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WILL MONGOLIA IMPLEMENT CURRENCY CONTROLS?

One of the headline issues giving rise to concerns among investors in Mongolia right now is the effect of a new Currency Law being approved by Parliament, and its implications both for existing and potential FDI.

Amid a falling MNT to USD rate, currently now over 2600 from a comparatively stable 2400 to 2500 through 2016 and 2017, the basis of the new legislation is not entirely clear. While it can be seen as a mechanism for stopping further devaluation of the MNT, to strengthen anti-money laundering compliance or discourage offshore transactions, some commentators view aspects of the new Currency Law as a means of enabling or ensuring that revenues from major projects go through the Mongolian banking system.

In June 2018, a revised version of the Law of Mongolia on Currency Regulation was submitted to the Parliament. Early in the autumn session of the Parliament, the Economic Standing Committee discussed the draft and resolved to prepare and submit the Draft to the Parliament for its consideration.

Certain politicians have been trying for some time, in different ways, to ensure that revenue streams from major projects, such as Oyu Tolgoi, largely flow

through Mongolian domestic banks. Given the size of the investment to Oyu Tolgoi, with over USD 4 billion provided by international lenders such as EBRD and IFC, it is understandable that diverting this volume of currency through the domestic banking system comes with high risk. Oyu Tolgoi's Mongolian bank accounts have been frozen by government order in the recent past, for example, in 2013 when Rio Tinto and the Government were discussing issues with, and possible amendments to, the Investment Agreement signed in 2009, and Oyu Tolgoi was subject to a significant tax claim.

A number of commentators and business groups have expressed serious reservations with the new draft, highlighting the following main concerns:

- The Bank of Mongolia (BoM) may open foreign currency accounts and implement settlements and transactions for foreign non-residents who are considered as strategic investors. This means that the BoM becomes a service provider, competing with other banks, which may compromise its current role as an independent regulator and policy maker.

- The BoM has the right to set restrictions on foreign transactions and foreign currency trading to promote macroeconomic stability.

- In addition, the Financial Regulatory Commission may set limits on transactions, taking into account the MNT exchange rate.

- The draft also seeks to reduce the threshold for a foreign-invested company from 25% of the equity to 10%, and imposes an obligation on foreign-invested companies to disclose their financial statements to the BoM (through the Ministry of Finance). While aspects of the draft are unclear, this appears to move away from the concept of equal treatment of foreign and domestic investors enshrined in the Investment Law.

These rights to restrict foreign transactions and foreign currency trading would seriously increase Mongolian country risk and damage ongoing and future FDI flows. The fact is that mega-projects are already at a reasonably high risk of politicization. To codify in law the ability of the regulators to become involved in commercial transactions and set limits for policy reasons would significantly increase risk for project financiers and enhance the risk, whether in reality or perception, of specific projects or businesses being singled out for unfair or uneven treatment.

Mongolia already has a Currency Settlement Law, enacted in 2009, which requires, with some exceptions, all payments in-country between domestic entities to be settled in MNT. This law is largely restated in the new draft Currency Law, without significant amendments, and it appears that the old law will be subsumed within the new, expanded Currency Law. The 2009 law was always somewhat unclear on whether contracts could be priced in or pegged to a foreign currency even though the payments under that contract would be made in MNT. It will be interesting to see whether this grey area is cleared up under the new legislation.

Given that the draft law is not yet finalized, it is too early to give a full assessment on its impact, in particular as there appears to be a similar draft submitted by the President's office in October. While it is to be expected that discussions, changes and amendments to the current draft will be made during the standing committee and Parliamentary sessions, it is important that law makers consider carefully the potential effects of some provisions on Mongolia's risk profile and the impact that this may have on mega-projects and foreign investment generally going forward.

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