<u>Unofficial translation</u>

Regulation on defining prudential ratios for cooperatives to conduct saving and credit activities, and monitoring of ratios

ONE. GENERAL PROVISION

1.1 The purpose of this regulation is to regulate relations by the Financial Regulation Committee (hereinafter refer as FRC) according to the article 6.1.2, the law on the legal status of the Financial Regulation Committee (FRC), article 8.4, Cooperative law, to define prudential ratios for a cooperative to conduct saving and credit activities, standards for a loan loss provision and other standards, monitor their implementation, and impose a responsibility.

1.2 Herein, Saving Credit Cooperative (hereinafter refer as Cooperative) shall assess an operational risk according to the following prudential ratios and adhere to its activity:

- 1.2.1 Prudential ratios for asset protection;
- 1.2.2 Prudential ratios for effective financial structures;
- 1.2.3 Prudential standards of assets quality;
- 1.2.4 Prudential rates of returns and cost;
- 1.2.5 Prudential ratios on liquidity;

1.3 A Cooperative shall estimate the prudential ratios correctly accordance with the reference 1.2 of this regulation, and calculate a probable risk evaluating reasons and factors influenced on ratios' changes, and take measurements to prevent.

1.4 A Cooperative shall establish additional rules and regulations in order to evaluate the possible risks related to its activity, monitor and manage the risks. All these regulations and rules should meet Cooperative law and other related laws and regulations.

1.5 In the present regulation, the following terms shall have the following meanings:

1. *Asset* is a financial reserve and capability under cooperative's ownership, formed by the result of the cooperative business activity, which bring an economical benefit.
2. *Other owned fixed assets* (hereinafter refer as other owning assets) are confiscating collateral fixed assets intended to sale because of inability to repay loans by a borrower.
3. *Fixed assets* are tangible assets which have limited usable period, to be used more than 1 year, which are not purposed for sale, intended to provide cooperative's normal business activity, imbue its first value into cost on the basis of the depreciation.
4. *Assets generating interest revenue* are sum of located remaining assets in order to generate interest revenue. For instance: Loan, the Central Bank Security, the Government Bond, Savings and Accounts in banks

5. *Loan* is an activity to borrow money to the members of cooperative on behalf of cooperative members with the definite purpose, term and repayment pledge with interest, and with a collateral asset or under a guarantee.
6. *Loan loss provision* is an established fund by the expense of the cooperative purposed to prevent from a possible risk in the future and calculate a risk previously.
7. *Loan centralization* is the issued loan with more than 30% of the equity to one borrower or to its related body in direct or indirect manner.
8. *Financial return* is a factor to increase the dividend by price difference, commission, and locating most of assets in assets generating revenues.
9. *Share capital* is the sum of members' paid-in collected capital to use the cooperative activity.
10. *Institutional capital* is the amount of the remained assets after subtracting share capitals from the equity.
11. *Liquidity* is a capability to immediately repay deposits and all other requests of payments upon the first inquiry.
12. *Solvency* is capability of the liquidation to repay total loans from all others, deposits and share capital.
13. *Short term* is the duration of savings, issued loans, purchased securities with less than one year term.

TWO. EVALUATING RATIOS

One. PROTECTION ON ASSETS

1.1 Asset consists of cash in hands, savings and accounts in bank, Government bond and Central Bank securities, granted loans to members (including receivable for financial leasing, credit card loans), fixed assets, other owned fixed assets, receivables and other assets.

1.2 Loan loss provision shall be established and classified according to the joint resolution approved by the President of the Mongol Bank and the Minister of the Ministry of Finance, numbered 207/459, of the year of 2004 "Regulation on classifying assets, establishing and expending risk funds" and amendment to the resolution amended by the joint resolution numbered 147/94 of the 2006.

1.3 If an inability of a legal body intended to repay the first loan and its interest partly or wholly under the contracts and negotiations related to the loan, Government bond, Central Bank security and other assets is defined with the appropriate documents, cooperative shall establish a loss provision by the expenditures.

1.4 Loan loss provision for performing loans and assets included in the performing class shall not be established when these assets indicated in the Balance sheet for the first time.

1.5 Terms of duration shall be a prime factor to classify a loan, Government bond, Central Bank security and other assets and quality of the assets shall be considered as a comparative factor. Duration and quality indicators shall be classified according to the factors showed in annex of the resolution indicated in the clause 1.2 of this chapter.

1.6 To calculate net assets of the cooperative, sum of asset accounts deducted their loss provisions and fixed assets deducted its depreciation.

1.7 Prudential ratio for the total assets of generating revenues should be more than 80 % of total assets.

1.8 Loan loss provision and other related loss provisions for a loan, Government bond, Central Bank security and other assets shall be established at the time of every change on assets according to the following classification and asset protection should be established accordance with the following:

1. Overdue loan	5 %
2. Nonperforming loans:	
-Substandard	40 %
-Doubtful	75%
-Bad	100%

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1.10 Loan loss provision and other related loss provisions for a loan, Government bond, Central Bank security and other assets shall not be allowed to use for the purpose except indicated in clause 1.2 of this chapter of the regulation.

1.11 In order to calculate solvency, total liability is divided by the total assets. This ratio should be greater than 110 %.

Two. EFFFECTIVE FINANCIAL STRUCTURE

2.1 ASSETS

2.1.1 Cash in hands doesn't generate revenue. To reduce risk and liquidate all payments immediately, a definite sum of cash is kept in cash in hand. Prudential ratio for this sum should not exceed more than 2%.

2.1.2 Total loans should be greater than 70 % of the total assets.

2.1.3 Total sum of purchased securities should not be greater than 10 % of total assets.

2.1.4 Other owned fixed assets should be not greater than 5 % of the total assets. (a growth of the other owned immovable assets shows that repayment of a loan is not in good shape and creates deficit on liquidity)

2.1.5 Total fixed assets of a cooperative should be not more than 5 % of the total assets.

2.2 LIABILITIES

2.2.1 Total deposits and savings should be greater than 90 % of total liabilities and not less than 70 % of total assets.

2.2.2 Loans from others should not be greater than 5 % of total assets.

2.2.3 Institutional capital of a cooperative should be more than 5 % of total assets.

2.2.4 Share capital of cooperative members should reach minimum 2 % of the total assets and be greater than 30 % of the equity.

2.2.5 Cooperative reserves should be greater than 40 % of the institutional capital.

Three. QUALITY OF THE ASSETS

3.1 Loan centralization:

(Depending on a specific of a cooperative activity, clause 3.1.1, 3.1.2 of this regulation shall refer to cooperatives, which assets reached 500 mln tug rugs)

3.1.1 A loan per one member should not be greater than 5 % of total loan portfolio and total loan issued to one member or a body related to that member should be not greater than 30 % of the equity.

3.1.2 Loan issued to share holder, members of Board of Directors, Supervisory Board and employees should not be greater than 5% of the total loan portfolio and issued loans to a body related to those should be not higher than 6 % of the equity.

3.1.3 A Cooperative should take necessary measurements to be adhered in order to limit other centralization.

3.2 Loan quality:

In order to estimate quality of the loan portfolio, the loan classification (performing loan, overdue, substandard, bad loan) should be compared to total loan. Nonperforming loans should be not greater than 5 % of the total loan portfolio.

Four. RATE OF RETURN AND COSTS

4.1 Rate of return of a loan portfolio shall be calculated by comparing net loan income to average net loan portfolio, and it is appropriate for this rate to less than the market average.

4.2 Cooperative shall establish a reserve fund by accumulation of a minimum 10% from net income, and reserve fund expenditure shall be done in accordance with procedures approved by general meeting of cooperative members.

4.3 Operating costs are related with asset management and should not exceed 8% of total assets.

4.4 Cooperative income and expenditure statement shall demonstrate operational performance, profit and loss, cost management, cost efficiency, financial performance and net growth. (Depending of specific nature of cooperative activities, loan interest income makes up the bulk part of the total income. Cooperative may have income from other sources such as service fees collection and foreign currency exchange rate income, and as it is basically funded by member deposits and share capital, the highest costs are usually related with savings interests).

For its operational risk management Cooperative shall calculate other additional ratios. For instance:

In order to calculate assert return of 1 MNT, earnings before tax shall be compared to average total assets and it is appropriate for this ratio to be higher than market interest rate.

- *Interest Income/Average Total Assets:* Ratio of income from all types of interests and Average Total Asset.

- *Interest Cost/Average Total Assets:* Ratio of all interest costs and Average Total Asset.

- *Net Interest income/Average Total Assets:* Ratio of the difference between interest income and interest costs to Average total assets.

- *Non-interest income/Average Total Assets:* Ratio of the sum of exchange rate translation income and all other incomes to Average total assets.

- *Non-interest costs/ Average Total Assets:* Ratio of the total of exchange rate translation costs, payroll costs, and all other types of costs other than potential risk costs to Average total assets.

- *Net Operating Income/Average Total Assets:* Ratio where the result of non-interest costs are deducted from the sum of net interest income and non-interest income and compared to average total assets.

- *Loss provision costs/Average total assets:* Ratio of total loss provision to average total assets.

- *Pre-tax income/Average Total assets:* The difference between net operating income and loss provision compared to average total assets.

- *Interest income/Average total productive assets:* Ratio between all types of interest income to average total productive assets.

- *Loan loss provision/Total loans:* Ratio between loan loss provision and total loans outstanding. (When loan loss provision increasing due to inability of issued loans to be repayed partially or fully leads to solvency deterioration and losses)

Five. LIQUIDITY RATIOS

5.1 This indicator shows whether the Cooperative faces problems in meeting deposit withdrawal requests in the circumstances of decreased liquid assets (cash on hand, fast sold assets).

5.2 In calculating liquidity ratio, liquid assets shall be compared to the sum of total deposits and short term payables. This ratio should stand at minimum 15%.

Six. OTHERS

6.1 General meeting of members, Board of Directors, Supervisory board, Risk Management committee and Head of the Cooperative within their powers and authority shall monitor whether Cooperative meets prudential ratios of Excellence.

6.2 Cooperative shall prepare the following reports on a quarterly basis and submit in hard or soft copy to the Monitoring and Legal Department within 10th of the next month:

1/Asset protection statement /Attachment 1/,
2/Effective financial structure statement /Attachment 2/
3/Quality of assets statement /Attachment 3/
4/Rate of return and costs statement/Attachment 4/
5/Liquidity statement /Attachment 5/
6/Brief balance sheet /Attachment 6/
7/Income and expenditure statement /Attachment 7/
8/Statement of loans and other loan comparable assets issued to members, employees, and related parties /Attachment 8/
9/Report on 20 Biggest Borrowers /Attachment 9/,
10/Report on Biggest Shareholders /Attachment 10/
11/Assets and liabilities due term report /Attachment 11/
12/Summary of prudential ratio indicators /Attachment 12/

6.3 The FRC shall supervise enforcement of prudential ratio standards by SCCs, and in non-criminal offences shall take measures to assign appropriate penalties.