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# MONGOLIA BUSINESS PLUS INITIATIVE

## Law on the Mongolian Central Securities Depository Draft

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## **ABBREVIATIONS AND ACRONYMS**

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BPI	Business Plus Initiative
MCSD	Mongolian Central Securities Depository
MSCHCDC	Mongolian Securities Clearing House & Central Depository Co., Ltd.
USAID	United States Agency for International Development



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## INTRODUCTION

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A central securities depository has three basic functions: registration of presumptive ownership of securities by means of book entries in electronic accounting systems; clearance and settlement of securities trades; and safekeeping of securities. There is a need in Mongolia for the modernization of the legal framework for the central securities depository currently known as the Mongolian Securities Clearing House & Central Depository Co., Ltd. (“MSCHCDC”).

The legal framework for the MSCHCDC is the Securities Market Law of 2002 in Articles 19, 24, and 25, Government Decree No. 72 of 2003 and State Property Committee Decree No. 298 of 2003. This framework is inadequate. The Securities Market Law is too general and is obsolete because it does not apply to the integrated functions of a modern central securities depository. Articles 24 and 25 posit two separate organizations, one for clearing and settlement of trades and the other for custody of securities. State Property Committee Decree No. 298 does not contain appropriate provisions for governance and is for a company with many shareholders.

Interviews with securities market participants and officials and staff of the MSCHCDC conducted in early September indicated that the operations of the MSCHCDC currently are generally considered adequate but it is anticipated that with Mongolia’s capital market development there is a need to strengthen the governance and operations of the central securities depository.

Annex I contains a draft Law on the Mongolian Central Securities Depository (“Law”) to provide a sounder legal basis for central securities depository activities. The Law incorporates Principle 30 of the IOSCO Objectives and Principles for Securities Regulation:

*Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.*

The Law also adopts key elements of the Recommendations for Securities Settlement Systems of the Basle Committee on Payment and Settlement Systems and the Technical Committee of IOSCO.

The Law provides rules for the Mongolian Central Securities Depository (“MCSD”): its governance; management; supervision; and funding. The detailed rules and procedures for clearing and settlement of securities transactions are extremely technical and complex and are not proper subject matter for a law. Most countries with developed financial markets provide authority to the central securities depository and to stock exchanges to establish their own rules on technical matters.

It would be especially inappropriate to have a law with detailed rules for a central securities depository for Mongolia at this time for several reasons. First, the London Stock Exchange is in the process of assisting the Mongolian Stock Exchange in strengthening its operations which has significant implications for the clearing and settlement of securities trades on that exchange. Second, the Financial Regulatory Commission is in the process of developing a regulation for second tier securities custodians and the precise nature of that regulation will also have implications for the operations of the MCSD. Third, the Mongolian securities market is expanding rapidly with the distribution of TT shares to all citizens and the anticipated entry of investment funds in the market. In addition, in general, laws are slow to change while new rules issued by the MCSD for its operations could be adopted quite rapidly to respond to developments in the market.

### **Substantive Rules regarding Rights to Securities**

The registration of securities in the name of an account holder at a central securities depository or at a sub-custodian provides presumptive ownership of securities but may be in the name of a fiduciary or other intermediary like a securities broker and not of the beneficial owner. In addition, the apparent beneficial owner may not be the legal owner based on the application of various laws to particular cases; for example, contract law, insolvency law, payments system law, secured credit law, family law (inheritance), and judicial procedure law (attachment).

Thus, there is a need for rules to cover rights to securities. This is not appropriate for a law on a central securities depository or for a securities law that is a regulatory law governing the issuance and trading of securities. Rather, such rules should be in a separate law or in the civil code. Such rules are contained in the Unidroit Convention on Substantive Rules for Intermediated Securities of 2009 that is currently being considered for adoption by states of the European Union. Mongolia could adopt such a law but the rules would probably best be incorporated in the Civil Code that contains some relevant provisions.

Annex II contains an outline of ten important substantive rules for rights to securities covered by the Convention. The Mongolian Civil Code currently seems to contain elements for only three, in Articles 88.3, 89.2, 154.1, 154.6, and 474.2.

## **SECTION I: BASIC PROVISIONS**

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### **Article 1. The Mongolian Central Securities Depository**

The Law establishes that there shall be only one central securities depository in Mongolia known as the “Mongolian Central Securities Depository” hereinafter (“MCSD”). Some countries with relatively small populations have had more than one but given the need for significant technical resources and the size of the population and capital market in Mongolia, there should be only one. The MCSD will be a limited liability company and the legal successor to the Mongolian Securities Clearing House & Central Depository Co., Ltd. A limited liability company has a more simplified legal regime than a joint stock company and is appropriate for a company with relatively few shareholders. It is unlikely that the MCSD would become a widely held company if privatized.

This article sets out the basic responsibilities of the MCSD: (i) registration of presumptive ownership of securities by means of book entries in electronic accounting systems; (ii) clearance and settlement of securities trades; and (iii) safekeeping of securities. The Law grants to the MCSD the powers described in the Law as well as incidental powers to the exercise of explicit powers that is appropriate to enable the MCSD to fulfill its technical functions, all of which cannot be anticipated in the Law.



## **SECTION II: GOVERNANCE AND MANAGEMENT OF THE MCSD**

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There has been a revolution in corporate governance throughout the world in the past twelve years for both public and private enterprises. The two most important reforms are a requirement for a board of directors to have a majority of independent directors and for an audit committee of the board composed of independent directors who perform specific important functions.

The current governance arrangements of the MSCHCDC are not in compliance with these two critical reforms. The board of the MSCHCDC is composed solely of government officials when the government wholly owns the MSCHCDC and there is a supervisory commission rather than an audit committee of the board of directors. This provides for divided accountability. Instead, the board of directors should be solely accountable for the operations and performance of any enterprise. The figure of a supervisory commission is a relic of the Soviet enterprise system and was often used precisely to diffuse accountability. It has no place in modern corporate governance.

In the absence of a modern company law in Mongolia and uncertainty as to what specific provisions for corporate governance will be in a new law that is expected to be enacted, the Law places significant emphasis on proper corporate governance. A central securities depository, no matter who is its owner, has a great responsibility to owners of securities and its governance should be designed to ensure the integrity of its operations.

### **Article 2. Board of Directors**

The MCSD will have a board of directors consisting of seven directors of which at least four must be independent directors. The board composition will include the MCSD executive director, at least one official of a Mongolian securities broker, one representative of the Mongolian Stock Exchange and, as long as the Government owns directly or indirectly twenty percent or more of the equity of the MCSD, one representative of the responsible governmental agency. The Law accommodates the possible future privatization of the MCSD; i.e., its shareholders may change but its governance and management would not if the law on limited liability companies that is before the parliament is appropriate for the MCSD and is enacted after the Law. If it is not, a new law for the MCSD may be required since it is not possible as a matter of rule of law for a prior law to supersede a future law. If the Law is enacted after the new companies law is enacted, this Law would govern.

Independent directors especially are to take an objective view of needs for the company that they serve and are those who are not connected by employment within the past three years, family relationship, or business or financial interest to officials or staff of the MCSD or of its predecessor MSCHCDC, to the Government or Parliament, to members of the Government or Parliament, or to shareholders who own more than ten percent of the equity of the MCSD.

Each director must meet the requirements of fitness and propriety established by rules of the Commission for companies which we assume will be issued pursuant to a new company law. Directors the MCSD will serve for a term of one year and may stand for re-election. Some company laws provide that a director may serve for more than one year but this is inappropriate because a director who is not adding value to a company should be replaced and not continue to serve beyond his unproductive one year. A director may be removed by the shareholders or by the board before the expiry of his term of office only for cause. Cause means misconduct in office or conviction of a crime unrelated to the position of director. This provision is to protect directors who are more assertive in combating corruption or other corporate misconduct than other directors and are unpopular as a result.

### **Article 3. Basic Responsibilities of the Board of Directors**

The board of directors shall (i) establish the strategy and policies for the MCSD's operations and (ii) oversee the implementation of that strategy and those policies by management of the MCSD. The board in consultation with MCSD management will determine the annual budget of the MCSD and review quarterly the outcome in relation to the budget.

The board of directors has several other key responsibilities: issue rules for the operations of the MCSD and its relationships with its participants and counterparties; appoint an executive director, a chief financial officer, and a chief risk officer of the MCSD, define their key responsibilities, and determine their compensation; approve the organization structure of the MCSD; and adopt and oversee enforcement of a code of ethics for MCSD officials and staff.

The board must Issue annually a strategy policy statement that includes an assessment of performance of the MCSD in relation to the previous year's strategy policy statement and qualitative and quantitative business objectives for the next year. The assessment of the past year's performance against the objectives for that year is an important accountability instrument.

### **Article 4. Chairman of the Board of Directors; Board Meetings**

The board will elect a chairman who is an independent director. Among other functions, the chairman will determine the information the board must receive from management prior to each board meeting. This is so the management or staff cannot conceal from the board information that is embarrassing to them. In many companies in many countries, the board receives what the management wishes to present to it. As an important matter of transparency, the board must also prepare minutes of its meetings that must be published on its website.

### **Article 5. Committees of the Board of Directors**

Committees of a board of directors are an important instrument for efficiency of operations and to enable independent directors to play key roles in the audit of operations and governance of a company. The board of the MCSD must establish Audit and Governance Committees each of which has three members of which two are independent directors and chair the committee.

The duties of the Audit Committee include: establishing appropriate accounting procedures and accounting controls and commissioning audits of the company's accounts and records; approving the strategy, operations and budget for the MCSD's internal auditing, monitoring internal audit operations, and providing for remedial measures; and establishing rules to identify, measure, manage and monitor operational risks arising in the clearing and settlement process through reliable systems.

The committee will have an adequate budget to commission audits and to engage experts like lawyers and forensic accountants to examine areas that the committee believes require investigation.

The duties of the Governance Committee include: establishing criteria for selecting new members of the board of directors and identifying qualified persons; establishing criteria for the evaluation of governance by the board; and providing for a program of an annual performance evaluation of the board. These provisions place emphasis on the important matter of governance.

### **Article 6. Liability of Members of the Board of Directors**

Another relic of the Soviet company regime was vindictive provisions for liability of directors that assumed that losses incurred by a company were in many cases due to director or

managerial misconduct like theft of company assets or income. The modern view in corporate governance is that directors cannot presage all of the consequences of their actions and there will be some negative outcomes for which they should not be personally responsible if actions are taken in good faith. If the liability of directors is unreasonable, active businessmen and women who are the best qualified persons will not accept directorships. Thus, since the MCSD will seek to attract and retain highly qualified persons as directors, the Law contains the “business judgment rule” for director liability.

Thus, a director of the MCSD will not be personally liable for the effect on the MCSD or on its members or its counterparties of a decision that he takes if: he informs himself of relevant considerations on the matter to be decided; he makes the decision in the best interest of the MCSD and not in his own personal interest; and the action decided is not in violation of law or rules.

#### **Article 7. Management of the MCSD**

The MSCHCDC is subject to the Law on Management and Financing of Budgetary Institutions and the Law on State and Local Property that provide for governmental authorities that are owners of state-owned enterprises like MSCHCDC to exercise excessive control and micromanagement in a top down, rigid approach, contrary to international best practices as recommended by the OECD Guidelines on Corporate Governance of State-owned Enterprises. Thus, the Law provides for a modern approach to management of the MCSD.

The executive director will be solely responsible for the appointment of senior management and staff of the MCSD, other than the chief financial officer and the chief risk officer who are appointed by the board, and the executive director will manage the day-to-day operations of the MCSD. He may also delegate duties as he deems appropriate to senior staff members so that more efficiency and responsibility should result for MCSD operations.



## **SECTION III: MCSD OPERATIONS**

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This section of the Law incorporates the Recommendations for Securities Settlement Systems of the standard setting bodies.

### **Article 8. Access to and Transparency of the MCSD**

The MCSD will have objective and publicly disclosed criteria for participation that permit fair access and will publish information for market participants that identifies the risks and costs associated with using MCSD services.

### **Article 9. Pre-Settlement Arrangements**

The MCSD board will issue rules for matters including: dematerialized securities registration; establishing and maintaining accounts for securities holders, including sub custodians; annotation of pledged securities; confirmation of securities trades and securities lending and borrowing.

### **Article 10. Settlement Arrangements**

The MCSD board will issue rules for matters including: securities transfer by entries in the MCSD's books of account; execution of trades by simultaneous delivery of securities by the seller against payment for the securities bought by the buyer which eliminates principal risk; failed trades; risk controls for intraday credit, if any; and cash settlement assets, if other than those of Mongol Bank.

### **Article 11. Operational and Custody Arrangements**

The board of the MCSD will issue internal rules for the operations of the MCSD with respect to operational risk arising in the securities registration, clearing and settlement process and also for accounting practices and safekeeping procedures for the protection of securities registered with it.



## **SECTION IV: REGULATION; SUPERVISION; ACCOUNTABILITY**

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### **Article 12. Rulemaking Procedures**

This article provides for transparency, responsiveness to the private sector, smart rulemaking and accountability by the MCSD. The Board must issue proposed rules for public comment at least thirty days before they become effective. Comments received will be posted on the MCSD website and acknowledged in the issuance of final rules with reasons why rejected comments have not been accepted. MCSD does not have to accept comments on proposed rules but must indicate why, which is a protection against arbitrary action.

In addition, any legal entity that is a participant in MCSD operations may petition the MCSD for the amendment or repeal of a rule or the issuance of a new rule. Also in the interest of transparency, all rules issued by the board and any guidance for securities market participants concerning MCSD operations must be posted on the MCSD website.

### **Article 13. Oversight by the Commission**

The governance and operations of the MCSD shall be supervised by the Commission and to facilitate this responsibility the Commission may conduct such investigations as it deems appropriate to determine whether the governance and operations of the MCSD are in compliance with this Law and it may order the MCSD to cease and desist from any violation of this Law. It is noteworthy that the Law does not give the Commission the ability to regulate MCSD activities because this is a highly technical field and it is unlikely that the Commission would add value to MCSD operations. However, the Commission could make its views known to the MCSD board concerning needs for changes in MCSD operations.

### **Article 14. External Audit**

The accounts and operations of the MCSD must be audited annually by an independent external auditor in accordance with International Auditing Standards for central securities depositories and the auditor would issue an auditor's opinion and a management letter as is common practice.

As long as the Government owns the majority of the equity of the MCSD, the MCSD may also be subject to annual audit by the Financial Auditing Department of the [Ministry of Finance]. However, private sector counterparties of the MCSD wish to know that the audit is by a Big Four international auditing firm in accordance with International Auditing Standards to provide confidence in the credibility of the MCSD's financial statements. The basis of an audit by the Financial Auditing Department is not familiar to many in the private sector including international financial services providers and investors.

### **Article 15. Reports**

The MCSD must publish on its website quarterly its financial statements and its annual audited financial statements and an annual report on its operations.



## **SECTION V: MISCELLANEOUS PROVISIONS**

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### **Article 16. Budget; Revenue**

The MSCHCDC is now owned by the Government and would be dependent upon a budgetary appropriation for its funding in part if necessary. Currently the MSCHCDC generates a profit but this could change once arrangements for cash settlement with Mongol Bank are adopted or once new needs for capital expenditures or new skilled personnel are determined. Thus, the Law provides that as long as the MCSD's equity is majority-owned by the Government, each fiscal year the budget of the Government shall provide the funding requested by the board of directors of the MCSD. This would mean that the MCSD budgetary request must be honored and is appropriate since the MCSD plays such a key role in the infrastructure of the capital market. The funding requested of the Government would be the excess of any projected expenses for the next fiscal year over projected revenue.

### **Article 17. Segregation of Assets**

This article contains an important provision to protect securities held in custody by the MCSD or sub-custodians. Assets held in custody by the MCSD and by MCSD sub-custodians are not assets of the MCSD or of MCSD sub-custodians and must not be used to satisfy liabilities to creditors of the MCSD or of MCSD sub-custodians in the event of their insolvency or otherwise.

### **Article 18. Interpretation**

This article contains rules of statutory interpretation that are self-explanatory.

### **Article 19. Repeal and Inapplicability of Laws and Decrees**

In order to make the governance and management of the MCSD modern and efficient, the Law provides that Government Decree No. 72 of 2003 and State Property Committee Decree No. 298 of 2003 that govern the MSCHCDC are repealed and that certain articles of the Securities Market Law of 2002 do not apply to the MCSD. It also provides that the Law on Management and Financing of Budgetary Institutions and the Law on State and Local Property are not applicable to the MCSD. Thus, the Law and the limited liability company law are the laws that will be applicable to the new MCSD.

Hopefully the new companies law will have more appropriate provisions for the governance and management of a limited liability company than the existing law that is also a Soviet relic. State Property Committee Decree No. 298 of 2003 duplicates numerous elements of that law that are not applicable to the MCSD as a company with one or few shareholders.

There is some ambiguity as to the current legal form of organization of the MSCHCDC. Its name indicates "Ltd." that usually designates a limited liability company that has a more simplified legal regime than a joint stock company. However, State Property Committee Decree No. 298 of 2003 indicates that the MSCHCDC is a joint stock company. The Law states that the MCSD is a limited liability company and, thus, there is no ambiguity.







## **ANNEX A: BASIC PROVISIONS**

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### **Article 1 The Mongolian Central Securities Depository**

1. There shall be one central securities depository in Mongolia known as the “Mongolian Central Securities Depository” hereinafter (“MCSD”).
2. The Mongolian Central Securities Depository shall be a limited liability company, the legal successor to the Mongolian Securities Clearing House & Central Depository Co., Ltd. established under Government Decree No. 72 of 2003 and State Property Committee Decree No. 298 of 2003.
3. The MCSD shall be responsible for: (i) registration of presumptive ownership of securities by means of book entries in electronic accounting systems; (ii) clearance and settlement of securities trades; and (iii) safekeeping of securities.
4. The MCSD shall exercise such powers as are bestowed by this Law and that incidental thereto.



## **ANNEX B: GOVERNANCE AND MANAGEMENT OF THE MCSD**

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### **Article 2 Board of Directors**

1. The MCSD shall have a board of directors consisting of seven directors of which at least four shall be independent directors.
  - a. The members of the board of directors shall include the MCSD executive director, at least one official of a Mongolian securities broker, one representative of the Mongolian Stock Exchange and, so long as the Government owns directly or indirectly twenty percent or more of the equity of the MCSD, one representative of the responsible governmental agency.
  - b. Independent directors are those who are not connected by employment within the past three years, family relationship, or business or financial interest to: officials or staff of the MCSD or of its predecessor: the Government or Parliament; members of the Government or Parliament; or shareholders who own more than ten percent of the equity of the MCSD.
  - c. If the MCSD fails to have the requisite number of independent directors within ninety days of the effective date of this Law or at any time thereafter, the Board of the Financial Regulatory Commission (hereinafter “Commission”) shall appoint one or more independent directors to the board of the MCSD to satisfy the required number of independent directors who shall serve until the next annual meeting of shareholders of the MCSD.
  - d. Each director must meet the requirements of fitness and propriety established by rules of the Commission for companies.
  - e. Directors the MCSD shall be elected or appointed by the MCSD shareholders for a term of one year and may stand for re-election.
  - f. A director may be removed by the shareholders or by the board before the expiry of his term of office only for misconduct in office or conviction of a crime unrelated to his activities as a board member.

### **Article 3 Basic Responsibilities of the Board of Directors**

1. The board of directors of the MCSD shall (i) establish the strategy and policies for the MCSD’s operations and (ii) oversee the implementation of that strategy and those policies by management of the MCSD.
2. The board of directors in consultation with MCSD management shall determine the annual budget of the MCSD and review quarterly the outcome in relation to the initial budget.
3. The board of directors shall:
  - a. Issue rules for the operations of the MCSD and its relationships with its participants and counterparties;
  - b. Appoint an executive director, a chief financial officer, and a chief risk officer of the MCSD, define their key responsibilities, and determine their compensation;

- c. Approve the organization structure of the MCS D in consultation with its executive director;
- d. Establish (i) policies for oversight by senior management of subordinate staff and (ii) in consultation with its executive director, reporting relationships within the MCS D;
- e. Adopt and oversee enforcement of a code of ethics for MCS D officials and staff.
- f. Issue annually a strategy policy and performance assessment statement.
  - i. The strategy policy statement must include an assessment of performance of the MCS D in relation to the previous year's statement and qualitative and quantitative business objectives for the next year regarding such factors as operational efficiency, risk management, and professional development of the staff.

**Article 4**  
**Chairman of the Board of Directors; Board Meetings**

1. The board of directors of the MCS D shall elect a chairman who shall be an independent director.
  - a. The chairman of the board of directors shall preside over meetings of the board of directors and call the meetings of the board. In his absence, the chair for a board meeting shall be elected by the members present.
  - b. The chairman, in consultation with other board members and management, shall establish the agenda for board meetings.
  - c. The board shall meet no less frequently than eight times each calendar year, at least once in each calendar quarter.
  - d. The chairman shall determine the information the board must receive from management prior to each board meeting.
  - e. The board may issue rules for the conduct of its meetings that are not inconsistent with the provisions of this article.
2. The board shall prepare minutes of its meetings. The minutes, with the redaction of business confidential information, if any, shall be published on its website within five days of its meetings.

**Article 5**  
**Committees of the Board of Directors**

1. The board of directors of the MCS D shall establish an Audit Committee and a Governance Committee.
  - a. Committees are responsible to the board of directors.
  - b. Committee decisions shall be taken by a majority of the members present and no abstentions shall be allowed.
2. The Audit Committee shall consist of three members appointed by the board, two of whom are independent directors. An independent director shall be the chairperson who shall have financial, auditing or accounting expertise.
3. The budget for the Audit Committee shall at a minimum be MTG 100,000,000 per annum.

4. The Audit Committee shall:
  - a. Establish appropriate accounting procedures and accounting controls for the MCSD, including those prescribed by the Commission or the Mongolian Stock Exchange for listed companies, supervise compliance with such procedures, and, as it deems appropriate, commission audits at the expense of the MCSD of some or substantially all of the company's accounts and records.
  - b. Approve the strategy, operations and budget for the MCSD's internal auditing that is appropriate for the nature and scope of the MCSD's business, monitor internal audit operations, and provide for remedial measures;
  - c. Establish rules to identify, measure, manage and monitor operational risks arising in the clearing and settlement process through reliable and secure systems, including backup facilities, and controls and procedures;
  - d. Establish and monitor implementation of policies and procedures for limits or restrictions on the amount and particular types of investments of the MCSD and for the safekeeping of assets;
  - e. Engage and terminate the MCSD's independent external auditors and determine the scope of the audit;
  - f. Assess the auditor's independence in relation to all relationships between the independent external auditor and the MCSD and remedy any conflicts of interest;
  - g. Discuss the annual audited financial statements and quarterly financial statements with management and the independent external auditor and report to the board of directors thereon;
  - h. Monitor and report to the board of directors on management's efforts to correct deficiencies described in an external audit or a regulatory examination;
  - i. Monitor and report to the board of directors on compliance of the MCSD with requirements for transactions of the MCSD with related persons;
  - j. Obtain advice and assistance, as it deems appropriate, at the expense of the MCSD from outside legal, accounting or other advisors and report to the board of directors thereon;
  - k. Deliver opinions to the board of directors on any matters that it wishes to address including those submitted to it by the management or the board; and
  - l. Meet once every calendar quarter and extraordinarily when convened by two of its members or by the board of directors.
5. The Governance Committee shall consist of three members appointed by the board of directors of which two are independent directors. The chairperson shall be an independent director.
6. The Governance Committee shall have a budget of a minimum of MTG 50,000,000 per annum
7. The Committee shall:
  - a. Establish criteria for selecting new members of the board of directors;
  - b. Identify in consultation with the board individuals qualified to become directors; and recommend that the shareholders elect or appoint the persons identified at the next annual meeting of shareholders;

- c. Establish criteria for the evaluation of governance by the board;
  - d. Provide for a program of an annual performance evaluation of the board;
  - e. Set the remuneration of members of the board of directors; and
  - f. Meet every six months or extraordinarily when convened by the board or by two of its members.
8. Committees of the board shall prepare minutes of their meetings and transmit same to all board members within three days of the conclusion of each meeting.

**Article 6**  
**Liability of Members of the Board of Directors**

A member of the board of directors of the MCSD shall not be personally liable for the effect on the MCSD or on its members or its counterparties of a decision that he takes if:

- a. he informs himself of relevant considerations on the matter to be decided;
- b. he makes the decision in the best interest of the MCSD and not in his own personal interest; and
- c. the action decided is not in violation of law or rules of the MCSD.

**Article 7**  
**Management of the MCSD**

1. The executive director shall be solely responsible for the appointment of senior management and staff of the MCSD other than the chief financial officer and the chief risk officer and shall determine their compensation.
2. The executive director shall propose to the board of directors an organization structure for the MCSD.
3. The executive director shall manage the day-to-day operations of the MCSD and may delegate duties as he deems appropriate to senior staff members.

## **ANNEX C: MCSD OPERATIONS**

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### **Article 8 Access to and Transparency of the MCSD**

1. The MCSD shall have objective and publicly disclosed criteria for participation in its operations or to benefit from its services that permit fair access.
2. The MCSD shall publish information for securities market participants that identifies the risks and costs associated with using MCSD services.

### **Article 9 Pre-Settlement Arrangements**

The MCSD board shall issue rules for:

- a. Dematerialized securities registration;
- b. Establishing and maintaining accounts for securities holders, including, but not limited to, those of sub-custodians of the MCSD;
- c. Annotation of pledged securities;
- d. Timely confirmation of securities trades between direct and indirect market participants;
- e. Settlement cycles;
- f. Central counterparties, if any, other than the MCSD; and
- g. Securities lending and borrowing, if any.

### **Article 10 Settlement Arrangements**

The MCSD board shall issue rules for:

- a. Securities transfer by entries in the books of account of the MCSD or of sub-custodians of the MCSD;
- b. Execution of securities trades by simultaneous delivery of securities by the seller against payment by the buyer for the securities bought;
- c. Failed trades;
- d. Timing of settlement finality;
- e. Intraday credit, if any;
- f. Risk controls for intraday credit, if intraday credit is extended;
- g. Cash settlement assets.

### **Article 11 Operational and Custody Arrangement**

1. The board of the MCSD shall issue internal rules for the operations of the MCSD with respect to operational risk arising in the securities registration, clearing and settlement process.
2. The board of the MCSD shall issue rules for accounting practices and safekeeping procedures for the protection of securities registered with it or its sub-custodians, including, but not limited to, protection against the claims of an account holder's or sub-custodian's creditors.



## **ANNEX D: RULEMAKING; SUPERVISION; ACCOUNTABILITY**

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### **Article 12 Rulemaking Procedures**

1. The Board shall issue proposed rules of the MCS D for public comment at least thirty days before they are to become effective.
2. Comments received on proposed rules shall be posted on the MCS D website and acknowledged in the issuance of final rules with the reasons why any rejected comments have not been accepted.
3. Any legal entity who is a participant in MCS D operations may petition the MCS D for the amendment or repeal of a rule or the issuance of a new rule.
4. All rules issued by the board and any guidance for securities market participants concerning MCS D operations shall be posted on the MCS D website.

### **Article 13 Oversight by the Commission**

1. Compliance by the MCS D with the rules for governance and operations of the MCS D in this Law shall be supervised by the Commission.
2. The Commission may conduct such investigations as it deems necessary or appropriate to determine whether the governance and operations of the MCS D are in compliance with this Law and may order the MCS D to cease and desist from any violation of this Law.

### **Article 14 External Audit**

1. The accounts and operations of the MCS D shall be audited annually by an independent external auditor in accordance with International Auditing Standards for central securities depositories and the auditor shall issue an auditor's opinion and a management letter.
2. As long as the Government owns the majority of the equity of the MCS D, the MCS D may be subject, in addition to that required by paragraph 1, to annual audit by the Financial Auditing Department of the [Ministry of Finance].

### **Article 15 Reports**

1. The MCS D shall publish on its website quarterly its financial statements.
2. The MCS D shall publish on its website annually within four months of the end of its fiscal years its financial statements, auditor's opinion on its financial statements, and a report on its operations.



## **ANNEX E: MISCELLANEOUS PROVISIONS**

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### **Article 16 Budget; Revenue**

1. For as long as the Government owns the majority of the equity of the MCSD, each fiscal year the budget of the Government shall provide the funding for the MCSD requested by the board of directors of the MCSD.
2. The funding requested by the board of directors of the MCSD from the Government budget shall be the excess of any projected expenses for the next fiscal year over projected revenue.

### **Article 17 Segregation of Assets**

Assets held in custody by the MCSD and by MCSD sub-custodians are not assets of the MCSD or of MCSD sub-custodians and must not be used to satisfy liabilities to creditors of the MCSD or of MCSD sub-custodians by way of lien, sequestration or otherwise in the event of their insolvency or otherwise.

### **Article 18 Interpretation**

1. The headings of the sections and articles in this Law are used solely for convenience of reference and are not a part of and are not intended to govern, limit, or aid in the construction of any term or provision hereof.
2. Terms used in the conjunctive or disjunctive in this Law may be read vice versa whenever the change is necessary to effectuate the obvious intention of the provision in question.
3. Words in the singular in this Law may be construed as plural and vice versa whenever the change is necessary to effectuate the obvious intention of the provision in question.
4. A masculine pronoun shall include the feminine and neuter pronoun.

### **Article 19 Repeal and Inapplicability of Laws and Decrees**

1. Government Decree No. 72 of 2003 and State Property Committee Decree No. 298 of 2003 are hereby repealed.
2. The Law on Management and Financing of Budgetary Institutions and the Law on State and Local Property are not applicable to the Mongolian Central Securities Depository.
3. Articles 19, 24 and 25 of the Securities Market Law of 2002 are not applicable to the Mongolian Central Securities Depository.



## **ANNEX F: SUBSTANTIVE RULES ON INTERMEDIATED SECURITIES**

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1. A securities account holder has right to receive and exercise rights attached to securities
2. Intermediaries must take measures to ensure that account holders receive and exercise their rights
  - a. Act only on authorization or instruction
  - b. Transmit to the account holder dividends and other distributions
3. Rights acquired are effective in insolvency proceedings (with exceptions)
4. Effect of securities settlement system—may reverse transactions
5. Acquirer of a security in good faith defeats rights of other persons
6. Priority among competing interests
  - a. Interests acquired under the central securities depository law have priority over interests acquired under other applicable law
7. Priority of interests granted by an intermediary
  - a. An interest in securities granted by an intermediary has priority over the rights of account holders of that intermediary unless the grantee knows that the interest granted violates the rights of other account holders
8. Rights of account holders are effective in the insolvency of an intermediary
9. An intermediary must hold securities of an aggregate number equal to the aggregate number credited to securities accounts that it maintains
  - a. If less, in insolvency of the intermediary, the shortfall is borne by the account holders in proportion to the respective number of securities credited to their securities accounts
10. Securities registered with a central securities depository may be pledged under a security collateral agreement