the pledgee has made reasonable efforts, including adequate public advertising, to attract potential buyers;* ***47**.1.2.the pledgee has notified the business borrower, and any relevant third party with an interest in or right to the asset, of its intention to sell the asset at least 10 days prior to offering the asset for sale;* ***47**.1.3.a valuation of the asset has been conducted prior to the private sale, and or a public auction in accordance with Article 46.1.3;* ***47**.1.4.the guide price of the asset is at least equal to the amount established in the valuation referred to in Article 47.1.3, at the time of offering the asset for private sale;* ***47**.1.5.the asset may be sold at a reduction of no more than 20% of value where both of the following apply:* ***47**.1.5.1.no buyer has made an offer in line with the requirements referred to in Articles **47**.1.4. and **47**.1.5.1. within 30 days;* ***47**.1.5.2. there is a threat of imminent deterioration of the asset.* ***47**.2. Where the asset has not been sold by private*	

Existing Law	Proposed Change	Explanation
	sale within 30 days of offering the asset for sale, the pledgee publicly advertises the sale for an additional period of at least 30 days before concluding any sale. ***47**.3. Where a second attempt at private sale takes place, Article **47**.1.1-**47**.1.4 shall apply but the asset may be sold at a further reduction [TBD].*	
Art.61.2 (Satisfaction of Claim against Residential Mortgage) 61.2. If the residential property has been sold in satisfaction of the secured obligation, that property shall be repossessed in accordance with procedures established by law.	Amend Art 61.2 as follows: "61.2. If the residential property has been sold in satisfaction of the secured obligation, that property shall be repossessed in accordance with procedures established by law, *except for the property securing a consumer loan and which is the primary residence of the borrower and his/her family*." Note: A borrower residing with his/her family in a residential property which secures a consumer loan shall be deemed a lessee vis-à-vis that property.	It is recommended to exclude primary private residential property from the out-of-court foreclosure (under the recommended amendment to Art. 44.4 of LCIP above). In addition, Art.175.5 of Civil Code would apply to residential property in Art.61.2 of LCIP. (FYI, Art. 175.5 of Civil Code is "175.5. *If debtor lives with his/her family members in a house or in a room of the house, which is subject to a mortgage, s/he shall become lessee by the moment of issuance of Court decision on forced sales of immovable property and shall be obligated to pay the rent to creditor at the current rate*.").
Article 48.Rights of Pledgee and Third Person	• Add the following new provision to Art 48. *Article 48.4. Where a secured credit agreement which provides for the right to use accelerated extrajudicial collateral enforcement, secured credit agreements to third parties is transferred by the credit institution or its subsidiary to any third party, that third party shall acquire the right*	

Existing Law	Proposed Change	Explanation
	to use this accelerated extrajudicial collateral enforcement in case of the pledgor's default under the same terms and conditions as the credit institution.	
Law on Deposits, Loans and Payment Transactions by Banks and Other Authorized Legal Entities		
Art. 29.5. Collateral 29.5. If an agreement of immovable collateral has been entered into in order to secure a loan extended to an individual or a legal person, the borrower may execute "baritsaalbar" [in favour of the creditor] in accordance with procedures established by the Law on Collateral of Immovable Property.	Amend Art 29.5 as follows: "29.5. If an agreement of immovable collateral has been entered into in order to secure a *business* loan extended to an individual or a legal person, the borrower ~~may~~ *shall* execute "baritsaalbar" [in favour of the creditor] in accordance with procedures established by the Law on Collateral of Immovable Property".	It is recommended to eliminate tentativeness of Art.29.5 (e.g., "*the borrower may execute*") by introducing a clear and imperative requirement to issue "*baritsaalbar*" in case of business loans (vs. consumer loans). Making "*baritsaalbar*" a mandatory feature of any business loan would yield the following benefits – securitization of loans under the Law on Asset-backed Securities, factoring of loans by banks and NBFIs, use in out-of-court debt restructuring.
Art.2. Legislation on deposits, loans and banking transactions 2.1. The legislation on deposits, loans and banking transactions is comprised of the Constitution of Mongolia, the Civil Code, the Banking Law, the Law on Collateral of Immovable Property, the Law on National Payment System, this law, and other laws and regulations which are consistent with them.	Amend Art 2.1 as follows: 2.1. The legislation on deposits, loans and banking transactions is comprised of the Constitution of Mongolia, the Civil Code, the Banking Law, *the Law on NBFIs, the Law on Savings and Credit Cooperatives,* the Law on Collateral of Immovable Property, *the Law on Pledge over Movable and Intangible Property, Law on Asset-backed Securities,* the Law on National Payment System, this law, and other laws and regulations which are consistent with them. *For the purpose of this Law, "Authorized Legal Entities" shall mean financial institutions licensed to engage in deposits, loans or payment settlements.*	LDLP does not contain indication of who is "Authorized Legal Entities". This has resulted in uncertainty over whether financial institutions such as NBFIs or savings-and-loan cooperatives fall within the purview of this Law or not. Thus, it is recommended to draw clear lines on the LDLP's scope – by making it clearly applicable to other, non-bank financial institutions so that these institutions may take advantage of the opportunities provided by the institute of "*baritsaalbar*".

Existing Law	Proposed Change	Explanation
Law on Registration of Rights over Immovable Property		
Art.50. Registration of the collateral's title in the name of the new owner Art. 50.1 If the creditor has taken the collateral in consideration of the debt or if the purchaser has acquired the collateral at the auction, the pledgee shall file the collateral transfer documents with the state registration authority. The application for registration shall contain the name of pledgee, pledgor, location of the collateral, if the collateral is land, then the relevant cadastral details, as well as confirmation of compliance of the sale process with this Law.	• Amend Art.50.1 as follows: *Art. 50.1 If the creditor has taken the collateral in consideration of the debt,* ***then the creditor/pledgee itself,*** *(or if the purchaser has acquired the collateral at the auction,* ***then*** *the* ~~***pledgee***~~ ***purchaser****) shall file the collateral transfer documents with the state registration authority. The application for registration shall contain the name of pledgee, pledgor, location of the collateral, if the collateral is land, then the relevant cadastral details, as well as confirmation of compliance of the sale process with this Law.*	With adoption of the Law on Registration of Property Rights (adopted in June 2018 and in effect from in Nov 2018), many of the recommendations herein for the Law on Registration of Rights over Immovable Property have become redundant. However, an inconsistency has been identified between the new Law on Registration of Property Rights and the LCIP, which potentially creates uncertainty regarding the registration procedure for newly acquired assets following a judicial enforcement procedure.
Law on Enforcement of Court Decisions		
Art.71. Conduct of Auction 71.14. If no appeal has been filed against the transfer of ownership title of the immovable property, the party who has acquired the property at the auction shall become the owner thereof. 71.17. Minutes of the auction proceedings shall be recorded and, at the conclusion of the auction, signed by the auctioneer, the note-taker and the bailiff. A participant of the auction has the right to view the minutes and the right to submit a motion.	Amend Art. 71.14 and Art. 71.17 as follows: 71.14. ~~If no appeal has been filed against the transfer of ownership title of the immovable property, the~~ The party who has acquired the property at the auction shall become the owner thereof. 71.17. Minutes of the auction proceedings shall be recorded and, at the conclusion of the auction, signed by the auctioneer, the note-taker and the bailiff. A participant of the auction has the right to view the minutes~~ and the right to submit a motion~~.	A challenge of the decision to pass an ownership title to a bone fide new owner should not be a reason to freeze the title.

Existing Law	Proposed Change	Explanation
Art.73. Offering an unsold property to judgment creditor 73.3. Except as otherwise provided in Art.73.5 herein, a property unsold at an auction shall be offered to the judgment creditor at 50% of the price. If the price of the unsold property is higher than the amount of claim (obligation), the creditor shall have the right to take the unsold property upon payment of the difference. 73.5. An asset pledged in favour of a secured creditor … shall be offered to that creditor at the valuation set in accordance with Art.55.3 herein.	Amend Art. 73.3 and Art. 73.5 as follows: 73.3. Except as otherwise provided in Art.73.5 herein, a property unsold at an auction shall be offered to the judgment creditor at 50% of the price *determined in accordance with Art.177.1 of Civil Code*. If the agreed price or valuation of the unsold property is higher than the amount of claim (obligation), the creditor shall have the right to take the unsold property upon payment of the difference. 73.5. A *movable or intangible* asset ~~pledged in favour of a secured creditor~~ … shall be offered to ~~that~~ a creditor at the valuation set in accordance with ~~Art.55.3 herein~~ *Art.177.1 of Civil Code*.	Art.73 is unclear as to from what base (price) the 50% reduction is to be calculated. It is, thus, recommended to clarify that the offer should be made based on the price determined in accordance with Art 177.1 of Civil Code. FYI, in the similar situation under the LCIP the Consultant has recommended reduction of the price of an unsold collateral (as determined by the valuator) by 40% (*please see the proposed amendment to Art. 46.12 of LCIP above*).]

CHAPTER THREE. LEGAL OBSTACLES TO OUT-OF-COURT NPL RESOLUTION

25. The use of non-judicial methods of NPL resolution is limited. Mongolian law currently entertains only mediation or arbitration out-of-court NPL resolution – which are discussed below. As described below, private consensual NPL resolution between a bank and a borrower is rare and to the extent practised is confined to loan rescheduling.

26. Mediation has become available under Mongolian law, but poses risks for the creditor. Pursuant to the Law on Mediation a court-appointed mediator, at the voluntary election of both parties, may settle civil law disputes, including NPL resolution matters, such as the restructuring of a NPL and agreement of revised contract terms for such NPL.

Procedural rules of mediation are set in simplified provisions of the CPC[85]. Under the simplified provisions of the CPC, once a settlement has been reached, the court approves the settlement agreement and closes the case[86].

Certain provisions in the CPC make mediation a risky method. Specifically, once approved by the court, the creditor is prevented from appealing to courts if the debtor breaches the terms of the settlement agreement. [87]

27. Similarly, arbitration is not broadly used for resolution of NPLs. A new Arbitration Law of Mongolia has been adopted, based on the UNCITRAL Model Law on International Commercial Arbitration.

The Arbitration Centre of the National Chamber of Commerce of Mongolia is the main arbitration forum in Mongolia. Its caseload has in general been growing, albeit from small base, and is largely made up of local disputes (i.e. disputes between local companies).[88] But no NPL matter has ever been presented to it, therefore it currently lacks any experience of handling NPL cases.[89]

Under the Arbitration Law, NPL-related disputes could be subject to arbitration, with a few exceptions, among other matters, the following:

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[85] Chapter VII, Articles 74-75, CPC.
[86] Art. 74.2, CPC.
[87] Art. 74.4, CPC.
[88] According to the General Office of Court Decision Enforcement, only one percent of the total bailiff-led proceedings involve enforcement of arbitral awards.
[89] In the first half of 2017, the total caseload of the Arbitration Center was 34 cases only. In comparison, the total civil caseload of courts consisted of 24,442 civil cases during the same period. Meeting with Mr.Gunjdagva, Secretary General of the Arbitration Center of the National Chamber of Commerce of Mongolia (2 October 2017).

- Disputes related to enforcement of immovable collateral are subject to the exclusive jurisdiction of the local competent court.[90] This exception likely discourages lenders from submitting their debt enforcement disputes to arbitration.
- Consumer loans may be submitted to arbitration only if the parties agree to it after the dispute has arisen.[91]

Considering the above, only NPLs secured by movable or intangible pledges may be submitted to arbitration. In addition, arbitral awards, if not voluntarily complied with by parties, are subject to enforcement under the LECD – i.e., enforcement of arbitral awards faces the same challenges as court awards discussed elsewhere in this Report. Thus, arbitration of NPLs would not probably present immediate advantages over the courts.

28. **Assignment or sale of NPLs is possible in theory, but not practiced due to (i) lack of detailed regulations and (ii) ensuing lack of market for trading of NPLs.** Assignment of rights and obligations, including receivables along with collateral, is permitted under the Civil Code.[92]

However, it is not clear-cut under the current Mongolian legal framework if the assignment clause of the Civil Code applies to the sale of debt. Besides, there are other uncertainties: the procedure to notify the other party, the need for the debtor's consent, or the requirements of collateral registration – all of which may hinder the assignment and/or sale of NPLs.

For instance, the Civil Code does not require the creditor to notify the debtor of the assignment. It is not clear if the debtor who has not been notified would be exonerated from any liability if it unintentionally pays its debt to the previous creditor.

In addition, the existing law which is not practiced well is the LCIP. This Law has introduced a negotiable instrument enabling and facilitating the sale and transfer of debt, together with the immovable collateral (called "baritsaalbar" in the LCIP – "*baritsaalbar*" is discussed in detail in the next part). However, unclear provisions in other laws (as described above) and litigious nature of most debtors have led the banks to use the mechanism of "*baritsaalbar*" only tentatively.

[90] Art. 16.1, CPC.
[91] Under Art. 8.11 of Arbitration Law, Arbitration agreement regarding disputes related to customer entitlements shall be made after the generation of real dispute. Agreement shall be written and contain a settlement of arbitration jurisdiction.
[92] Art.123, Civil Code.

Furthermore, NPLs cannot be securitized under the Law of Mongolia on Asset-backed Securities (2011) – this Law prohibits securitization of "overdue assets".[93]

Finally, while the Bankruptcy Law does not address sale/transfer of claims, the broad moratorium or stay provisions available in the current version of the Bankruptcy Law appear to preclude the sale/transfer of claims during a bankruptcy process.

29. **The institute of "*baritsaalbar*" does not function as intended.** The LCIP has introduced a negotiable instrument called "*baritsaalbar*", roughly translated into English as "evidence of pledge". The lawmaker's intention behind introduction of "*baritsaalbar*" in the LCIP was to enable and facilitate the out-of-court enforcement of a debt, e.g., through sale or transfer.[94] Sale or transfer of debt would be accompanied by the immovable collateral as evidenced by "*baritsaalbar*". In short, under the LCIP "*baritsaalbar*" is a type of negotiable instrument which (i) evidences the right of pledge and (ii) serves as the means of out-of-court sale or transfer of the debt.

However, lack of clarity in the law surrounding "*baritsaalbar*" has led the banks to use the institute of "*baritsaalbar*" only tentatively. For one, despite numerous provisions dealing with "*baritsaalbar*", the LCIP contains a vague, even cryptic Art.14.2 saying that "*Baritsaalbar shall be issued only if prescribed by law*". One could argue that the LCIP itself constitutes that "*law*".

Yet another law - the LDLP – contains a set of provisions related to "*baritsaalbar*", too. These provisions, while suggesting that the LDLP, not the LCIP, is the "*law*", appear imperfect. For example, according to Art.29.6 of the LDLP, banks "… *may sell the collateral evidenced by baritsaalbar in an extrajudicial manner … if prescribed by law*". It is believed the "*law*" which prescribes the extrajudicial manner of selling the collateral. Is now the LCIP, not the LDLP. However, as discussed in Para.26 below, the LCIP as the "*law*" fails to prescribe the procedures for extrajudicial sale of the collateral.

Furthermore, neither the LCIP nor the LDLP prescribes who may use the institute of "*baritsaalbar*" – i.e., banks, non-banks, or individuals. Lack of precision as to who exactly can use "*baritsaalbar*" adds to overall uncertainty surrounding "*baritsaalbar*". The LDLP suggests, again inconclusively, that it is banks and other financial institutions only who may use "*baritsaalbar*" and, by extension, extrajudicially sell NPLs evidenced by the "*baritsaalbar*" (for instance, Art.29.5 of the LDLP says *"[banks and other authorized bodies] may execute baritsaalbar in accordance with the LCIP subject to entry into an immovable pledge agreement*").

[93] Art. 9.3, Law on Asset-Backed Security.
[94] Art 38, LCIP.

The above provisions of the two laws – LCIP and LDLP – are inconclusive and generate more questions than answers. For instance, some of the questions are - whether any extrajudicial sale is possible in the presence of "*baritsaalbar*" only? Whether "*baritsaalbar*" is the institute designed for banks only? Or whether extrajudicial sale by other categories of creditors (i.e., non-bank creditors) requires "*baritsaalbar*" as evidence, too? Can or should "*baritsaalbar*" be used in securitization of NPLs? Etc.

Last, not least, it is unacceptable from the legal writing perspective for an important legal concept (such as "*baritsaalbar*") to be dispersed in disparate laws in a confusing or even contradictory manner.

The end result of the above uncertainties is the banks use the institute of "*baritsaalbar*" cautiously, if at all.

30. **Out-of-court corporate debt restructuring is very limited.** There is a lack of a supportive legal and regulatory framework for corporate debt restructuring. Bilateral loan restructuring, to the extent it is carried out, is rather rudimentary and usually involves extending the repayment schedule, reducing the principal and/or collecting assets in consideration for part of the debt. (*Please see Chapter Four below for discussion of the Mongolian law relating to out-of-court debt restructuring*).

Recommendations

Existing Law	Proposed Change	Explanation
Civil Procedure Code		
Art. 65.1 A judge shall refuse to accept a claim in the following circumstances: Art. 65.1.6. there is a decision of a Court or an arbitrator with full legal effect, made on the subject-matter mentioned in the claim and guilt of the litigants or a decision of a Court or an arbitrator with full legal effect to refuse to accept the claim or to dismiss the case	Allow the creditor to re-file the settlement agreement with the court if the debtor breaches the settlement agreement during repayment of the resettled loan by adding the following new clause: 65.8 "*Article 65.1.6 shall not apply to cases which have been closed but which the judgment debtor has breached the settlement terms in, whether fully or partially*".	Under the simplified provisions of the CPC, once the settlement has been reached, the court approves the settlement agreement and closes the case. If the debtor performs under the settlement agreement for the first 4 years, but reneges sometime from the fifth year, judicial enforcement is prevented under the current Art 18.1.1 of LECD.
Civil Code		
Art.123 Transfer of claims 123.1. The obligor shall perform its obligations under the agreement to the original (first) obligee until it is notified about the transfer of the claim. 123.2. If it does not contradict the law, or contract, or the nature of the obligation, the obligee may transfer its rights to a third party under an agreement without the consent of the obligor.	Re-draft Art.123.1 as follows: "*123.1.* • *The obligee may transfer a right (claim) which belongs to it under the agreement to a third party.* • *The obligor shall perform its obligations under the agreement to the original obligee until it is notified about the transfer of the claim.* • *If the obligor has not been notified in writing of the transfer of obligee's claim to a third party, the new obligee bears the risk of resulting consequences, if any, unfavourable to it (new obligee). The obligation of the obligor shall be terminated by its performance to the original obligee made prior to*	According to Art. 123 of the Civil Code it is possible to transfer rights and claims. However, there may exist lack of clarity about the notification and the consent of the borrower in order to transfer a loan hence the proposed redrafting of the provision.

Existing Law	Proposed Change	Explanation
	receiving notice of the transfer of the claim to a third party."	
Art. 283 Term of Loan Facility	Add the following paragraph to Art.283: • "*A claim under the loan facility may be transferred or sold by the creditor to a third party in accordance with Article 123 of this Code".*	
Bankruptcy Law		
		The Bankruptcy Law should expressly permit and regulate the sale/transfer of claims during insolvency proceedings.
Law on Asset-backed Securities		
Art. 9.3. Portfolio; requirements of a portfolio 9.3. The following assets shall be prohibited from inclusion in a portfolio: 9.3.1. security asses consisting of incomplete construction or vacant (empty) land; 9.3.2. secured loan which exceeds the ratio of loan amount vs. security valuation (set by an authorized body); 9.3.3. overdue assets.	Amend 9.3.3 as follows: "*9.3.3. overdue assets not exceeding [20] percent of the particular portfolio*".	The Law on Asset-backed Securities excludes NPLs from securitization. The proposed amendment would allow a certain percentage of a portfolio (in our recommendation 20%, but could be higher or lower) to be securitized consisting of eligible overdue assets. This recommendation, if accepted, would require a more detailed regulation as well as discussions with BoM.

CHAPTER FOUR. LEGAL OBSTACLES TO CORPORATE DEBT RESTRUCTURING

31. **Multicreditor loans are currently limited in Mongolia, but will grow over time.** The Corporate Debt Restructuring Committee is intended to be a forum for workout for the borrowers and a number of banks to work out non-performing, but feasible debt resolutions without having to resort to legal proceedings. Yet Mongolia's banking sector so far practices little syndicated credit. However, the risk of cross-defaults of bilateral loans and/or shared security is growing. In addition, commercial banks currently do not have capacity to provide long-term large-size investment and project financing. The need for such financing will only grow given the extensive plans by both public and private sectors to build new infrastructure in Mongolia.[95]

32. **The CDRC is not meant to replace, and substitute, the NPL resolution mechanisms** commonly available to creditors – such as bilateral restructuring, judicial or non-judicial enforcement, bankruptcy etc. Nor is it appropriate to restructure any debt of any borrower. Effectively designed and efficiently executed, in transactions where there are multiple creditors the CDRC structure can serve as a welcome option for the lenders and for the borrowers alike, in addition to, and separate from, other options available in Mongolia for resolving NPLs.

33. **Mongolian law does not contain a procedure for out-of-court debt restructuring whereby a majority creditor supported restructuring plan concluded out of court can be made by binding on all creditors (including dissenting minority creditors) by sanctioning of the court.** For example, the existing Bankruptcy Law (1997) only provides for court-approved and court-controlled reorganization plans concluded within the course of bankruptcy proceedings and is only available for debtors that are technically insolvent, meaning that early reorganization is not possible, thus reducing the prospect of business rescue. This contrasts with many countries that have introduced so-called "pre-packaged" bankruptcy plans, such as Serbia and the UK through the use of combined schemes of arrangement and administration procedures and have allowed a not yet insolvent debtor to seek a preventive reorganization aimed at avoiding insolvency, subject to satisfaction of certain tests including equal treatment and fairness to dissenting creditors. This trend has been confirmed by the 2016 proposal by the European Commission for a directive requiring

[95] FYI, a bill has been presented in 2017 to the Mongolian Parliament which intends to permit establishment and operation of a foreign bank in Mongolia in an attempt to support financing of large infrastructure projects. According to the bill, the future foreign bank in Mongolia would be restricted to corporate banking only - namely, the bank would be authorized to issue a single loan of no less than MNT 100b (approx. US$40m) to a corporate borrower, issue guarantees, trade in securities and other financial instruments.

Member States to have a framework for preventive restructuring which is expected to come into force later this year[96]. A number of countries have additionally introduced special out-of-court procedures for restructuring but typically these have not proved that successful absent court involvement and the ability to 'cram down' dissenting creditors. This is similar in Mongolia.

The Mediation Law (2012) allows court-mediated debt restructuring[97]. However, a court-mediated debt restructuring under the Mediation Law cannot bind dissenting minority creditors since mediation is voluntary.

In addition, the Bankruptcy Law and legal framework do not facilitate various financial restructuring tools such as the super-senior status of restructuring financing, debt for equity swaps or reduction in debt principal. The senior status of new financing, which exists in a number of jurisdictions including the US Chapter 11 reorganization procedure, is not recognised by the existing Bankruptcy Law making it unlikely that creditors will provide new funding to a distressed business. Mongolia's Company Law (2011) allows debt-to-equity conversion.[98] But such conversion is subject to the mandatory pre-emptive right of existing shareholders which may not be forthcoming in a bankruptcy scenario [99]. A number of jurisdictions such as Slovenia have recognised this issue and have expressly removed shareholder pre-emptive rights in a reorganization scenario. At the same time, the Banking Law of Mongolia (2010) expressly allows commercial banks to foreclose on a defaulting borrower's shares, albeit such foreclosure is restricted to 10% of the total capital of a single borrower.[100] From the tax perspective, the Corporate Income Tax Law of Mongolia (2006) would caps potential loans of a shareholder (such as a bank) at 3 (three) times that shareholder's equity in the borrower, meaning if the amount of that shareholder loan (e.g., extended under restructuring) exceeds three times the amount of shareholding of that shareholder, the interest paid on the excess amount of the loan is non-deductible[101]. Instead, it is deemed to be a dividend to the investor. This limits potential shareholder investment in a future restructuring.

A fully functioning Bankruptcy Law that supports reorganization could be expected to have a positive effect on private reorganizations concluded out of court. However, the Regulation on Asset Classification, Provisioning and its Disbursements (2017) does not contain provisions dealing with debt restructuring. It instead requires relatively high provisioning requirements

[96] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0723&from=EN
[97] Art. 30, Mediation Law.
[98] Art. 25, Company Law.
[99] Art. 25.6, Company Law.
[100] Art.10.2, Art.17.4, Banking Law.
[101] Art.14.3, Corporate Income Tax Law.

of NPLs – e.g., if a loan is in arrears for more than 365 days, the loan needs to be provisioned at 100 percent of the gross value of the loan disregarding any collateral value incentives for dealing with debt restructuring. The same Regulation does not appear to contain any special treatment of provisioning for the NPL which are restructured. For instance, a loss on a restructured debt's interest or principal would only be possible by way of writing that NPL off the bank's balance sheet.[102] Most write-offs require a court's prior debt judgment – that is, debt restructuring is legally available only after the formal judicial proceedings have been undertaken, and concluded, by the bank[103]. This makes private reorganizations or restructurings unlikely. One possibility of a write-off which does not require a debt judgment is an NPL which is over "one year past due", but such write-off would likewise require the banks' Board formal resolution[104]. It should be noted the Regulation on Asset Classification, Provisioning and its Disbursements requires the banks to continue recovery efforts for the already written-off assets. Mechanics of the write-off are not spelled out, either – such as conditions and requirements of the write-off, e.g., partial write-off. Overall, the Regulation on Asset Classification, Provisioning and its Disbursements does not appear to permit debt restructuring (e.g., partial reductions) for viable corporate debtors (e.g., by way of reducing the interest and/or the principal debt due). Last, but not least, an inter-creditor agreement and its core concepts of a waterfall of creditor priorities on enforcement and/or insolvency are not explicitly recognized under the laws of Mongolia. It is not clear if Mongolian courts would recognize, and enforce, various provisions of an intercreditor agreement which reduces certainty for creditors and the ability to conclude an out –of-court private reorganization or restructuring of the debtor.

The lack of an existing culture for reorganization could, coupled with targeted reforms to address the above issues, be helped by the development of the Corporate Debt Restructuring Committee and the introduction of further guidance or principles of best practice based on the INSOL Guidelines for Multi-Creditor Restructurings or other Central Bank initiatives such as in Hungary.[105]

34. **Beside the above gaps, the Mongolian law does already contain tools supportive of out-of-court debt restructuring**. For instance, as discussed in the above paragraph, the Banking Law expressly allows commercial banks to acquire defaulting borrower's shares in consideration of debt.[106] Registration of most secured transactions (immovable, movable and intangible) is legislated and widely practiced under LCIP and Law on Registration of Movable Property Pledges (2015). Arbitration Law and Mediation Law, despite their

[102] Art.3.5.1, Regulation on Asset Classification, Provisioning and its Disbursements.
[103] Art.3.5.1.1-3.5.1.3, Regulation on Asset Classification, Provisioning and its Disbursements.
[104] Art.3.5.1.4, Regulation on Asset Classification, Provisioning and its Disbursements.
[105] http://www.mnb.hu/letoltes/oocr-en-10-oct-2017-clean.pdf
[106] Art.10.2, Banking Law.

weaknesses described in this Report, do set the framework for ADRs such as arbitration and mediation. Also, the Anti-Money Laundering and Anti-Terrorism Financing Law of Mongolia (2011) makes mandatory disclosure of ultimate beneficiaries of corporate debtors. Finally, the Law on Credit Information Database (2009) allows establishment of a privately-run credit information database. [107]

35. **Sale of the collateral (which is a fixed asset) is subject to VAT.** Under Mongolian law, any input VAT incurred on capital expenditures is not allowed to be deducted as input credit or refund. This means that any input VAT paid on purchasing or procuring fixed assets (including collateral such as buildings, equipment, plant, machineries etc.) is unrecoverable. Such tax treatment results in additional investment cost for businesses. On the other hand, the banks are required to impose VAT on the sale of the fixed assets (including collateral). This effectively reduces the sales price of the underlying asset sold by the banks, therefore reducing value of the collateral being sold and the recovery for the banks in an enforcement scenario.

36. **There exists double taxation on title transfer of immovable collateral.** Mongolian law sets 2% income tax on the sale of immovable properties, which tax is paid at the time of the title transfer. Notably, this tax is imposed on the gross transaction value, i.e., without deducting any associated historical costs. Therefore, it can be characterized as a "transfer tax" (vs. "income tax") and it applies to a title transfer where the title of property is transferred from the debtor to the bank (following the default). Then, the same 2% gross tax applies when the bank sells the same property to a buyer to recover cash proceeds. Therefore, the tax is effectively paid twice.

37. **While Mongolian tax allows deduction of losses deriving from NPLs, there exists uncertainty as to timing of when such loss should be tax deductible.** Losses caused by from NPLs are an essential part of costs for lending businesses. Thus, Mongolian law permits deduction of such losses from gross interest proceeds when determining income tax obligations. In particular, the Corporate Income Tax Law of Mongolia recognizes such losses through systematic provisioning for the potential risk of default in order to match associated costs over entire loan periods. However, there exists uncertainty in Mongolian law over exact timing of when such loss will be tax deductible – i.e., in which reporting period. As a result, for the tax reporting purposes the banks have to choose between the BoM rule - the Regulation on Asset Classification, Provisioning and its Disbursements (which is based on age of delayed repayments) or IFRS 9 rule (which assesses the risk based on certain forward-looking factors). While the prevailing practice so far has been for the banks to follow the

[107] It should be noted that the Law on Credit Information Database is yet to be implemented. Currently the credit information database is maintained and operated at the BoM.

Regulation on Asset Classification, Provisioning and its Disbursements (jointly adopted by BoM and Ministry of Finance of Mongolia), accounting regulations have been recently revised one of the outcomes of which is that assessment of the assets is now subject to IFRS 9. The two rules – the BoM rule and the IFRS 9 rule - lead to different outcomes resulting in compliance burdens for the banks.

38. **There exists a tax disincentive in the form of VAT for the sale of the NPLs under Mongolian law.** Sale or transfer of an NPL is a financial transaction which is usually exempt from VAT in most jurisdictions. However, if a bank in Mongolia wishes to sell its NPL portfolio to a third party (such as factoring firms or other market players), the portfolio being sold would likely be subject to the 10% VAT under Law of Mongolia on Value-Added Tax. As a policy matter, such sale of NPLs should be exempted from VAT in order to encourage development of NPL market.

Implementation of the NPL Framework:

Last not least, in addition to effective legal framework, successful resolution of NPLs requires a similarly effective soft infrastructure – strong professional bodies of bailiffs, appraisers and judges, accountability and disciplining mechanism of the personnel (especially in the bailiff department), transparent and ethical conduct, cooperation and exchange of information between various public agencies and officials etc. Some of the non-legal reforms that are equally instrumental to successful legal reform and that have been observed by the Consultant during preparation of this Report are below:

- Support the development of a professional body of appraisers well-versed in market economy and valuation methods in line with the best international practices and standards;
- Review, and if necessary revise, laws regulating the profession of appraisers. Specific areas of review include licensing, insurance, sanctions, jurisdiction and resolution of appraisal-related disputes, scope of the appraiser's professional body, role of the regulator (Ministry of Finance of Mongolia);
- Strengthen the capacity of the self-regulator - the Mongolian Institute of Certified Appraisers NGO under the Law on Valuation of Assets - which performs, under the Law on Valuation of Assets, professional development and oversight of its members (i.e., appraisers). Specific areas of support include training and retraining curriculum, standards, code of conduct,
- Review the institutional and HR policy of the bailiff department and provide operational support. Specific areas of review include training and retraining curriculum, pay system, high HR turnover, complaints and disciplining mechanism,
- Develop training programmes for judges in NPL resolution and related fields, including summary proceedings and consider the feasibility of designating specialist judges/benches in NPL resolution.

Recommendations

Existing Law	Proposed Change	Explanation
Law on Deposits, Loans and Payment Transactions by Banks and Other Authorized Entities		
N/A	Add a new chapter titled "Out-of-court corporate debt restructuring" legislating the following: • A loan which is non-performing may be restructured and repaid out-of-court, • Such restructuring should be subject to an Intercreditor Agreement where there are multiple creditors or a Debtor-Creditor Agreement for bilateral loans (*one option to consider is to equate these agreements to "mediation agreements" under Mediation Law. The effect of the Mediation Law would be (i) the agreements would need court approval and (ii) upon breach, would be subject to judicial enforcement*). • Restructuring is also subject to Mongolian law, except as provided otherwise by the parties, • Parties may agree that any new financing under a restructuring plan shall be accorded "super-senior" status in the event of bankruptcy. Please note that this would need to be recognised under the new Bankruptcy Law to be effective.[108] • Intercreditor Agreement or Debtor-Creditor Agreement may contain others provisions such as	An enabling legal and regulatory framework for corporate debt restructuring does not exist. It is thus suggested to lay out the general framework in a law, subject to discussions with the BoM and ADB and its consultants

[108] The recommendations above are limited to the subject of corporate debt restructuring only. IFC Mongolia is working, with the Ministry of Justice, on amendments to the Bankruptcy Law. .

Existing Law	Proposed Change	Explanation
	"standstill", waiver of rights, arbitration of disputes, avoidance of transactions etc. which provisions shall be valid and enforceable in Mongolian law, • Ranking of a secured creditor shall be protected and preserved vis-à-vis unsecured creditors under any Agreement, • The Mongolian Bankers Association would be the dedicated entity to administer corporate debt restructurings. The MBA would then have the authority to issue further enabling regulations and procedures. • In addition, corresponding references/articles would need adding to other laws (Civil Code, CPC, Bankruptcy Law etc.) to avoid direct contradictions.	
Company Law		
Art. 25.6. "*A shareholder has the pre-emptive right to purchase the shares that have been issued to exchange the company debt for shares.*"	Amend Art. 25.6 as follows: "*A shareholder has the pre-emptive right to purchase the shares that have been issued to exchange the company debt for shares, except for any issue of new shares to a creditor bank under restructuring of a non-performing debt of the company carried out pursuant to the Bankruptcy Law or others laws of Mongolia. For the purpose of this law, a "non-performing debt" would be any debt which is over [91] days past due."*	While the Banking Law expressly allows commercial banks to acquire defaulting borrower's shares in consideration of debt, this is inconsistent with the Company Law which does not provide for such exemption from the pre-emptive rights of existing shareholders of a debtor.
Bankruptcy Law		
	Add the new provisions which cover among other	The recommendations herein are limited to

Existing Law	Proposed Change	Explanation
	matters: • The Court shall approve the "pre-packaged restructuring" if the restructuring plan has been agreed by the debtor and majority creditors by value in advance, subject to certain conditions e.g. dissenting creditors will receive at least as much as they would have received in a liquidation. • Ranking of a secured creditor shall be protected and preserved vis-à-vis unsecured creditors and the security interest shall survive the insolvency/ restructuring. • The new financing under a restructuring plan shall be accorded "super-senior" status provided that there should be stringent rules regarding any purported priority over existing secured creditors.	the subject of "debt restructuring" only. The IFC Mongolia is working, with the Ministry of Justice, on amendments to the Bankruptcy Law and it is proposed to provide feedback on the importance of these provisions for NPL resolution to the IFC, subject to discussions with the BoM.
The Regulation on Asset Classification and Loan Loss Provisioning		
	Add the new provisions to the following effect: • Allow non-judicial partial write-off by a bank of the interest and/or the principal due in case of out-of-court restructuring of indebted, but viable debtors (i.e., without requiring court judgment, Board resolution, or other legal proceedings), consider introducing certain quantitative thresholds for the Board resolution (intervention) if too much discretion in the hands of the management is a concern. • Introduce special (flexible) loan loss provisioning levels for a new loan category – "NPLs in	The Regulation on Asset Classification, Provisioning and its Disbursements does not address debt restructuring at all. Most write-offs require a court's prior debt judgment – debt restructuring is legally available only after the formal judicial proceedings have been concluded by the bank. One other possibility of a write-off which does not require a court decision is an NPL which is over 365 days past due, but such write-off would require the banks' Board formal resolution. The mechanics of the write-off are not spelled out, either – such as conditions and

Existing Law	Proposed Change	Explanation
	restructuring mode". To be discussed with BoM.	requirements of the write-off, or treatment of partial write-off. As a result, the Regulation does not appear to permit debt restructuring (e.g., partial reductions) for viable corporate debtors (e.g., by way of reducing the interest and/or the principal debt due).
Value Added Tax Law		
Art. 7.2 The following shall be subject to [VAT]: …. 7.2.16 providing financing by a way of purchasing claims (including factoring, forfeiting and other similar activities)	Delete Art. 7.2.16.	If a bank wishes to sell its NPL portfolio to a third party (e.g., factoring firm or other NPL market player), the portfolio sold would be subject to the 10% VAT. Sale of an NPL as a financial transaction should be exempt from VAT in order to encourage development of NPL market.
Art. 14.1.5. Input VAT incurred in importing or purchasing goods, services, or works in developing a fixed asset or input VAT incurred in purchasing a fixed asset shall not be deducted.	Delete Art. 14.1.5.	Under Mongolian law, any input VAT incurred on capital expenditures is not allowed to be deducted as input credit or refund. As a result, any VAT paid on purchasing collateral (which qualifies as a fixed asset - buildings, equipment, plant, machineries etc.) is unrecoverable. In addition, banks are required to impose VAT on the sale of the fixed assets (collateral). This effectively reduces the value of the collateral being sold.
Corporate Income Tax Law		
12.1. The following expenses shall be deducted for the purpose of determining the taxable income:	• Add the following sentence to Art. 12.4: "*The tax deductions of provisions made for non-*	Article 12.4 of CIT Law can be revised and adopt an approach that tax deductions for non-performing loan risk fund can be determined

Existing Law	Proposed Change	Explanation
… 12.1.16. funds provisioned by commercial banks or NBFIs for potential loan losses; Art. 12.4. The expenses set out in Para.12.1.16 of this Law shall exclude funds provisioned by banks or NBFIs for performing loans.	*performing loans shall be determined according to the accounting treatment under IFRS9*".	according to accounting policy of the banks which effectively refers to IFRS 9 treatments. That way, it will reduce the complex administrative burden is this area and provide more certainty on the tax deductibility rules.
Art. 17.2. The following income shall be subject to the tax rates stipulated herein: 17.2.5. sale proceeds of immovable property – 2 (two) percent.	• Add the following new paragraph to Art.17.2: "*17.3. The tax set out in Art.17.2.5 shall not apply to transactions involving a title transfer of collateral property from the borrower to the lender bank*".	Mongolian law imposes 2% income tax on the sale of immovable properties. However, this tax effectively operates as a "transfer tax" – it applies to a title transfer where the title of property is transferred from the debtor to the bank (following the default).

Annex I. COMPARATIVE REVIEW OF STATUTORY CLAUSES RELATED TO AUCTION

As discussed in the Report, auction - whether judicial auction or voluntary (out-of-court) auction - is extensively covered in Mongolian law. However, the provisions related to auction are spread out among three separate laws of Mongolia – the Civil Code, the LCIP and the LCED. In addition, these provisions are often contradictory, overlap and even lack clarity. The below table highlights these auction-related provisions and gaps therein.

CIVIL CODE	LCIP	LCED	GAPS
177.1. If creditor, debtor and auctioneer fail to agree on the minimum starting price ahead of the upcoming auction, the minimum staring price would be set as follows - 70% of the market value determined by the independent valuator.	Art. 46.2.	Art. 55.1. Art. 55.3. Art. 55.7. Art. 27.1.4.	Valuation of an asset is a professional activity undertaken by independent licensed appraisers under the Law on Valuation of Assets (2010). However, Art. 55.1 of the LECD "ignores" the appraisal under the Law on Valuation of Assets. Instead, it entrusts the bailiff with coming up with valuation of collateral. The bailiff cannot and should not replace a professional appraiser – he/she would lack basic prerequisites to valuate collateral asset (e.g., market data, valuation techniques, professional license, experience, liability insurance[109] etc.). Hence, incorrect valuation is a major source of multiple appeals delaying the judicial enforcement. Further, under Art. 55.7 of the LECD it is the judge who is to hear and resolve the appeal challenging the bailiff's valuation. Similar to the bailiff, the judge would lack qualifications to determine whether the valuation is fair or not. Also, the appraisal determined by a valuator can be appealed within 30 days to the Professional Committee of Appraisers (under Law on Valuation of Assets[110]). But the same law or no other law prescribes what should happen after the appeal is so filed – when and how the Professional Committee should review and determine the fair valuation or whether such valuation by the Committee is final and binding.
177.2. If no price offer was up to the		Art. 71.6.	The LECD's Art.71.6 defers to the Civil Code with regard to the second

[109] A licensed appraiser has the obligation to reimburse and indemnify any loss or damage caused to others as a result of his/her professional activity. (Art. 14.1.3, Law on Valuation of Assets). To this end, a licensed appraiser is subject to mandatory liability insurance (Art. 14.1.6, Law on Valuation of Assets). The Consultant notes this requirement of liability insurance by licensed appraisers is not strictly complied with at present.

[110] Art. 11.1.3, Law on on Valuation of Assets.

CIVIL CODE	LCIP	LCED	GAPS
level of the price offered at the initial auction, or no one participated in the auction, the second auction shall be conducted. 177.3. Second auction shall be organized within 30 days after the first one. Second auction shall be publicly announced as provided by law. 177.4. The price offered by auction participants shall be sufficient to cover the costs related to organizing the auction and meeting the creditor's requirements. If the price was not high enough, it shall be considered that the auction did not take place.		Art. 73.5. Art. 73.6.	auction, including the Civil Code's Art. 177.4 reducing the minimum auction price from 70% to 50%. However, the same LECD, in its Art.71.6, contradicts Art.177.4 of Civil Code by requiring the bailiff to transfer the unsold collateral to the creditor in consideration of the debt at the valuation established by the appraiser.
174.1. Creditor shall be entitled to demand to sell the immovable property, in case the debtor exceeded the period of satisfaction of hypothec demand.	Art. 41		There are various inconsistencies between the provisions of the Civil Code and the LCIP amongst others, the following: - the breach under the Civil Code that would trigger the creditor's right to demand enforcement is that of "late payment of secured obligation". However, the breach under the LCIP is "non-performance" or "inadequate performance" of the debtor's obligations. The LCIP requires the creditor (i) to submit a mandatory notice to the debtor, and (ii) then to approach the court if the notice is not acted on by the debtor. Neither Civil Code nor LCIP provide clear rules for procedures of making the claim, notice, timelines etc. As a result, inconsistency of these provisions in the Civil Code and in the LICP leads to inconsistency in the judicial scrutiny - for instance, the Consultant is aware of cases when the bank's claim was dismissed by the court due to "insignificant" delay in repayment of secured loan or due to "insignificant" amount overdue.
	Art. 42		The provisions in the LCIP which allow entering the notice by the

CIVIL CODE	LCIP	LCED	GAPS
			creditor to the debtor in the state pledge registry contradict with the provisions of the Law on State Registration of Property Rights. In particular, the Law on State Registration of Property Rights sets out an exhaustive list of entries can be made in the state pledge registry (Art.20.1). The notice from the creditor to the debtor is not included in the list of the Law on State Registration of Property Rights. Entries which are to be recorded in the state pledge registry are a court decision to enforce collateral (Art.20.1.2), or sale of the collateral and transfer of the ownership title thereto (Art.20.1.5). Omission of the notice from the creditor to the debtor from the state pledge registry denies the creditor the opportunity to register its notice claim and to accordingly put other parties, including creditors, on alert.