The 12th day of June, 2008 No. 157 Ulaanbaatar

To adopt the Regulation of on-site examination
of non-bank financial institutions' activities.

Pursuant to the Articles 6.1.1 and 6.1.2 of the Law on Legal Status of the Financial Regulatory Commission and the Article 19.1 of the Law on Non-bank Financial Activities, the Financial Regulatory Commission decrees:

1. To adopt the Regulation of on-site examination of non-bank financial institutions' activities stipulated by attachment to this document. The regulation will come into force on the 1st day of July, 2008.

2. In regard to the adoption of this regulation, Head of staff (O.Ganbat) shall request the Bank of Mongolia to resolve for termination of the Regulation of the on-site examination and evaluation of the non-bank financial institutions' activities and financial conditions, adopted by the Bank of Mongolia Governor's Decree No. 639 of 2006.

3. Microfinance Department (N.Oyunchimeg) shall be responsible to power the maintenance of this decree and Administrative Department (N.Udaanjargal) shall be responsible to publicize this decree.

CHAIRMAN D.BAYARSAIKHAN

Copy certified:
CHIEF OF STAFF O.GANBAT

Regulation of on-site examination of Non-Bank Financial Institutions' Activities

ONE. GENERAL PROVISION

1.1. This regulation stipulates on-site examination activities conducted by the Financial Regulatory Commission of Mongolia ('the Commission') at the Non-bank Financial Institutions ('the NBFIs') to examine their operations, financial condition and compliance with the Law on Non-bank Financial Activities and other related laws and regulations. This regulation is to be followed for the assessment of the risks associated with the NBFIs' financial performance, liquidity and operations; and for taking measures, in case of violations.

1.2. Basing on the financial statements adjusted after the on-site examination of the NBFIs operations and financial performance by an officer or state supervisor of the Financial Regulatory Commission, following areas of performance are to be evaluated:
1.2.1. Capital;
1.2.2. Assets quality;
1.2.3. Management skills;
1.2.4. Earnings;
1.2.5. Liquidity;
1.2.6. Sensitivity to market risk.

1.3. To evaluate the above components, each of component sub factors, which are principal (qualitative) or other pertinent factors listed in the annex are assessed individually given a rating of 1 or 'strong', 2 or 'satisfactory', 3 or 'fair', 4 or 'marginal', 5 or 'unsatisfactory', which afterwards are weighted by their individual rate and consolidated.

1.4. Basing on the on-site examination report and the financial performance, the composite rating of the NBFIs' operations and financial condition is comprised of individual component sub factors assessment, weighted by the corresponding rate, listed in the Annex 7. The ratings are as follows:

STRONG or 1

SATISFACTORY	or 2
FAIR	or 3
MARGINAL	or 4
UNSATISFACTORY	or 5

1.5. During the on-site examination, besides advising directions for future operations, the officer shall evaluate and acknowledge the NBFI's financial performance changes and trends, reasons behind the changes, measures taken after the previous examination and their results.

TWO. CAPITAL ADEQUACY

The officer evaluates the CAPITAL ADEQUACY pursuant to the Annex No.1 of this regulation basing on the following factors:

2.1. Principal (qualitative) factors

Evaluation of the qualitative factors of capital adequacy is based on the NBFI's exposure, its essence and form and on the management skills to manage these risks.

2.1.1. Level of the NBFI's capital to assets and capital to risk weighted assets ratios with respect to the standards set out by the Commission.

2.2. Other pertinent factors

2.2.1. Compliance of the NBFI's operations with the laws and regulations related to the capital and paid-in capital.

a) In regard to the subordinated debt, if available, completeness of the contracts and other paperwork and authorization.

2.2.2. Amount of the paid-in capital with respect to the level set out by the Commission. Compliance with the Commission orders and resolutions, to raise paid-in capital and with the reporting and feedback acknowledgement procedures related to the changes in the paid-in capital stock.

THREE. ASSET QUALITY

The officer evaluates the ASSET QUALITY of the NBFIs pursuant to the Annex No.2 of this regulation basing on the following factors:

3.1. Principal (qualitative) factors

Evaluation of asset quality is based on the following:

level, trend of inferior quality, past due, non-accrual and renegotiated loans of on- and off-balance sheet;

provisions for loan losses;

skills to identify, manage and liquidate problem assets and quality and diversification of the assets and investments;

loans and investments policy, rules and regulations accuracy;

credit risk and concentration risk contingent to occur from the off-balance accounts;

productivity of loan management;

risk identification rules and regulations, control and information systems.

3.1.1. Prudent amount of problem assets as percentage of the total assets;

3.1.2. Prudent amount of problem assets as percentage of equity;

3.1.3. Prudent amount of provisions as percentage of equity;

3.1.4. Assets concentration risk or prudent amounts of the NBFI's 20 large loan outstanding balances as percentage of equity.

3.2. Other pertinent factors

3.2.1. The amount of non interest bearing assets as percentage of the total assets;

3.2.2. Credit policy implementation, Credit committee operations and loan repayment;

a) Ability to identify, measure, monitor and control other risks of assets;

b) Collateral size, quality;

c) Cumulative credit risk of interrelated borrowers;

d) Ratio of disbursed to repaid loans as of the examination period.

3.2.3. Compliance of the NBFI's operations with the limits set forth in regard to loans and other assets in the Law on Non-bank Financial Activities and other related regulations.

3.2.4. Classification of the NBFI's loans and other risky and contingent assets according to the related regulation.

3.2.5. Adequacy of provisions for loan losses.

3.2.6. Identification of the reasons behind the changes in the ratio of inferior quality assets to the total assets; measures, taken to reduce such assets; liquidation activities.

FOUR. MANAGEMENT SKILLS

The officer evaluates the MANAGEMENT SKILLS of the NBFIs pursuant to the Annex No.3 of this regulation basing on the following factors:

4.1. Principal (qualitative) factors
To qualitatively evaluate the skills of the Management of an NBFI, it is to consider the compliance of the NFBI's operations with the prudential standards, and the management's capability to identify, measure and control the risks associated with the operations.

4.1.1. Average evaluation of the five components of this regulation.

4.1.2. Prudent amount of the operating expenses with respect to the operating income.

4.2. Other pertinent factors

4.2.1. Execution and implementation of measures prescribed after the last on-site examination from the FRC, quality and impact of the measures taken.

4.2.2. Capacity to evaluate the financial condition of the NBFI, define the strategy of the NBFI and make correct decisions according to it. Executive's ability to manage the NBFI’s operations according to the power given by laws and in coherence with the sector trend and economic changes.

4.2.3. Internal auditing activity is evaluated by assessing the responsible unit’s ability to identify risks of the NBFI, measures to control those risks. Legitimacy of establishment and compliance of reporting of the internal audit unit with the laws and the NBFIs’ internal rules and charter.

4.2.4. Presence of management information system; the ways of data collection on operations and financial performance; data collection coverage and collected data genuineness control availability.

4.2.5. Compliance with the internal rules and charter; adequacy of those in respect to the laws and government regulations.

4.2.6. History of management staff regarding the exercise of professional misconduct and misuse of the position.

4.2.7. Compliance of the financial reporting with the relevant laws and regulations and compliance of the bookkeeping with the International Accounting Standards.

FIVE. EARNINGS

The officer evaluates the EARNINGS pursuant to the Annex No.4 of this regulation basing on the following factors:

5.1. Principal (qualitative) factors
Evaluation of earnings is based on the following:
ability to increase capital by stock ups in retained earnings;
profitability level, trends and stability;
quality and source of earnings;
operating expenses compared to peer group average;
volatility of earnings because of market risk;
adequacy of provisions for loan losses;
sensitivity of earnings to the untraditional or unusual activities;

impact of taxes on income;
pro-forma budgets, adequacy of budgeting methodology;
adequacy of the management information systems.

5.1.1. Return on assets (net income of the reporting period as percentage of average assets of the period of examination).

5.1.2. Return on equity (net income of the reporting period as percentage of paid-in capital).

5.1.3. Changes of the ROA value at the examination period (Tendency and reasons of such changes compared to the previous periods figures).

5.1.4. Net spread (Ratio of difference of gross interest income and gross interest expenses to the average assets amount of the period of examination).

5.1.5. The NBFI which has losses shall be given an evaluation ‘5’ equivalent to ‘unsatisfactory’.

5.2. Other pertinent factors

5.2.1. The amount of financial resources with low sensitivity to interest rate volatility.

SIX. LIQUIDITY

The officer evaluates the LIQUIDITY pursuant to the Annex No.5 of this regulation basing on the following factors:

6.1. Principal (qualitative) factors

Evaluation of liquidity is based on the following:
changes in financial liabilities, trend and stability;
degree of reliance on short-term volatile sources of funds, level of financing long term assets by these funds;
availability of assets readily convertible to cash without undue loss, ratios of these as

percentage of total assets;

access to money markets, ability to attract other funds and meet (short-term) financial obligations;

adequacy and compliance with internal rules and policies;

liabilities management strategies;

management information system;

provisional plans to attract funds;

management competency to identify, measure, monitor and control liquidity position (risks);

level of funding sources on- and off-balance sheet.

6.1.1. Compliance with the standards of liquidity prudential ratios, set out by the Commission.

6.2. Other pertinent factors

6.2.1. Contingency of liquidity problems;

a) Assets-liabilities management, adequate match of maturities, foreign assets and liabilities position (risk level), leverage ratio;

b) Ratio of current assets to total liabilities;

c) Stability of funds attracted by trust services;

d) Liquidity risk management;

e) Ability to attract funds;

f) Provisional plans to attract funds.

6.2.2. Repayments of project loans and loans taken from banks and other financial institutions.

6.2.3. Payments history; amounts, reasons and resolutions of past due loan repayments if applicable.

a) Outstanding balances of other payables and liabilities.

SEVEN. SENSITIVITY TO MARKET RISK

The officer evaluates the SENSITIVITY TO MARKET RISK or the NBFI's ability to control market risks (interest rate risk, price and foreign exchange risk) pursuant to the Annex No.5 of this regulation basing on the following factors:

7.1. Principal (qualitative) factors (foreign exchange risk)

7.1.1. Level of foreign currency positions by single currency and in total;

a) Compliance with the prudential ratios of foreign currency exposure; accuracy of accounting of foreign currencies revaluations.

7.1.2. The ratio of currency revaluation gains to risk-weighted total assets.

7. 1.3. The ratio of income, generated by financial instruments and derivatives as percentage of total income.

7.2. Other pertinent factors

7.2.1. NBFI management actions to measure, reduce and protect from risks;

a) Management ability to identify, measure, monitor and control risks; availability of effective policies to reduce risks.

7.2.2. Management information systems capability to identify risks.

a) Level and adequacy of the management information systems; usage of relevant and extensive data;

b) Ability to identify sources and correlation of risk factors, and to integrate the findings in the management and strategies along with price and foreign exchange volatility factors;

c) Economic value of NBFIs capital to changes of market factors;

d) Ability to meet risks, absorb losses; management ability to evaluate the NBFI's capacity to recover from losses;

e) Adequacy, solidity and coherence of NBFIs risk evaluation methodology.

EIGHT. COMPOSITE RATING

The following rules shall be used to evaluate the composite rating of the NBFIs operations and financial positions pursuant to the results of on-site examination and to the Annex No. 7 of this Regulation:

8.1. Pursuant to the directives of the on-site examination description, all members and the leader of the examination team rate each of the six components according to the examination findings.

8.2. The examination team leader calculates the mean rating for each component from the members' individual ratings. After the composite rating of the NBFI's operations and financial position is calculated, it is then acknowledged by each member's signatures and stamps of state supervisors.

8.3. Basing on the composite rating, the NBFI is given a rating analysis and interpretation (after rounding up by first decimal place values) as follows:

8.3.1. If the composite rating is between 1.0 and 1.5 – STRONG, meaning operations are sound in every respect;

8.3.2. If the composite rating is between 1.6 and 2.5 – SATISFACTORY, meaning there is contingency of problems occurrence;

8.3.3. If the composite rating is between 2.6 and 3.5 – FAIR, meaning the need of supervision;

8.3.4. If the composite rating is between 3.6 and 4.5 – MARGINAL, meaning viability of solvency and liquidity risks;

8.3.5. If the composite rating is between 4.6 and 5.0 – UNSATISFACTORY, meaning insolvency;

8.4. The on-site examination team shall provide an extensive rationale for the given composite rating in the examination reports.

8.5. The on-site examination team may increase or decrease the given rating basing on the present situation and future trends of operations and financial position. In this case it shall provide clear explanations in the reports highlighting the conditions and grounds of such revisions.

8.6. The ratings shall be given pursuant to the Annexes 1 through 6 of this Regulation consolidated by calculation of the mean value and consideration of other pertinent factors; the examination reports on composite rating shall be acknowledged with signatures of the team leader and members and stamps of state supervisors.

8.7. The on-site examination team hands a copy of the reports to the management of the NFBI prior to introducing them to the Director of the Microfinance Department of the FRC (or if required to be discussed, to the Commission meeting).

8.8. In case if the management of the NBFI disagrees with the assessment and rating, it may complain in written form to the State general supervisor of the Commission within 10 days from the receipt of examination reports.

NINE. RESPONSIBILITIES

9.1. NBFIs given the composite rating analysis of 'fair' and lower shall be enforced with following step-by-step measures:

9.1.1. The examination reports shall include orders to eliminate violations and incompliance;

9.1.2. In case if the violations are of serious nature, statements of state supervisors shall be produced to the NBFI;

9.1.3. Penalties and administrative measures set forth in the Law on non-bank financial activities and other regulations shall be taken;

9.1.4. Other consecutive measures set out in the Law on non-bank financial activities.

THE FINANCIAL REGULATORY COMMISSION

CAPITAL ADEQUACY

	FACTORS	WEIGHT RATE	STRONG /1/	SATISFAC-TORY /2/	FAIR /3/	MARGINAL /4/	UNSATISFAC-TORY /5/	RATING
1	PRINCIPAL FACTORS							
1.1	Maintenance of the Tier 1 capital to the Net total assets ratio prudential standard	30 %	Always comply	complied for 3 consequtive quarters	complied for 2 or inconsequtive quarters	Not complied for last 2 consequtive quarters	Not complied for period of over last 3 consequtive quarters	
1.2	Maintenance of the Capital to the Net total assets ratio prudential standard	20 %	Always comply	complied for 3 consequtive quarters	complied for 2 or inconsequtive quarters	Not complied for last 2 consequtive quarters	Not complied for period of over last 3 consequtive quarters	
1.3	Maintenance of the Capital to the Total assets ratio prudential standard	20 %	Greatest of peer group average	Above peer group average	Equal to peer group average	Below peer group average	Least of peer group average	
2	OTHER PERTINENT FACTORS							
2.1	Compliance with the laws and regulations related to the equity and paid-in capital.	30 %	Comply	incompliances can be eliminated upon day-to-day actions	incompliance were not addressed to be eliminated	repeated incompliances were not addressed to be eliminated	incompliances are affecting financial position	
	RATING	100 %						

Note: Corrected statements of the NFBIs examination date are considered as end of quarter reports.

ASSET QUALITY

	FACTORS	WEIGHT RATE	САЙН /1/	SATISFAC-TORY /2/	FAIR /3/	MARGINAL /4/	UNSATISFAC-TORY /5/	RATING
1	PRINCIPAL FACTORS							
1.1	Ratio of inferior quality assets to the total assets.	25 %	Least of peer group average	Below peer group average	Equal to peer group average	Above peer group average	Greatest of peer group average	
1.2	Ratio of inferior quality assets to the equity.	20 %	0,0-9,9 percent	10,0-29,9 percent	30,0-60,0 percent	60,1-99,9 percent	100.0 percent and above	
1.3	Ratio of prudent level of provisions to the equity.	10 %	Up to5 percent	5-15 percent	16-30 percent	31-50 percent	Above 51 percent	
1.4	Volume of concentrations or amounts of the NBFI's 20 large loan outstanding balances as percentage of equity.	10 %	Least of peer group average	Below peer group average	Equal to peer group average	Above peer group average	Greatest of peer group average	
2	OTHER PERTINENT FACTORS							
2.1	Ratio of non interest bearing assets to total assets.	10 %	Least of peer group average	Below peer group average	Equal to peer group average	Above peer group average	Greatest of peer group average	
2.2	Credit policy implementation, Credit committee operations and loan repayments; (Ratio of disbursed to repaid loans as of the examination period).	5 %	Loan repayment ratio is above 91 percent	Loan repayment ratio is 81-90 percent	Loan repayment ratio is 71-80 percent	Loan repayment ratio is 61-70 percent	Loan repayment ratio is below 60 percent	
2.3	Compliance to the loans and other assets limits	5 %	*Comply*				*Do not comply*	
2.4	Compliance of risky assets classification to the Regulation on provisioning	5 %	100 percent classified	Above 91 percent classified	71-90 percent classified	30-50 percent not classified	51 above percent not classified	
2.5	Adequacy of provisioning, subject to compliance to the regulation on provisioning.	5 %	100 percent adequate	above 91 percent adequate	71-90 percent adequate	30-50 percent inadequate	Inadequacy of above 51 percent	
2.6	Ratio of inferior quality assets to the total assets, identification of the reasons behind the changes in this ratio; measures, taken to reduce such assets; liquidation activities.	5 %						
	RATING	100 %						

MANAGEMENT SKILLS

	FACTORS	WEIGHT RATE	STRONG /1/	SATISFAC-TORY /2/	FAIR /3/	MARGINAL /4/	UNSATISFAC-TORY /5/	RATING
1	PRINCIPAL FACTORS							
1.1	Average of the other five component ratings (mean value)	40 %						
1.2	Ratio of operating expenses to the operating income	25 %	Least of peer group average	Below peer group average	Equal to peer group average	Above peer group average	Greatest of peer group average	
2	OTHER PERTINENT FACTORS							
2.1	Execution and implementation of measures prescribed after on-site examination from the FRC, quality and impact of those measures taken.	5 %						
2.2	Management of the NBFI operations in coherence with the sector trend and economic changes. Capability to evaluate the financial conditions of the NBFI and make correct decisions accordingly.	5 %						
2.3	Ability of internal audit to identify, monitor and control risks of the NBFI and consistency of taking timely measures to eliminate weaknesses and violations discovered by internal supervision.	5 %						
2.4	Presence of management information system; the ways of data collection on operations and financial performance; data collection coverage and collected data genuineness control availability.	5 %						
2.5	Compliance with the internal rules and charter; adequacy of those in respect to the laws and government regulations.	5 %						
2.6	History of management staff regarding the exercise of professional misconduct and misuse of the position.	5 %						
2.7	Compliance of the financial reporting with the relevant laws and regulations and compliance of the bookkeeping with the International Accounting Standards.	5 %						
	RATING	100 %						

EARNINGS

	FACTORS	WEIGHT RATE	STRONG /1/	SATISFAC-TORY /2/	FAIR /3/	MARGINAL /4/	UNSATISFAC-TORY /5/	RATING
1	PRINCIPAL FACTORS							
1.1	Return on assets *(net income of the reporting period divided by average).*	25 %	Greatest of peer group average	Above peer group average	Equal to peer group average	Below peer group average	Least of peer group average	
1.2	Return on equity *(net income of the reporting period divided by paid-in capital).*	25 %	Greatest of peer group average	Above peer group average	Equal to peer group average	Below peer group average	Least of peer group average	
1.3	Changes of the ROA	15 %	Greatest increase and least decrease of peer group average	Above peer group average increase	Equal to peer group average	Below peer group average increase	Least increase and greatest decrease of peer group average	
1.4	Net spread *(Gross interest income less gross interest expenses divided by the average assets).*	15 %	Greatest of peer group average	Above peer group average	Equal to peer group average	Below peer group average	Least of peer group average	
2	OTHER PERTINENT FACTORS							
2.1	The amount of financial resources with low sensitivity to interest rate volatility.	20 %	Above peer group average	10 percent different from peer average	20 percent below peer average	20 percent above peer average	Least of peer group average	
	RATING	100 %						

Note: Corrected statements of the NFBIs examination date are considered as end of quarter reports.

LIQUIDITY

FACTORS		WEIGHT RATE	STRONG /1/	SATISFAC-TORY /2/	FAIR /3/	MARGINAL /4/	UNSATISFAC-TORY /5/	RATING
1	PRINCIPAL FACTORS							
1.1	Compliance with the standards of liquidity prudential ratios.	40 %	Always comply	complied for 3 consequtive quarters	complied for 2 or inconsequtive quarters	Not complied for last 2 consequtive quarters	Not complied for period of over last 3 consequtive quarters	
2	OTHER PERTINENT FACTORS							
2.1	Contingency of liquidity problems	30 %	Sound protection	Possible problems after one year	Possible problems from 2 quarters to one year period	Possible problems within 2 quarters period	Possible problems during the nearest quarter	
2.2	On time repayments of project loans and loans taken from banks and other financial institutions.	20 %	Yes	-	-	-	No	
2.3	Payments history, delays	10 %	No delays	Possible delays	Delays for one quarter	Delays for two quarters	Delays for more than three quarters	
RATING		100 %						

SENSITIVITY TO MARKET RISK

	FACTORS	WEIGHT RATE	STRONG /1/	SATISFACTORY /2/	FAIR /3/	MARGINAL /4/	UNSATISFACTORY /5/	RATING
1	PRINCIPAL FACTORS							
1.1	Compliance with the prudential ratios of foreign currency exposure in total	25 %	Always comply	Complied for 3 consequtive quarters	Complied for 2 or inconsequtive quarters	Not complied for last 2 consequtive quarters	Not complied for period of over last 3 consequtive quarters	
1.2	Compliance with the prudential ratios of foreign currency exposure in individual currencies	20 %	Least of peer group average	Below peer group average	Equal to peer group average	Above peer group average	Greatest of peer group average	
1.3	The ratio of currency revaluation gains to risk-weighted total assets.	20 %	Greatest of peer group average	Above peer group average	Equal to peer group average	Below peer group average	Least of peer group average	
1.4	The ratio of income, generated by financial instruments and derivatives as percentage of total income.	10 %	Greatest of peer group average	Above peer group average	Equal to peer group average	Below peer group average	Least of peer group average	
2	OTHER PERTINENT FACTORS							
2.1	NBFI management actions to measure, reduce and protect from risks	15 %	Adequate capability	Measures are effective	Measures are partially effective	Measures produce little effective	Inadequate capability	
2.2	Management information systems capability to identify risks.	10 %	Capable				Not capable	
	RATING	100 %						

NBFI'S COMPOSITE RATING OF ITS OPERATIONS, FINANCIAL POSITION AND LIQUIDITY

No.	Component / category		WEIGHT RATE	EXAMINATION RATING		PREVIOUS EXAMINATION RATING	DIFFERENCE
				Rating scale	Weighted		
1	Capital adequacy	C	25 %				
2	Asset quality	A	25 %				
3	Management	M	10 %				
4	Earnings	E	20 %				
5	Liquidity	L	10 %				
6	Sensitivity to market risk	S	10 %				
COMPOSITE RATING			100 %				

Note: Any increase or decrease to the given rating shall have clear explanations and grounds respectively.

RATED BY:

EXAMINATION TEAM LEADER

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EXAMINATION TEAM MEMBERS:

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