

BANK OF MONGOLIA, FIU, FRC, GASR, GIA, IAAC

**RISK ASSESSMENT OF LEGAL ENTITIES ILLEGAL
USAGE, MONGOLIA**

2019

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1. INTRODUCTION

1-1. Transparency of Legal person and ultimate beneficial ownership

Partnership is an essential mechanism for individuals and legal persons for starting an enterprise in business, commerce, finance and other fields. This mechanism requires establishment of a legal person. In today's globalized socio-economic relations, various types of partnership methods are being adapted.

A corporate vehicle is defined as a legal entity or legal arrangement in accordance to the law. A legal person or legal entity - incorporates a company, partnership, foundation, or non-governmental organization, where such legal agreements constitute trust, contract, and representation. While the legal agreements originate from England, this mechanism is not fully developed in Mongolia. However, the use of legal entities has been widespread in Mongolia.

Similarly to countries around the world, different forms and types legal entities have been established in Mongolia. On the other hand, the illegal use of legal persons have been a common phenomenon as well. Criminal activities and illicit funds generated from those activities are being laundered and legitimized through complex and sophisticated legal person structures, which have become tougher to identify. This challenge related to lack of transparency and identification of beneficial ownership persist not only in Mongolia but throughout the world as well. In fact, the G20 raised this issue of transparency of legal person and beneficial ownership during one of the meetings. To address this concern, the Group committed to lead by example in implementing the agreed principles and international standards that prevent misuse of legal persons or legal arrangements.

1-2. RECOMMENDATION 24 AND 25

In 2017, Mongolia was evaluated the technical implementation of 40 FATF Recommendations. The evaluation report indicated that Mongolia failed to comply with standards related to transparency of legal persons and beneficial ownership of Recommendations 24 and 25, which also resulted in low scoring in Immediate Outcomes. Therefore, the Mutual Evaluation Report recommended a series of measures which included incorporation of provisions in legislation and improvement in the implementation.

Mongolia has taken several measures to improve the implementation of Recommendations 24 and 25. On the 21 June, 2018, The Law on State Registration of Legal Entities was revised and technical work was done such as approval of this law, approve the relative rule, etc. However,

Mongolia does not evaluate the risk assessment of legal person referred to in Recommendation 24.2 of the Technical compliance.

1-3. PURPOSE OF THE RISK ASSESSMENT

The purpose of this report is divided into two general sections. These include:

1. To determine the share of shadow economy that is generated by illicit revenues and its source, and how legal persons mechanism is applied to launder those funds.
2. Take effective measures to combat illegal use of legal entities and increase awareness of private and public institutions;

For this purpose, the Bank of Mongolia, GASR, Law Enforcement Agency, FIU and other organizations collaborated to analyze statistical data related to legal persons to investigate crimes and common illegal acts

1-4. General information regarding the risk assessment report of the legal entity

1.4.1 This report uses statistical data provided by the GASR, the FIU database, and the criminal investigations of law enforcement agencies.

1.4.2 An example of the illegal use of legal entities in a report is based on the common practice of law enforcement agencies and investigative documents. However, the misuse of a legal entity should not be limited to these characteristics. Because the criminals use a variety of techniques to combine the types of legal entities, it is possible to conceal them as much as possible.

1.4.3 The FATF and other international organizations recommended the use of good standards for other countries to combating illegal use of legal entities.

2. Risk Assessment

2-1. Mongolian Regulation and general information on the legal person

- Legal persons are registered by the GASR. Registration of legal persons in the state registration is regulated by the following laws. These include:
- General Law on State Registration / Updated June 21, 2018)
- Law on State Registration of Legal Entities / Updated June 21, 2018)
- Law on Combating Money Laundering and Terrorist Financing (April 26, 2018)
- Regulation on Approval of Legal Persons Name / Resolution 339 of the Government of Mongolia on November 14, 2018 /
- Resolution of registration of branches and representative offices of legal entities /Decree No. A / 208 of 2018 of Minister of MOJHA/
- Registration of organizations and their representative offices established under international agreements between Governments in the State Registry (Decree No. A/16 of Minister of Justice and Domestic Affairs (24 January 2019)

Article 7 of the General Law on State Registration the types of legal entities state registration as follows:

1. The establishment of a new legal person;
2. restructuring of a legal entity;
3. changes to information of legal persons;
4. termination of the activities of the legal entity;
5. representative office of the foreign legal person;
6. branch and representative office of the legal entity;
7. sealing of the legal entity's seal and its control;
8. Prohibited or canceled the registration of a legal entity by a decision of the competent authority of the state.

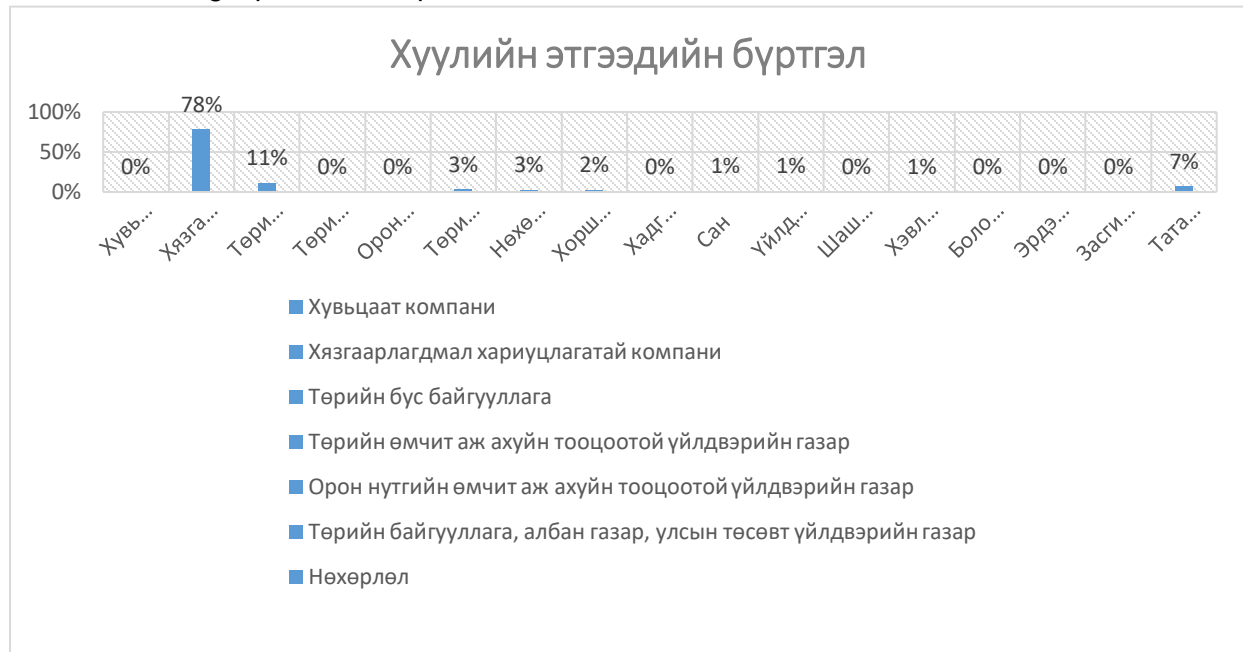
Article 7 of the Law on State Registration of Legal Entities states that the following legal persons shall be registered in the state registration: These include:

1. Partnership;
2. company;
3. association / non-governmental organization /;
4. foundation;
5. Cooperative;
6. Religious organizations;
7. legal person of public law;
8. governmental organizations and offices;
9. State enterprises;
10. Industrial estate.

These following regulations had been set in the Law on the State registration of legal entities about Representative office/branch of a foreign legal entity (company, partnership), Organization between Government that established by the international contract or agreement, their branch:

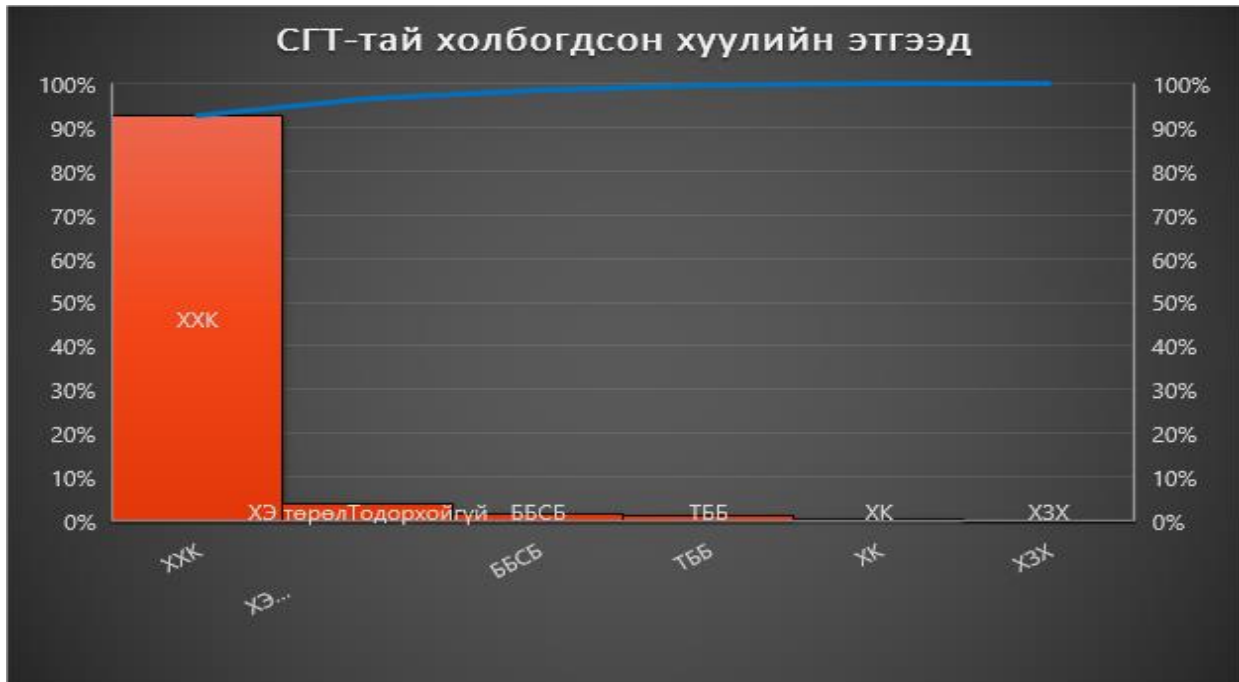
1. The State Registration Office shall register a foreign legal person (company, partnership) representative office and the relevant procedure shall be approved by the Government member in charge of state registration.
2. The state registration authority shall register the intergovernmental organization and its representative office established by international treaties and agreements and the relevant procedures shall be jointly approved by the members of the Government in charge of state registration and foreign relations.
3. Registration of any legal persons not indicated in the Section 7.2 and 7.3 of this law shall be determined in accordance with Section 7.4 of this law.
4. The provisions of Articles 7.1.8 and 7.1.9 of this Law shall not apply to the state registration of international organizations and Government special funds, commissions, committees and national councils.
5. The Supreme Court shall register political parties in accordance with this law and other laws.

Statistics on legal persons are provided in the table below. These include:



As of May 2019, 78% of total legal entities registered in the state register account for a total of 146,404 limited liability companies (LLCs). A total of 9103 foreign invested companies are registered at 6% of all listed companies (LLCs).

2.1.1 The following graph shows the suspicious transactions by the type of legal entity submitted to FIU.



93% of all Suspected Transaction Reports (STR) related to LLC, and only 1% are related to NGOs.

As a result, LLC has a statistical related with STR at 73%.

2-2. Typologies and cases in Mongolia

2.2.1 GIA

Case 1.

A dozen of money remittance and currency exchange services in Mongolia transferred millions of dollars between different bank accounts to the foreign trading company which is currently operating in Mongolia.

Immediately after the placement into the MNT banking accounts the whole amount of funds has been transferred to USD banking account of the foreign trading company. Those funds then fragmented into smaller amounts and wired to four companies registered in Hong Kong. According to preliminary investigation it has become clear that this company has not been engaged in consistent business activity and does not own or possess significant assets and liabilities.

Initial analysis shows that companies registered in Hong Kong also share the same address with each other.

Those transactions were part of the money laundering scheme to conceal or disguise the origins of funds (see attached scheme) obtained illegally in the foreign country abusing Mongolian financial and banking system.

Though, investigative authority determined that the large amounts of money entered into Mongolian financial system, with the “hawala” type money remittance.

2.2.2 Anti-Corruption Agency

Case 2.

The Mongolian company has obtained a loan from the Foreign Bank, which has signed a USD 100 million contract with state-owned enterprise. At the time of receiving a loan from our country, 8 officials from foreign banks formally established a limited liability company (COMPANY 1) in Mongolia. Three months before the establishment of the enterprise, the account opened in the commercial bank and transferred 100,000 USD from each investor by SWIFT. “c”, who has worked in foreign Bank, lead this company, and transferred his invest by Company 2.

In the COMPANY 1, COMPANY 2 bank accounts, foreign nationals have made significant cash flows. Afterwards, large amounts of discrepancies were transferred to international legal entities via online and internet transactions to the legal entities "K", which opened a variety of securities accounts and changed the illegal resources.

2.2.3 Police case

Case 3.

The BOM's FIU has sent STR to the police department, suspect that citizens of Mongolia has organized money laundering arrangements with foreigners. Mongolian citizen G, A and X are working together with foreign nationals E to create 16 enterprises with the same name as foreign entities between June, 2011 and October 2018. Received a total of 1,142.383 euros, \$ 99,889 or 3.6 billion tugrugs from the Republic of India, Greenland, the Republic of Turkey, the United States of America and the Republic of Italy through Golomt Bank of Mongolia It has been established.

In order to conduct a financial investigation, a Mongolian citizen, A and G., bought two apartments and two grants valued at 714,000,000 MNT on their own behalf and invested in money for the investigation of the monetary value of the proceeds of the crime, Measures taken to limit the movement of two housing purchases into the name.

Also, the names of those who have been identified as having a criminal offense have been purchased for 1 license of mineral deposits in the name of the third party.

A request from a foreign country is sent to 4 countries via an interpol and a total of 6 requests from Egmont lines to 2 countries, 3 requests are received and 3 requests are not expected. In addition, Turkey has submitted one petition under mutual legal assistance treaty.

The case is under investigation at this stage of the investigation.

2-3 International typologies and cases

The following examples shows how legal entities being used in money laundering in other countries.

2.3.1 Russia

Embezzled public funds worth RUB 300 million (Russian rubles) (USD 11 million) were transferred from the account of Company K to the account of Company R. Company R, a Delaware corporation, was owned and managed by the Russian wife of the suspect, a state official. The same day, Company R transferred USD 11 million as a loan to an account of Company A (BVI) held by a Cypriot bank. Company A then transferred more than USD 11 million to the Company D (US) to purchase real estate in France. Company D transferred more than USD 12 million to a French Notaries Bureau. Information from the FIU of Luxembourg showed that one of the US banks acted as a guarantor for the suspect's wife in a transaction to purchase of shares of a French company – and the holder of the real estate. The transaction was conducted via an S.S. company – a French subsidiary of a Luxembourg S.D. SA., incorporated and owned by the same individual. Analysis showed that these two chains were interrelated and the real estate was purchased with the proceeds of public funds embezzled for the benefit of the state official's wife.

2.3.2 Turkey

A group of persons create and operate websites to provide illegal betting over the internet. In order to hide their identity, these persons use natural persons and shell companies to open bank accounts, and withdraw or transfer the deposited funds. The natural persons are aged around 30, are not registered as taxpayers and do not have social security records, live in different cities, and are generally unemployed, housewives or minimum wage workers. The straw men are paid a certain amount of money for the use of their accounts. The intermediary accounts are changed constantly. The sums collected in the bank accounts of those persons are withdrawn in cash from the banks or from ATMs, transferred to the bank accounts of persons/companies established for this purpose, or transmitted to an offshore corporation.

2.3.3 Fiji

Mr. X used two shell companies to launder the money he had fraudulently obtained from his business partner Mr. Z. Mr. X set up a fake real estate company to facilitate the purchase and transferred the funds to another shell company and to his wife. The funds were then used to acquire property under their names.

2.3.4 Croatia

Croatian Company A received funds from Company B (incorporated in a financial centre), which were used to invest in real estate on Croatian coast. The founder of Company A was another Croatian company, the founders of which were citizens of Country D. The funds of foreign Citizen K (citizen of Country D) were suspected to originate from bribery in Country D, and were sent to the account of Company B, which then transferred funds as loan to the account of Company A. The ownership structure of Company A involved another Croatian company and 4 other citizens of Country D, but based on intelligence there is reason to suspect that beneficial owner of Company A is Citizen K.

3. Activities undertaken to reduce risks

3.1 In 2018, the Law on State Registration was revised. Article 12 of the General Law on State Registration provides for open, closed and limited information based on the database of GASR. The following information of the legal person is openly disclosed.

- Legal entity's name;
- Address;
- Registration number;
- Type;
- Shape;
- Areas of activity;
- Date of entry into state registration;
- Name and number of founders;
- Name of shareholder;
- The name of the person to whom the trust is represented;
- Reorganized information;
- Liquidated information

Other information of legal entity shall be granted with the permission of the legal entity or in accordance with the law, with the request of an authorized official of the competent authority.

On the website of the State Registration Office <http://opendata.burtgel.gov.mn/>, the public information is disclosed.

With the disclosure of legal entity, citizens and legal entities have access to information on the other party when concluding contracts or arrangements.

The Law on State Registration of Legal Entities contains information on the legal owner's ownership of the legal entity, its shares, interests, and voting rights, recording changes to the information, and the founder of the new legal entity to register such information to the state registration. The regulation will take effect on January 1, 2020.

The Law on Procedure of Complying with the General Law on Taxation states that the legal entity registered in the state registration of a legal entity before 1 January 2020 must register the registration of the beneficial owner of the property before the 1st of January, 2021.

As of June 4, 2019, 408 mineral license holders are registered the beneficial owner of the legal entity.

Also, the registration of the legal entity's registration software development is due to registering the beneficial owner of the legal entity from 2020.

Article 12.12 of the General Law on State Registration stipulates that "The Government shall approve the rules for the exchange of digital information, creating and using the database between State organizations and other organizations based on the proposal of the Cabinet Member." The Cabinet meeting on 5 June 2019 approved.

Upon the adoption of this regulation, the General Authority of the State Registration of Citizens, Legal Entities and Property Rights shall be placed in the national data center and the government and other organizations will be able to use State Registry information as a web service based on the agreement with the General Authority of State Registration.

Organizations such as the relevant authorities, the General Intelligence Agency, the General Police Department, the Anti-Corruption Agency, the Bank of Mongolia and the Financial Regulatory Commission have established "Information exchange agreements" to provide the founders, shareholders and other information of the legal entity.

The State Registration Authority is regularly monitoring the state registration of the legal entity that is registered as a fraud legal entity /does not provide financial X report or not active, etc/ or break the related law.

Order of A / 289 by the Director of the General Authority for State Registration dated on April 2019.04.04, the "Regulation on the supervision of State Registration" has been updated and approved, and the regular and monthly sampling inspections are conducted by the Supervision Department in the state registration of legal entities in the form of planned, un-planned, and executed.

For example, under the un- planned supervision, the GASP established the Working group to supervise whether the state registration of legal entities are in compliance with the law.

The examination reviewed the state registration of 438 foreign legal entities registered from January 2 to December 1st of the same year as 2018.

For the purpose of eliminating and preventing the identified violations, some legal entities has been suspended, investigated to the relevant law enforcement agencies, and imposed disciplinary sanctions on guilty officials.

Within this inspection, the state registration of 139 legal entities has been revoked and reported to the public media and published on the website.

In addition, the Customs General Office and the Financial Information Unit of the Bank of Mongolia have been cooperating with the Bank for the fraudulent conduct of customs declarations. In the future we are planning to jointly create databases.

Established a working group from the General Department of Taxation and the General Department of State Registration, verify the registration of the legal entity's registration database with the taxpayer's registration database and ensure the accuracy of the registration.

The Joint Working Group identifies taxpayer registration discrepancies, identifies the reasons for discrepancies, and taking some actions to reduce the discrepancies.

Section 26.1 of Article 26 of the Law on State Registration of Legal Entities states that the state registration office has its own website based on the proposal of the state central administrative body in charge of finance and budget matters that has not submitted the financial statements for eight or more consecutive quarters and has not submitted to the client financial institution. shall be declared publicly and within 6 months written notice, no complaints, bankruptcy case, financial statement not made, judicial decision established a debt-free is referred to dispose of state registration of the legal entity.

4. Conclusion

4-1. Challenges

There are many illegal use of legal entities. In particular, crime actions as a money laundering using new modern technologies, techniques, tools and forms of legal entities. There is a risk that the organization of this type of crime in the world will be similar in Mongolia. Therefore, it is necessary to take immediate action to prevent any further risks in this area.

For the first time in Mongolia, a risk assessment of the illegal use of legal entities has been performed. This assessment was used to collect data used by the GASR statistical data, information relating to suspicious transaction reports of FIU, and information that illegal use of legal entities from criminal law enforcement agencies.

The number of data used in the risk assessment and the result of the crimes investigated are summarized below. However, there are following issues with regard to improving risk assessment. These include:

1. Improve the database used for risk assessment;
2. Announce the importance of risk assessment to the authorities and private organizations;
3. Assess the risk assessment of other countries in relation to the effective use of risk assessment and the abuse illegal use of the legal entity;
4. Obtain advice and technical assistance related to the risk assessment by relevant international organizations;
5. Examine the FATF and APG typology, especially the FATF's recommendations and best practices regarding the "disclosure of transparency and ultimate ownership" and "concealment beneficial owner of the legal entity" and take necessary measures;

4-2. Further action

The use of a legal entity for illicit purposes in Mongolia is quite common. The majority of registered crimes were mostly related legal entities. In particular, the use of legal entities through money transfers and state-owned companies using the multi-lingual structure of the legal entity and concealing the beneficial owner, and legal entities of foreign citizens, jointly with legal persons of Mongolia, have made illegal cases using the types and forms of legal entities. These are highlighted in this risk assessment report.

In the future, the relevant authorities should improve the quality of the report's risk assessment and periodic reviews at regular intervals.

In this way, it is important to properly distribute the sources and fight against the AML/CTF crimes.

It is also important to publish the Risk assessment to public, and need to take some actions to improve the proper use of this risk assessment.

4-3. Recommendations under assessment

Recommendation 1. Cooperate with other government agencies to improve the database of state registration of legal entities;

Recommendation 2. Improve collaboration with the GASR to provide a system for efficient use of other law enforcement and state authorities;

Recommendation 3. Risk assessment is to be conducted within the first half of 2020, create regulatory framework for risk assessment;

Recommendation 4. Creation of regulation related to registering beneficial owner of legal entity and increase the capacity building of state registrar;

Recommendation 5. The law enforcement agencies will enrich the illegal use of legal entities typology and submit it to the next report and other competent authorities;

Recommendation 6. Explore international best practices and mitigate risks, and improve the system;

Recommendation 7. Take action to address the issues raised in this risk assessment and prepare the report

Appendix:

Appendix 1

Table 1. Statistics of legal entities

| | | | |
|--|--------------------|--------|----------|
| All legal entities registered in the State register | | 187300 | 100.000% |
| Public company | | 296 | 0.158% |
| LLC | | 146404 | 78.166% |
| From that | Foreign investment | 9103 | 4.860% |
| NGO | | 20947 | 11.184% |
| State owned self financing enterprises | | 76 | 0.041% |
| Local owned self financing enterprises | | 349 | 0.186% |
| State enterprise, office, and state owned financial enterprise | | 4815 | 2.571% |
| Partnership | | 4780 | 2.552% |
| From that | Foreign investment | 8 | 0.004% |
| Cooperative | | 3949 | 2.108% |
| Savings and Credit cooperative | | 530 | 0.283% |
| Funds | | 1525 | 0.814% |
| Trade unions | | 1395 | 0.745% |
| Religious organizations | | 525 | 0.280% |

| | | |
|--|-------|--------|
| Media organizations | 1074 | 0.573% |
| Education and Training Organization | 632 | 0.337% |
| Research organization | 2 | 0.001% |
| Organization between governments | 1 | 0.001% |
| Legal entity that has been dismissed from a state registration | 12697 | 6.779% |

Table 2. Legal entities related with STRs

| Types of legal entities | All number of STRs | Percentages of legal entities related with STRs |
|--------------------------------|--------------------|---|
| Unknown | 27 | 4% |
| NBFI | 11 | 2% |
| Savings and Credit cooperative | 1 | 0% |
| Public companies | 2 | 0% |
| NGO | 9 | 1% |
| LLC | 622 | 93% |
| | 672 | 100% |

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