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*Economic Policy Reform and
Competitiveness Project*

Development of Mortgage Securities Laws

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ABBREVIATIONS AND ACRONYMS

ABS	Asset Backed Security
BOM	Bank of Mongolia
CMB	Collateralized Mortgage Bonds
DST	Documentary Stamp Tax
EBRD	European Bank for Reconstruction and Development
EPRC	Economic Policy Reform and Competitiveness Project
FHLBB	Federal Home Loan Bank Board
FRC	Financial Regulatory Commission
GDP	Gross Domestic Product
ISE	International Securities Exchange
ISIN	International Securities Identifying Number
MFCs	Mortgage Finance Companies
MIK	Mongolian Mortgage Finance Company
NBFI	Non-Bank Financial Institution
OTC	Over the Counter
SPC	Special purpose company
USAID	United States Agency for International Development
VAT	Value added tax

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SECTION I: PROJECT OUTPUT

Specific outputs of the work delivered to the Financial Regulatory Commission (FRC) include:

1. Concept Note on Collateralized (Covered) Mortgage Bonds
2. Concept Note on Securitization and Asset Backed Securities
3. Draft Law of Mongolia on Collateralized (Covered) Mortgage Bonds
4. Draft Law of Mongolia On Securitization and Asset Backed Securities
5. Draft FRC Regulation On Collateralized (Covered) Mortgage Bonds
6. Draft FRC Regulation On Securitization and Asset Backed Securities
7. Memorandum on Amendments to Laws of Mongolia Required to Implement Mortgage Securities
8. Memorandum on Amendments to the proposed Law of Mongolia on Real Estate Collateral (Mortgage Law)
9. Power Point Presentation: Mortgage Bond and Asset Backed Securities Laws for Mongolia

In addition, the consultant provided the FRC with various models of legal documents for mortgage lending and issuance of mortgage securities.

SECTION II: PRESENTATIONS

The consultant made four significant presentations as follows:

- May 8, 2007 - Presentation to a joint meeting of the standing committees on Law and Economics of the Mongolian Parliament.
- May 10, 2007 - Presentation organized by the FRC for agencies of Government, private sector financial community, and international donors.
- June 26, 2007 - Presentation of concepts of mortgage securitization to members of the Mongolian Bankers' Association
- June 28, 2007 - Roundtable Discussion at the Mongolian Parliament co-sponsored by the Parliament, FRC, EPRC, Ministry of Construction and Urban Development, and World Bank at which presentations on development of the legal environment for mortgage securities were made by the Consultant; Mr. Gankhuyag, MP and Chair of the Economic Standing Committee; the Honorable Mr. Narantsatsrant, Minister of Construction and Urban Development; Mr. Bayasgalan, State Secretary of the Ministry of Justice; Mr. Jargalsaihan, Chairman of the Mongolian Housing Finance Corp; Mr. Fernando Bertoli, Chief of Party of USAID-EPRC; and Mrs. D. Dugerjav, Vice-Chairperson of the Financial Regulatory Committee

SECTION III: MEETINGS

Most of the work was carried out in intensive discussions between the consultant and the working group created by the FRC for purposes of developing the legislation. The working group consisted primarily of staff of the FRC, including D. Dugerjav, Vice Chairperson of the Financial Regulatory Committee and Mr. Ganbat, the FRC General Counsel, but was joined from time to time by representatives of the Ministry of Justice, Ministry of Construction and Urban Development, Mongolian Housing Finance Corporation and the Bank of Mongolia.

The Consultant met with the inter-ministerial working group on mortgage securities created by the Ministries of Justice, Finance and Construction and Urban Development, which includes representation of the FRC, to discuss the group's future work on the laws.

In addition, discussions were held with the following persons to discuss the objectives and content of the proposed laws:

- G. Bayasgalan - State Secretary, Ministry of Justice and Chairman of the working group on mortgage securities.
- R. Sodkhuu - Chairman of the Mongolia Stock Exchange
- Mr. Enkhhuuyag - Deputy Governor, Bank of Mongolia
- Kh. Ragchaa - Director of Policy Planning, Ministry of Finance
- The Honorable Mr. Narantsatsrant, Minister of Construction and Urban Development
- Mr. Munkh-Orgil - MP and Chairman of the Legal Standing Committee

SECTION IV: ASSESSMENT

In the Consultant's opinion the project succeeded in preparing useful draft legislation appropriate to the Mongolian context, transferring significant knowledge of the legal and regulatory issues to the staff of the FRC who will be responsible for implementing and regulating mortgage securities, and raising awareness in the Government and Parliament about the role of mortgage securitization and the content of the proposed laws.

At the inception of the project the Consultant was presented with a draft law on mortgage securities based on the Russian law. Having worked on development of the Russian law, the Consultant pointed out that it did not necessarily reflect best practice, but mainly institutionalized the preferences of a few of the major Russian mortgage banks. The Consultant recommended instead an approach of drafting separate laws for European-style covered mortgage bonds and for asset backed securitization using a generic "special purpose company" model. This recommendation was accepted and the Consultant was advised by the inter-ministerial working group on June 27, 2007 that the drafts prepared by the Consultant together with the FRC would henceforth be the working drafts for further consideration of the group.

The success of these laws will depend significantly on improvements in the basic legal infrastructure for the primary mortgage market. In that regard, the Consultant was asked to provide a comprehensive critique of the proposed Law on Real Estate Collateral, or Mortgage Law. The draft under consideration is taken directly from the Russian law. The Consultant provided recommendations for changing the draft, primarily regarding issues of enforcement. The EPRC project was advised that many of the recommended changes will be adopted by the working group which is preparing the final draft of the law to be considered by Parliament. Nevertheless, it appears that there is still significant resistance among lawmakers to any system which has the appearance of treating borrowers harshly by accelerating foreclosure mechanisms, even though there is widespread understanding of the need for improved creditor rights.

In addition to further advances in mortgage enforcement procedure, further development of the primary mortgage market may depend on advances in creation of uniform property appraisal and credit reporting systems.

It is difficult to say whether the proposed mortgage securitization laws are premature for most of the banks, which presently have sufficient liquidity but nevertheless rely primarily on short term deposit accounts. It appears, however, that no financial institution, including the Mongolian Mortgage Finance Company (MIK) initiated by the EPRC, would be able to issue any useful mortgage securities in the short term without at least some amendments to the laws, as discussed further below.

There is some question whether the infrastructure of the present securities market is up to trading anything other than simple bonds having serial or short duration bullet maturities. There is no over the counter trading facility, but government and corporate bonds are traded in small amounts on the stock exchange. In addition, there are as yet no institutional investors other than the banks themselves. The state pension fund is essentially pay as you go, but does appear to have some significant cash accounts deposited with the banks. In the short run it appears likely that the banks may be the largest market for mortgage securities, particularly if Bank of Mongolia policy permits arbitraging risk reserve requirements between whole mortgage loans and collateralized mortgage bonds.

An open question appears to be the role of government in creating the secondary mortgage market. There still appears to be significant support for a state initiative to create some form of liquidity facility, such as a state mortgage conduit or liquidity window. The Consultant took the opportunity to point out the risks of such a model, not the least of which is the crowding out of private sector activity.

SECTION V: NEXT STEPS

Recommendations for further work on these issues include the following:

1. FRC has requested whether the Consultant can be available on a "stand by" basis to assist when the laws are actually introduced to Parliament, which is expected to be at the Fall session of 2007. It is expected that at that time there will be a need to respond to further questions from lawmakers and other government agencies and to react to proposals for amendments to the drafts.

2. *Immediate amendments to laws.* Regardless of whether or not the proposed laws on mortgage securities are adopted, certain steps should be taken immediately to permit the private sector to move forward with the design of simple mortgage securities. It is the Consultant's opinion that the Mongolia Mortgage Finance Corp., affiliated with EPRC, cannot today carry out its intended function without some changes to the laws. Most of these changes have been referenced in the Consultant's work, primarily the Memorandum on Amendments to Laws of Mongolia Required to Implement Mortgage Securities delivered to the FRC. The main changes are:

- Amend the Law on Companies to recognize an exception for collateralized bonds to the rule that bonds may only be issued up to the amount of the issuer's paid in capital. This rule would prevent issuance of meaningful amounts of mortgage bonds and probably prevent implementation of the MIK program.
- Adopt the proposed Law on Secured Transactions. The Ministry of Justice is presently working on a draft of a modern law on Secured Transactions (with moveable property) based on the EBRD model. Adoption of this law would greatly enhance the ability to design some forms of mortgage securities, regardless of whether or not the proposed laws on mortgage securities are adopted.
- Consider creation of simple legal concept of a financial trust. Like the law on secured transactions, development of a simple legal concept on trust administration of property, even if limited specifically to the needs of financial transactions (financial trust), could enhance the ability of private sector institutions to develop various forms of securitization, even if the proposed laws on securitization are not adopted. This can be accomplished by amendment of the Civil Code or by adoption of a separate law. The Consultant has provided a draft of what a general purpose law on trust administration of property might look like.
- Adopt FRC regulations concerning collateralized bonds and pass through or asset backed securities. The Law on Securities Markets is written so broadly that it is possible to bring some guidance to creation of mortgage bonds and asset backed securities by adoption of appropriate regulations of the FRC. Such bonds and securities would not have all the benefits of the securities proposed in the draft laws, but they could be simple and effective in the absence of specific laws on covered bonds and securitization.
- Amend the corporate tax law to provide tax transparency for any entity created to issue mortgage securities and which distributes its revenues to shareholders in during the tax year.

3. *Work with the Mortgage Finance Company (or another financial institution) to register and bring a simple bond transaction to market.* This exercise would not only assist MIK to organize its operations, but also help to educate the FRC and implement its policies on mortgage securities, which are now of course theoretical. It is highly recommended that MIK not develop its own portfolio of mortgage loans, but rather work on a FHLBB model and make

secured, full recourse liquidity loans to participating institutions. To do this MIK will need to develop loan underwriting and servicing manuals, loan agreements, asset pledge agreements, and bond offering documents, as well as the usual internal management and accounting systems.

4. *Provide further technical assistance to the FRC.* The FRC may be in need of further assistance in developing registration forms and procedures; templates for offering documents; concepts of periodic reporting for mortgage securities and special purpose companies; registration and supervision of mortgage finance companies; private placement regimes; and use of open or shelf registrations for mortgage securities.

5. *Over the Counter Trading Facility.* The FRC has expressed considerable interest in the creation of an over the counter market. The current Law on Securities Markets appears to provide sufficient legal basis for an over the counter facility, but the private sector has not yet taken the initiative.

ANNEX A: CONCEPT NOTE ON COLLATERALIZED (COVERED) MORTGAGE BONDS

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CONCEPT PAPER OF THE DRAFT LAW ON COLLATERALIZED MORTGAGE BONDS

One. Rationale and requirements for drafting the law

1.1. There is a shortage of good quality and affordable housing. One way to address this shortage is to encourage private sector savings and investment and to encourage banks to increase lending for housing development and improvement. Two key problems affect the availability of housing finance: an overall shortage of funding and the duration of bank funding sources.

1.2. The current payments on housing loans can be made more affordable to consumers by extending the repayment period. However, the short duration of present sources of bank funding, primarily deposits and other short term borrowings, prevents banks from offering loans of sufficiently long duration to achieve the full benefits of housing finance.

1.3. Developed and emerging markets have addressed these problems by implementing a type of capital markets security known generally as collateralized mortgage bonds (CMBs). Such bonds are an important source of funds for housing finance in practically every developed economy, and among emerging economies of the former Soviet Union are being successfully implemented today in Russia, Kazakhstan, Ukraine, and Latvia.

1.4. The CMB is a high quality investment security collateralized by rights to claim under housing loans, but the intended quality of the security cannot be achieved under the usual civil legislation of most countries, and therefore implementation has typically required adoption of special laws. A new law is also required in Mongolia.

1.5. Use of the CMB instrument would give banks direct access to capital markets investors, increasing the amount of funding for housing finance. Such investors typically will include investors with longer investment horizons than deposit savers and short term lenders, in particular pension funds, investment funds and insurance companies, decreasing reliance on short term funding and permitting gradual extension of the terms of housing loans and consequent increase in affordability.

Legislative need

1.6. The present Laws On Companies and On Securities Markets limit the amount of bonds any company can issue to the amount of its capital, while the amount of CMBs that can be issued is limited only by the amount of qualifying collateral available. Tying the amounts of bonds issued to company capital would result in inadequate amounts of financing.

1.7. The current laws, including primarily the Law on Securities Market and the Law On Companies, do not clearly authorize issuance of bonds secured by specific collateral. Even if such instruments could be issued under the general provisions of the Civil Code, the current legislation governing pledge of assets does not permit pledge of assets to an open class of investors, or permit pledge of assets to be identified in the future, both of which are necessary to create secure collateralized bonds.

1.8. The present laws do not provide an orderly and transparent procedure for enforcing rights of investors to collateral in the event of failure of a bond issuer to meet its obligations. Moreover, current laws do not provide the means to supervise and monitor the segregation and protection of assets used as collateral for a bond.

1.9. The present Law on Bankruptcy does not provide adequate protection to investors secured by collateral, who could be subjected to various costs and delays of bankruptcy proceedings in the event of a bankruptcy of the bond issuer, as well as superior rights of other classes of creditors. Such bankruptcy rules undermine the effectiveness of collateralized securities and increase interest yields demanded by investors.

1.10. Current laws do not provide tools to create a standardized, high quality financial instrument and assure that the quality of the financial instrument will be maintained over time.

Practical requirements

1.11. Housing finance can be the single most important tool to expand housing opportunities for the population. In emerging economies today housing finance is rapidly expanding as a component of the financial sector as measured as a proportion of Gross Domestic Product. In Mongolia, housing mortgage lending is just in the initial stages and significant further expansion is possible and desirable.

Housing Mortgage Lending as % of GDP in Emerging Markets

Country	% of GDP
Mongolia	1.95%
Estonia	16%
Latvia	12%
China	11%
Hungary	10%
Poland	6%
Turkey	4%
Russia	2%
Ukraine	2%

1.12. Also of concern is the short duration (maturity) of housing loans today, which may average 5 years, resulting in greater financial burden on borrowers. By comparison, many emerging economies, including Russia, China, Ukraine and Turkey, have already managed to extend average terms of mortgage loans to over 15 years, and in some cases to over 20 years.

1.13. Many of these emerging economies (China, Russia, Ukraine, Latvia, Turkey, Poland, Bulgaria, etc.) have implemented laws for issuance of mortgage securities, including CMBs, as a tool to increase the amount of funding for housing loans and the length of loan maturities. In developed mortgage markets today, such as the US and Europe, mortgage securities of various types provide on average 30% or more of the funding for all housing loans, and among European countries the CMB is the primary form of mortgage security. The success of these instruments in providing long term and affordable funding for housing loans in both developed and emerging economies cannot be overlooked.

1.14. In Mongolia today there are few private sector savings and investment alternatives. A cursory review of the recent history of the financial markets reveals only a handful of corporate bonds and the shares of only [] companies are listed on the stock exchange. A subsidiary benefit of the proposed law would be further development of the capital markets. The law would introduce the concept of collateralized corporate bonds, which can be transferable to other sectors and industries. It will provide a safe and attractive alternative savings and investment instrument to banks, corporate investors and citizens. It will contribute to development of a longer term "yield curve" for the financial markets, enhancing the ability to price and trade other forms of corporate debt.

1.15. The fundamental law governing mortgage lending is undeveloped at this time and movement on the secondary mortgage securities market provides necessary incentive to improve the primary market legal framework as well. The mortgage loan and mortgage are the primary assets of the mortgage securities system, and further development of a law on collateralization of real estate (mortgage law) is necessary to assure that these assets are attractive and secure for creditors and investors.

Two. Overall content of the draft law and framework

2.1. The draft law authorizes and regulates the issuance of collateralized mortgage bonds by banks and bank-sponsored special purpose legal entities referred to as Mortgage Finance Companies (MFCs).

2.2. The main principles of the proposed law, which closely follows international practice, are:

2.2.1. The CMB is a financial instrument to be used by licensed banks to directly access the capital markets to provide long term and well priced funds for housing finance. Smaller banks with small mortgage loan portfolios may pool their loans and more efficiently access the capital market with bonds issued by a jointly owned Mortgage Finance Company. Issuance of the CMB is limited to banks and bank sponsored entities to assure the security of the investment and the perception of quality. Non-banking entities may issue similar types of instruments under the proposed Law on Securitization and Asset Backed Securities, but to avoid confusion of quality standards these would not be called "collateralized mortgage bonds."

2.2.2. The CMB is designed to be a high-quality and low-risk financial instrument suitable for investment by conservative and regulated investors, including pension funds, insurance companies and banks.

2.2.3. The CMB is a distinct subset of "asset backed securities" having its own legal framework, which is complementary to the legislation governing asset backed securities generally that has been proposed simultaneously with this draft law.

2.2.4. The CMB is a general financial obligation of the issuer, but it is secured by a pledge of rights to claim under loans for acquisition or improvement of housing made to citizens by the CMB issuer (or member banks of an MFC), together with the collateral rights which secure those loans.

2.2.5. Unlike other types of asset backed securities, the loans pledged as collateral for the CMB typically will remain on the balance of the issuing bank, simplifying the structure of the transaction.

2.2.6. The high quality of the CMB is achieved by several distinct approaches embodied in the draft law, including:

- use of the CMB is limited to banks and to MFCs which are subject to prudential oversight by the Central Bank and FRC, respectively;
- high standards are established for the type of loans which may be provided as collateral for the CMB;
- loans provided as collateral for the CMB must be clearly identified on a registered schedule;
- the schedule of loan collateral is subject to oversight and supervision by a specially appointed monitor responsible to the investors and regulators;
- investors have a strong and well defined pledge right over the loan collateral which is superior to the rights of any other creditor of the CMB issuer; and

- in the event of a bankruptcy or other credit event affecting the CMB issuer, the loans provided as collateral for CMBs are excluded from the bankruptcy estate of the issuer and will be managed for the benefit of investors by a special administrator appointed by the Central Bank or FRC.

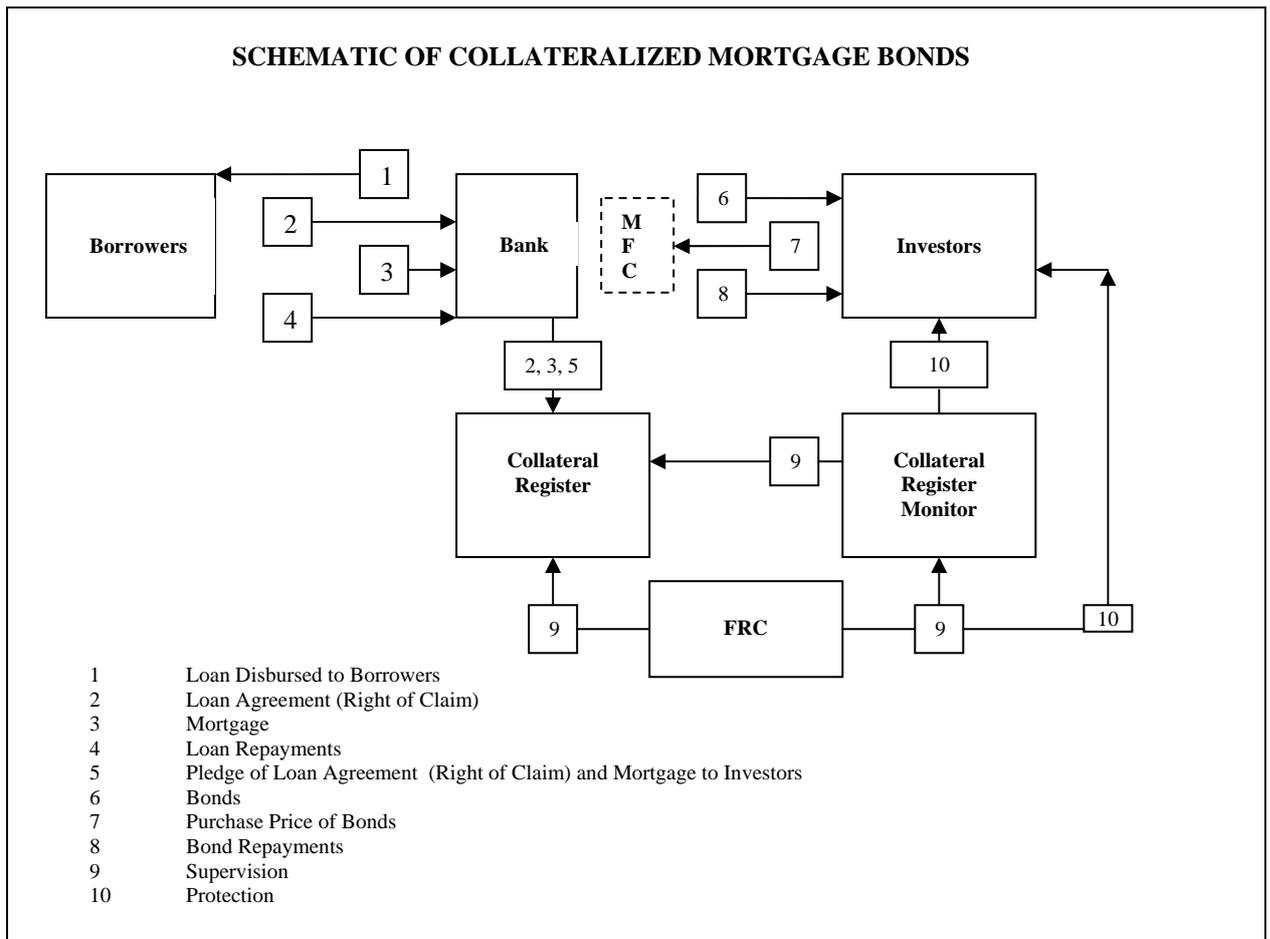
2.3. The specific content of the draft law is as follows:

2.3.1. To protect the quality of the asset, use of the name "collateralized mortgage bond" or any equivalent is limited to bonds issued under this law.

2.3.2. Banks may issue CMBs directly in the securities market or may create an MFC. The MFC is a non-banking financial institution the shares of which are owned by member banks. The activities of the MFC are limited to acquisition of housing loans, issuance of CMBs and making loans to its member banks secured by housing loans.

2.3.3 The Central Bank and the FRC may by regulation establish rules and procedures for licensing banks and MFCs, respectively, to issue CMBs. MFCs may purchase housing loans from member banks or make loans to a member bank on the basis of a pledge of housing loans which remain on the balance of the member bank. In either case, the MFC may issue its own CMBs to finance its loans or loan purchases.

2.3.4 The amount of CMBs that may be issued is not restricted by the capital of the issuer, but only by the amount of loan collateral securing the bonds and any other prudential restrictions which may be imposed by the Central Bank or FRC. The bonds are in dematerialized form and may be issued using a wide range repayment structures prevalent in modern securities markets. Issuance of bonds is subject to the laws and regulations on registration and issuance of securities generally, as modified by specific regulations of the FRC.



2.3.5 The collateral provided for the CMBs is divided into Primary Collateral and Substitute Collateral. The Primary Collateral consists of bank loans made for construction, acquisition or improvement of housing, including free standing structures and apartments. Up to 10% of the collateral can be comprised of loans made with respect to commercial real estate, but loans on vacant land or incomplete construction cannot be offered as collateral. To assure the objective of providing more financing for housing, at least 80% of the collateral securing the CMBs must be Primary Collateral.

2.3.6. All loans included in collateral must be (1) first priority liens on the real estate by which they are secured, (2) repayable in periodic cash installments, (3) documented in accordance with the requirements of the Civil Code and the Law On Mortgage of Real Estate, (4) made only on the security of real estate which is insured against damage or destruction.

2.3.7. In calculating the value of the Primary Collateral, the Issuer may not consider any amount of a housing loan which exceeds 70% of the value of the real estate by which it is collateralized, unless that excess amount is guaranteed by the government. The maximum amount of a loan credited to collateral would be 50% in the case of a loan collateralized by non-residential real estate. The value of real estate which is the object of a mortgage collateralizing a loan must be determined by a professional licensed under the Law on Valuation of Real Estate.

2.3.8. To provide bond issuer's with the flexibility to dynamically manage the collateral, up to 20% of the collateral may be Substitute Collateral, which is comprised of cash and other secure short term financial instruments such as government bonds.

2.3.9. Issuer's may use different forms of derivative securities or contracts solely to manage risks and maintain the value of the loan collateral, including primarily interest rate and currency swaps, options and futures. All derivative contracts are included in the CMB collateral, and contrary to standard international practice may not be terminated by the obligor in the event of a bankruptcy or other credit event of the bond issuer. Instead, the obligor of a derivative contract included in the bond collateral would be treated as an investor and have a priority claim to the bond collateral to satisfy any claims against the Issuer.

2.3.10. The collateral for the bonds is subject to certain "balance principles," implying that the values of the collateral and the Issuer's obligation on the bonds must be "in balance" at all times. The balance principles require that (1) the nominal amount or value of the collateral be at least 110% of the nominal obligation on the bonds, (2) the average weighted yield on the collateral at least equal the yield on the bonds, and (3) the average weighted duration (maturity) of the Primary Collateral not be substantially shorter than the maturity of the bonds.

2.3.11. All collateral, including loans, accounts, securities and other forms of substitute collateral, and derivative securities must be registered in a collateral register to be maintained by the Issuer in form to be specified by the FRC. An Issuer may maintain a single collateral register to secure all of its outstanding CMBs, or separate registers for one or more issues of CMBs. The collateral register(s) are registered with the Central Bank or the FRC for information purposes.

2.3.12. Entry of the collateral into the collateral register constitutes a legal pledge of the collateral to the bond investors. Upon entry, with respect to the Primary Collateral a notation will be made in the register of real estate rights that a mortgage has been pledged as collateral for a CMB. In general, removal of collateral from the register may be done only for good reason. Addition of collateral to the register may be done by the Issuer to support issuance of additional bonds or to comply with the balance principles. Once entered into the collateral register the collateral is considered to be segregated from other assets of the bond Issuer.

2.3.13. All investors have equal rights to the collateral in proportion to their bond holdings. The rights of the investors extends first to the assets included in a collateral register which specifically secures their bond, and then to any excess collateral in other registers of the same bond Issuer. In the event that the collateral held in the register(s) is insufficient to pay the claims of all investors, the investors may claim against other assets of the Issuer as unsecured creditors. The rights of the investors extend to all accounts, balances, and proceeds of the collateral in the register, as well as to rights of claim under derivative contracts.

2.3.14. Entry and removal of collateral in the collateral register is supervised by an independent collateral register monitor who is obligated to periodically review the register to assure that the requirements of the law concerning the quality of the collateral and the balance principles are obeyed. Qualifications of collateral register monitors and rules for their appointment and removal may be established by regulation of the FRC, which may require licensing of monitors.

2.3.15. In the event that the Issuer becomes bankrupt or is affected by an equivalent credit event (e.g. conservatorship or suspension of banking license), or if the Issuer fails to meet its obligation on the bonds, the collateral register monitor is authorized to take steps to assemble, collect and preserve the collateral for the benefit of Investors and to petition the Central Bank (in the case of a bank) or the FRC (in the case of an MFC) to

appoint a special administrator to take control of the collateral. No such event will result automatically in the acceleration of the maturity of the bonds and liquidation of the collateral. Rather, the special administrator shall recommend to the Central Bank or the FRC whether to liquidate the collateral and pay the bonds, or to maintain the integrity of the collateral register and continue to pay the bonds by transferring the collateral to a substitute issuer or entrusted manager which would continue to collect the revenues from the collateral and apply it to repayment of the bonds. The decision whether to liquidate the collateral or continue the existence of the collateral register would be made by the Central Bank or the FRC and would be final.

2.3.16. In the event of the Issuer's bankruptcy or other credit event that could result in appointment of a conservator, receiver, or liquidator for the assets of the Issuer, the collateral included in the collateral register is excluded from the assets of the Issuer, and the collateral may not be attached by any other creditor of the Issuer until the claims of all CMB investors have been satisfied in full. This limitation on the rights of other creditors of the Issuer would take effect even if the decision is taken to maintain the integrity of the collateral register and continue to pay the bonds until maturity.

2.3.17. Primary responsibility for regulating issuance of CMBs lies with the FRC as the regulator of the securities market and agency responsible for protection of investors. However, nothing in the law interferes with the authority of the Central Bank to regulate the activities of banks.

2.3.18. Because of the early stage of development of the securities market generally, and the relative novelty of the CMB concept in the Mongolian context, significant authority remains with the FRC to regulate issuance of CMBs. This regulatory authority is considered necessary to provide flexibility to adjust to the lessons of experience and further developments in the capital markets, and extends to such matters as licensing of CMB issuers (other than banks); rules and procedures for registration and issuance of CMBs; financial characteristics of CMBs; use of derivative contracts in CMB collateral; rules for valuing CMB collateral; implementation of the "balance principles" of CMB collateral; and the qualifications and appointment of collateral register monitors.

Three. Socio-economic and legal consequences and proposal for actions to be taken for implementation

3.1. Implementation of the collateralized mortgage bond would not require creation of new government agencies. Limited budgetary expenditures may be required for additional staff or staff training for existing agencies in agencies that will be responsible for supervising the market for CMBs, including the FRC and the Bank of Mongolia.

- 3.2. The anticipated socio-economic consequences of the proposed law include:
- An increase in the total amount of funding available for housing loans;
 - An increase in the duration of funding available to banks to support housing loans;
 - Longer durations for housing loans, resulting in decreased financial burdens on consumers and an expansion of the potential market for housing loans;
 - Ultimately, a decrease in the interest rates on housing loans;
 - Improvements in housing options and housing conditions of citizens;
 - Availability of a safe and attractive savings and investment alternative to banks and investors;
 - Continued development of the capital market.

3.3. To assure effective implementation of the proposed law certain related actions should be taken which may include:

3.2.1. *Law on Collateralization of Real Estate (Law on Mortgage)*. Current work on the proposed Law on Valuation of Real Estate should take into consideration the proposed law and assure that contradictions are avoided or appropriate exceptions made as necessary to facilitate issuance of collateralized mortgage bonds. The housing loan secured by mortgage of real estate is the underlying asset of the collateralized mortgage bond system and it is extremely important for the protection of investors to assure that mortgages can be created and enforced efficiently and economically. In that regard, particular attention should be paid to the process of enforcing mortgage rights to minimize delay and the possibility of unjustified interference in the procedure.

3.2.2 *Consumer protection in mortgage lending*. Consideration should be given to development of rules for disclosure of information by banks to borrowers in the process of housing finance. Creation of these rules could be authorized in the Law On Collateralization of Real Estate and elaborated in executive regulations.

3.2.3. *Law on Loan History Reporting*. Along with the Law on Collateralization of Real Estate, a law on reporting of loan history would reduce costs and increase the efficiency of the housing finance market, encouraging banks to increase lending for housing.

3.2.4. *Adoption of the proposed Law on Securitization and Asset Backed Securities*. The collateralized mortgage bonds are only one form of mortgage security and should be supplemented and complemented by the companion Law on Securitization and Asset backed Securities. This companion law will provide additional options for structuring and issuance of mortgage securities which would be useful to both banks and non-banking financial institutions, in particular the possibility of "off balance sheet" funding of mortgage loans.

3.2.5. *"OTC" Securities Market*. Financial instruments like collateralized mortgage bonds are most efficiently traded in "over the counter" markets and not listed on exchanges. The FRC should explore with representatives of the securities industry accelerated development of appropriate "over the counter" securities trading or bond trading platforms at the earliest possible time, and take such steps as may be necessary to modify the Law on Securities Markets or to issue appropriate regulations.

3.2.6. *Law on Secured Transactions (Pledge of Moveable Property)*. Current work on development of the proposed Law on Secured Transactions should consider the implications of this proposed law and assure that contradictions are avoided or appropriate exceptions made to accommodate the unique registration rules for the pledge of rights under the collateralized mortgage bond system.

3.2.7. *Law on Bankruptcy*. Current work on revising the Law on Bankruptcy should take into consideration the unique bankruptcy provisions extended to Mortgage Finance Companies under the proposed law and assure that contradictions are avoided or appropriate exceptions made to accommodate the unique registration rules for the pledge of rights under the collateralized mortgage bond system.

3.2.8. *Law on Valuation of Real Estate*. Current work on the proposed Law on Valuation of Real Estate should take into consideration the proposed law and assure that contradictions are avoided or appropriate exceptions made to accommodate the role of real estate valuation in the collateralized mortgage bond system. More importantly, the proposed Law on Valuation of Real Estate and any necessary executive regulations should be adopted at or around the same time as the proposed law to assure that licensing of real estate valuers will proceed expeditiously.

3.2.9. *Treatment of collateralized mortgage bonds by bank regulator.* The Bank of Mongolia should consider its treatment of collateralized mortgage bonds for purposes of risk based capital requirements of banks in light of experience in other countries as well as the Basle II Protocols. In addition, the Bank of Mongolia should consider any further policies it may wish to establish regarding the balance sheet risk issues which may arise for banks under the collateralized mortgage bond system.

Four. Linkage of draft law and Constitution of Mongolia and other legislation, a proposal for laws needed to be developed and amended in relation to implementation of the law

4.1. With the aim of linking the draft law with other legislation comprehensive legal review and research will be undertaken regarding appropriate amendments and modifications to existing laws, which may include:

4.1.1. Limitations on the issuance of bonds in the Law On Companies (article 42) may be modified to reflect the exception of collateralized mortgage bonds. Limitations in the Law on Banking on the maturities of securities that may be purchased by banks will have to be amended (article 14). A definition of collateralized bonds should be added to the Law on Securities Markets.

4.1.2. The Law on Banks should be modified to confirm the special treatment of collateralized mortgage bond assets in the event of a bankruptcy of the issuing bank.

4.1.3. The Law on Non-Banking Financial Activities may be modified to reflect the Mortgage Finance Corporation as a form of non-banking financial institution.

4.1.4. The Law on Licensing may be amended to provide for licensing of MFCs.

4.1.5. Consideration should be given to amendment of the Law on Registration of Real Estate and Rights to Real Estate to facilitate entry of information on the encumbrance of a mortgage as collateral for a collateralized mortgage bond.

4.1.6. The proposed law may require further development of the legal concept of a trust contract or entrusted management found in the Civil Code to define the role of the collateral register monitor in CMB transactions.

**ANNEX B: CONCEPT NOTE ON SECURITIZATION AND ASSET BACKED
SECURITIES**

ANNEX B: CONCEPT NOTE ON SECURITIZATION AND ASSET BACKED SECURITIES

CONCEPT PAPER OF THE DRAFT LAW OF MONGOLIA ON SECURITIZATION AND ASSET BACKED SECURITIES (SECOND DRAFT-5-18-07)

One. Rationale and requirements for drafting the law

1.1. There is a shortage of good quality and affordable housing. One way to address this shortage is to encourage private sector savings and investment and to encourage banks to increase lending for housing development and improvement. Two key problems affect the availability of housing finance: an overall shortage of funding and the duration of bank funding sources.

1.2. Repayment of housing loans can be made more affordable to consumers by extending the repayment period. However, the short duration of present sources of bank funding, primarily deposits and other short term borrowings, prevents banks from offering loans of sufficiently long duration to achieve the full benefits of housing finance.

1.3. In addition, a bank may be discouraged from making housing loans because to do so entails placing a long term, relatively illiquid and somewhat risky asset on its balance sheet, requiring commitment of capital reserves, reduction in the amount of capital to support other forms of lending, and greater inflexibility in management of balance sheet risk.

1.4. Developed and emerging markets have addressed these problems by implementing capital markets securities known generally as asset backed securities (ABS). Such securities are an important source of funds not only for housing finance, but for other forms of consumer and business credits as well, including credit card and trade receivables, automobile loans and equipment leases. Among the emerging economies some form of ABS have been successfully implemented in China, Thailand, Turkey, Russia, Kazakhstan, and Ukraine.

1.5. The ABS is an investment security collateralized by self liquidating (amortizing) rights of claim which are removed from the balance sheet of the ABS issuer by sale to a special purpose legal entity which issues the ABS. The ABS depend primarily on the cash flow of the underlying rights of claim and are not general obligations of the originator of the assets (e.g. a bank) or the issuer of the ABS. They are "self-liquidating" in the sense that the principal obligation of the ABS security is repaid as the principal obligation of the underlying assets is repaid. The ABS are a useful alternative and complement to the collateralized mortgage bonds (CMBs) which are the subject of another law which has been proposed (see "Draft Law of Mongolia On Collateralized Mortgage Bonds"). Moreover, the CMB is intentionally limited to issuance by banks and to housing finance, while in line with international practice the ABS would permit a broader range of issuers and assets.

1.6. The desired structure of the ABS cannot be achieved under laws of most countries, and therefore implementation has typically required adoption of special statutory instruments in most countries in which they are used. This is the case also in Mongolia.

1.7. Use of the ABS instrument would give banks and other companies and securities market participants direct access to funding from capital markets investors for purposes of consumer and business lending, increasing the amount of funding for housing finance as well as other purposes. Availability of the ABS to provide "off balance sheet" financing will provide banks with an important tool to manage balance sheet risk, removing one obstacle to long term bank lending for housing. The ABS will serve to further develop the securities

markets, providing a flexible type of security which can be structured to meet the needs of a wide range of investors and provide alternatives for savings and investment.

Legislative need

1.8. The current legislation does not authorize issuance of a capital market security which is not an equity security (an ownership interest in all the assets of a company), a bond (a general debt of the issuer secured by all of its assets), or an investment fund (a fund of assets subject to common ownership of investors and having unlimited duration). The ABS has some characteristics of all of these types of securities, and is not contemplated under the current legislation.

1.9. The current legislation, including primarily the Law on Securities Market and the Law On Companies, does not clearly authorize issuance of any type of capital markets security secured by specific collateral. Even if such instruments could be issued under the general provisions of the Civil Code, the current legislation governing pledge of assets does not permit pledge of assets to an open class of investors, or permit pledge of assets to be identified in the future, both of which are necessary to create ABS.

1.10. The present laws do not provide an orderly and transparent procedure for enforcing collateral rights of investors in the event of failure of a security issuer to meet its obligations. Moreover, current laws do not provide the means to supervise and monitor the segregation and protection of assets used as collateral for a security.

1.11. The present Law On Bankruptcy, the current stage of implementation of international accounting standards, and the lack of familiarity with the concept of ABS in Mongolia may result in ambiguities regarding protection to investors secured by collateral, who could be subjected to various costs and delays of bankruptcy proceedings in the event of a bankruptcy of originator of the securitized assets, as well as superior rights of other classes of creditors, which would undermine the objective of ABS. While in theory an ABS transaction could be structured under current law and accounting standards which would address some of these issues, there are too many legal ambiguities to provide the necessary degree of certainty.

1.12. Current laws do not permit creation of the type of special purpose legal entity typically used in world markets for issuance of ABS, which is characterized by legal restrictions on business activities and debt, and which is exempted from profits taxation on revenues which it "passes through" to investors.

Practical requirements

1.13. Housing finance can be the single most important tool to expand housing opportunities for the population. In emerging economies today housing lending is rapidly expanding as a component of the financial sector as measured as a proportion of Gross Domestic Product. In Mongolia, housing mortgage lending is just in the initial stages and significant further expansion is possible and desirable.

Housing Mortgage Lending as % of GDP in Emerging Markets

Country	% of GDP
Mongolia	1,95%
Estonia	16%
Latvia	12%
China	11%

Hungary	10%
Poland	6%
Turkey	4%
Russia	2%
Ukraine	2%

1.14. Also of concern is the short duration (maturity) of housing loans today, which may average 5 years, resulting in greater financial burden on borrowers. By comparison, many emerging economies, including Russia, China, Ukraine and Turkey, have already managed to extend average terms of housing loans to over 15 years, and in some cases to over 20 years.

1.15. Many emerging economies (China, Russia, Ukraine, Turkey, Thailand, Korea, etc.) have implemented laws for issuance of ABS, as a tool to increase the amount of funding for housing finance and the length of loan maturities. In developed mortgage markets today, such as the US and Europe, mortgage securities of various types provide on average 30% or more of the funding for all housing finance, and in the US the ABS is the primary form of mortgage security. The success of these instruments in providing long term and affordable funding for housing credits in both developed and emerging economies cannot be overlooked.

1.16. In Mongolia today there are few private sector savings and investment alternatives. A cursory review of the recent history of the financial markets reveals only a handful of corporate bonds and the shares of only [] companies are listed on the stock exchange. A subsidiary benefit of the proposed law would be further development of the capital markets. The law would introduce the concept of asset backed securities, which in addition to housing finance can be transferable to other sectors and industries, including credit card finance, automobile loans, and equipment leases. It will provide an attractive alternative savings and investment instrument to banks, corporate investors and citizens. Most importantly, securitization can provide banks and non-banking financial institutions with an important financial tool to manage balance sheet risk, which tools are mostly lacking in Mongolia today.

Two. Overall content of the draft law and framework

2.1. The draft law authorizes and regulates the issuance of asset backed securities by banks and other participants in the securities market by creation of regulated Special Purpose Companies (SPCs) authorized to acquire and own revenue producing assets and to issue ABS.

2.2. The main principles of the proposed law, which closely follows international practice, are:

2.2.1. The ABS is a financial instrument which allows banks and other authorized participants in the securities market direct access to capital market investors to obtain long term and well priced funding for a wide variety of consumer and business finance, including most importantly housing finance.

2.2.2. The ABS is intended to be a self-liquidating (amortizing) security which is secured by the collateral of self-liquidating loans of various types made to consumers and businesses, and depends for repayment primarily on the repayments of those loans, with certain well defined exceptions.

2.2.3. Issuance of properly structured ABS is intended to remove the securitized loans from the balance sheet of the originator of the loans, providing to a wide range of creditors not only greater liquidity, but also greater flexibility in managing balance sheet risks.

2.2.4. A main focus of the law is creation and regulation of the Special Purpose Companies (SPCs) that are intended to acquire the loans by purchase from one or more

creditors, and creation and management of the collateral rights of investors to the securitized credits.

2.2.5. The ABS is designed to be a highly flexible financial instrument which can take many forms with respect to repayment of principal and interest to investors, permitting asset originators to design securities which meet current market demands and the needs of a broad range of investors.

2.2.6. For purposes of housing finance markets, the ABS is intended to be an alternative and complement to a more narrowly structured collateralized mortgage bond, permitting the securitization of a wider variety of housing credits and a wider variety of repayment terms.

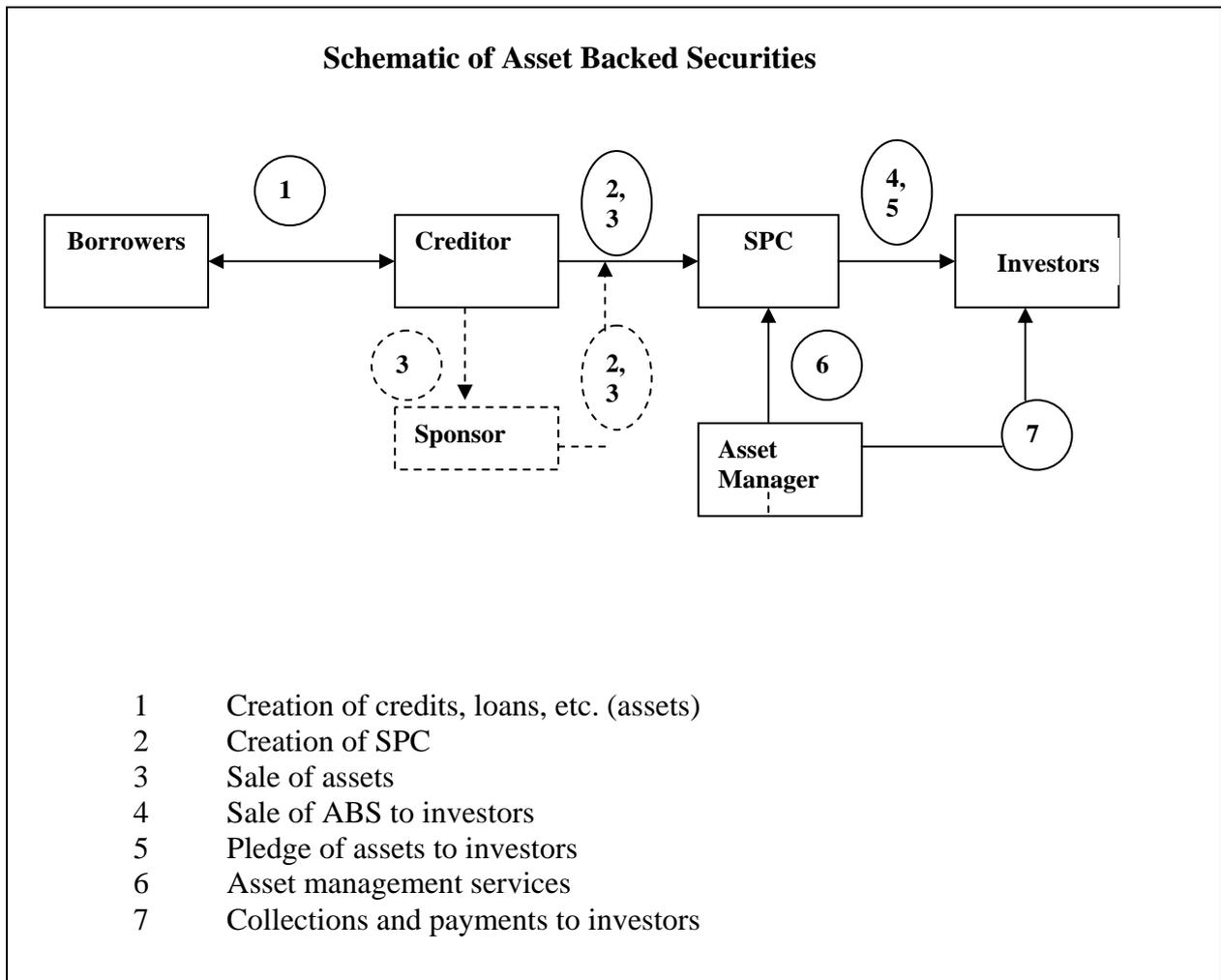
2.3. The specific content of the draft law is as follows:

2.3.1. The ABS are registered and issued in accordance with the Law on Securities Markets and general regulations of the FRC for issuance of securities, as may be modified by the FRC for purposes of reflecting the unique nature of the ABS.

2.3.2. Assets permitted to be securitized include any credits, loans, rights of claim with an expected cash payment stream, including for example housing loans secured by mortgage, credit card receivables, equipment (finance) leases, and concession contracts.

2.3.3. Both the securitized assets and the ABS are self-liquidating (amortizing), meaning that the ABS by definition has a finite term. There are a few restrictions on the type of assets that may be securitized, in particular that they must be free and clear of any other claims or encumbrances when transferred to an SPC, and must be performing assets as defined by rules of the Bank of Mongolia.

2.3.4. ABS is issued in the form of bonds, notes or other debt of the SPC, or "participation certificates" representing a common ownership interest in the securitized assets. ABS does not represent shares of the SPC.



2.3.5. The proposed law provides that all expenses of ABS issuance will be paid from principal and interest payments on the assets before payments to the investors. Expenses may include costs of issuance, management costs, guaranty fees (if any) and contributions to reserve funds (if any). The law anticipates that there may be revenue from the assets which exceeds the issuer's obligation on the ABS and those revenues may be allocated by the issuer in its discretion in a variety of ways.

2.3.6. Special Purpose Companies are created for issuance of ABS. In general, creation and regulation of an SPC is under the authority of the FRC. The SPC may be created by any originator of assets or licensed participant in the securities market (a "Sponsor"). The entity which creates or "originates" the assets is not necessarily the creator of the SPC. Smaller banks and other non-banking institutions that do not wish to incur the costs of issuing ABS can sell their assets to another institution which will be the SPC sponsor.

2.3.7. The activities of the SPC are restricted to acquiring assets and issuing ABS. The SPC may not take deposits, incur debt (other than the ABS) or have employees; all management functions of the SPC must be contracted with third parties. Shares of an SPC may not be listed and traded, but may be transferred with the approval of the FRC. The foundation documents of the SPC may not be modified without the approval of the FRC.

2.3.8. An SPC is not subject to profits tax on any distributions it makes to holders of ABS. In addition, transfer of assets from an originator to an SPC would not be subject to VAT, stamp duty or other state exaction.

2.3.9. Upon acquiring assets from originator(s) the SPC places the assets in a "asset pool" which is pledged to investors as collateral for the ABS. Creation and management of the asset pool is subject to rules established under the law and regulations of the FRC. The asset pool is registered with the FRC by means of an inventory.

2.3.10. In general, a separate SPC must be created for each issue of ABS. However, the FRC may provide by regulation for instances in which an SPC may be permitted to issue more than one ABS.

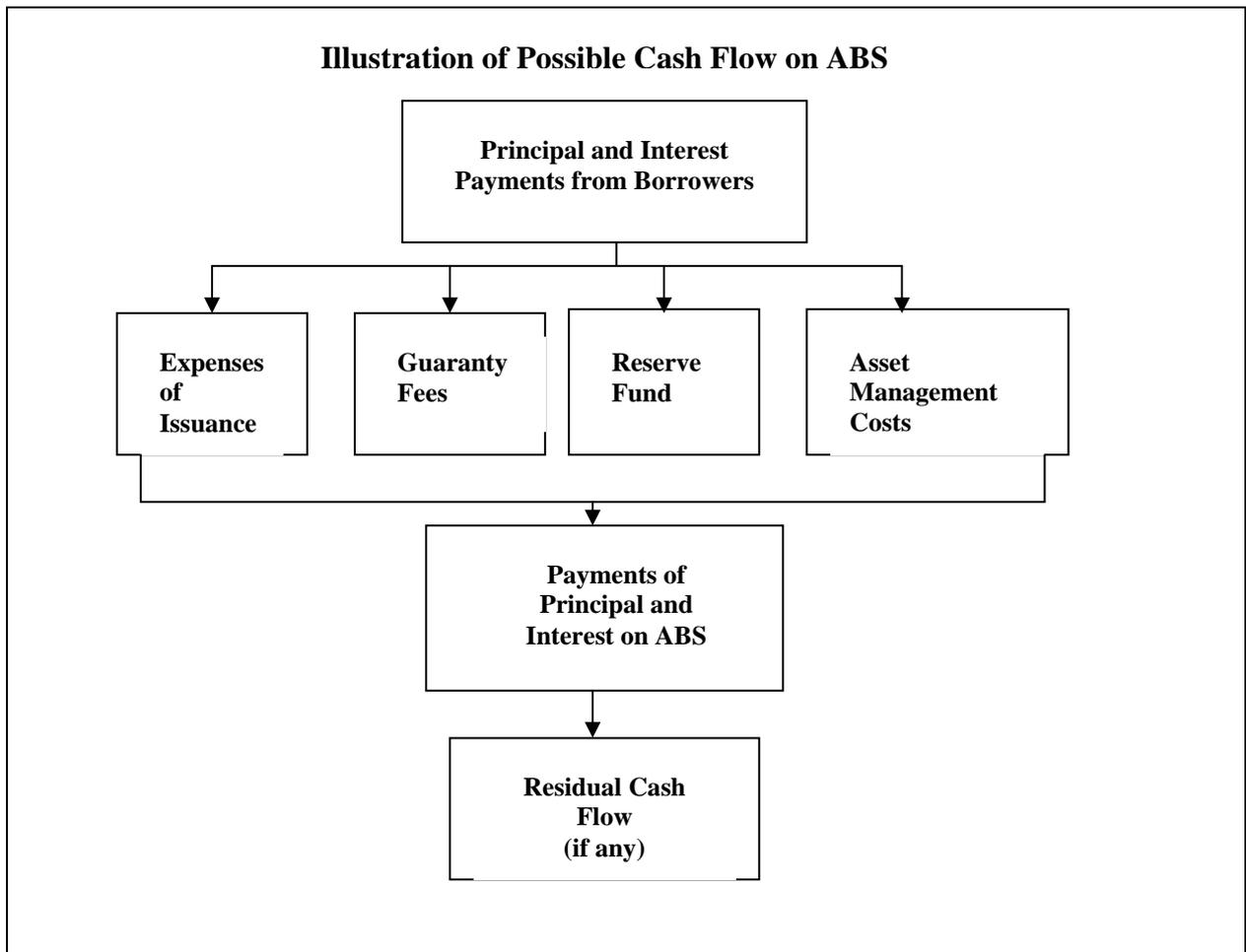
2.3.11. In general, once created, assets may not be added or removed from an asset pool, assuring eventual liquidation of the pool and the ABS. However, the FRC may provide by regulation for instances in which assets may be added to the asset pool.

2.3.12. Provided that the sale of assets to the SPC meets the established conditions, the assets will be reserved exclusively for the protection of the ABS investors, and will not be subject to claims from any other creditors. The conditions established for sale of the assets to the SPC are that (1) the sale be at fair market price, (2) the sale is "without recourse" to the originator or seller of the assets and the SPC assumes the risks and rewards of the assets, and (3) the originator or seller of the assets relinquishes all control over the assets. Certain clarifications are made to the conditions of sale, consistent with international practice, which assure that the ABS issuers can properly manage the issue in the best interests of investors.

2.3.13. Various techniques are permitted to improve the credit quality of the ABS, including guarantees, reserve funds and providing excess collateral.

2.3.14. An issue of ABS may be divided into separate classes of securities which have different interest rates, repayment terms or collateral rights with respect to the assets. Included among these classes would be one which subordinates its claim to repayment to holders of one or more other classes of the issue, thereby improving the credit quality of such other classes.

2.3.15. Emphasis in the law is placed on the management of the assets for the benefit of investors. The qualifications and management procedures of persons or entities who are retained to manage the assets, including collections and disbursements of revenues and enforcement of rights of claim, will be subject to written agreement which describes the standards and procedures of management and which will be disclosed to investors. All issuers will have to assure efficient replacement of asset managers if the need arises.



2.3.16. All persons dealing with the assets on behalf of investors will be subject to a high standard of care and responsibility to the investors.

2.3.17. Steps are taken to assure protection of investors, including independent audit of the asset pool, pledge of assets to investors, and registration of asset pools with the FRC.

2.3.18. Bankruptcy of an SPC would not be governed by the Law on Bankruptcy, but rather would be subject to administration of the FRC, including by appointment of a special legal representative of the investors who would be authorized to collect, manage and liquidate the assets on their behalf.

Three. Socio-economic and legal consequences and proposal for actions to be taken for implementation

3.1. Implementation of the asset backed security would not require creation of new government agencies. Limited budgetary expenditures may be required for additional staff or staff training for existing agencies in agencies that will be responsible for supervising the market for asset backed securities, including the FRC and the Bank of Mongolia.

3.2. The anticipated socio-economic consequences of the proposed law include:

3.1.1. An increase in the total amount of funding available for housing finance and other forms of consumer and business lending;

3.1.2. An increase in the duration of funding available to banks to support housing finance;

- 3.1.3. Longer durations for housing loans, resulting in decreased financial burdens on consumers and an expansion of the potential market for housing loans;
- 3.1.4. Ultimately, a decrease in the interest rates on housing loans;
- 3.1.5. Improvements in housing options and housing conditions of citizens;
- 3.1.6. Availability of an attractive savings and investment alternative to banks and investors;
- 3.1.7. Implementation of an important financial tool to allow banks and other credit institutions to manage balance sheet risk;
- 3.1.8. Better allocation of risk between banks and capital market investors that are better able and willing to accept risk;
- 3.1.9. Continued development of the capital market.

3.3. To assure effective implementation of the proposed law certain related actions should be taken which may include:

3.3.1. *Adoption of the proposed Law on Collateralized Mortgage Bonds.* The ABS are only one form of mortgage security and should be supplemented and complemented by the companion Law On Collateralized Mortgage Bonds. This companion law will provide additional options for structuring and issuance of mortgage securities which would be useful to both banks and non-banking financial institutions.

3.3.2. *"OTC" Securities Market.* Financial instruments like ABS are most efficiently traded in "over the counter" markets and not listed on exchanges. The FRC should explore with representatives of the securities industry accelerated development of appropriate "over the counter" securities trading or bond trading platforms at the earliest possible time, and take such steps as may be necessary to modify the Law On Securities Markets or to issue appropriate regulations.

3.3.3. *Law on Collateralization of Real Estate (Law on Mortgage).* Current work on the proposed Law on Collateralization of Real Estate (Law on Mortgage) should take into consideration the proposed law and assure that contradictions are avoided or appropriate exceptions made as necessary to facilitate issuance of collateralized mortgage bonds. The housing loan secured by mortgage of real estate is the underlying asset of the asset backed securities system and it is extremely important for the protection of investors to assure that mortgages can be created and enforced efficiently and economically. In that regard, particular attention should be paid to the process of enforcing mortgage rights to minimize delay and the possibility of unjustified interference in the procedure.

3.3.4. *Law on Valuation of Real Estate.* To the extent that housing loans will be an important component of the ABS market, rules for valuation of real estate will be very important to ABS. Current work on the proposed Law on Valuation of Real Estate should take into consideration the proposed law and assure that contradictions are avoided.

3.3.4. *Law on Secured Transactions (Pledge of Moveable Property).* Current work on development of the proposed Law on Secured Transactions should consider the implications of this proposed law and assure that contradictions are avoided or appropriate exceptions made to accommodate the unique registration rules for the pledge of rights under the asset backed securities system.

3.3.5. *Law on Bankruptcy.* Current work on revising the Law on Bankruptcy should take into consideration the unique bankruptcy provisions extended to Special Purpose Companies under the proposed law and assure that contradictions are avoided or appropriate exceptions made to accommodate the unique registration rules for the pledge of rights under the asset backed securities system.

3.3.7. *Treatment of ABS by bank regulator.* The Bank of Mongolia should consider its treatment of ABS for purposes of risk based capital requirements of banks in light of experience in other countries as well as the Basle II Protocols. In addition, the Bank of Mongolia should consider any further policies it may wish to establish regarding the asset-liability issues which may arise for banks under the ABS system.

Four. Linkage of draft law and Constitution of Mongolia and other legislation, a proposal for laws needed to be developed and amended in relation to implementation of the law

4.1. With the aim of linking the draft law with other legislation comprehensive legal review and research will be undertaken regarding appropriate amendments and modifications to existing laws, which may include:

4.1.1. Limitations on the issuance of bonds in the Law On Companies (article 42) may be modified to reflect the exception of asset backed securities. Limitations in the Law on Banking on the maturities of securities that may be purchased by banks will have to be amended (article 14). A definition of asset backed securities should be added to the Law on Securities Markets.

4.1.2. The Law on Banks and Law on Bankruptcy should be modified to confirm the special treatment of ABS assets in the event of a bankruptcy of the SPC or sponsor of the SPC.

4.1.3. The Law on Non-Banking Financial Activities may be modified to reflect licensing of the SPC as a form of non-banking financial institution.

4.1.4. Consideration should be given to amendment of the Law on Registration of Real Estate and Rights to Real Estate to facilitate entry of information on the encumbrance of a mortgage as collateral for an ABS.

4.1.5. The Law on Taxation of Profits should be modified to reflect the exemption of SPC revenues from taxation if disbursed to investors. The Law on Value Added Tax should be amended to exempt transfer of loan asset from banks or other originators to special purpose companies.

**ANNEX C: DRAFT LAW OF MONGOLIA ON COLLATERALIZED (COVERED)
MORTGAGE BONDS**

ANNEX C: DRAFT LAW OF MONGOLIA ON COLLATERALIZED (COVERED) MORTGAGE BONDS

DRAFT LAW OF MONGOLIA ON COLLATERALIZED MORTGAGE BONDS

Chapter 1. General Provisions

Article 1. Purpose of the law

It is the policy of Mongolia to promote the development of affordable housing and mortgage finance for construction, acquisition, and improvement of housing, as well as to promote development of the capital markets, by implementing a type of capital markets security to be known as collateralized mortgage bonds, providing a legal and regulatory framework for such bonds, and creating a favorable market environment for the bonds and a variety of other mortgage securities. This law is intended to authorize banks and housing finance companies sponsored by banks to issue collateralized mortgage bonds subject to the supervision of the Financial Regulatory Commission and the Central Bank of Mongolia as provided in this law, and to describe the rules and procedures for creating and issuing collateralized mortgage bonds.

Article 2. Concept and definitions

1. A collateralized mortgage bond (herein "Bond") authorized under this law is a debt obligation of an Issuer secured by pledge of rights to claim under Housing Loans and other collateral permitted by this law, which rights and collateral are segregated on the balance of the Bond issuer and managed in accordance with the provisions of this law.

2. Terms used in this law are defined as follows:

Value of the real estate collateral - the market value of the real estate which serves as collateral for a Housing Loan included in Bond Collateral, as defined in article 9 of this law.

Balance principles - the financial tests which determine whether the value of the Bond Collateral is sufficient to pay the Issuer's obligation on the Bonds, as defined in article 12 of this law.

Bank - a depository banking institution licensed under the Law on Banking.

BOM - the Bank of Mongolia.

Collateral Register - the register of Bond Collateral maintained in the form specified by the FRC, as defined in article 13 of this law.

Collateral Register Monitor - the independent professional appointed by the Bond Issuer to supervise maintenance of the Collateral Register, as defined in article 16 of this law.

Derivative Contracts - any contract, agreement or security which depends for its valuation on reference to the performance of another financial asset, including without limitation interest rate and currency futures and forward contracts, interest rate and currency swaps, options and credit default swaps.

FRC - the Financial Regulatory Commission of Mongolia.

Investor - the purchaser and owner of a Bond.

Mortgage - a contractual pledge of real estate which complies with the provisions of the [Law on Collateralization of Real Estate] and the Civil Code which secures repayment of a Housing Loan included in a Collateral Register under this law.

Housing Loan - a loan to an obligor for the acquisition, construction or improvement of residential real estate, together with the Mortgage which secures repayment of the loan.

Creditor - the creditor (owner of the right to claim) named in a Housing Loan and Mortgage, or its legal successor.

Obligor - an obligor (debtor) named in a Housing Loan, and any legal successor.

Real Estate Collateral - real property which is the subject of a Mortgage included in Bond Collateral.

Bond Collateral - Housing Loans, Mortgages and other collateral which are identified in the Collateral Register and pledged for the benefit of Investors, as defined in article 7 of this law.

Primary Collateral - Housing Loans and Mortgages, as defined in article 8 of this law.

Substitute Collateral - cash and short term financial investments permitted under this law to be included in the Collateral Register.

State Registry - the government agency authorized to register Mortgages and other rights to real estate under the [Law on Registration of Real Estate and Rights to Real Estate].

Residential real estate - completed residential structures for occupancy by a single family, or completed apartments in a multi-family residential building intended for occupancy by a single family. Residential real estate does not include a multi-family residential building intended for lease to occupants.

Mortgage Finance Company (MFC) - any legal entity created and owned by one or more member Banks as shareholders solely for the purpose of issuing Bonds and making loans to the shareholding Banks secured by their Housing Loans. An MFC is a non-bank financial institution as defined in the Law on Non-Bank Financial Activities.

Article 3. Limited use of name

The term "collateralized mortgage bond" or any equivalent or derivative of that term may be used only in reference to Bonds issued in accordance with the provisions of this law.

Article 4. Eligible issuers of collateralized mortgage bonds

1. Any Bank or Mortgage Finance Company may be an Issuer of Bonds.
2. Issuance of Bonds shall be regulated by the FRC, provided that nothing in this law is intended to modify or limit the authority of the BOM to regulate the activities of Banks. The FRC and the BOM may by executive regulation require that MFCs and Banks, respectively, be licensed to issue Bonds and establish the conditions and procedures for such licensing.

Article 5. Specific rights and obligations of MFCs

1. An MFC shall be licensed as a non-banking financial institution under the Law on Non-Banking Financial Activities. The FRC may by executive regulation establish the requirements for licensing and registration of an MFC, including minimum capital requirements.
2. An MFC may purchase Housing Loans from its member Banks and other financial institutions, make loans to its member Banks secured by Housing Loans, issue Bonds, and

engage in such other activities as may be permitted to non-banking financial institutions under the Law On Non-Banking Financial Activities and the MFC's license.

3. An MFC may make a loan to a member Bank secured by Bond Collateral entered on a Collateral Register created specifically for purposes of securing such loan, in which case upon failure of the member Bank to repay its debt to the MFC in accordance with its terms the MFC shall have the same rights to the Bond Collateral as are provided to Investors under this law, and the MFC shall be considered an Investor for all purposes of this law.

4. To secure its Bonds an MFC may pledge to Investors the Bond Collateral pledged to it by member Banks to secure their loans as provided in paragraph 3 of this article, in which case the MFC shall create and maintain a Collateral Register which reflects all of the Bond Collateral pledged by its member Banks and provided as a secondary pledge to the MFC's Investors.

5. The Bond Collateral for a Bond issued by an MFC and secured by rights to claim under loans made to member Banks under paragraph 3 of this article shall include the MFC's right to claim under any loan agreement with a member Bank, and such loan agreements shall be included on the MFC's Collateral Register.

Article 6. Characteristics of bonds

1. Bonds shall be in dematerialized form, have a defined principal amount, and a defined interest rate or formula by which the interest rate can be calculated at any point in time.

2. Bonds may:

- a) have serial or term maturities;
- b) be redeemable by the issuer at or prior to the stated maturity;
- c) provide for periodic amortization of bond principal or payment of principal at maturity;
- d) have fixed or floating interest rates;
- e) have such other characteristics as are not prohibited by this law or by executive regulation of the FRC.

3. An issue of Bonds may be reopened to allow issuance of additional Bonds or series of Bonds at any time within the period of 2 years following the initial issuance date of the Bonds as defined by the Law on Securities Markets and executive regulations issued pursuant thereto.

4. Registration and issuance of Bonds shall comply with the requirements of the Law on Securities Markets. Registration and issuance of Bonds shall be governed by executive regulations to be issued by the FRC.

Chapter 2. Bond Collateral

Article 7. Bond Collateral, Generally

1. Bond Collateral shall consist of Primary Collateral and Substitute Collateral.

2. Bond Collateral shall be free of any pledge or encumbrance other than the pledge for the benefit of Investors created under this law.

3. Bond Collateral may not include Mortgages on incomplete construction or vacant land.

4. No more than 10% of the Bond Collateral entered into a Collateral Register may consist of Housing Loans made with respect to construction, acquisition or improvement of real estate which is not residential real estate as defined in this law.

Article 8. Primary Collateral

1. Primary Collateral includes claims under Housing Loans and real estate receivables, and in the case of mortgage finance companies, pledge rights to Housing Loans and real estate receivables and rights to claim under loans made under article 5 of this law. All other collateral for Bonds permitted under this law is Substitute Collateral.
2. Housing Loans, real estate receivables and Mortgages shall comply with the provisions of the [Civil Code], the [Law on Deposits, Loans and Bank Transactions] and the [Law On Collateralization of Real Estate] and executive regulations issued pursuant thereto.
3. A Mortgage included in a Collateral Register shall be a first priority lien on real estate located in Mongolia, and shall be duly registered as such in the name of the Creditor in the Registry of Real Estate and Rights to Real Estate. A lease-purchase, installment sale or equivalent contract or instrument for financing the acquisition of real estate may be included in Primary Collateral if permitted by executive regulations of the FRC.
4. Housing Loans and real estate receivables included in Primary Collateral shall provide for repayment of principal and interest on the Mortgage Loan only in cash installments made at least once each quarter during the term of the Mortgage Loan.
5. No Housing Loan or real estate receivable shall be included in the calculation of the total amount of Primary Collateral if such is characterized as a non-performing loan under the regulations of the BOM.
6. Real Estate Collateral shall be fully insured by the Obligor for the benefit of the Creditor against loss and damage in the full replacement cost of the Real Estate Collateral for the entire term of the Housing Loan.
7. The Housing Loan or real estate receivable shall prohibit the Obligor, without the consent of the Creditor, from (1) making physical modifications to the Mortgaged Real Estate which may result in a decrease in its value, and (2) leasing the Real Estate Collateral to others.
8. Housing Loans made with respect to residential apartments in multi-family buildings may be included in Bond Collateral only if a condominium association has been created for the building under the [Law on Condominium].
9. No portion of the principal obligation of a Housing Loan which exceeds seventy percent (70%) of the Value of the Real Estate Collateral shall be included in the calculation of the total amount of the Bond Collateral, unless repayment of such portion of the Housing Loan is fully guaranteed by the Government of Mongolia or an agency or instrumentality thereof. With respect to Housing Loans made with respect to real estate which is not residential real estate as defined in this law, the portion of the loan which may be included in the calculation of total Bond Collateral may not exceed fifty percent (50%) of the Value of the Real Estate Collateral.

Article 9. Valuation of Real Estate Collateral

The Value of Real Estate Collateral shall be determined by a licensed valuer in accordance with the provisions of the [Law on Valuation of Real Estate]. The Value of the Real Estate Collateral shall be the market value of the real estate conservatively estimated. The FRC may establish additional requirements for valuation of Real Estate Collateral necessary to implement this law, provided that such additional requirements do not contradict the requirements of the [Law on Valuation of Real Estate].

Article 10. Substitute Collateral

1. Substitute Collateral includes:

- a) cash;
 - b) treasury securities of the Government of Mongolia and other securities which may be discounted or subject to repurchase agreements with the BOM; or
 - c) real estate acquired by the Issuer in the enforcement of a Mortgage, but only for a period of two years following the date that title to the real estate is acquired by the Issuer.
2. Not more than 20% of the Bond Collateral may at any time consist of Substitute Collateral.
 3. The FRC shall establish by executive regulation rules for calculating the value of Substitute Collateral.

Article 11. Use of Derivative Contracts

1. Issuers may acquire and enter into Derivative Contracts solely to protect the value of the Bond Collateral against interest rate, currency, credit and similar risks or to facilitate repayment of the Bonds. The Derivative Contracts and proceeds arising from such contracts are also part of the Bond Collateral and shall be included on the Collateral Register.
2. Derivative Contracts included in the Bond Collateral shall contain a clause prohibiting the other party to the contract from terminating the contract in the event of bankruptcy or other credit event of the Bond Issuer as defined in article 17 of this law, subject to the rights of the Derivative Contract counterparty to satisfaction of its claim as described in article 15 of this law. Other requirements with governing the use and characteristics of Derivative Contracts included in Bond Collateral may be established by executive regulation of the FRC.

Article 12. Balance Principles of Bond Collateral

1. At all times during which an Issuer has Bonds outstanding:
 - a) the nominal principal amount of the Bond Collateral entered in the Collateral Register shall not be less than one hundred and ten percent (110%) of the unpaid nominal principal amount of the Bonds;
 - b) the average weighted yield of the Bond Collateral shall be at least equal to the average yield of the outstanding Bonds;
 - c) the revenue from the Bond Collateral shall be sufficient to pay the interest on the Bonds as it becomes due; and
 - d) the average weighted maturity of the Bond Collateral shall not be substantially shorter than the average weighted maturity of the Bonds.
2. The FRC shall issue executive regulations for definition and implementation of the provisions of this article.

Chapter 3. Creation and Supervision of the Collateral Register

Article 13. Collateral Register

1. Each Issuer of Bonds shall create a Collateral Register on which shall be identified all Bond Collateral securing the Issuer's Bonds. A single Collateral Register may be created for all Bonds of the same Issuer, or separate Collateral Registers for separate issues of Bonds of the same Issuer.
2. The Collateral Register shall be provided to the FRC and the BOM for information. The FRC shall by executive regulation define the format of the Collateral Register and the rules for its maintenance.

3. Upon entry of a Housing Loan into the Collateral Register a notation shall be made in the State Registry that the Mortgage has been pledged to secure Bonds under this law. The FRC and the State Registry shall jointly establish by executive regulation the content of and procedure for making such notation.

Article 14. Addition and Replacement of Mortgage Bond Collateral

1. Primary Collateral may be added to the Issuer's Collateral Register at any time in connection with issuance of additional Bonds and as required under this law to comply with the Balance Principles.

2. With the consent of the Collateral Register Monitor, Bond Collateral may be replaced at any time with other collateral, for good cause, subject to the limitations of this law and provided that the Issuer remains in compliance with the Balance Principles.

Article 15. Segregation and Pledge of Mortgage Bond Collateral

1. By entry of the Bond Collateral into the Collateral Register the Bond Collateral is separated from other assets of the Issuer and subject to separate accounting. Bond Collateral may not be used for any purpose other than to secure the Bonds, and no transaction with any Housing Loan or other asset entered into the Collateral Register is permitted without the consent of the Collateral Register Monitor.

2. The pledge of Bond Collateral under this law is a statutory pledge and is perfected for the benefit of Investors by entry of Bond Collateral on the Collateral Register, and notwithstanding the provisions of any other law no further registration of the pledge of the Bond Collateral shall be required.

3. Investors have a first priority right to repayment of principal and interest on their Bonds from the Bond Collateral on an equal basis with all other Investors secured by the same Collateral Register. For purposes of this article and the following article of this law the priority collateral rights of the Investors extends to:

- a) any proceeds, accounts, benefits and balances arising from or maintained in connection with the Bond Collateral; and
- b) any claims under Derivative Contracts included in the Bond Collateral.

4. In consideration of waiving rights of termination and set-off, parties to Derivative Contracts held in Bond Collateral shall have the rights of Investors with respect to the Bond Collateral to the extent of their claims against the Issuer.

5. The rights of Investors secured by a separate Collateral Register established for a specific issue of Bonds are limited in the first instance to the Bond Collateral entered into that Collateral Register. Investors who hold Bonds secured by a separate Collateral Register shall have a priority right to surplus assets entered into any other Collateral Register established by the same Issuer after the claims of Investors secured by such Collateral Register have been satisfied in full.

6. All Investors shall have a right to satisfy their claims from assets of the Issuer not entered into a Collateral Register on an equal basis with other unsecured creditors of the Issuer.

7. Assignment or other transfer of Bond Collateral and the Issuer's obligations under Bonds in their entirety for reasons other than bankruptcy of the Issuer or failure of the Issuer to perform its obligations shall be permitted in accordance with the terms of decision on issuance of the Bonds, subject to and in compliance with executive regulations of the FRC governing such transfers.

Article 16. Collateral Register Monitor

1. There shall be appointed by the Issuer upon written notification to the FRC a Collateral Register Monitor who shall supervise creation and maintenance of the Collateral Register and compliance with the Balance Principles. The Collateral Register Monitor shall not be an employee or related person of the Issuer. Collateral Register Monitors shall be approved by the FRC, and the FRC shall establish by executive regulation the qualifications, duties and procedures for approval, appointment, removal and replacement of Collateral Register Monitors.

2. The Collateral Register Monitor shall review the Collateral Register periodically as required by regulations of the FRC, but at least semi-annually, and must review the Collateral Register upon issuance of a Bond. The Collateral Register Monitor shall:

- a) assure that the Bond Collateral complies with the Balance Principles;
- b) assure that the Collateral Register is maintained in compliance with this law and the regulations of the FRC;
- c) respond to requests for approval of replacement of, or other transactions with, Bond Collateral entered into the Collateral Register;
- d) provide to the FRC and the BOM a copy of the Collateral Register within 30 days of its creation and of any additions or modifications to the Collateral Register approved by the Collateral Register Monitor within 30 days of the change or addition, in each case certified by the Collateral Register Monitor to be a true representation of the original;
- e) within 30 days of completion of a review of the Collateral Register, provide to the Issuer, the FRC and the BOM a report setting out any discrepancies or violations in the maintenance of the Collateral Register and recommendations for their correction;
- f) take such actions as may be required under this law for preservation of the Bond Collateral for the benefit of the Investors; and
- g) take such other actions with respect to the Collateral Register as may be required from time to time by executive regulation of the FRC.

3. The Collateral Register Monitor is entitled to demand information from the Issuer and the State Registry relating to the bonds and the Bond Collateral, and to inspect relevant records, and the Issuer and State Registry are required to provide the information and documents requested by the Collateral Register Monitor within five (5) business days of the request. If the request of the Collateral Register Monitor for information is denied or delayed he shall inform the FRC immediately.

4. The Collateral Register Monitor may be replaced only with the consent of the FRC. The FRC may demand replacement of the Collateral Register Monitor for good cause.

Chapter 4. Bankruptcy of Issuers; Default and Remedies

Article 17. Bankruptcy of Issuers; Default and Remedies

1. In the event of bankruptcy, liquidation, receivership, compulsory reorganization, suspension of license or other similar event affecting the Issuer (herein collectively referred to as "bankruptcy"), and notwithstanding the provisions of any other law governing such events, the Bond Collateral is excluded in its entirety from the bankruptcy estate of the Issuer until such time as the claims of Investors have been satisfied in full.

2. Bankruptcy or other default of the Issuer shall not result automatically in acceleration of the maturity of the Bonds and liquidation of the Mortgage Bond Collateral.

3. The Bonds shall provide that in the event of bankruptcy of the Issuer, failure of the Issuer to pay all or any portion of the principal and interest on the Bonds as due, or violation of any other provision of the Bond constituting a default of the Issuer (herein collectively "default"), each Investor waives any individual right which the Investor may have to demand acceleration and repayment of his Bond before its stated maturity date, but rather shall be subject to the provisions of this law for orderly liquidation or other action with respect to the Bond Collateral.
4. In the event of a default of the Issuer, upon request of any Investor the Collateral Register Monitor shall take possession of the Bond Collateral for the benefit of Investors and petition the FRC (in the case of bankruptcy of an MFC) or the BOM (in the case of bankruptcy of a Bank) for appointment of a special administrator (which may be the Collateral Register Monitor) for purposes of taking action on behalf of Investors with respect to the Bond Collateral. Until such time as a special administrator is appointed the Collateral Register Monitor shall take such action as may be necessary to take possession of, preserve and collect the proceeds of the Bond Collateral for the benefit of Investors, and the Issuer shall be obligated to deliver to the Collateral Register Monitor or any duly appointed special administrator all accounts, original documents and other materials necessary to safeguard the Bond Collateral for the benefit of Investors.
5. The special administrator shall recommend to the FRC (in case of bankruptcy of an MFC) or to the BOM (in case of bankruptcy of a Bank) whether (a) to accelerate the maturity of the Bonds and liquidate the Bond Collateral or (b) to continue the life of the Bonds until maturity by (i) transfer of the Bond Collateral to a substitute issuer of the Bonds which will assume the rights and obligations of the Issuer with respect to the Bonds and the Bond Collateral, or, (ii) if no substitute Issuer can be found, appointment of an entrusted manager for the Bond Collateral for the benefit of Investors without assuming the obligations of the Issuer. All decisions on the recommendations of the special administrator shall be final and made by the FRC or the BOM, as the case may be, in their sole discretion.
6. The Collateral Register Monitor and/or special administrator shall be compensated for their services in accordance with the standards of the industry from the proceeds of the Bond Collateral and such compensation shall have priority over the rights of Investors. Compensation shall be approved by the FRC or the BOM, as the case may be.
7. Executive regulations for implementation of the provisions of this article shall be issued jointly by the FRC and BOM.

Chapter 5. Enforcement and Penalties

Article 18. Enforcement and Penalties

1. Issuer's and Collateral Register Monitors shall be subject to legal action and penalties under this law for:
 - 1.1. Misuse of the name "collateralized mortgage bond;"
 - 1.2. Failure to register issuance of the Bonds in compliance with the Law on Securities Markets and executive regulations of the FRC;
 - 1.3. Failure to provide registers and reports to the FRC and BOM in accordance with the requirements of this law, or to provide any other information demanded by the FRC in carrying out its supervisory functions under this law;
 - 1.4. Negligent or intentional failure to comply with the balance principles or to maintain the accuracy and reliability of the Collateral Register;

- 1.5. Failure to appoint or replace a Collateral Register Monitor;
 - 1.6. Dealings with the Bond Collateral inconsistent with the obligations of an Issuer or Collateral Register Monitor under this law, including unauthorized sale or pledge of the collateral or misdirection or misappropriation of funds rightfully belonging to Bond Collateral;
 - 1.7. Fraud or misrepresentation in the creation and maintenance of the Collateral Register;
 - 1.8. Misrepresentation in any licensing application submitted to the FRC;
 - 1.9. upon notice from the Collateral Register Monitor or the FRC, failure to cure within a reasonable time any defect in performance necessary to comply with the provisions of this law and the executive regulations of the FRC;
 - 1.10. such other negligent or intentional violations of the obligations of Issuers and Collateral Register Monitors under this law which in the opinion of the FRC may negatively affect the rights of Investors.
2. In addition to any other rights or remedies which the FRC may have under this law or the Law On Securities Markets, upon violation of any provision of this law or executive regulations issued pursuant to this law by the Issuer or any Collateral Register Monitor the FRC may take the following actions:
- 2.1. demand that action be taken to cure any violation of this law or executive regulations;
 - 2.2. decline to register any issue of Bonds;
 - 2.3. revoke or suspend any license issued by the FRC;
 - 2.4. demand removal and replacement of a Collateral Register Monitor;
 - 2.5. seek a court order compelling compliance with this law and enjoining further violations;
 - 2.6. impose financial penalties and fines;
 - 2.7. take such other actions as are permitted to executive agencies of the Government of Mongolia in carrying out responsibilities under enacted laws.
3. Suspension of further issuance of Bonds or suspension or revocation of a license to issue Bonds shall not be an event of default giving rise to a right to demand acceleration of the Issuer's obligation under any outstanding Bonds.
4. The amounts of fines and other financial penalties imposed for violations of this law shall be established by executive regulation of the FRC.

**ANNEX D: DRAFT LAW OF MONGOLIA ON SECURITIZATION AND ASSET
BACKED SECURITIES**

ANNEX D: DRAFT LAW OF MONGOLIA ON SECURITIZATION AND ASSET BACKED SECURITIES

DRAFT LAW OF MONGOLIA ON SECURITIZATION AND ASSET BACKED SECURITIES (THIRD DRAFT -7-10-07)

Chapter I. Concept and Definitions

Article 1. Concept of the Law

It is the policy of Mongolia to promote the development of the housing finance market and the capital markets generally by supporting implementation of securitization, by providing a legal and regulatory framework for securitization, and creating a favorable market environment for a variety of asset backed securities. This law is intended to provide the framework for implementation of securitization and the asset backed securities market by authorizing Special Purpose Companies to be created for the sole and exclusive purpose of holding revenue producing assets and issuing asset backed securities, subject to the regulation of the Financial Regulatory Committee of Mongolia.

Article 2. Definitions

2.1. Key terms used in this law are defined as follows:

2.1.1. **Assets.** Assets include credits, loans, receivables or other rights of claim and similar financial assets, presently existing or to be created in the future, with an expected cash payment stream, whether or not such cash payments are certain. Examples include mortgage loans for real property, receivables of credit card issuers, bonds, equipment leases and concession contracts for operation of revenue producing properties, including toll roads and seaports, and other asset backed securities

2.1.2. **Affiliated person.** Any legal entity which owns or controls, or is owned or controlled by, another legal entity, regardless of whether such entity is legally characterized as a subsidiary or parent entity of the other. With regard to natural persons, an affiliated person includes any person who is an owner or employee of a legal entity, and any person related to such person to the third degree of consanguinity.

2.1.3. **Asset-backed securities.** Securities issued by a Special Purpose Company pursuant to this law which are secured by an asset pool and depend primarily for repayment on the flow of revenues from the assets in the asset pool.

2.2.4. **Asset pool.** The unique collection of assets which secure a single issue of asset backed securities.

2.1.5. **Credit enhancement.** Any legally enforceable scheme intended to improve the marketability of asset backed securities and increase the likelihood that the holders of the securities are repaid.

2.1.6. **Derivative contract.** Any contract, agreement or security which depends for its valuation on reference to the performance of another financial asset, including without limitation interest rate and currency futures and forward contracts, interest rate and currency swaps, options and credit default swaps.

2.1.7. **Obligor.** Any person who is directly or indirectly obligated by contract to make payments on an asset.

2.1.8. **FRC** - the Financial Regulatory Committee of Mongolia

2.1.9. **Investor.** n owner of an asset backed security.

2.1.10. **Issue.** A single registered issue of asset backed securities, consisting of one or more classes.

2.1.11. **Issuer.** The issuer of the asset backed securities, being the SPC.

2.1.12. **Open issue.** An issue of asset backed securities that may be increased in amount after the original issue date by issuance of additional series of securities.

2.1.13. **Originator.** The person or legal entity which was the original creditor of the assets, such as a financial institution that grants a loan.

2.1.14. **Participation certificate.** An investment security which grants to it holder a right to a share in the revenues, profits and liquidation proceeds of a designated asset pool, whether or not accompanied by a grant of a common or joint ownership interest in the assets included in the asset pool. An investment security may be a participation certificate even if the Investor's share in revenues, profits and liquidation proceeds is less than the share of Investors of other classes of participation certificates of the same issue, or tied to a specific portion of the assets in the asset pool, or there is Residual Value in the asset pool.

2.1.15. **Residual value.** Any income, revenues, profits or proceeds of the asset pool remaining after payment of the SPC's obligations to investors.

2.1.16. **Securitization.** The process through which assets are sold by an Originator or Seller to a Special Purpose Company and put beyond the effective control of the Originator or Seller for the purpose of issuing asset backed securities.

2.1.17. **Seller.** Any person or legal entity that sells assets of which it is not the Originator to a Special Purpose Company, such as an entity that assembles assets from multiple Originators for sale to a Special Purpose Company.

2.1.18. **Asset Manager.** The entity designated by the Special Purpose Company to collect and record payments on the assets from obligors, to remit such collections to the Special Purpose Company, to interact with obligors, to make allocations or distributions to investors, or to perform such other services and activities with respect to the assets as may be required by the Special Purpose Company in the Asset Management Agreement. A Sponsor, originator or seller may be an Asset Manager. Asset Managers may be of three types:

- a) *Primary asset manager* - the asset manager responsible for the entire asset pool, to which multiple Secondary asset managers may report;
- b) *Secondary asset manager* - an asset manager responsible for a portion of the asset pool, which reports to a Primary asset manager;
- c) *Replacement asset manager* - An asset manager that has agreed with the Special Purpose Company to assume responsibility for managing the assets in case the Primary asset manager is removed or otherwise unable to perform its obligations under the Asset Management Agreement.

2.1.19. **Special Purpose Company.** A limited liability company created and registered in accordance with this law, the Civil Code, and the Law on Companies.

2.1.20. **Sponsor.** Any person or legal entity that organizes or initiates an asset backed securities transaction by selling assets to a Special Purpose Company, either directly or

indirectly, including through an affiliated person. A Sponsor may be an Originator or Seller.

2.2. Unless otherwise provided in this law other terms used herein shall have the same meaning as in the Civil Code, the Law on Securities Markets and other laws of Mongolia.

Chapter II. Asset Backed Securities

Article 3. Registration, Issuance and Sale of Asset-Backed Securities

3.1. Matters pertaining to issuance of asset backed securities not specifically addressed in this law are subject to the Law on Securities Markets and the regulations of the FRC.

3.2. The provisions of this law apply only to asset backed securities issued by a Special Purpose Company created under this law.

3.3. Asset backed securities shall be registered with the FRC in accordance with the provisions of the Law on Securities Markets. Asset backed securities issued by Special Purpose Companies which are affiliates of banks are not exempt from registration with the FRC unless otherwise subject to exemption under the Law on Securities Markets Regulation.

3.4. Asset backed securities may be sold by public or closed offering. Asset backed securities may be traded on any securities trading institution authorized under the Law on Securities Markets.

3.5. The FRC may provide by regulation for open issues of asset backed securities.

3.6. A separate Special Purpose Company shall be created for each issue of asset backed securities. The FRC may provide by regulation for instances in which a Special Purpose Company may make multiple issues of asset backed securities.

3.7. Unless specifically permitted by the FRC, the Originator, Seller or Sponsor may not purchase more than 10% by face value of the asset backed securities, excepting any class of asset backed securities held for purposes of credit enhancement.

Article 4. Form of Asset Backed Securities

4.1. Asset backed securities may take the form of bonds, other forms of debt securities, participation certificates, or other forms of securities specifically permitted by the FRC.

4.2. A participation certificate which transfers to the holder an ownership interest in a claim, right or property that must be registered under the Laws on Registration of Rights to Real Property or On Registration of Rights to Immovable Property shall not be registered with the State Register of Rights to Real Property or the State Register of Rights to Immovable property, as the case may be.

4.3. Asset backed securities of the same registered issue may be divided into separate classes which differ with respect to amount or priority of payment, maturity, claims to collateral or other characteristics, as described in the registration statement and prospectus of the asset backed securities.

4.4. Repayment of asset backed securities shall occur on or before a defined maturity date.

4.5. Repayments of principal on assets which are included in an asset pool must be paid to Investors holding one or more classes of the asset backed securities within one hundred twenty (120) days of when they are received by the SPC and may not be held and reinvested by the SPC or Asset Manager, other than short term investment pending distribution to Investors.

Article 5. Credit Enhancement

5.1. Credit enhancement may be provided to asset backed securities by a Sponsor, Originator or Seller, or a third party, and may include:

5.1.1. a guarantee, on terms prevailing in the market in commercial transactions, of payment of the asset backed securities;

5.1.2. a guarantee, on terms prevailing in the market in commercial transactions, of liquidity to assure timely payment of interest and principal on the asset backed securities, not amounting to a guarantee of payment;

5.1.3. retention or sale of ownership of a class of asset backed securities which are subordinate to the rights of other classes of the same issue;

5.1.4. dedication of any Residual Value of the asset pool to creation of a reserve account for payment of the asset backed securities;

5.1.5. sale to a Special Purpose Company of assets valued in excess of the price paid by the Special Purpose Company, provided that such excess value may be recaptured by the Sponsor, Originator Seller, or investor in Residual Value; and

5.1.6. any other form of credit enhancement specifically permitted by regulation of the FRC.

Chapter III. Special Purpose Companies

Article 6. Creation of Special Purpose Companies

6.1. A Special Purpose Company may be created by any bank, non-banking credit organization, finance and investment companies, professional participant in securities markets, leasing and mortgage finance companies. Other types of Sponsors may be specifically approved by regulation of the FRC.

6.2. A special purpose company shall be created as a limited liability company in accordance with the provisions of this law and Law on Companies.

6.3. The Charter of the Special Purpose Company shall provide:

6.3.1. The Special Purpose Company shall be created and operated solely for purposes of securitization and issuance of asset backed securities.

6.3.2. The shares of a Special Purpose Company may not be sold, exchanged, pledged or otherwise transferred by their owners except as provided by the FRC;

6.3.3. The Special Purpose Company may not be reorganized or the Charter of the Special Purpose Company amended or modified after submission to the FRC, except with the consent of the FRC.

6.3.4. A majority of the directors of a Special Purpose Company shall not be affiliated persons of Sponsors, Originators or Sellers.

6.4. Capitalization and financial reporting requirements for special purpose companies shall be determined by regulation of the FRC.

6.5. Each special purpose company shall be registered with the FRC as well as in the manner required for companies.

6.6. No special purpose company may bear the name of its sponsor or any originator or seller. Each special purpose company shall include in its name the words "special purpose limited liability company."

6.7. A special purpose company shall be licensed as such by the FRC as an entity engaging in non-banking financial activities. A special purpose company created under this law is not an investment fund, trust fund or a professional participant in the securities markets as such terms are defined in the Law on Securities Markets.

6.8. A Special Purpose Company is not subject to voluntary or involuntary proceedings under the Law on Bankruptcy or the Law on Banking. Dissolution and liquidation of a Special Purpose Company and the rights of investors and other creditors of a Special Purpose Company are determined under this law.

Article 7. Powers of the Special Purpose Company

7.1. A special purpose company has the power to:

7.1.1. accept the sale or transfer of assets;

7.1.2. own and manage assets on behalf of investors;

7.1.3. issue asset backed securities;

7.1.4. enter into contracts for services and undertake all activities necessary and appropriate to carry out the foregoing, to the extent permitted under regulations of the FRC and described in the registration statement and prospectus of the asset backed securities.

7.2. A Special Purpose Company may not accept deposits or incur debt other than the asset backed securities, any short term obligation to a Sponsor, Originator or Seller to be retired with the proceeds of sale of the asset backed securities, and indebtedness represented by derivative contracts or contracts for services entered into pursuant to its powers.

7.3. Permitted activities of the Special Purpose Company consistent with this law shall be defined in the registration statement and prospectus of the asset backed securities. The Special Purpose Company may not undertake activities not specifically permitted by this law, the regulations of the FRC and such activities as are permitted in the application for issuance of securities and prospectus of the asset backed securities which do not conflict with this law.

7.4. A Special Purpose Company shall not have employees, and shall contract with third parties, which may include a Sponsor, Originator or Seller, for all services necessary to carry out its purposes.

7.5. A Special Purpose Company is responsible for the acts and omissions of all persons to which it delegates any of its functions.

Chapter IV. Formation of Asset Pools

Article 8. Characteristics of Assets

8.1. Assets included in an asset pool must be owned by the Originator or Seller free and clear of any other encumbrances, restrictions or interests at the time they are transferred to the Special Purpose Company.

8.2. On the date of issuance of the asset backed securities all assets in an asset pool must be performing assets, and no more than [ten percent (10%)] of the assets in the asset pool may be delinquent assets. For purposes of this law, a performing asset is any asset that is not required to be classified as non-performing on the books of the holder under generally applicable accounting principles or the regulations of any public authority, and a delinquent asset is any asset on which payments of principal and interest are overdue.

8.3. The Special Purpose Company may acquire, invest in or incur obligations with respect to derivative contracts solely for the purpose of protecting and preserving the value of the assets or assuring liquidity to the asset pool. The FRC may regulate the type and amount of derivative contracts in which the Special Purpose Company may invest.

8.4. Assets must be self-liquidating from payments made by obligors with respect to the principal obligation and/or liquidation of property by which the assets are secured.

8.5. The Assets include all rights of claim, income, revenues, profits, benefits and proceeds of the assets from whatever source, held or to be received by the Special Purpose Company, as further provided in this law.

Article 9. Transfer of Assets to a Special Purpose Company

9.1. The sale of assets to a Special Purpose Company implies the sale and transfer of all contracts, titles, deposits, collateral, mortgages, and other legal instruments, including guarantees, attached to the assets and necessary for their performance.

9.2. On the date assets are transferred to a Special Purpose Company the Originator or Seller must not be subject to any bankruptcy or liquidation proceeding or any demand for appointment of a conservator or receiver for the assets of the Originator or Seller.

9.3. The provisions of any other law notwithstanding, until the obligations under the asset backed securities have been repaid in full, no claim may be made against the assets of the Special Purpose Company by any person or creditor other than the investors and parties to contracts with the Special Purpose Company specifically permitted by this law if:

9.3.1. the sale is made at a fair market price;

9.3.2. the Sponsor, Originator or Seller lacks the legal right to transfer, pledge, replace, recover, repurchase, use or otherwise deal with the assets or revenues of the assets without the consent of the Investors or their legal representative; and

9.3.3. the sale is made without recourse to the Sponsor, Originator or Seller and the Special Purpose Company assumes the risks and rewards associated with ownership of the assets.

9.4. Notwithstanding paragraph 3 of this article, a Sponsor, Originator or Seller may:

9.4.1. provide normal and usual representations and warranties regarding the type or quality of assets, and assume the obligation to repurchase or replace assets which fail to comply with such representations or warranties;

9.4.2. act as a Asset Manager or provide other contractual services to the Special Purpose Company on market terms;

9.4.3. provide Credit Enhancement permitted under this law;

9.4.4. hold a right to repurchase assets without the consent of Investors upon reduction of the principal value of the asset pool to [twenty percent (20%)] of its original principal value.

Article 10. Creation of Asset Pool

10.1. The asset pool is created by entry of the assets in a schedule of assets filed with the FRC in accordance with the provisions of this law.

10.2. By regulation the FRC may allow a portion of the asset pool to be acquired by the Special Purpose Company after the date of issuance of the asset backed securities.

Article 11. Registration of Asset Pools

11.1. Prior to the sale of asset backed securities, the asset pool shall be registered with the FRC in written or electronic format, in the discretion of the FRC, for a fee to be established by the FRC. Registration of the asset pool in accordance with this law constitutes registration of transfer of the assets to the Special Purpose Company, and notwithstanding any other provision of law, it shall not be required to register a transfer of an asset to a Special Purpose Company in any other state register.

11.2. Registration of an asset pool shall be amended from time to time to as necessary to reflect addition or removal of assets from the asset pool.

11.3. Registration of the asset pool is sufficient to protect the rights and priority of the Special Purpose Company and the investors to all of the assets in the asset pool against claims of all other creditors arising after the date of registration. The protection extended under this article extends to an asset not yet reflected in the registered schedule of assets if addition of the asset to the schedule is required under the terms of the prospectus and application for issuance of the asset backed securities.

11.4. The FRC shall establish a separate register for asset pools and issue regulations governing public access to information in the register.

11.5. Nothing in this article is intended to relieve the Originator or Seller of the asset to notify an obligor of the sale or assignment of the asset if such is required by law to preserve the rights of the transferee.

Article 12. Removal and Addition of Assets

12.1. After registration of an asset pool assets may be removed from the pool only in the following cases:

12.1.1. as necessary to replace an asset which does not comply with representations and warranties of a Sponsor, Originator or Seller;

12.1.2. to facilitate recovery of a non-performing asset;

12.1.3. to repurchase assets upon decline of the principal value of the asset pool to [20%] of its original principal value, if permitted under the terms of the prospectus of the asset backed securities;

12.1.4.. other cases as may be specifically provided by this law and executive regulation of the FRC.

12.2. After registration of an asset pool assets may be added to the pool in the following cases:

12.2.1. as necessary to comply with obligations of the Special Purpose Company to maintain a minimum principal balance of assets in the asset pool;

12.2.2. as necessary to replace an asset which does not comply with representations and warranties of a Sponsor, Originator or Seller;

12.2.3. in connection with issuance of additional securities of an open issue;

12.2.4. other cases as may be specifically provided by this law and executive regulation of the FRC.

Article 13. Management of Assets

13.1. Asset Managers shall be licensed banks or other licensed entities engaging in non-banking financial activities.

13.2. The Asset Manager shall perform its obligations pursuant to the terms and conditions of a Asset Management Agreement and such other written instructions as the Special Purpose Company or its agents may issue to the Asset Manager. The Asset Management Agreement shall be included in the application for issuance of the asset backed securities.

13.3. The Asset Management Agreement shall provide that:

13.3.1. Assets are to be segregated from other assets of the Asset Manager and subject to separate accounting;

13.3.2. Revenues and proceeds of the assets are to be maintained in a separate account for each asset pool or portion of assets of a particular asset pool held by the Asset Manager;

13.3.3. In the event the Asset Manager is in default under the terms of the Asset Management Agreement, or is otherwise unable to perform its obligations under the Asset Management Agreement, the Asset Management Agreement may be terminated by the Special Purpose Company and a new Asset Manager appointed;

13.3.4. Upon termination of the Asset Management Agreement the Asset Manager will deliver to the Special Purpose Company or a new Asset Manager designated by the Special Purpose Company all original books, records and documents relating to the assets whether in electronic or paper form;

13.3.5. Upon termination of the Asset Management Agreement the Asset Manager will deliver to the Special Purpose Company or a new Asset Manager designated by the Special Purpose Company all cash and accounts relating to the assets without set off or deduction of any kind;

13.3.6. Until a Replacement Asset Manager is in place, the Asset Manager will continue to carry out its obligations under the Asset Management Agreement unless otherwise prevented by law; and

13.3.7. Such other provisions relating to the responsibilities of an Asset Manager as may be established by regulation of the FRC.

13.4. Asset Managers may be compensated. The Sponsor, Originator or Seller may act as the Asset Manager.

13.5. The Asset Management Agreement shall be a fiduciary contract for the benefit of Investors and the Asset Manager shall be liable to the Investors for willful or negligent failure to perform its duties resulting in loss or damages.

13.6. The Special Purpose Company is obligated to name a Replacement Asset Manager and to provide the Replacement Asset Manager periodically with the information that would be necessary to assume the responsibilities of the Primary Asset Manager under the Asset Management Agreement on short notice without disruption of the flow of revenues from the assets to the investors.

13.7. Qualifications, responsibilities and minimum charter capitalization of Asset Managers may be defined by regulation of the FRC.

Article 14. Residual Value of Asset Pools

14.1. Residual value of the asset pool is the property of the SPC and may be allocated and used in accordance with the provisions of the prospectus.

14.2. Interests in Residual Value of the asset pool may be reflected in a class or classes of the asset backed securities.

Chapter V. Investor Protection

Article 15. Obligation of Entrusted Management of Assets

15.1. The Special Purpose Company is subject to an obligation of entrusted management of the assets for the benefit of holders of the asset backed securities. The Special Purpose Company shall:

15.1.1. Hold and manage the assets in the best interests of investors;

15.1.2. Maintain detailed financial records pertaining to the assets separate from other records of the Sponsor, Originator or Seller;

15.1.3. Provide timely and accurate reporting and disbursements to investors;

15.1.4. Take such other steps for management of the assets and protection of investors as may be prescribed by regulation of the FRC.

15.2. A Special Purpose Company shall maintain complete and accurate accounts and records of its assets, liabilities, income and expenditures in accordance with regulations of the FRC and established accounting standards.

Article 16. Pledge of Assets to Investors

16.1. Assets of the Asset Pool are deemed to be pledged for the exclusive benefit of investors under a statutory pledge arising under this law.

16.2. The pledge of the Assets includes, without limitation, all rights of claim, income, revenues, profits, and proceeds of the assets from whatever source, held or to be received by the Special Purpose Company or its agents, representatives, custodians or designees, such revenues and proceeds to include without limitation principal, interest, insurance proceeds, fees, charges and penalties; rights under any pledge, deposit, collateral or security agreements; cash and cash accounts held by the Special Purpose Company or any Asset Manager pending acquisition of assets or disbursement to investors; all derivative contracts made for the purpose of preserving the value of the assets and assuring liquidity of the asset pool; and all contracts for services to the Special Purpose Company, including the Asset Management Agreement.

16.3. This pledge of Assets for the benefit of the investors is perfected by registration of the schedule of assets with the FRC and such registration is sufficient to protect the security interest and priority of the investors against all other claims arising after the date of registration.

16.4. The pledge of assets for the benefit of the investors may be reflected in a pledge and security agreement having terms which do not conflict with this law.

16.5. Revenues and proceeds of assets may be used to pay the costs and expenses of the asset backed securities transaction and of the Special Purpose Company in accordance with the provisions of the prospectus and executive regulation of the FRC.

16.6. Nothing in this provision is intended to prevent the sale of participation certificates which transfer common or joint ownership interests in the assets to investors.

Article 17. Independent Auditor

17.1. The books and records of the Special Purpose Company, including the schedule of assets, shall be subject to independent audit.

17.2. Auditors may be removed for good cause, with the consent of the FRC. The FRC may require that auditors be removed for good cause.

17.3. The form and frequency of audit, other responsibilities of auditors, the qualifications of auditors and the procedures for their appointment, shall be determined by regulations of the FRC.

Article 18. Reporting to Investors

18.1. The Issuer shall provide to Investors and the Capital Markets Board at least semi-annually a report on the status of the assets in the asset pool, which shall include since the prior report

18.1.1. the remaining principal balance of the assets in the asset pool;

18.1.2. the amount of scheduled and unscheduled principal payments on the assets since the prior report;

18.1.3. the number of assets prepaid in their entirety since the prior report;

18.1.4. the number of assets which have become non-performing and/or delinquent since the last report;

18.1.5. the amount of principal paid and remaining principal balance of the asset backed securities;

18.1.6. such other information as may be material to the financial condition of the assets and the asset backed securities.

18.2. The report of the auditor of the special purpose company shall be provided to investors.

18.3. Information shall be provided for each class of securities of an issue, as applicable.

18.4. Other reports to Investors may be required by executive regulations of the FRC. The form and content of reports to Investors may be established by executive regulation of the FRC.

Chapter VI. Dissolution and Liquidation of Special Purpose Companies

Article 19. Termination of a Special Purpose Company

19.1. The Special Purpose Company shall be dissolved in the following cases:

19.1.1. upon repayment of the asset backed securities or exercise by the Special Purpose Company or any Sponsor, Originator or Seller of the right to repurchase the assets as permitted under this law;

19.1.2. upon failure of the Special Purpose Company to make payments on the asset backed securities in accordance with the terms of the prospectus, or other material default as defined under the terms of the prospectus, and a demand for termination by investors or their legal representatives in accordance with the provisions of the prospectus;

19.1.3. upon violation of the provisions of this law.

19.2. Upon dissolution of the Special Purpose Company in the case described under subparagraph 19.1.1 of the first paragraph of this article, the Special Purpose Company shall be dissolved and liquidated in accordance with the provisions of the prospectus and Chapter 4 of the Civil Code governing dissolution and liquidation of legal persons generally, as applicable. Dissolution of the Special Purpose Company under items subparagraphs 19.1.2 and 19.1.3 of paragraph 1 of this article shall be subject to articles 20, 21 and 22 of this law.

Article 20. Involuntary Dissolution and Liquidation of the Special Purpose Company

20.1. Upon the occurrence of any event described in subparagraphs 19.1.2 and 19.1.3 of paragraph 1 of article 19 the FRC may take steps to dissolve and liquidate the Special Purpose Company in accordance with the provisions of this article. Action by the FRC may be taken on its own initiative or on the request of Investors.

20.2. If the prospectus of the asset backed securities provides for an agent or representative to act on behalf of investors the FRC may order such agent or representative to exercise the remedies provided under this law. If the FRC finds that there is no suitable agent or authorized representative to act on behalf of investors the FRC may name any person or persons to act as the legal representative for the investors, or the FRC may itself assume representation of the investors.

20.3. The legal representative of the investors appointed pursuant to this article may:

20.3.1. Take possession and control of the assets for the benefit of investors;

20.3.2. Replace directors and officers of the Special Purpose Company;

20.3.3. Settle any guarantees or other forms of credit enhancement for the benefit of investors;

20.3.4. Terminate Asset Management Agreements or other contracts for services to the Special Purpose Company;

20.3.5. With the consent of the FRC, appoint a Replacement Asset Manager or other provider of services;

20.3.6. Dissolve and liquidate the Special Purpose Company in accordance with the provisions of this law;

20.3.7. Take all actions necessary and appropriate for carrying out the foregoing; and

20.3.8. Take such other steps to protect the interests of investors as may be permitted by regulation of the FRC.

20.4. Directors, officers, and contract service providers of the Special Purpose Company shall take all appropriate steps to safeguard the assets for the benefit of the investors, deliver the assets, accounts, documents, and corporate indicia of the Special Purpose Company to the legal representative of the investors on demand, and shall cooperate in every way with the exercise of rights and remedies by the legal representative of the investors.

20.5. Dissolution and liquidation of Special Purpose Companies under this law may proceed by order of the FRC. Exercise of the remedies provided in this article shall be under the supervision of the FRC.

Article 21. Distribution of Liquidation Proceeds

21.1. Proceeds of liquidation of the Special Purpose Company shall be distributed in the following order:

21.1.1. first, to the costs and expenses of liquidation;

21.1.2. second, to the investors in accordance with the order of priority set out in the prospectus,

21.1.3. third, to any person other than the Sponsor, or any Originator or Seller to whom the Special Purpose Company is indebted under contracts permitted under this law;

21.1.4. third, to Sponsors, Originators and Sellers to whom the Special Purpose Company is indebted under contracts permitted under this law;

21.1.5. fourth, to any other creditors; and

21.1.6. fifth, remaining funds, if any, shall be distributed to the shareholders of the Special Purpose Company.

Article 22. Rules of Liquidation

22.1. Liquidation of the Special Purpose Corporation shall follow the procedures of the Civil Code for liquidation of legal persons generally unless such procedures conflict with the provisions of this law.

Chapter VII. Miscellaneous Provisions

Article 23. Profit Taxation of Special Purpose Company

23.1 All revenues and profits arising from assets included in an asset pool and distributed to investors or dedicated to permitted credit enhancement are characterized as deductions from the gross income of the Special Purpose Company under Chapter 3 of the Law On Economic Entity Income Tax.

Article 24. Transfer of Assets to Special Purpose Company Exempted from VAT

24.1. The sale or transfer of assets to a Special Purpose Company, and any subsequent transfer of assets from the Special Purpose Company to the Sponsor, Originator or Seller in accordance with the terms of the prospectus, is exempt from value-added tax (VAT), transfer tax and documentary stamp tax (DST), or any equivalent taxes on the transfer of assets.

Article 25. Banks Participating in Securitization

25.1 The Bank of Mongolia retains authority under the Law On Banking to regulate the activities of banks acting as Sponsors, Originators, Sellers and Asset Managers.

Article 26. Banking Secrecy

26.1. Any Sponsor, Originator, Seller, Asset Manager, or Special Purpose Company, their officers, directors, employees, agents and persons or entities providing services to them in a securitization, are not classified as third parties for purposes of application of any laws governing secrecy of banking information.

Article 27. Penalties and Enforcement.

27.1. Issuer's and Sponsors shall be subject to legal action and penalties under this law for:

27.1.1. failure to meet their financial obligations with respect to the asset backed securities;

27.1.2. failure to register issuance of asset backed securities in compliance with the Law On Securities Markets and executive regulations of the FRC;

27.1.3. negligent or intentional fraud or misrepresentation in any licensing application, application for issuance or prospectus submitted to the FRC and/or provided to investors;

27.1.4. failure to provide reports to investors as required by this law;

27.1.5. negligent or intentional fraud or misrepresentation in the creation and maintenance of the schedule of assets or any reporting to investors required under this law;

27.1.6. dealings with the assets which are inconsistent with the obligations of an Issuer under this law, including unauthorized sale, pledge or removal of the assets from the asset pool or misdirection or misappropriation of funds rightfully belonging to investors;

27.1.7. negligent or intentional failure to service the assets in accordance with the provisions of this law and the terms of the Asset Management Agreement;

27.1.8. upon notice from the FRC, failure to cure within a reasonable time any defect in performance necessary to comply with the provisions of this law and the executive regulations of the FRC;

27.1.9. such other negligent or intentional violations of the obligations of Issuers or Sponsors under this law which in the opinion of the FRC may negatively affect the rights of Investors.

27.2. In addition to any other rights or remedies which the FRC may have under this law or the Law On Securities Markets, upon violation by the Issuer or Sponsor of any provision of this law or executive regulations issued pursuant to this law FRC may take the following actions:

27.2.1. demand that action be taken to cure any violation of this law or executive regulations;

27.2.2. decline to register or revoke the registration of any issue of asset backed securities;

27.2.3. decline to issue a license or revoke or suspend any license issued by the FRC;

27.2.4. demand termination of a Asset Management Agreement and removal and replacement of a Asset Manager;

27.2.5. seek a court order compelling compliance with this law and enjoining further violations;

27.2.6. impose financial penalties and fines;

27.2.7. appoint a legal representative for investors;

27.2.8. initiate dissolution and liquidation of a special purpose company in accordance with the provisions of this law;

27.2.9. take such other actions as are permitted to executive agencies of the Government of Mongolia in carrying out responsibilities under enacted laws.

27.3. The amounts of fines and other financial penalties imposed for violations of this law shall be established by executive regulation of the FRC.

Article 28. FRC to Issue Regulations.

28.1. The FRC shall have the authority to issue regulations governing implementation of this law, including without limitation regulations governing procedures for registration, issuance and sale of asset backed securities; creation, registration and charter capitalization of Special Purpose Companies; rules and procedures for registering transfer of assets to a Special Purpose Company; fees for registration of Special Purpose Companies and transfer of assets; the type and characteristics of assets permitted to be included in asset pools; and such other matters as may be necessary for implementation of this law.

**ANNEX E: DRAFT FRC REGULATION ON COLLATERALIZED (COVERED)
MORTGAGE BONDS**

ANNEX E: DRAFT FRC REGULATION ON COLLATERALIZED (COVERED) MORTGAGE BONDS

FINANCIAL REGULATORY COMMITTEE OF MONGOLIA REGULATION ON REGISTRATION AND ISSUANCE OF COLLATERALIZED MORTGAGE BONDS

SECTION ONE Purpose, Scope and Definitions

Article 1. Purpose and Scope.

1.1. This regulation establishes the principles regarding registration, issuance and sale of Collateralized Mortgage Bonds (CMBs) pursuant to the Law of Mongolia on Collateralized Mortgage Bonds.

Article 2. Legal authority.

2.1. This regulation is issued pursuant to the authority granted to the Committee under the Law on Collateralized Mortgage Bonds and the Law on Securities Markets.

Article 3. Abbreviations and Defined Terms.

3.1. For the purpose of this regulation, the abbreviations and defined terms established in the Law on Securities Markets, Law on Collateralized Mortgage Bonds, the Civil Code and the [FRC Regulations] shall apply. References to the "law" in this regulation are to the Law on Collateralized Mortgage Bonds.

SECTION TWO

Definition, Issuers and Supervision of Collateralized Mortgage Bonds

Article 4. Definition of Collateralized Mortgage Bonds

4.1. Collateralized Mortgage Bonds are debt securities which are general obligations of the issuer secured by Housing Loans and Real Estate Collateral as provided in the law and this regulation.

4.2. A bond is a general obligation of the issuer if the issuer's liability to the Investor extends to all assets and revenues of the issuer notwithstanding the existence of specific collateral pledged to secure the debt.

Article 5. Protection of the name “Collateralized Mortgage Bond”

5.1. Securities or bonds that are not issued under the law and this regulation and do not meet the requirements of this law and this regulation may not be named or characterized as “collateralized mortgage bonds,” or any combination or equivalent of those words which the Committee determines may confuse investors.

5.2. The Committee may decline to register any issue of securities which is misnamed or mischaracterized as a collateralized mortgage bond.

Article 6. Issuers

6.1. Collateralized Mortgage Bonds may be issued by banks and mortgage finance companies.

6.2. Mortgage finance companies shall be licensed by the Committee to issue CMBs. Issuance of CMBs by banks may require the concurrence of the BOM to the extent required under the Law on Banking and applicable regulations of the BOM.

6.3. Prior to registration of an issue of CMBs by a bank, the Committee will seek the opinion of the BOM.

Article 7. Issuer requirements

7.1. Mortgage finance companies shall be registered as legal entities and licensed as non-banking financial institution prior to licensing by the Committee to issue CMBs. Application for licensing as a non-banking financial institution may be made simultaneously with an initial application for issuance of CMBs.

7.2. Mortgage finance companies shall have a minimum paid in capital requirement of [----
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7.3. Prior to issuance of a CMB the issuer must demonstrate to the satisfaction of the Committee: (1) familiarity and experience with techniques for management of the financial risks that may arise with respect to the bonds and Bond Collateral; and (2) that the necessary organizational structure and resources for issuance and management of CMBs is in place. These requirements may be met by a combination of factors, including without limitation:

7.3.1. demonstrated staff experience and capabilities of key personnel;

7.3.2. written policies and procedures pertaining to risk management;

7.3.3. contractual arrangements or affiliations with entities having demonstrated familiarity and experience with risk management, or possessing resources necessary for management of the risks associated with issuance of CMBs.

7.4. A determination under paragraph 7.2 shall be in the discretion of the Committee.

7.5. For purposes of this regulation any bank subject to regulation by the BOM with respect to banking operations generally and which meets the requirements of the BOM shall be considered to demonstrate sufficient familiarity and experience with techniques for management of financial risks necessary to issue CMBs, unless otherwise decided by the BOM.

7.6. Nothing in this by-law is intended to replace, modify or interfere with any further conditions to be met by banks prior to issuance of CMBs which may be imposed by the BOM.

Article 8. Supervision

8.1. The Committee shall carry out the supervision of issuance of Collateralized Mortgage Bonds in accordance with the provisions of the law, the Law on Securities Markets and this regulation. Issues not specifically governed by the law shall be governed by the Law on Securities Markets.

8.2. In the registration of an issue of CMBS the Committee may give any instructions that are appropriate and necessary to ensure that the Issuer complies with the law, this regulation and the Law on Securities Markets.

SECTION THREE

Bond Collateral

Article 9. Bond Collateral

9.1. The Bond Collateral is the aggregate of assets segregated by the Issuer as collateral for repayment of the Collateralized Mortgage Bonds. The Bond Collateral comprises Housing Loans, real estate collateral, proceeds and products of the Housing Loans and real estate collateral regardless of where held or by whom, substitute assets and derivative contracts registered in the Collateral Register in accordance with the law.

9.2. The Bond Collateral shall be free of any encumbrance or security interest other than the statutory pledge for the benefit of investors created by the law.

9.3. An asset shall be considered to be included in the Bond Collateral from the date of its entry into the Collateral Register, except that proceeds and products of an asset included in a Collateral Register are included in the Bond Collateral from the moment they come into existence.

Article 10. Standards for Housing Loans and real estate collateral

10.1. A Housing Loan is a receivable collateralized by residential property which is a free standing structure designed for occupancy by a single family or a residential unit in a multifamily residential building. A real estate receivable is a receivable secured by a single property intended for use for non-residential purposes or by a multi-unit residential property held for rental. In order for a Housing Loan or real estate receivable to be eligible to be included in the Bond Collateral:

10.1.1. The receivable shall have been collateralized for its full amount by a first degree collateral agreement which is registered in the state registry in the name of the Issuer;

10.1.2. The receivable shall be payable in cash installments at least quarterly;

10.1.3. The real estate property securing the receivable shall be within the borders of Mongolia;

10.1.4. The property securing the receivable shall have been insured against natural disasters for its full value for the entire term of the receivable, and the Issuer shall be named as an insured party under the insurance contract;

10.1.5. In case the real estate property is a unit in a multifamily residential building, a housing association shall have been established for management of the building as defined in the [Law on Housing Associations],

10.1.6. The real estate property securing the receivable shall have been valued at market value by a licensed valuer who is not an employee of the issuer, during the prior two years up to the date of the inclusion of the receivable in the Bond Collateral

10.1.7. All the payments due up to date of inclusion in the Bond Collateral, shall have been made by the debtor.

10.2. A Housing Loan or real estate receivable that requires provisioning under the regulations of the BOM shall not enter into the calculation of the nominal value, weighted average yield, or other parameters of the Bond Collateral required to be calculated under the Balance Principles of the law and this regulation.

10.3. There is no limitation on the principal amount of a Housing Loan included in Bond Collateral relative to the value of the real estate collateral by which it is secured. However, no portion of a Housing Loan in excess of 70% of the value of the real estate by which it is

collateralized is considered to be included in the value of the Bond Collateral for purposes of calculating the nominal value, weighted average yield, or other parameters of the Bond Collateral required to be calculated under the Balance Principles of the law and this regulation, unless repayment of that amount is guaranteed by the Government of Mongolia or any agency of the Government of Mongolia authorized by law to issue such guarantees.

10.4. There is no limitation on the principal amount of a real estate receivable included in Bond Collateral relative to the value of the real estate collateral by which it is secured. However, no portion of a real estate receivable in excess of 50% of the value of the real estate by which it is collateralized is considered to be included in the value of the Bond Collateral for purposes of calculating the nominal value, weighted average yield, or other parameters of the Bond Collateral required to be calculated under the Balance Principles of the law and this regulation.

Article 11. Standards for substitute assets

11.1. The following assets may be included in the Bond Collateral as substitute assets:

11.1.1. Mongolian currency,

11.1.2. Treasury securities of the Government of Mongolia and other securities which may be discounted or subject to repurchase agreements with the BoM; or

11.1.3. real estate acquired by the Issuer in the enforcement of a Mortgage, but only for a period of two years following the date that title to the real estate is acquired by the Issuer.

11.2. Cash is valued at face amount. Treasury and other securities traded on an organized exchange or market as defined under the Law on Securities Markets are valued at their published market price on the date of valuation.

11.3. Currency that is included in the Cover Pool shall be deposited in a separate account and the securities that are included in the Cover Pool shall be deposited in a separate account at the. Accounts shall be held in the name of the Issuer as custodian of Bond Collateral securing Collateralized Mortgage Bonds.

11.4. The value of Substitute Collateral shall not exceed 20% of the Bond Collateral. The ratio of Substitute Collateral to Bond Collateral shall be calculated on the basis of the actual value of the Bond Collateral as determined under this regulation.

Article 12. Standards for derivative contracts

12.1. The Issuer may enter into contracts ("derivative contracts") with institutions regulated under the Law On Banking or the Law On Securities Markets in order to reduce the risk of financial loss arising from:

12.1.1. fluctuations in interest rates, and

12.1.2. fluctuations in currency exchange rates.

12.2. In addition, the Issuer may enter into derivative contracts for purposes of achieving correspondence between the cash flows of the Bond Collateral and the payment obligations on the bonds, including interest rate and currency swaps.

12.3. A derivative contract which places the Issuer in a short position with respect to the obligations under the contract may not be included in Bond Collateral.

12.4. If a derivative contract relates to Collateralized Mortgage Bonds issued and/or assets included in the Bond Collateral, it may not relate to any other assets or liabilities of the Issuer.

Derivative contracts acquired for purposes permitted under this article must specifically refer to the Bond Collateral to which they refer.

12.5. The derivative contracts that relate to Collateralized Mortgage Bonds issued and/or the assets included in the Bond Collateral are also a part of the Bond Collateral.

12.6. The derivative contracts shall:

12.6.1 have a clause that prohibits the contract counterparty from netting, setoff or terminating the contract in the event of bankruptcy of the Issuer,

12.6.2. state that the contract is entered into in accordance with the law and that the financial obligations of the institution under the contract are secured to the counterparty by the assets included in the Bond Collateral *pari passu* with the Investors in the Collateralized Mortgage Bonds.

SECTION THREE

Collateral Register and Collateral Register Monitor

Article 13. Collateral register

13.1. The Issuer shall establish and keep a Collateral Register in respect of the assets included in the Bond Collateral. The Collateral Register shall be kept in electronic format.

13.2. The issuer may make or amend an entry in the Collateral Register only with the consent of the Collateral Register Monitor.

13.3. An Issuer may create a single Collateral Register to secure all Collateralized Mortgage Bonds of the Issuer or multiple Collateral Registers for separate issues of Collateralized Mortgage Bonds of the same issuer.

Article 14. Information content of the Collateral Register

14.1. The issuer shall include in the Collateral Register the following information related to the Bond Collateral:

14.1.1. Identification data of the asset, including the obligor's name(s), currency, nominal principal amount, interest rate and interest computation method, and origination date;

14.1.2. Identification data of the real estate collateral for the asset, including the location, title register information and the value at the origination date of the receivable;

14.1.3. Cash accounts associated with the Collateralized Mortgage Bonds, including the account number and the institution with which the account is held;

14.1.4. With respect to securities, ISIN number, nominal value, currency, maturity, interest rate, interest computation method, payment schedule and the account information at [depository].

14.1.5. With respect to derivative contracts, identification data of the counterparty to the contract, nominal value, type of contract and date of the contract.

14.2. All data contained in the Collateral Register shall be collected for the purposes of the law and this regulation only. The data contained in the Collateral Register shall only be disclosed to authorized staff of the Issuer and the Committee as well as the Collateral Register Monitor. Upon the insolvency of the Issuer and after the Committee's decision to transfer the assets, the

data may be disclosed to the Investor Protection Fund, another qualified issuer or an appointed manager.

Article 15. Collateral Register Monitor

15.1. The issuer must appoint a collateral register monitor, with the consent of the Committee, authorized to monitor the Collateral Register for compliance with the provisions of the law and this regulation.

15.2. The role of Collateral Register Monitor shall be performed by either banks or audit companies approved by the Committee. The audit company or the bank appointed as the Collateral Register Monitor shall appoint a natural person as permanent representative for fulfilling the mandate. The permanent representative of the Collateral Register Monitor:

15.2.1. Shall have legal or economic university degree,

15.2.2. Shall have a professional experience in its field of at least 5 years,

15.2.3. Shall not have been found guilty of a violation of the Law on Securities Markets, Law on Banking, and any law on prevention of money laundering;

15.2.4. Shall not have been sentenced for:

15.2.4.1 The offenses of infamous crimes such as embezzlement, peculation, extortion, bribery, theft, fraud, forgery, breach of trust, fraudulent bankruptcy, smuggling;

15.2.4.2. Involvement in fraudulent activities in official tenders and sale/purchase transactions;

15.2.4.3. Tax evasion or attempt for tax evasion;

15.2.4.4. Shall not have been subject to legal prosecution due to bankruptcy;

15.2.4.5. Shall not be an individual held responsible for dismissal of a capital market institution from stock exchange membership temporarily or permanently, or for revocation of a license of a professional participant of the securities markets, or for revocation or restriction of a banking license or license of a non-banking financial institution, temporarily or permanently,

15.3. The Collateral Register Monitor may not delegate its duties, except for early termination of its mandate. The Collateral Register Monitor may be replaced only with the consent of the Committee. The Committee may demand replacement of the Collateral Register Monitor for good cause.

15.4. The Collateral Register Monitor shall be contractually bound to the Issuer but bound also by the regulations and instructions of the Committee.

Article 16. General duties of the Collateral Register Monitor

16.1. The Collateral Register Monitor shall:

16.1.1. Assure that the Collateral Register is maintained in compliance with the law and this regulation;

16.1.2. Assure that the assets registered in the Collateral Register exist and comply with the requirements of the law and this regulation with respect to asset standards and composition of the Bond Collateral and the Balance Principles;

16.1.3. Respond to requests for approval of replacement or removal of assets from the Collateral Register;

16.1.4. Notify in writing the issuer and the Committee upon the occurrence and persistence for a period of 10 working days of a violation of or non-compliance with the law and this regulation pertaining to maintenance of the Collateral Register, asset standards, composition of the Bond Collateral, and the Balance Principles;

16.1.5. Take such other actions with respect to the Collateral Register and the assets included in Bond Collateral as may be required from time to time by regulation of the Committee.

16.2. Inspection of the Collateral Register shall be made monthly and at any time modifications to the register are proposed by the Issuer.

16.3. After each inspection the Collateral Register Monitor shall prepare and deliver to the Issuer and the Committee a summary report containing:

16.3.1. an opinion that the Collateral Register and Bond Collateral comply with the requirements of the law and this regulation, or

16.3.2. a description of the ways, if any, that the Collateral Register and the Bond Collateral fail to comply with the law and this regulation, and

16.3.3. a description of steps that must be taken by the Issuer to bring the Collateral Register and the Bond Collateral into compliance with the law and this regulation.

Article 17. Powers of the Collateral Register Monitor

17.1. The Collateral Register Monitor shall be entitled to inspect the books and records of the issuer pertaining to the Covered Mortgage Bonds and to call for information at all times insofar as the records or information relate to the Collateralized Mortgage Bonds and the assets recorded in the Collateral Register. The issuer shall be required to keep the Collateral Register Monitor continually informed of the principal repayments relating to the assets recorded in the Collateral Register as well as of other changes relating to these assets that are of relevance to the Investors.

Article 18. Safekeeping duties

18.1. All original documents pertaining to the Bond Collateral held in paper form shall be segregated and held in a safe and secure facility under the joint control of the Issuer and the Collateral Register Monitor. The Collateral Register Monitor shall ensure the safekeeping of such assets and may hand over those items only in accordance with the provisions of the law and this regulation.

18.2. The Collateral Register Monitor is required to hand over the assets recorded in the Collateral Register and deeds relating to such assets and to assist in their deletion from the Register provided that the other assets recorded in the register suffice as cover for the Collateralized Mortgage Bonds.

SECTION FOUR

Balance Principles

Article 19. Nominal Balance

19.1. The value of the Bond Collateral reflected in the Collateral Register must be not less than 110% of the value of the collateralized mortgage bonds.

19.2. The value of the Bond Collateral is the aggregate unpaid principal balance of the Housing Loans, real estate receivables, and any financial instruments held as a substitute cover

asset, plus the amount of any currency held. The value of the Collateralized Mortgage Bonds shall be the aggregate unpaid principal balance of the bonds then outstanding.

19.3. For purposes of calculating nominal balance, derivative contracts must be valued at their current market value at the time of calculation, either positive or negative. If market values are not available through an exchange or other market making mechanisms, the value of the derivative contract should be calculated on the basis of the current loss or gain that the holder of the contract would experience were the contract to be redeemed on the day the calculation is made.

Article 20. Yield Balance

20.1. The yield of the assets included in the Bond Collateral and the yield of the Collateralized Mortgage Bonds shall be computed as the weighted average coupon yields. The weighted average yields of the Bond Collateral and the Covered Mortgage Bonds shall be calculated by (1) multiplying the actual coupon yield on each asset or bond, as the case may be, by a fraction having as a numerator the nominal value of the asset or bond and as a denominator the aggregate nominal value of the Bond Collateral or the Collateralized Mortgage Bonds, as the case may be, and (2) adding the results of such calculations to arrive at the weighted average yield.

20.2. For purposes of calculating yield derivative contracts are considered only to the extent that the proceeds of the derivative contract is a substitute for the interest income of some or all of the assets included in Bond Collateral.

Article 21. Revenue Balance

21.1. For purposes of matching revenues of the Bond Collateral to the payments due on the Collateralized Mortgage Bonds, revenues from the assets shall include only regularly scheduled and predictable payments of principal and interest. The payments due on the bonds shall include principal and interest due in accordance with the terms of the bonds.

21.2. When computing the revenues from the Bond Collateral, revenues of derivative contracts shall be included to the extent that they are substitutes for revenues of the assets included in the Bond Collateral.

Article 22. Maturity Balance

22.1. The average weighted remaining maturity of the Housing Loans and the real estate receivables must equal or exceed the average weighted remaining maturity of the bonds.

22.2. The remaining maturity of an asset or bond is the amount of time remaining from the date of calculation until the stated maturity of the asset. The remaining maturity shall be calculated in number of months remaining, considering the last day of month in which the maturity date occurs as a complete month.

22.3. The average weighted maturity of the Housing Loans and real estate receivables shall be calculated by (1) multiplying the actual remaining maturity of the asset by a fraction having as a numerator the unpaid principal balance of the asset and as a denominator the aggregate outstanding principal balances of all Housing Loans and real estate receivables included in Bond Collateral, and (2) adding the results of such calculations to arrive at the weighted average maturity.

Article 23. Infringement of Balance Principles

23.1. If the balance principles are not observed, additional assets shall be included in the Bond Collateral to the extent required to achieve the required balance.

23.2. The Committee may examine periodically that cover for the Collateralized Mortgage Bonds is sufficient, and it may call on the services of other persons and institutions, including the Issuer, for this purpose.

23.3. Issuers may acquire their own Collateralized Mortgage Bonds for asset-liability management purpose. The Collateralized Mortgage Bonds acquired by the issuer shall not be deemed outstanding and shall not be entered into the calculation of the balance principles as long as they remain in the ownership of the issuer. Issuers may at any time redeem the Collateralized Mortgage Bonds they own.

SECTION FIVE

Registration and Issuance of Collateralized Mortgage Bonds

Article 24. Registration and Issuance and Procedure

24.1 Collateralized Mortgage Bonds may be offered to the public or may be sold by private placement. Except as provided in this regulation, an offering of Collateralized Mortgage Bonds must be registered with the Committee in the manner provided for other public offerings of securities.

24.2. The public offering or the private placement of Collateralized Mortgage Bonds shall be conducted through a professional participant in the securities market authorized to intermediate issuance of securities.

Article 25. Collateralized Mortgage Bonds Application and Prospectus

25.1. Upon approval by the Committee an application for issuance of collateralized mortgage bonds shall remain in effect for a period of 3 years and will permit issuance of additional bonds within that period upon filing of a supplemental application.

25.2. The application for issuance shall contain the information required for application of securities generally under the regulations of the Committee. The supplemental application submitted in connection with a subsequent issuance of bonds shall contain:

25.2.1. Any information necessary to reflect material changes in the business and financial position of the issuer since approval of the initial application, including the most recently available financial statements of the issuer;

25.2.2. Any information regarding material credit events affecting bonds issued earlier under the same application;

25.2.3. The specific information regarding the terms of the new bonds or series of bonds proposed to be issued under the application.

25.3. Likewise, the Collateralized Mortgage Bond prospectus may consist of a base prospectus and a supplemental prospectus for all subsequent issues or series of bonds during the effective period of an approved application. The base prospectus shall contain all relevant information concerning the issuer and the bonds offered to the public or to be admitted to trading on an exchange as required for securities generally under the Committee's regulations.

25.4. Once registered, a base prospectus shall be applicable to all subsequently issued Collateralized Mortgage Bonds of the same Issuer during the effective period of the approved

application unless there have been, or facts exist suggesting a substantial likelihood of, material institutional, legal or financial changes affecting the Issuer.

25.3. The information given in the base prospectus shall be supplemented by the supplemental prospectus to be prepared for each subsequent issue or series of Covered Mortgage Bonds. The supplemental prospectus shall contain:

25.3.1. Any information necessary to reflect material changes in the business and financial position of the issuer since approval of the initial application, including the most recently available financial statements of the issuer;

25.3.2. Any information regarding material credit events affecting bonds issued earlier under the same application;

25.3.3. The specific information regarding the terms of the new bonds or series of bonds proposed to be issued under the application.

25.4. Application for registration of an Issuer's first issue of Collateralized Mortgage Bonds shall entail simultaneous registration of the base prospectus and the form of the supplemental prospectus for subsequent issues under the same application.

25.5. Changes and amendments to a registered application and prospectus shall be made in accordance with the generally applicable rules of the Committee.

Article 26. Required content of applications and prospectus

28.1. Any application or prospectus must contain the following information pertaining to the bonds to be issued:

26.1.1. nominal values of the Bond Collateral and the bonds;

26.1.2. the composition of the Bond Collateral in terms of Housing Loans, real estate receivables, and substitute collateral, including the aggregate nominal values of each category;

26.1.3. the general locations of the real estate collateral which secures the Housing Loans and real estate receivables;

26.1.4. the ratio of amounts of Housing Loans and real estate receivables to the value of the real estate collateral by which they are secured;

26.1.5. loss and delinquency experience of the Collateral Register;

26.1.6. the interest rates on the Housing Loans and real estate receivables and the terms of adjustable interest rates;

26.1.7. the composition of substitute collateral, including the aggregate nominal values of each category;

26.1.8. the current value, positive or negative, of derivative contracts held on the Collateral Register or to be held on the Collateral Register;

26.1.9. the average weighted yield calculation for the Bond Collateral;

26.1.10. the nominal and remaining maturities of the Housing Loans and real estate receivables;

26.1.11. the average weighted nominal and remaining maturities of the CMBs and of the Housing Loans and real estate receivables contained in the Bond Collateral;

26.1.12. estimated balance sheets and income statements of the Collateral Register upon issuance, in which the bonds are considered to be liabilities of the Collateral Register.

26.2. A prospectus for an initial issuance of bonds secured by a single Collateral Register shall include the required information for the Bond Collateral and Collateral Register as it will be immediately upon issuance of the bonds. If an application or prospectus pertains to issuance of additional bonds from an existing Collateral Register, the information provided must reflect the status of the entire Collateral Register and all bonds outstanding both before the additional issuance and after.

26.3. Presentation of information pertaining to Housing Loans, real estate receivables and real estate collateral may be done by tables which aggregate information into appropriate segments as in the following examples:

Interest Rate Distribution of Bond Collateral

<u>Rate (%)</u>	<u>Number of Loans</u>	<u>% of Loans</u>
5 - 5.5		
5.6 - 6		
6.1 - 6.5		
6.6 - 7		

Remaining Maturities of Housing Loans and Real Estate Receivables

<u>Years</u>	<u>Number of Loans</u>	<u>% of Loans</u>
3 - 4		
4 - 5		
5 - 6		
6 - 7		

Article 27. Periodic reporting

27.1. The issuer shall file with the Committee and provide to investors on a quarterly basis a report containing the information required under paragraph 28.1. The report shall be presented in such a way as to show changes in the information since the last quarterly report.

27.2. The quarterly report shall include the most recent report of the Collateral Register Monitor.

SECTION SIX

Insolvency of the Issuer

Article 28. Authority of the Committee

28.1. In case an issuer becomes insolvent, is subjected voluntarily or involuntarily to administration (conservatorship), reorganization or bankruptcy procedures, the license of the issuer is suspended, terminated or restricted, or the issuer otherwise seeks the protection of the courts against creditors, the income and proceeds of the Bond Collateral will be used to make payments to the investors and counterparties of the derivative contracts made for the purpose of protecting the Bond Collateral from risks and the Committee or the BOM, acting jointly or individually in accordance with their authorities under the law, may on their own initiative or on the request of a Collateral Register Monitor or any investors:

28.1.1. issue any order, instruction or decree necessary to permit or facilitate possession, conservation and management of the Bond Collateral by the Collateral Register Monitor on behalf of investors;

28.1.2. appoint a special administrator of the Bond Collateral empowered to take possession of, conserve and manage the Bond Collateral for the benefit of investors, and

issue any order, instruction or decree necessary to permit or facilitate possession, conservation and management of the Bond Collateral by such special administrator;

28.1.3. upon recommendation of the special administrator, to decide, in their sole discretion, to accelerate the maturity of the bonds and liquidate the Bond Collateral or to continue the life of the bonds in accordance with the provisions of the law.

28.2. In case of occurrence of any event described in paragraph 30.1, the primary objective of the Committee shall be the maintenance of the integrity of the Bond Collateral and continuance of the Collateralized Mortgage Bonds in existence until maturity.

28.3. The Committee shall decide for continuation of the life of the bonds as long as a substitute issuer willing to assume the issuer's obligations on the bonds and any associated obligations is available on commercially reasonable terms, and if not available, the Committee shall decide for transfer of the Bond Collateral to an entrusted manager.

28.4. Transfer of the Bond Collateral will be considered only if it appears to the Committee that the future income of the Bond Collateral would be sufficient to pay the interest and principal obligations of the bonds in accordance with the terms of the bonds, as well as obligations to third parties under derivative contracts considered necessary to the protection of the value of the Bond Collateral. Determination of the advisability of entrusted management shall be solely in the discretion of the Committee, based on the Committee's estimation of commercial reasonableness and the best interests of the holders of the Collateralized Mortgage Bonds.

28.5. In case an entrusted manager can be found, the Committee may decide for gradual liquidation of the Bond Collateral by payment of principal on the bonds periodically as principal payments are received from the Bond Collateral, regardless of whether the bonds permit payment of principal prior to maturity, if the Committee determines that gradual liquidation is in the interests of investors.

28.6. The Committee shall approve compensation for a Collateral Register Monitor or special administrator based on compensation for equivalent asset management or trust services in the market. Compensation will be paid from the proceeds of the Bond Collateral prior to payments to the investors and the claim for unpaid compensation shall be superior to the rights of the investors.

Article 29. Release of excess Bond Collateral

29.1. All collateral reflected in the Collateral Register in excess of the amounts required by the law and this regulation is considered to be included in the Bond Collateral. Such excess collateral includes any non-performing asset and the portion of the Housing Loans that exceed 70 per cent of the market value of the real estate collateral securing the asset and the portion of the real estate receivables that exceed 50 per cent of the market value of the property securing the receivable are a part of the Bond Collateral, although these are not entered into calculation of the value of the Bond Collateral and the Balance Principles.

29.2. After calculation of the Balance Principles if there is a surplus of Bond Collateral the Issuer may remove collateral from the Collateral Register with the approval of the Collateral Register Monitor, provided that to do so would not impair the Balance Principles and that the Collateral Register Monitor has determined that the removal would not diminish the quality of the security provided to investors.

29.3. If all bonds secured by a Collateral Register have been retired, the Collateral Register may remain in existence for issuance of subsequent bonds or may be terminated and remaining

Bond Collateral returned to the Issuer upon approval of the Collateral Register Monitor and written notice to the Committee.

**ANNEX F: DRAFT FRC REGULATION ON SECURITIZATION AND ASSET
BACKED SECURITIES**

ANNEX F: DRAFT FRC REGULATION ON SECURITIZATION AND ASSET BACKED SECURITIES

FINANCIAL REGULATORY COMMITTEE OF MONGOLIA DRAFT REGULATION ON SECURITIZATION AND ASSET BACKED SECURITIES

SECTION ONE

Purpose, Scope and Definitions

Article 1. Purpose and Scope. This regulation establishes the principles regarding registration, issuance and sale of asset backed securities (ABS) pursuant to the Law of Mongolia on Securitization and Asset Backed Securities.

Article 2. Abbreviations and Definitions. For the purpose of this regulation, the abbreviations and definitions established in the Law on Securities Markets, Law on Securitization and Asset Backed Securities, the Civil Code and the [FRC Regulations] shall apply. References to the "law" in this regulation are to the Law on Securitization and Asset Backed Securities

SECTION TWO

Asset Backed Securities

Article 3. ABS.

3.1. ABS represent an Investor's interest in assets and the revenues and proceeds of those assets designated and described by the Issuer in the application for issuance and prospectus of the ABS.

3.2. ABS may be represented by debt obligations of an SPC, secured by pledge of assets in an asset pool, or participation interests in the assets and/or the revenues and proceeds of the assets. Participation interests may entail conveyance of an undivided joint ownership interest in the assets to investors. ABS may not be issued as shares of the SPC.

3.3. Except as specifically permitted in the law and this regulation, ABS are not redeemable by the SPC, the Sponsor, or any Originator or Seller, and are not convertible into any other security of the SPC, Sponsor, or any Originator or Seller.

3.4. Payments of principal and interest on ABS shall be made at least monthly and shall depend primarily on principal and interest payments from the assets included in the asset pool. Primary reliance does not exclude repayment of a portion of the obligation from revenues derived from the sale or liquidation of property which secures the assets, provided that the sale of such property is incidental to the credit transaction by which the asset was created, nor does it exclude repayment from permitted credit enhancement.

3.5. ABS shall have defined principal values and interest rates. Residual value of the assets in excess of the payments of principal and interest due to investors is the property of the SPC and may be allocated in accordance with the law, this regulation and the prospectus.

3.6. Repayments of principal from assets must be paid to Investors holding one or more classes of the ABS within forty-five (45) days of when principal payments from the assets are received by the SPC and may not be held and reinvested by the SPC or Asset Manager, other than short term investment pending distribution to Investors.

Article 4. Residual Value.

4.1. The residual value of the assets shall be allocated in accordance with the provisions of the application for issuance and prospectus. Residual value may be allocated as follows:

- a) to Investors in a class of ABS which depend for repayment on residual value;
- b) to the equity shareholders of the SPC;
- c) to the Sponsor, or any Originator or Seller, either periodically or upon repayment of the ABS;
- d) pending repayment of the Investors, to any reserve account created as credit enhancement;
- e) any other allocation determined by the Committee to be consistent with the purposes of securitization.

4.2. Sources and uses of residual value must be described in the application for issuance and prospectus as provided in these regulations.

Article 5. Maturity of ABS.

5.1. ABS shall have a maturity date. The maturity of ABS shall not exceed by more than [90 days] the maturity of the asset having the longest term to maturity among those included in the asset pool on the date of issuance of the ABS, or on the final day for adding assets to the asset pool, whichever is later.

Article 6. Classes of ABS.

6.1. An issue of ABS may be comprised of multiple classes having different rights in terms of maturity, risk and payment characteristics. Classes of an issue of ABS may differ with respect to, *inter alia*;

- a) Issuance price;
- b) Interest rate;
- c) Maturity;
- d) Schedule or priority for the payment of either principal or interest;
- e) Rights to proceeds derived from liquidation of the assets;
- f) Credit risk; and
- g) Other characteristics as may be specifically approved by the Committee.

Article 7. Credit Enhancement.

7.1. To protect Investors from the risk of failure or disruption of cash flow from the assets credit enhancement may be provided by the Sponsor, an Originator or Seller, or another third party in the form of insurance, guarantees, letters of credit or other direct obligations. In addition to direct forms of credit enhancement, permitted indirect forms of credit enhancement include:

- a) Internal structuring of the ABS issue in such a way that the right of certain classes of the issue to repayment from the revenues or proceeds of the assets are inferior to the rights of other classes retained or acquired by the Sponsor, Originator or Seller, or by any third party investor;
- b) Conveyance to the SPC of assets having a market value and expected cash flow in excess of the amounts required to repay the ABS, provided such excess assets and cash flows are accounted for as residual value of the assets;

- c) Creation of reserve accounts funded by a Sponsor, Originator or Seller, including by allocation of residual value of the assets;
- d) Other forms of credit enhancement which may be approved by the Committee, if in the opinion of the Committee such arrangements are not designed primarily to avoid the requirement of the law that the SPC assume the risks and rewards arising from ownership of the assets.

7.2. Choice of a form of credit enhancement, if any, is in the discretion of the Sponsor and subject to detailed disclosure in the application for issuance and prospectus of the ABS.

7.3. Credit enhancement in the form of direct obligations of a Sponsor, Originator or Seller must be provided on arm's length business terms prevailing in the market for equivalent financial products.

SECTION THREE **Creation of the SPC**

Article 8. Nature of the SPC.

8.1. An SPC is a limited liability company created under the provisions of the Law On Companies. An SPC may not engage in any transactions other than those permitted in the law and this regulation, and may not issue securities other than its own shares and ABS.

8.2. An SPC is not characterized as an investment or trust fund under the terms of the Law on Securities Markets, and is not deemed to be engaged in factoring or trust activity under the Law on Non-Banking Financial Activity.

8.3. A separate SPC must be created for each issue of ABS.

Article 9. Sponsors of SPCs.

9.1. Banks, non-bank financial institutions, professional participants in the securities market, mortgage finance companies, and leasing companies may register SPCs with the Committee. Other entities may register an SPC upon approval of the Committee.

9.2. Sponsors, Originators or Sellers may own shares of the SPC.

9.3. The Sponsor is considered to be the responsible party for purposes of compliance with the law and this regulation. Determination of which entity is a Sponsor will be made by the Committee considering the totality of circumstances of the issue, including without limitation initiative in creating the issue, origination of the assets, ownership of the assets, provision of credit enhancement and the flow of funds in the transaction. There may be one or more Sponsors of the issue. The Committee presumes that any person or legal entity owning ten percent (10%) or more of the shares of the SPC is a Sponsor.

9.4. The operations of a Sponsor of an SPC must not have been suspended or stopped in the 5 year(s) prior to application for issuance on the basis of regulatory or legal infractions within the framework of the Law on Banking, the Law on Securities Markets, the Law on Non-Banking Financial Activity, or any other legislation specifically governing the business activities of the Sponsor. Any other disciplinary actions taken against a Sponsor by the Committee or any other public regulatory agency prior to application for registration may be considered by the Committee on a case by case basis and serve as the basis for denial of registration of an SPC and rejection of an application for issuance if in the opinion of the Committee such incident renders the Sponsor unsuitable as a Sponsor of an SPC.

9.4. The key management personnel of the Sponsor must not have been subjects of bankruptcy proceedings, or convicted of crimes related to financial integrity, including fraud, embezzlement, speculation, extortion, bribery, theft, swindling, misrepresentation, breach of trust, and forgery. Other disciplinary action or sanction taken against key management personnel of the Sponsor by the Committee or by any other public regulatory agency for non-compliance with the Law on Banking, the Law on Securities Markets, the Law on Non-Banking Financial Activity or any other legislation specifically governing the business activities of the Sponsor may be considered by the Committee on a case by case basis and serve as the basis for denial of registration of an SPC and rejection of an application for issuance if in the opinion of the Committee such incident renders the Sponsor unsuitable as a Sponsor of an SPC.

9.5. For purposes of this regulation, key management personnel of an entity include the president, chief financial officer, chief accountant, chief attorney, and any vice-presidents, department heads, division heads or equivalent positions having responsibility for matters directly affecting the assets, the SPC or the ABS.

Article 10. Creation and licensing of the SPC.

10.1. The SPC shall be registered as a limited liability company in accordance with applicable law prior to submission of an application to the Committee for issuance of the ABS, and the Charter of the SPC and proof of creation shall be submitted with the application for issuance of the ABS in accordance with the provisions of this regulation.

10.2. An SPC must have paid in capital equal to the minimum amount of paid in capital required for limited liability companies under the Law on Companies.

10.3. Prior to issuance of the ABS, the SPC shall be licensed by the Committee pursuant to the law and the Law on Licensing. The application for licensing shall be considered to be submitted with the application for issuance of the ABS, and approval of issuance of the ABS shall constitute approval of the SPC license also.

10.4. Documentation required for issuance of the SPC license is set forth under article [] of this regulation.

10.6. Upon approval of an application for issuance of ABS, the Charter of the SPC shall be registered by the Committee in the Committee's register of SPCs. Only SPCs licensed and registered by the Committee may issue ABS under the law.

Article 11. SPC Charter.

11.1. The SPC Charter shall comply with the law, the regulations of the Committee, and any other law governing creation of legal entities generally or limited liability companies in particular. The Charter of the SPC shall provide:

- a) The SPC is created pursuant to the law;
- b) The SPC is created and operated solely for purposes of securitization and issuance of the ABS;
- c) Shares of the SPC shall consist of single class and shall not be publicly traded or traded on an organized exchange;
- d) The shares of the SPC may not be sold, exchanged, pledged or otherwise transferred by their owners except with the consent of the Committee;
- e) The SPC may not be reorganized or its Charter amended or modified after submission to the Committee, except with the consent of the Committee

f) The SPC may not incur debt, other than the ABS.

11.2. The charter of the SPC may not be modified or amended without the consent of the Committee. In case there occurs a need for a change in the charter of the SPC registered with the Committee, The Board of the SPC shall submit a request for changes to the Committee, together with all relevant documents. The Committee may deny approval of changes to the charter if in its opinion such a change would result in violation of the law or this regulation, or if the proposed change is considered by the Committee to be contrary to the interests of investors.

11.3. Changes to the charter of the SPC approved by the Committee shall be disclosed to Investors in the manner required for any modification to an application for issuance or prospectus.

SECTION FOUR Management Bodies of the SPC

Article 12. The SPC Board.

12.1. Each SPC shall have a board of directors consisting of three directors, two of whom shall be independent outside directors. For purposes of this regulation an independent outside director means a director who is not an affiliated person, controlling person or controlled person of a Sponsor, Originator or Seller, and is not an employee, officer or director of a Sponsor, Originator or Seller, as defined in the Law on Securities Markets.

12.2. Members of the SPC Board shall be university graduates with at least five years of experience in law, accountancy, banking or capital markets.

12.3. Members of the SPC Board are subject to restrictions stated in paragraph 9.4 of Article 9 of this regulation.

12.4. The SPC Board shall represent, manage or supervise the management of the SPC in such a manner as to protect the rights and interests of the investors. The SPC Board shall be responsible for the following:

- a) Execute and register the SPC charter;
- b) Constitute the SPC, register and provide for the safekeeping and custody of the SPC assets in accordance with the provisions of this regulation;
- c) Assure that the SPC is managed in conformity with the principles and methods established in this regulation, the SPC Charter, the application for issuance and the prospectus;
- d) Establish accounts in the name of the SPC at any bank, supervise accounting and audit of the SPC, approve and supervise payments to Investors and payment of other fees and expenses of the SPC;
- e) Provide periodic reports to investors in compliance with the provisions of this regulation;
- f) Assure proper servicing of the assets and replace a servicer that is unable to perform its responsibilities under the servicing agreement;
- g) Such other responsibilities as may be provided in the SPC Charter, the application for issuance, the prospectus, the law, this regulation, or in any other regulation of the Committee.

12.5. Members of the SPC Board may be compensated.

12.6. Members of the SPC Board may carry insurance against liabilities arising from errors and omissions made in good faith in the performance of their responsibilities, but penalties for deliberate acts in violation of the law or their fiduciary obligations to investors cannot be indemnified by the SPC, the Sponsor or any person or entity acting on behalf of either of them.

Article 13. The SPC External Auditor.

13.1. External audit of the SPC shall be performed annually by an independent auditor in accordance with the regulations of the Committee. The SPC external auditor shall be subject to the regulations of the Committee.

13.2. Annual audit of the books and records of the SPC shall be limited to the following:

- a) sources and uses of income from the assets and any investments of proceeds, cumulatively and for the prior period;
- b) principal repayments on the assets, cumulatively and for the prior period;
- c) remaining principal balances of the assets;
- d) average remaining maturity of the assets;
- e) distributions made on the ABS, by class, cumulatively and for the prior period;
- f) remaining principal balances of the ABS, by class;
- g) default, delinquency and loss experience on the assets, cumulatively and for the prior period;
- h) the condition of reserve accounts, if any.

13.3. The annual report of the external auditor shall include the conclusion of the auditor that during the prior period the ABS have been paid in accordance with the terms of the prospectus.

Article 14. The Asset Manager.

14.1. The asset manager is responsible for day to day management of the assets. The asset manager may be an Originator or Seller, the Sponsor, as well as other institutions specifically approved by the Committee. Any licensed bank or professional participant in the securities markets may be an asset manager.

14.2. An asset manager must have paid in capital equal to the paid in capital required for a licensed bank.

14.3. The asset manager and its key personnel are subject to paragraphs 9.3 and 9.4 of Article 9 of this regulation.

14.4. The asset manager must have the experience, human resources, management and information technology systems necessary for management of the assets to the highest standards.

14.5. The asset manager shall be responsible for the following:

- a) Timely collection of the interest and principal payments from the assets and remittance to the SPC of income from the assets;
- b) Assuring that appropriate steps are taken to protect the legal rights of the SPC and the Investors, including monitoring activities necessary to preserve and protect property serving as collateral for the assets;
- c) Supervision and monitoring of obligors' performance of their obligations and providing notifications to obligors of delinquencies and defaults;

- d) If provided in the asset management agreement, enforcing the rights of the SPC and the Investors in case of defaults by obligors;
- e) At least monthly, reporting to the SPC Board regarding the status of the assets and sources and uses of revenues from the assets;
- f) Other tasks described in the asset management agreement which are not inconsistent with this regulation.

14.6. The responsibilities of the asset manager must be defined in an asset management agreement between the Asset Manager and the SPC. The asset management agreement shall provide:

- a) That if the asset manager is in default in performance of its obligations under the agreement, or becomes bankrupt, or is otherwise unable to perform its obligations under the agreement, the agreement may be terminated by the SPC Board and another asset manager appointed;
- b) Upon termination of the asset management agreement the asset manager shall deliver to the SPC Board or the replacement asset manager on demand copies of all documents, books and records pertaining to the assets, whether in electronic or paper form;
- c) Upon termination of the asset management agreement the asset manager shall deliver to the SPC Board or the replacement asset manager all cash and accounts pertaining to the assets without set off or deduction of any kind; and
- d) Until a replacement asset manager is in place, the asset manager shall continue to carry out its obligations under the agreement unless otherwise prevented by law.

14.6. Where the asset manager is unable to continue its performance under the asset management agreement, the SPC Board may assume the responsibilities of the asset manager.

14.7. All proceeds of assets held by an asset manager pending remittance to the SPC shall be held in separate accounts segregated from other accounts of the asset manager and identified by the name of the SPC, or shall be transferred to the account of the SPC at another bank.

14.8. There must be a Primary Asset Manager appointed for each issue of ABS.

14.9. Secondary Asset Managers may be retained by separate asset management agreement and shall be subject to the same performance standards as are contained in the asset management agreement between the Primary Asset Manager and the SPC. Secondary Asset Managers are subordinated to the Primary Asset Manager.

14.10. Any asset management agreement with a Primary Asset Manager shall provide that the Primary Asset Manager will be jointly liable with any Secondary Asset Manager for breach of the Secondary Manager's obligations under the asset management agreement or other misfeasance or malfeasance in the performance of its obligations.

14.11. The SPC is obligated to name in the application for issuance and the prospectus a Replacement Asset Manager and to provide the Replacement Asset Manager periodically with the information that would be necessary to assume the responsibilities of the Primary Asset Manager under the Asset Management Agreement on short notice without disruption of the flow of revenues from the assets to the investors. Information provided to the Replacement Asset Manager necessary to assuming the responsibilities of the Primary Asset Manager include the original schedule of assets filed with the Committee; any modifications or amendments to the schedule, as they occur; and monthly reports on the assets which shall include for each asset on the schedule its current payment status; amount of principal paid to

date; remaining principal balance; interest rate and pending interest rate adjustments; and any other information necessary to facilitate transfer of asset management responsibility to the Replacement Asset Manager.

14.12. Information transferred to a Replacement Asset Manager as required by this law shall be in electronic format.

SECTION SIX

Principles of SPC Management

Article 15. General Principles Regarding SPC Assets.

15.1. The SPC's assets may include:

- a) The assets, as defined in the law;
- b) Cash or cash-equivalent short term investments;
- c) Reserve accounts;
- d) Derivative securities;
- e) Contractual rights against service providers;
- f) Moveable or immovable property pending liquidation.

15.2. All assets included in an asset pool other than cash or cash equivalents must be self-liquidating and subject to a finite maturity.

15.3. Within the scope of this regulation, cash equivalent short term investments include **repo** and deposits shorter than one month, money market operations in an ISE Settlement and Custody Bank and other money and capital market instruments approved and publicly announced by the Committee.

15.4. A separate SPC account shall be opened in a bank in the name of the SPC to collect all cash flows from assets, to make all disbursements to Investors and to pay all expenses of the SPC.

15.5. SPC assets shall not be used for any purpose other than realization of the obligations under the ABS, and implementation of responsibilities arising under the law, this regulation and the SPC Charter. Until the redemption of the ABS, the SPC's assets may not be pledged, used as collateral, distrained, including for the collection of public receivables, subject to attachment by court judgment, or included into the bankruptcy estate of the SPC or any Originator or Seller.

15.6. Assets included in the asset pool must be free and clear of encumbrances, restrictions and other interests.

15.7. Assets included in the asset pool must be owned by the SPC on the issuance date of the securities, provided that up to 50% of the assets may be acquired by the SPC during the period ending one year following the issuance date of the ABS. Assets may be acquired after the issuance date of the ABS if:

- a) The Originators and Sellers of the assets to be added to the pool are identified in the application for issuance and the prospectus;
- b) The assets added the pool are of the same characteristics and quality as the assets described in the application for issuance and the prospectus; and
- c) Notwithstanding addition of assets, the maturity date of the ABS is unaffected.

- d) Pending acquisition of the remainder of the assets any cash proceeds of the issuance held for further acquisitions will be included on the schedule of assets of the SPC and the schedule of assets will be amended periodically to reflect acquisition of additional assets.

15.7. Regarding assets which are secured by real property, the property shall have been appraised by an independent appraiser within the 2 year period prior to the date the asset is included in the asset pool, which shall be the date of registration of the schedule of assets or any later amendment of the schedule of assets.

15.8. With regard to any asset included in the asset pool, the right of the Originator or Seller and the SPC to any collateral must be perfected by registration with the appropriate state registry, if required by law.

15.9. Non-performing assets may not be included in the asset pool on the date of issuance of the ABS. For purposes of this regulation an asset is considered to be non-performing if under the regulations of the Bank of Mongolia it is required to be classified as non-performing and provision made for the full amount of the asset on the books of the owner.

15.10. No more than ten percent 10% of the assets in the asset pool may be delinquent on the date of issuance of the ABS. For purposes of this regulation a delinquent asset is an asset on which any required payment of principal or interest, or portion of such payment, is more than 30 days overdue.

15.11. An asset pool may be sub-divided into one or more sub-pools, and the assets of such sub-pools dedicated to repayment of one or more classes or series of the ABS issue. Any sub-pool must be clearly numbered or otherwise identified and clearly identified with the class of series of securities which it supports.

Article 16. Expenses To Be Paid From Revenues of the Assets.

16.1. Expenses of the SPC and the ABS transaction may be paid from the revenues and proceeds of assets prior to distributions to Investors to the extent described in the application for issuance and prospectus, and may include:

- a) Usual and ordinary registration, announcement and issuance costs and fees;
- b) Fees for legal, accounting, auditing, custodial and other management services provided to the SPC;
- c) Premiums for insuring Board members against liability for errors and omissions;
- d) Fees paid to any Asset Manager;
- e) The costs of derivative contracts;
- f) Fees, commissions, premiums and other payments made by the SPC to providers of credit enhancement;
- g) Underwriting and brokerage fees and commissions;
- h) Accruals to reserve and spread accounts described in the application for issuance and prospectus;
- i) Taxes of the SPC;
- j) other expenses that are specifically permitted by the Committee

16.2. All expenses and fees are to be paid according to invoices and not to exceed market value for equivalent services.

Article 17. Derivative Contracts.

17.1. The SPC may enter into derivative contracts on exchanges and other organized markets with institutions regulated under the Law on Banking or the Law on Securities Markets or regulated abroad in order to reduce the risk of financial loss to Investors arising from fluctuations in interest rates and currency exchange rates, or to coordinate the cash flow of the assets and ABS. The SPC may not enter into derivative contracts for other purposes.

17.2. The SPC's claims under the derivative contracts included in the asset pool can not exceed the total nominal principal value of the SPC assets, exclusive of the derivative contracts. The share of the SPC's liabilities under derivative contracts can not exceed the total nominal principal value of ABS outstanding. Derivative contracts under which the SPC is in short position are not permitted in the asset pool.

17.3. The valuations of the derivative contracts shall be made on the basis of fair values for comparable financial instruments.

17.4. Intended use of derivative contracts must be described in the application for issuance and the prospectus. Additional derivative contracts may not be entered into following the issuance of the ABS, other than renewals, extensions or roll overs of the contracts described at the time of issuance.

Article 18. Removal, replacement and addition of assets to the asset pool.

18.1. With the exception of open issues, assets may only be removed from the asset pool and/or replaced by other assets in the following instances:

- a) The Sponsor or an Originator or Seller is obligated to repurchase and/or replace assets when it has breached any condition, representation or warranty with respect of the characteristics of the assets stated in the law, this regulation, the application for issuance or the prospectus;
- b) The application for issuance and prospectus permit removal of an asset from the asset pool for purposes of enforcement of the rights of the SPC against an obligor;
- c) In the event of a SPC reorganization transaction and in accordance with the conditions of such transactions;
- d) To repurchase assets upon decline of the principal value of the asset pool to 20% of its original principal value, if permitted under the terms of the prospectus.

18.2. Replacement assets shall comply with the law, this regulation and representations and warranties regarding the characteristics of the assets made in the application for issuance and the prospectus.

18.3. Assets may be added to the asset pool as described in articles 19 (revolving receivables) and 20 (open issues) of this regulation.

Article 19. Revolving receivables.

19.1. The Committee is aware that some assets which would otherwise be appropriate for securitization, including for example credit card receivables, revolving trade receivables, and public utility receivables, by their nature tend to have short or indeterminate maturities, and ABS having maturities attractive to investors may be difficult to achieve. In such cases, the Committee may allow addition of assets to the asset pool which are acquired by re-investment of the revenues of the asset pool, on the following conditions:

- a) Addition of assets is pursuant to a legal obligation of the Issuer to maintain a minimum value of the asset pool for a determinate period of time;
- b) The Originators and Sellers of the assets to be added to the pool are identified in the application for issuance and the prospectus;
- c) The assets added the pool are of the same characteristics and quality as the assets described in the application for issuance and the prospectus;
- d) The period during which assets may be added to the asset pool may not exceed 3 years from the date of issuance; and
- e) Notwithstanding addition of assets, the maturity date of the ABS will be unaffected.

19.2. Upon expiration of the period for adding assets to the asset pool, the asset pool shall amortize in accordance with the terms of the assets and it will no longer be permitted to invest income from the assets in acquisition of new assets.

Article 20. Open issues of ABS.

20.1. The Committee may permit open issues of ABS which anticipate issuance of more than one series of the same issue over a period of 3 years from the date of issuance of the initial series of ABS. Open issues entail addition of new assets to the asset pool. Open issues may be permitted on the following conditions:

- a) The Originators or Sellers of the assets to be added to the asset pool are identified in the application for issuance and prospectus;
- b) The assets added to the pool are of the same characteristics and quality as the assets described in the application for issuance and prospectus;
- c) There is no modification of the terms of the ABS outstanding, and the Committee has determined that the security of investors in earlier series of the issue have not been adversely affected or their security interests diluted by addition of new assets and issuance of the new series of securities.

20.2. The registration of an open issue of ABS shall remain in effect for the entire duration of the issue, provided that the issuer shall file with the Committee a supplemental application for issuance and supplemental prospectus which shall include all information required by this regulation for the new series of ABS to be issued and any changes to the original application for issuance and prospectus made necessary by events occurring in the period since the initial registration, and shall update the financial information of Sponsor, Originators and Sellers provided with the initial application for issuance. The form of the supplemental prospectus shall accompany the original application for issuance.

20.3. A supplemental application for issuance or prospectus may enhance but not contradict or materially modify the sense of any information provided in a previously approved application for issuance or prospectus.

Article 21. Reports to Investors.

21.1. In addition to any other reports that may be required under regulations of the Committee for registered Issuers generally, the SPC shall provide to Investors and to the Committee:

- a) A monthly report on the status of the assets within 15 days subsequent to the related period, which shall include a detailed description of the sources and uses of income received from the asset and investment of proceeds of the assets since the last report, including without limitation fees and expenses paid and the parties to whom paid;

assets removed from or added to the asset pool, and the reasons for the addition or removal; the number and characteristics of remaining assets, including weighted average interest rates and remaining terms to maturity; delinquency, loss and prepayment data on the assets for the prior period; the remaining principal balance of the unpaid assets; the principal paid and remaining principal balance of the ABS; the amount of excess cash flow and its uses; and other material legal or financial data known to the Issuer or Sponsor which affect the assets or the ABS arising since the last report.

- b) An annual report of the SPC including:
 - i) the report of the external auditor;
 - ii) a certification of the Primary Asset Manager that the asset management standards and criteria described in the prospectus have been met for the prior period;
 - iii) a discussion of any material legal or financial data known to the Issuer or Sponsor which affect the assets or the ABS arising since the last report, including any adverse financial events affecting any significant obligor, or provider of credit enhancement, or party to a derivative contract.

SECTION SEVEN

Register and the Safe Keeping of the Assets in the SPC Portfolio

Article 22. SPC Schedule of Assets.

22.1. The SPC shall establish and maintain at all times that ABS are outstanding a schedule of assets. The schedule of assets shall be kept in electronic format. The SPC's schedule of assets shall include at least the following information related to the assets:

- a) identification data of the asset, including the names of the obligors, currency, initial principal amount, origination date, maturity date, original interest rate, interest computation method, maximum interest rate (if any), and periodic payment;
- b) identification data of the property which secures the asset, including its location, the title register information, and appraised value;
- c) the account number of any SPC account and the institution in which it is held;
- d) identification data of any securities or other financial instruments held by the SPC, including the issuer, issue date, maturity, identification or registration number, principal amount, currency, interest rate, interest computation method and payment plan;
- e) identification of any derivative contract to which the SPC is a party, by name of counterparty, contract date, type of contract, and nominal amount;
- f) other information which may be required by the Committee.

22.2. Assets may be added to or removed from the SPC asset register only as permitted under this regulation and only with the consent of the SPC Board of Directors.

22.3. The schedule of assets shall be submitted to the Committee with the application for issuance, if available, or as a supplement to the application for issuance at any time prior to the issuance date of the ABS. The SPC is responsible for submitting to the Committee in a timely manner amendments of the schedule of assets to reflect addition to or removal of assets from the asset pool or material changes to the description of assets, but in any case an amendment shall be submitted within 30 days of the addition, removal or change.

22.4. The schedule of assets shall be registered by the Committee under the name of the SPC. Schedules of assets registered with the Committee are public documents which may be made available in accordance with the regulations of the Committee. For purposes of disclosing the schedule of assets the Committee shall delete any information relating to personal identification of debtors, and take such other steps as may be necessary to comply with laws of banking secrecy or data privacy.

Article 23. Safekeeping of Assets.

23.1. The SPC shall establish and maintain a system for safekeeping of legal documents relating to the assets. All original documents pertaining to the assets of the SPC held in paper form shall be segregated and held in a safe and secure facility. Original documentation pertaining to the assets may be removed from safe-keeping only in connection with the removal of an asset from the asset pool as permitted under this regulation, and only upon the consent of the SPC Board of Directors.

23.2. Legal documentation pertaining to the assets may be held by a third-party custodian.

23.3. Assets in paperless form shall be held in the usual manner in the name of the SPC.

**SECTION FIVE
Registration of ABS**

Article 24. Registration of ABS.

24.1. The Sponsor shall apply to the Committee for registration of the ABS within one month of the registration of the SPC as a legal entity.

24.2. Before the Committee will approve the application for issuance of the ABS (or approval of further series of an open issue) the Sponsor must demonstrate to the satisfaction of the Committee that:

- a) the SPC has been registered as a legal entity;
- b) the asset manager and external auditors identified, and the systems for accounting, record-keeping and safe-keeping of documentation relating to the SPC have been implemented;
- c) the necessary organization, facilities, technical equipment, services and human resources for managing the assets and the ABS are available to the SPC;
- d) conditions of the law and this regulation for creation and management of the SPC and issuance of the ABS have been met;
- e) the Sponsor is current with respect to all reports, filings and other obligations to the Committee pertaining to other securities issued by the Sponsor.

24.3. ABS and different classes of an ABS issue (article 6 of this regulation) may be offered in public offerings or by private placement, in which case the registration of such securities must comply with the rules of the Committee governing the form of offering.

24.5. If the assets are themselves securities or other financial instruments (underlying securities) which would be required to be registered under the Law on Securities Markets if they were issued in a separate transaction, approval of an application for issuance will not be given until such registration occurs. Registration of underlying securities may be waived by the Committee in its discretion if:

- a. the underlying security has the same Sponsor as the ABS;

- b. the underlying security is a participation certificate or other evidence of ownership in a pool of assets which is issued by an Originator or Seller solely to facilitate the ABS transaction, provided that the Committee determines that the device is not intended primarily to avoid registration.

Article 25. Principles Regarding the Registration Statement and Prospectus.

25.1. It is the intention of the law that the SPC must be a single-purpose legal entity created solely for the purpose of issuing ABS, and it is expected that the SPC may not have an established history of operations or financial performance. For purposes of regulation, it is the Sponsors, Originators and Sellers involved in the ABS transaction that are of interest to the Committee and the Investors. Accordingly, the objective of this regulation is to substitute information on the Sponsor, certain Originators and Sellers in the application for issuance and prospectus which would otherwise be provided with respect to the Issuer of the securities. Similarly, in place of extensive descriptions of the business operations of the Issuer, this regulation seeks to emphasize descriptions of the assets which secure the ABS.

25.2. The content of the application for issuance and prospectus is based on the principles of materiality and applicability to the nature of the assets and the transaction, and not all of the information identified in this regulation is necessarily required to be included in the documentation for all issues.

25.3. The Committee presumes that information or materials provided to independent credit rating agencies is material also to the Committee and to Investors, though not necessarily in the level of detail provided to such agencies. Summaries and narratives which reasonably present the essence of such information are acceptable to the Committee.

25.4 The emphasis of documentation should be on communication of information clearly and simply, and all documentation should be in plain language accessible to the ordinary Investor, accompanied by appropriate visual aids (charts, tables, and other graphic representations) to the extent such enhance understanding.

25.5 The application for issuance and prospectus for ABS should be prepared in accordance with the requirements of the FRC's for registration statements and prospect generally, unless otherwise provided in this regulation.

25.6. The application for issuance must be signed by all persons determined by the Committee to be Sponsors of the issue.

Article 26. Documents Accompanying Registration Statement.

26.1. In addition to any other documents required to be submitted to the Committee for registration of securities generally, documents required to be submitted to the Committee with the application for issuance of ABS shall include:

- a) The names of the members of the board of directors and the key personnel of any Sponsor, and a list of the other legal entities in which these individuals hold interests and the nature of their interests;
- b) The names of shareholders of a Sponsor holding more than 10% of the Sponsor's shares, a list of the other legal entities in which these shareholders hold interests, and the nature of their interests;
- c) Financial statements of any Sponsor for the 3 year period immediately prior to the date of the application;
- d) A copy of the SPC's registered Charter;

- e) A pro-forma balance sheet of the SPC as of the prospective date of issuance of the ABS;
- f) Detailed biographical information about the members of the SPC's board of directors, including education, present and prior employment and professional affiliations, any affiliation with or financial interest in the Sponsor, any Originator, Seller, or Asset Manager, and any other information pertinent to assessing the qualifications of the members of the SPC's Board of Directors;
- g) Any agreements between or among Originators, Sellers and the Sponsor or SPC for transfer of the assets to the Sponsor or SPC, including a description of any terms, conditions and limitations on the transfer of rights to the assets from the Originators or Sellers to the SPC;
- h) For the Primary and any Replacement Asset Manager, the information required under subparagraphs (a) - (c) of this paragraph, together with copies of the Asset Management Agreement and a letter of commitment from the Replacement Asset Manager;
- i) A description of the independent auditor and a copy of the proposed audit agreement;
- j) A description of the nature of the Investors' security interest in the assets, together with a copy of any pledge or security agreement to be used for the purpose of pledging assets for the benefit of Investors;
- k) A detailed description of the assets, including without limitation total nominal value; average principal amounts, interest rates, maturities, age and time remaining to maturity; the distribution of principal amounts, interest rates, maturities, age and time remaining to maturity by segments of the asset pool; information about the principal and interest payments on the assets; the interest computation method; whether the assets may be prepaid by borrowers and the terms and conditions of prepayment;
- l) A detailed description of the real or movable property which will secure the assets, including without limitation the type of property; general locations; and appraised values;
- m) If the SPC's assets consist of underlying securities, the information in (j) and (k) shall be provided for both the ABS and the underlying securities;
- n) A comprehensive description of each class of the ABS, including without limitation total and nominal values; total number of securities to be issued; maturity of the issue; interest rate; interest computation method; payment schedule; whether and under what conditions the ABS may be called, redeemed or repurchased by the SPC, Sponsor or any Originator or Seller; a description of expected Residual Value remaining after the Investors are paid, and the sources and uses of the Residual Value; rights of security holders; registration, subscription, trading, etc.; residual or equity interests not offered in the transaction; payment procedures; and likely tax treatment of investors;
- o) A description of any contracts for services that will be executed by the SPC together with copies of any such contracts then available;
- p) A description of expected periodic costs, fees and expenses to be paid from proceeds of the assets prior to distributions to Investors;
- q) A description of any credit enhancement, its terms and conditions, together with the information required under subparagraphs (a) - (c) of this paragraph with respect to the provider of the credit enhancement and copies of any legal agreements relating to credit enhancement;

- r) A description of any derivative contracts to be purchased by the SPC;
- s) The preliminary report of a securities rating agency, if any;
- t) The schedule of assets, if available;
- u) Other information and documents requested by the Committee as necessary to supplement and clarify information submitted.

26.2. Any information or documents required to be provided with respect to the Sponsor shall be provided also with respect to:

- a) any Originator or Seller which originates or sells to the SPC more than 20% of the assets included in the asset pool;
- b) any obligor with respect to an asset or assets which comprise more than 20% by value of the asset pool at the time of issuance of the ABS;
- c) any party to a derivative contract to be included in the asset pool, other than contracts available on an exchange or other organized market; and
- d) any third party which provides credit-enhancement.

26.3. The requirements of paragraph 26.2 apply as well to any group of persons affiliated by a relationship of control, as such control would be determined under the Law On Securities Markets.

26.4. The information required in paragraph 26.1 of this article may be provided in the prospectus, in which case the application documentation shall contain an index of the items and an information about where they can be found in the prospectus.

26.5. Any financial statements required to be provided under this regulation may be provided by reference to financial statements or annual reports filed with the Committee most proximate in time to the issuance date of the ABS, but this approach may be taken in a prospectus only if it is accompanied by information on where the reader may obtain copies of such financial statements through an internet web site of either the entity to which the financial statement pertains or the Committee.

26.6. The schedule of assets may be submitted at the time of application for issuance, or may be submitted as a supplement to the application prior to effectiveness of the registration.

Article 27. Contents of the prospectus.

27.1. In addition to the requirements for the prospectus of securities generally under regulations of the Committee, information provided in the ABS prospectus shall include:

- a) A comprehensive summary description of the ABS transaction in clear language, including without limitation the legal structure of the transaction; relationships of parties to the transaction; the method of origination, acquisition and transfer of assets; registration of assets; accounts and flow of funds; temporary investment of funds; payments to investors; credit enhancement; use of derivatives; fees, expenses and other distributions to persons other than investors; events of issuer default and actions to be taken upon default;
- b) A summary of significant transaction documents, including without limitation the SPC Charter; any asset purchase and sale agreement; the Asset Management Agreement and any agreement for a Replacement Asset Manager; any significant contract for provision of services to the SPC; any custodial agreements; underwriting agreements; derivative contracts; and agreements for credit enhancement;

- c) A comprehensive description of each class of the ABS, including without limitation total and nominal values; total number of securities to be issued; maturity of the issue; interest rate; interest computation method; payment schedule; whether and under what conditions the ABS may be called, redeemed or repurchased by the SPC, Sponsor or any Originator or Seller; a description of expected Residual Value remaining after the Investors are paid, and the sources and uses of the Residual Value; rights of security holders; registration, subscription, trading, etc.; residual or equity interests not offered in the transaction; payment procedures; and tax treatment of investors;
- d) A discussion of the main risk factors affecting the ABS issue, including the credit and prepayment risk of the assets; the absence of a secondary market for the ABS; and other risks affecting asset backed securities in particular;
- e) A detailed description of the assets, including quantitative parameters; total nominal value; the interest computation method; whether the assets may be prepaid by borrowers and the terms and conditions of prepayment; average principal amounts, interest rates, maturities, age and time remaining to maturity; the distribution of principal amounts, interest rates, maturities, age and time remaining to maturity by appropriate segments of the asset pool; geographic distribution of properties securing assets; underwriting criteria applied to pool assets; valuation of assets and description of valuation techniques; description of collateral rights attached to pool assets; rules and procedures for removal of assets from the pool, including revolving or pre-funding periods;
- f) A description of significant obligors or a related group of obligors who account for 20% or more of the assets in the asset pool;
- g) A description of significant originators or a related group of originators who account for 20% or more of the assets in the asset pool;
- h) Performance data on assets included in the asset pool, including delinquency, loss and prepayment data on assets (actual) up to the issuance date of the ABS (if possible); delinquency, loss and prepayment data on the assets of other ABS of the Sponsor; and delinquency, loss and prepayment data on the Sponsor's or Originator's portfolio of equivalent assets up to issuance date of the ABS;
- i) If repayment of the ABS relies to any extent on proceeds of liquidation of property which secures some or all of the assets in the asset pool, a statement of the portion of repayment that depends or may depend on such liquidation, a description of the procedures for liquidation, and the assumptions underlying the estimated liquidation value of the property.
- j) Pertinent information on participants in the ABS transaction, including Sponsor(s), originator(s), sellers, underwriter(s), and external auditors.
- k) Pertinent information on the Primary Asset Manager, the Replacement Asset Manager and any Secondary Asset Manager servicing more than 10% of the assets in the asset pool;
- l) A description of asset management procedures, including management standards; foreclosure and collection on defaulted assets; provisions for monitoring performance of asset managers; arrangements for replacement management; causes and procedures for replacement of a manager;

- m) A description of the organizational and management structure of the SPC, including its legal status; identification and key biographical data on the Board of Directors and officers;
- n) Qualifications, procedures for appointment and removal, responsibilities and compensation of the SPC's Board of Directors;
- o) The procedures for determining the maximum total nominal value and maturity of the ABS;
- p) A description of the legal rights of Investors, generally, to the SPC assets, and the conditions and procedures for exercising investor rights;
- q) The rights and priorities granted to different classes of the ABS, if applicable;
- r) The principles and methods related to issuance and trading of the ABS;
- s) The valuation principles of the SPC's assets in cases where valuation may be required, in particular in cases where any person has the right to re-purchase the assets;
- t) Measures to be taken in case of default in payment of any of the assets by any obligor;
- u) Measures to be taken in case of default in payment of the ABS;
- v) Measures to be taken in case of default of asset managers or other service providers under the terms of their contracts;
- w) Appointment and removal of the SPC external auditor, and the procedures and periodicity of internal audit;
- x) The fees, commissions and other costs and expenditures of the SPC to be paid from the revenues from the assets prior to distributions to Investors;
- y) A description of the accounts to be established for the SPC and the flow of revenues and disbursements among such accounts;
- z) Conditions and procedures for removing, replacing or adding assets to the asset pool;
- aa) Terms and conditions of investment of undisbursed cash flows of the SPC pending distribution to Investors;
- bb) A description of the types and uses of derivative contracts which may be used by the SPC;
- cc) Terms and conditions of any credit enhancement;
- dd) Restrictions on the characteristics of assets to be included in the asset pool or any sub-pool;
- ee) Conditions and procedures for liquidation, termination, merger, consolidation, sale or other reorganization of the SPC;
- ff) The content and periodicity of reports to Investors.

27.2. The Committee may require other provisions of the Prospectus considered necessary to reflect the nature of the transaction and to protect the interests of Investors.

27.3. The format of the ABS prospectus is attached as Annex [] of this regulation.

SECTION EIGHT

SPC Dissolution, Liquidation and Reorganization Events and SPC Valuation

Article 28. SPC Reorganization Events.

28.1. An SPC may not be reorganized, merged, sold, or acquired, without the consent of the Committee and then only for good cause and upon a determination of the Committee that the interests of the Investors will not be adversely affected.

28.2. With the consent of the Committee, for good cause, and upon a determination of the Committee that the interests of the investors will not be adversely affected, ownership of an SPC may be transferred to another Sponsor that assumes the obligations of the Sponsor under the original application for issuance and prospectus.

28.3. Voluntary liquidation of the SPC may be undertaken only in the case of affirmative vote of investors holding 2/3rds or more of the ABS, by principal value, or in accordance with a right of the Sponsor or any Originator or Seller reserved in the registration statement and prospectus to liquidate the SPC and repurchase the assets upon a reduction in the value of the assets to 20% or less of the original principal value of the asset pool.

28.4. Involuntary liquidation of the SPC shall be carried out under the supervision of the Committee and its representatives in accordance with the provisions of the law. In lieu of liquidation, the Committee may compel transfer of ownership of the SPC to another capable Sponsor willing to assume all of the obligations of the Sponsor and shareholders of the SPC under the application for issuance if the Committee determines it to be in the best interests of the Investors and the transfer would not place Investors in a worse position than liquidation of the SPC and its assets.

Article 29. Valuation of Assets.

29.1. In the event of any liquidation or sale of assets the following principles will be applied:

- a) The value of assets traded on a stock exchange or on other organized market is determined by the fair value of the assets in the market on the date of sale or the most recent date for which market data is available;
- b) Assets not traded on an organized market and assets which are traded on an organized market but for which bid and asked prices are not publicly available on a regular basis shall be valued at a price determined by institutions licensed as professional participants in the securities market, and having substantial experience in the valuation of assets.

29.2. Sale of assets in connection with a liquidation of the SPC shall be accompanied by a report to investors and the Committee setting forth:

- a) The schedule of assets together with the price obtained for the assets;
- b) With respect to any assets traded on an organized exchange, the name of the exchange and source and date of data used in the valuation;
- c) The identity of any institution performing valuation of the assets;
- d) The theoretical basis for the valuation of any assets not traded on an organized exchange;
- e) An opinion of the institution performing the valuation that the valuation has been carried out in accordance with valuation techniques prevalent in the market and that the valuation reflects the fair market value of the assets as of the date of sale.

**ANNEX G: MEMORANDUM ON AMENDMENTS TO LAWS OF MONGOLIA
REQUIRED TO IMPLEMENT MORTGAGE SECURITIES**

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MEMORANDUM

TO: Dugerjav D.
CC: Tim O'Neill, Ashidmaa D.
FROM: Stephen B. Butler
RE: Amendments to the laws of Mongolia to implement the proposed laws
on mortgage securities - Draft
DATE: May 29, 2007

Based on my review I believe there are only a few changes to the present laws that would be necessary or useful to implement the proposed laws on mortgage securities. The changes I would recommend are described below.

A major portion of the material below consists of the recommendation that the Civil Code be amended to include a modern concept of a legal trust. Although this concept is found primarily in common law countries, it is increasingly adopted in civil law countries as well. The provisions below are adapted from the Civil Code of the Province of Quebec, Canada, a civil law jurisdiction.

Regarding our conversation on over-the-counter securities markets, it is my opinion that the present article 23 of the Securities Markets Law ("Dealers Trading Centers") probably provides enough authority to initiate an OTC market. The real work of actually creating an OTC market would require extensive discussions with interested market participants, development of regulations and by-laws, etc., as well as development of the modern hardware and software systems which are important to such a market.

Law on the Legal Status of the Committee on Financial Regulations

1. Paragraph 3.1 of article 3 of the law On Non-Bank Financial Activities is amended by adding new subparagraphs 3.1.6 and 3.1.7 as follows:

3.1.6 activities of Special Purpose Companies under the Law On Securitization and Asset backed Securities;

3.1.7 activities of Mortgage Finance Companies under the Law On Collateralized Mortgage Bonds.

The current subparagraph 3.1.6 becomes subparagraph 3.1.8.

Comment: These activities should be characterized as non-banking financial activities.

2. Paragraph 6.2 of article 6 of the law On Non-Bank Financial Activities is amended by adding the following new subparagraphs 6.2.6 and 6.2.7:

6.2.6. the law On Securitization and Asset Backed Securities;

6.2.7. the law On Collateralized Mortgage Bonds.

Comment: Add the mortgage securities laws to the sources of law governing the activities of the FRC.

Law on Non-Bank Financial Activities

1. Paragraph 3.2 of article 3 of the Law on Non-Bank Financial Activities is amended as follows:

3.2. Banking, insurance, security companies, pension funds and cooperatives loan and saving activities, pawnshops, project units, Government's special purpose funds loan activities, special purpose companies and mortgage finance companies shall be regulated by other related laws.

Comment: Refer to the new mortgage securities laws in the law on non-banking financial activities.

2. Paragraph 1 of article 4 of the Law on Non-Bank Financial Activities is amended by adding new subparagraphs 4.1.11 and 4.1.12 as follows:

4.1.11. "Special purpose company" is any company created under the Law On Securitization and Asset Backed Securities for the purpose of issuing asset backed securities;

4.1.12. "Mortgage finance company" is any such company created under the provisions of the Law On Collateralized Mortgage Bonds.

Comment: Add definitions of special purpose companies and mortgage finance companies to the law on non-banking financial activities.

3. Paragraph 1 of article 7 of the Law on Non-Bank Financial Activities is amended by adding new subparagraphs 7.1.11 and 7.1.12 as follows:

7.1.11. issuance of asset backed securities under the law on Securitization and Asset Backed Securities;

7.1.12. issuance of collateralized mortgage bonds by a housing finance company.

Comment: Define issuance of ABS and mortgage bonds (by MFCs) as non-banking financial activities.

4. Article 8 of the Law on Non-Bank Financial Activities is amended by adding a new paragraph 8.3 as follows:

8.3. Subparagraphs 8.1.2, 8.1.4, 8.1.5, 8.1.7 and 8.1.8 of this article shall not be applicable to special purpose companies or mortgage finance companies. The Committee on Financial Regulations shall establish by executive regulations alternative requirements for registration of special purpose companies and mortgage finance companies.

Comment: Some of the requirements of paragraph 8.1 are not applicable to special purpose companies and mortgage finance companies. It should be anticipated that these forms of entities may have different requirements for registration.

5. Paragraph 11.1 of Article 11 of the Law on Non-Bank Financial Activities is amended as follows

11.1. With the exception of special purpose companies, Aname of non-bank financial institution shall consist of its own name and the word "The non-bank financial institution" or the abbreviation "NBFI".

Comment: The proposed law on asset backed securities contains separate provisions for naming special purpose companies.

6. Paragraph 13.1 of article 13 of the law On Non-Bank Financial Activities is amended as follows:

3.1. The total amount of loans, assets equivalent to a loan, and guarantees issued to one borrower and related parties by the non-bank financial institution shall not exceed 30 percent of non-bank financial institution's paid in capital. The restriction of this paragraph shall not apply to special purpose companies or mortgage finance companies.

Comment: Paid in capital is not a useful restriction on special purpose companies or mortgage finance companies, which are thinly capitalized.

7. Paragraph 14.4 of the Law on Non-Bank Financial Activity is amended as follows:

14.4 The shareholders of the non-bank financial institution shall bear financial liability to the extent of their invested contribution to the share capital of the non-bank financial institution. This paragraph shall not apply to any securities issued by a special purpose company without recourse to the issuer.

Comment: Securities of special purpose companies are intended to be essentially non-recourse, depending for payment on the underlying assets.

8. Add a new article 18¹ to the law as follows:

Article 18¹. Exceptions for special purpose companies and mortgage finance companies

Notwithstanding any other provision of this chapter four, matters of capitalization, preparation, audit and disclosure of financial statements, and liquidation and dissolution of special purpose companies and mortgage finance companies, shall be governed by this chapter only to the extent they are not governed by the Law On Collateralized Mortgage Bonds and the Law On Securitization and Asset Backed Securities, as applicable, and executive regulations of the Financial Regulatory Committee issued pursuant to those laws.

Comment: Many of the provisions of this chapter four are not relevant to special purpose companies, which are not intended to be "going concerns" and may have different requirements for capitalization and financial reporting, as well as dissolution.

Law on Banking

1. Paragraph 1 of article 6 of the law On Banking is amended by adding a new sub-paragraph 10) as follows:

10) purchase and sale of loans and other financial assets;

Comment: It is not clear that banks may engage in the purchase and sale of loan assets, which would be essential for securitization.

2. Paragraph 3 of article 6 of the law On Banking is amended to read in its entirety as follows:

3. Paragraph 2 of this Article shall not apply to the Insurance Company, Credit and Loan Cooperative, Security Companies, Special Purpose Companies and Mortgage Finance Companies.

Comment: It is proposed that the consent of the Bank of Mongolia not be required to create the special purpose company or mortgage finance company, but only the approval of the FRC.

3. Paragraph 3 of article 7 of the Law on Banking is amended to read in its entirety as follows:

3. Inter-bank exchange of information on loans disbursed, and exchange of information between a bank and a Special Purpose Company or Mortgage Finance Company, shall not included in a category of Confidential information specified in paragraph 2 of this article.

Comment: Special purpose companies and mortgage finance companies are not banks and therefore an exception from the secrecy law is necessary to allow transfer of loan assets between banks and such companies.

4. A new sentence is added to paragraph 2 of article 14 as follows:

The foregoing restriction does not apply to Collateralized Mortgage Bonds or Asset-Backed Securities issued under the Law On collateralized Mortgage Bonds and Law On Securitization and Asset Backed securities, respectively.

Comment: The one year maturity limitation of article 14 is too restrictive, particularly if the intention is to increase durations. It may be advisable to eliminate paragraph 2 of article 14 entirely.

5. Paragraph 4 of article 16 of the Law on Banking is amended as follows:

4. The total amount of securities that may be purchased by a bank shall not exceed 20 percent of the paid in capital of the bank or 10 percent of the total amount of the shares issued by one company. This shall not apply to any securities issued by the Government and the Central Bank. Notwithstanding the foregoing a bank's holdings of collateralized mortgage bonds issued under the Law On Collateralized Mortgage Bonds shall not exceed fifty percent (50%) of the paid in capital of the bank, and there shall be no restriction on the number of shares of a special purpose company or mortgage finance company created pursuant to the provisions of the Law On Securitization and Asset Backed Securities or the Law On Collateralized Mortgage Bonds, respectively, which may be held by a bank.

Comment: Purchase of mortgage bonds by banks should be less restrictive than purchase of securities generally because of safety and the special regulatory regime. Investment in shares of a special purpose company does not need to be limited as there is no risk of loss associated with ownership of such shares.

6. Add a new article 36² to the Law on Banks as follows:

Article 36². Treatment of Collateralized Mortgage Bonds During Conservatorship.

Notwithstanding any other provision of this Chapter 6, bank assets which are pledged for the repayment of collateralized mortgage bonds under the provisions of the Law On Collateralized Mortgage Bonds shall not be attached, sold, liquidated, terminated, or otherwise dealt with by a plenipotentiary representative other than in accordance with the provisions of said Law On Collateralized Mortgage Bonds. Rejection or suspension of the bank's obligation to holders of collateralized mortgage bonds shall constitute an

event of default giving rise to all bond holder remedies under the Law On Collateralized Mortgage Bonds.

Comment: It should be clarified that the plenipotentiary representative is subject to the provisions of the law on collateralized mortgage bonds.

7. Add a new subparagraph 4) to paragraph 3 of article 40, as follows:

4) in the absence of fraud, any assets transferred to a special purpose company for purposes of issuing asset backed securities under the Law On Securitization and Asset Backed Securities.

Comment: It should be clarified that transfer of assets to a special purpose company is irreversible in a bankruptcy proceeding, except in the case of fraud.

8. Add a new article 46¹ to the law On Banks as follows:

Article 46¹. Treatment of Collateralized Mortgage Bonds During Receivership

Notwithstanding any other provision of this Chapter 7, bank assets which are pledged for the repayment of collateralized mortgage bonds under the provisions of the Law On Collateralized Mortgage Bonds shall not be attached, sold, liquidated, terminated, or otherwise dealt with by a receiver appointed under this chapter other than in accordance with the provisions of said Law On Collateralized Mortgage Bonds. Rejection or suspension of the bank's obligation to holders of collateralized mortgage bonds shall constitute an event of default giving rise to all bond holder remedies under the Law On Collateralized Mortgage Bonds.

Comment: It should be clarified that the bank receiver is subject to the law on collateralized mortgage bonds.

Law on Companies

1. Add a new article 51 to the Law On Companies as follows:

Article 51. Special Purpose Companies and Mortgage Finance Companies

5.1. Matters pertaining to special purpose companies and mortgage finance companies organized as limited liability companies under the provisions of this law and the Law On Securitization and Asset Backed Securities or the Law On Collateralized Mortgage Bonds shall be governed by the provisions of those laws as provided therein, and by this law only with respect to matters not governed by those other laws. In the event of a conflict between this law and the Law On Securitization and Asset Backed Securities or the Law On Collateralized Mortgage Bonds, the provisions of the latter laws shall govern.

Comment: The proposed laws on securitization and collateralized mortgage bonds contain specific provisions governing the formation, management, dissolution, etc. of special purpose companies and mortgage finance companies organized as limited liability companies.

2. Article 42 of the Law On Companies is amended by adding a new paragraph 42.6 as follows:

42.6. The provisions of this article shall not apply to the issuance of collateralized mortgage bonds or asset backed securities, which shall be governed by the provisions of the Law On Collateralized Mortgage Bonds and the Law On Securitization and Asset Backed Securities, respectively.

Comment: Article 42 presently restricts the amount of bonds that may be issued by a company, and this restriction should be waived for special purpose companies and mortgage finance companies.

Law on Bankruptcy

1. Article 3 of the Law on Bankruptcy is amended by adding a new sentence to subparagraph 3.1.2 as follows:

A Respondent (debtor) under this law shall not include any legal entity for which alternative rules and procedures of bankruptcy are established by another law, including without limitation banks, special purpose companies created under the Law On Securitization and Asset Backed Securities, Mortgage Finance Companies created under the Law On Collateralized Mortgage Bonds, and Investment Funds created under the Law on Securities Markets.

Comment: The simplest way to exclude the special purpose company and mortgage finance company from the operation of the bankruptcy law is to define the "debtor" to exclude these types of entities. The proposed laws include separate provisions for bankruptcy and liquidation of SPCs and MFCs.

Law on Economic Entity Income Tax

1. Paragraph 12.1 of article 12 of the Law On Economic Entity Income Tax is amended by adding a new subparagraph 12.1.28 as follows:

12.1.28. Any income or revenues of a special purpose company or mortgage finance company created under the Law On Securitization and Asset Backed Securities which is distributed in the tax year to holders of the asset backed securities issued by the special purpose company.

Comment: Income of a special purpose company should be exempt from profits tax to the extent it is passed through to holders of the asset backed securities.

Law on Value Added Tax

1. Paragraph 13.1 of article 13 of the Law on Value Added Tax is amended by adding a new subparagraph 13.1.15 as follows:

13.1.15. Transfer of any loan, lease or other right from a bank, non-banking financial institution or other legal entity to a bank, special purpose company or mortgage finance company for purposes of issuance of collateralized mortgage bonds or asset backed securities under the Law On Collateralized Mortgage Bonds or Law On Securitization and asset backed securities, respectively.

Comment: Transfer of assets for purposed of securitization or mortgage bonds should be exempt from VAT.

Law on Licensing

1. Amend article 6 of the Law on Licensing by adding a new paragraph 6.5 as follows:

6.5. Notwithstanding the foregoing provisions of this article, the duration of a license of any entity created pursuant to law for purposes of issuing securities having a defined maturity shall be not shorter than the maturity of the securities.

Comment: The duration of a licensed special purpose company should be at least as long as the maturity of the asset backed securities it issues.

2. Paragraph 15.3 of article 15 of the Law on Licensing is Amended by adding new subparagraphs 15.3.3 and 15.3.4 as follows:

15.3.3. issuance of collateralized mortgage bonds by a mortgage finance company or asset backed securities by any special purpose company;

15.3.4. performing services as a collateral monitor under the Law On Collateralized Mortgage Bonds.

Comment: These include as licensed activities the issuance of ABS or collateralized mortgage bonds and providing services as a collateral monitor.

Law on Securities Market

1. Article 3 of the Law on Securities Market by amending subparagraphs 3.1.1, 3.1.4 and 3.1.6 to read in their entirety as follows:

3.1.1. "**Securities**" means the debt instruments /bonds/ issued by the Government and other authorized legal bodies, all kinds of company shares, options entitling to sell or purchase shares issued or proposed to be issued by a company, shares of an investment fund, asset backed securities and other instruments defined as securities by the Committee on Financial Regulations (hereinafter referred to as " the Committee") in conformity with this law;

3.1.4. "**Derivative Security**" means a security or contract in the nature of a security, such as an option or futures contract, whose value is derived in part from the value and characteristics of another security, the underlying asset.

3.1.6. "**Bond**" means a security, which certifies the obligation to repay the principal and interest rates in the form of cash, assets and rights for the assets periodically or after a specific period;

Comment: Several of the definitions of the present law should be modified to reflect the new types of securities authorized under the proposed laws on mortgage securities.

Law On Deposits, Transactions and Loans of Banks and Authorized Legal Persons

1. Amend the second paragraph of article 23 of the Law on Deposits, Transactions and Loans of Banks and Authorized Legal Persons by amending subparagraph 8 and adding new subparagraphs 8, 9 and 10 as follows:

8) a report on any other bank loans or other loans, credits, debts or equivalent financial obligations held in the name of the borrower;

9) information on the borrower's income from employment or business, including financial statements of the borrower's business;

10) a report of an independent credit reporting agency, if required by the lender.

Comment: These proposals are to improve the law governing mortgage loan underwriting. The current provisions seem to be too restrictive and do not allow gathering information on the borrower's income or all of the borrower's obligations, and do not anticipate use of credit reporting agencies.

2. Amend the seventh paragraph of article 23 of the Law on Deposits, Transactions and Loans of Banks and Authorized Legal Persons by adding a new sentence as follows:

7. The lender shall be prohibited from requiring documents other than those set out in paragraph 2 of this article from the borrower. Any information required from the

borrower may be supplied by a report of an independent credit reporting agency on demand of the lender.

Comment: The purpose of the amendment is to clarify that an independent credit report may be obtained and included in underwriting documentation.

Civil Code

1. Amend the first sentence of paragraph 32.1 of article 32 as follows:

32.1. Unless otherwise provided by law, A a juristic person shall be liquidated on the following grounds:

Comment: The proposed mortgage securities laws provide alternative procedures for dissolution and liquidation of special purpose companies and mortgage finance companies.

2. Amend the first sentence of paragraph 32.5 of article 32 as follows:

32.5. Unless otherwise provided by law, Claims against a juristic person in liquidation shall be satisfied in the following order:

Comment: The proposed mortgage securities laws provide alternative procedures for dissolution and liquidation of special purpose companies and mortgage finance companies.

3. Amend article 32 by adding a new paragraph 32.12 as follows:

32.12. The provisions of this article shall apply to liquidation of juristic persons unless otherwise provided in other laws.

Comment: The proposed mortgage securities laws provide alternative procedures for dissolution and liquidation of special purpose companies and mortgage finance companies.

4. Amend article 235 of the Civil Code by adding new paragraphs 235.6 as follows:

235.6. Property of the obligor may be transferred to a third party under a feduci contract to secure performance of the obligor's obligation to one or more obligees, in which case such third party shall own and administer such property for the benefit of such obligees as a trustee under chapter 37 of this law.

Comment: The present law seems to permit the transfer of property under a feduci contract only to the obligee. A better approach used in modern finance structures would be to permit transfer of the property to an agent or representative of the obligee or a class of obligees (e.g. security holders) who would serve as a trustee.

5. Amend article 241 by adding a new paragraphs 241.8 and 241.9 as follows:

241.8. Co-obligees may be defined as an open or closed class of persons who own securities or other negotiable obligations of the obligor, and the composition of such class (identity of co-obligees) may change from time to time.

241.9. Co-obligees may be the beneficiaries of a pledge of property to secure their rights of claim.

Comment: It should be clarified that co-obligees may be a class of persons who may change over time, such as holders of bonds or other securities. This would allow pledge of assets to an open class, which is not permitted under present law.

6. Delete chapter 37 and add new chapter 37, as follows:

CHAPTER 37: ENTRUSTED PROPERTY

SUBCHAPTER ONE: THE TRUST

Article 406. Nature of the Trust

406.1. A trust results from a legal act whereby a person, the settlor, transfers property to a trustee selected by him which he dedicates to a particular purpose and which the trustee undertakes, by his acceptance, to hold and administer.

406.2. The trust property, consisting of the property transferred in trust, constitutes a separate property estate by segregation and dedication, autonomous and distinct from that of the settlor, trustee or beneficiary and in which none of them has any real right. The trust is not a legal entity.

406.3. A trust is established by contract, whether by transfer of legal title for compensation or gratuitously, by will, or, in certain cases, by operation of law. Where authorized by law, it may also be established by a court judgment.

406.4. The purpose of a trust established by contract may be to secure the performance of an obligation. If that is the case, to have effect against third persons, the fact of the trust must be published in the state register of moveable or immovable property rights, according to the movable or immovable nature of the property transferred in trust.

406.5. In case of default by the settlor, the trustee is governed by the rules regarding the exercise of hypothecary rights set out in sub-chapter 3 of chapter 13 of this law.

406.6. A trust is constituted upon the acceptance of the trustee or of one of the trustees if there are several. In the case of a trust created by will, the effects of the trustee's acceptance are retroactive to the day of death.

406.7. Acceptance of the trust divests the settlor of the legal ownership of the trust property, charges the trustee with seeing to the appropriation of the property and the administration of the trust property and is sufficient to establish the right of the beneficiary with certainty.

Article 406¹. Various kinds of trusts and their durations

406¹.1. Trusts are constituted for personal purposes or for purposes of private or social utility. Provided it is designated as a trust, a trust may be identified by the name of the settlor, the trustee or the beneficiary or, in the case of a trust constituted for purposes of private or social utility, by a name which reflects its object.

406¹.2. A personal trust is constituted gratuitously for the purpose of securing a benefit for a determinate or determinable person or persons.

406¹.3. A private trust is a trust created for the object of erecting, maintaining or preserving a thing or of using a property dedicated to a specific use, whether for the indirect benefit of a person or in his memory, or for some other private purpose.

406¹.4. A trust constituted for the purpose of allowing the making of profit by means of investments, providing for retirement or procuring another benefit for the settlor or for the persons he designates or for the members of a partnership, company or association, or for employees or shareholders, or for purposes of securing the settlor's obligations is also a private trust.

406¹.5. A social trust is a trust constituted for a purpose of general interest, such as a cultural, educational, philanthropic, religious or scientific purpose. It does not have the making of profit or the operation of an enterprise as its main object.

406¹.6. A personal trust constituted for the benefit of several persons successively may not include more than two ranks of beneficiaries of the fruits and revenues exclusive of the beneficiary of the capital; it is without effect in respect of any subsequent ranks it might contemplate.

406¹.7. The right of beneficiaries of the first rank of the trust to revenues and fruits of the trust must commence not later than 100 years after the trust is constituted, even if a longer term is stipulated. The right of beneficiaries of subsequent ranks may commence late. In no case may a legal person be a beneficiary for a period exceeding 100 years, even if a longer term is stipulated.

406¹.8. A private or social trust may be perpetual.

Article 406². Administration of the trust

406².1. Any natural person having the full exercise of his civil rights, and any legal person authorized by law, may act as a trustee.

406².2. The settlor or the beneficiary may be a trustee but he shall act jointly with a trustee who is neither the settlor nor a beneficiary.

406².3. The settlor may appoint one or several trustees or provide the mode of their appointment or replacement.

406².4. The court may, at the request of an interested person and after notice has been given to the persons it indicates, appoint a trustee where the settlor has failed to do so or where it is impossible to appoint or replace a trustee.

406².5. The court may appoint one or several other trustees where required by the conditions of the administration.

406².6. A trustee has the control and the exclusive administration of the trust property, and the titles relating to the property of which it is composed are drawn up in his name, subject to the terms of the contract of administration; he has the exercise of all the rights pertaining to the property and may take any proper measure to secure its appropriation. A trustee acts as the administrator of the property of others charged with either simple or full administration under subchapter 2 of this chapter, in accordance with the terms of the constituting legal act.

Article 406³. Beneficiaries of the trust

406³.1. Only a person having the qualities to receive by gift or by will at the time his right to the revenues and fruits of the trust commences may be the beneficiary of a trust constituted gratuitously. Where there are several beneficiaries of the same rank, it is sufficient that one of them have such qualities to preserve the right of the others if they avail themselves of it.

406³.2. To receive the benefits of the trust, the beneficiary of a trust shall meet the conditions required by the constituting contract.

406³.3. The settlor may reserve the right to receive the fruits and revenues or even, where such is the case, the capital of the trust, even a trust constituted gratuitously, or share in its benefits.

406³.4. The settlor may reserve for himself the power to appoint the beneficiaries or determine their shares, or confer it on the trustees or a third person. In the case of a social trust, the trustee's power to appoint the beneficiaries and determine their shares is presumed. In the case of a personal or private trust, the power to appoint may be exercised by the trustee or the third person only if the class of persons from which he may appoint the beneficiary is clearly determined in the constituting act.

406³.5. The person holding the power to appoint the beneficiaries or determine their shares exercises it as he sees fit. He may change or revoke his decision for the requirements of the trust. He may not appoint beneficiaries for his own benefit.

406³.6. While the trust is in effect, the beneficiary has the right to require, according to the constituting act, either the provision of a benefit granted to him or the payment of both the fruits and revenues and the capital or of only one of these.

406³.7. The beneficiary of a trust constituted gratuitously is presumed to have accepted the right granted to him and he is entitled to dispose of it. He may renounce it at any time; he shall then do so by notarial act if he is the beneficiary of a personal or private trust.

406³.8 If the beneficiary renounces his right, or if his right lapses, it passes, according to whether he is the beneficiary of the fruits and revenues or of the capital, to the co-beneficiaries of the fruits and revenues or of the capital, in proportion to the share of each. If he is the sole beneficiary of the fruits and revenues of his rank, his right passes, in proportion to the share of each, to the beneficiaries of the fruits and revenues of the second rank, or where there are no such beneficiaries, to the beneficiaries of the capital.

Article 406⁴. Supervision of the trust

406⁴.1. The administration of a trust is subject to the supervision of the settlor or of his heirs, if he has died, and of the beneficiary, even a future beneficiary. In addition, in cases provided for by law, the administration of a private or social trust is subject, according to its object and purpose, to the supervision of the persons or bodies designated by the Minister of Justice.

406⁴.2. Upon the constitution of a private or social trust subject to the supervision of a person or body designated by law, the trustee shall file with the Ministry of Justice a statement indicating, in particular, the nature, object and term of the trust and the name and address of the trustee. The trustee shall, at the request of the Ministry of Justice, allow the trust records to be examined and furnish any account, report or information requested of him.

406⁴.3. The rights of the beneficiary of a personal trust, if he is not yet conceived, are exercised by the person who, having been designated by the settlor to act as trustee, accepts the office or, failing him, by the person appointed by the court on the application of the trustee or any interested person. The Minister of Justice may be designated to act. In a private trust of which no person, even determinable or future, may be a beneficiary, the rights granted to the beneficiary under this subsection may be exercised by the Minister of Justice.

406⁴.4. The settlor, the beneficiary or any other interested person may, notwithstanding any stipulation to the contrary, take action against the trustee to compel him to perform his obligations or to perform any act which is necessary in the interest of the trust, to enjoin him to abstain from any action harmful to the trust or to have him removed. He

may also impugn any acts performed by the trustee in fraud of the trust property or the rights of the beneficiary.

406⁴.5. The court may authorize the settlor, the beneficiary or any other interested person to take legal action in the place and stead of the trustee when, without sufficient reason, he refuses or neglects to act or is prevented from acting.

406⁴.6. The trustee, the settlor and the beneficiary are jointly liable for acts in which they participate that are performed in fraud of the rights of the creditors of the settlor or of the trust property.

Article 406⁵. Increases to trust property

406⁵.1. Any person may increase the trust patrimony by transferring property to it by contract or by will in conformity with the rules applicable to the constitution of a trust. The person does not acquire the rights of a settlor by that fact. The transferred property is mingled with the other property of the trust patrimony and is administered in accordance with the provisions of the constituting act.

Article 406⁶. Termination of the trust

406⁶.1. Where a trust has ceased to meet the first intent of the settlor, particularly as a result of circumstances unknown to him or unforeseeable and which make the pursuit of the purpose of the trust impossible or too onerous, the court may, on the application of an interested person, terminate the trust; the court may also, in the case of a social trust, substitute another closely related purpose for the original purpose of the trust. Where the trust continues to meet the intent of the settlor but new measures would allow a more faithful compliance with his intent or favor the fulfillment of the trust, the court may amend the provisions of the constituting legal act.

406⁶.2. Notice of the application shall be given to the settlor and to the trustee and, where such is the case, to the beneficiary, to the liquidator of the succession of the settlor, or his heirs, and to any other person or body designated by law, where the trust is subject to their supervision.

406⁶.3. A trust is terminated by the renunciation or lapse of the right of all the beneficiaries, both of the capital and of the fruits and revenues. A trust is also terminated by the expiry of the term or the fulfillment of the condition, by the attainment of the purpose of the trust or by the impossibility, confirmed by the court, of attaining it.

406⁶.4. At the termination of a trust, the trustee shall deliver the property to those who are entitled to it. Where there is no beneficiary, any property remaining when the trust is terminated devolves to the settlor or his heirs.

406⁶.5. The property of a social trust that terminates by the impossibility of its fulfillment devolves to a trust, to a legal person or to any other group of persons devoted to a purpose as nearly like that of the trust as possible, designated by the court on the recommendation of the trustee. The court also obtains the advice of any person or body designated by law to supervise the trust.

SUBCHAPTER 2: ADMINISTRATION OF THE PROPERTY OF OTHERS

Article 406⁷ General Provisions

406⁷.1. Any person who is charged with the administration of property that is not his own assumes the office of administrator of the property of others. The rules of this subchapter apply to every administration unless another form of administration applies under the law or the constituting act of the administration, or due to circumstances.

406⁷.2. Unless the administration is gratuitous according to law, the act or the circumstances, the administrator is entitled to the remuneration fixed in the constituting act of administration, by usage or by law, or to the remuneration established according to the value of the services rendered. A person acting without right or authorization is not entitled to any remuneration.

Article 406⁸. Simple Administration of the Property of Others

406⁸.1. A person charged with simple administration shall perform all the acts necessary for the preservation of the property or useful for the maintenance of the use for which the property is ordinarily destined.

406⁸.2. An administrator charged with simple administration is bound to collect the fruits and revenues of the property under his administration and to exercise the rights pertaining to the property. He collects the debts under his administration and gives valid receipts for them; he exercises the rights pertaining to the securities administered by him, such as voting, conversion or redemption rights.

406⁸.3. An administrator shall continue the use or operation of the property which produces fruits and revenues without changing its destination, unless he is authorized to make such a change by the beneficiary or, if that is prevented, by the court.

406⁸.4. An administrator is bound to invest the sums of money under his administration in accordance with the rules of this subchapter relating to presumed sound investments. He may likewise change any investment made before he took office or that he has made himself.

406⁸.5. An administrator, with the authorization of the beneficiary or, if the beneficiary is prevented from acting, of the court, may alienate the property by sale or charge it with a hypothec where that is necessary for the payment of the debts, maintenance of the use for which the property is ordinarily destined, or the preservation of its value. He may, however, alienate alone any property that is perishable or likely to depreciate rapidly.

Article 406⁹. Full Administration of the Property of Others

406⁹.1. A person charged with full administration shall preserve the property and make it productive, increase the value of the property or appropriate it to a purpose, where the interest of the beneficiary or the pursuit of the purpose of the trust requires it.

406⁹.2. An administrator having power of full administration may, to perform his obligations, alienate the property by sale, charge it with a real right or change its destination and perform any other necessary or useful act, including any form of investment.

Article 406¹⁰. Obligations of the Administrator To the Beneficiary

406¹⁰.1. The administrator of the property of others shall, in carrying out his duties, comply with the obligations imposed on him by law or by the constituting legal act. He shall act within the powers conferred on him. He is not liable for loss of the property resulting from a superior force or from its age, its perishable nature or its normal and authorized use.

406¹⁰.2. An administrator shall act with prudence and diligence. He shall also act honestly and faithfully in the best interest of the beneficiary or of the object pursued.

406¹⁰.3. No administrator may exercise his powers in his own interest or that of a third person or place himself in a position where his personal interest is in conflict with his obligations as administrator. If the administrator himself is a beneficiary, he shall exercise his powers in the common interest, giving the same consideration to his own interest as to that of the other beneficiaries.

406¹⁰.4. An administrator shall, without delay, declare to the beneficiary any interest he has in an enterprise that could place him in a position of conflict of interest and of the rights he may invoke against the beneficiary or in the property administered indicating, where that is the case, the nature and value of the rights. He is not bound to declare to him the interest or rights deriving from the act having given rise to the administration. Any interest or right pertaining to the property of a trust under the supervision of a person or body designated by law is disclosed to that person or body.

406¹⁰.5. No administrator may, in the course of his administration, become a party to a contract affecting the administered property or acquire otherwise than by succession any right in the property or against the beneficiary. He may, nevertheless, be expressly authorized to do so by the beneficiary or, in case of impediment or if there is no determinate beneficiary, by the court.

406¹⁰.6. No administrator may mingle the administered property with his own property.

406¹⁰.7. No administrator may use for his benefit the property he administers or information he obtains by reason of his administration except with the consent of the beneficiary or unless it results from the law or the act constituting the administration.

406¹⁰.8. Unless it is of the very nature of his administration to do so, no administrator may dispose gratuitously of the property entrusted to him, except property of little value disposed of in the interest of the beneficiary or of the object pursued. No administrator may, except for valuable consideration, renounce any right belonging to the beneficiary or forming part of the property estate administered.

406¹⁰.9. An administrator may sue and be sued in respect of anything connected with his administration; he may also intervene in any action respecting the administered property.

406¹⁰.10. If there are several beneficiaries of the administration, concurrently or successively, the administrator is bound to act impartially in their regard, taking account of their respective rights.

406¹⁰.11. The court, in appreciating the extent of the liability of an administrator and fixing the resulting damages, may reduce them in view of the circumstances in which the administration is assumed or of the fact that the administrator acts gratuitously or that he is a minor or a protected person of full age.

406¹⁰.12. Where an administrator uses property without authorization, he is bound to compensate the beneficiary or the trust for his use by paying an appropriate rent or the interest on the money.

Article 406¹¹. Obligations of the Administrator and the Beneficiary Towards Third Persons

406¹¹.1. Where an administrator binds himself, within the limits of his powers, in the name of the beneficiary or the trust property, he is not personally liable towards third persons with whom he contracts. He is liable towards them if he binds himself in his own name, subject to any rights they have against the beneficiary or the trust property.

406¹¹.2. Where an administrator exceeds his powers, he is liable towards third persons with whom he contracts unless the third persons were sufficiently aware of that fact or unless the obligations contracted were expressly or tacitly ratified by the beneficiary.

406¹¹.3. An administrator who exercises alone powers that he is required to exercise jointly with another person exceeds his powers. He does not exceed his powers if he exercises them more advantageously than he is required to do.

406¹¹.4. The beneficiary is liable towards third persons for the damage caused by the fault of the administrator in carrying out his duties only up to the amount of the benefit he has derived from the constituting legal act. In the case of a trust, these obligations fall back upon the trust property.

406¹¹.5. Where a person fully capable of exercising his civil rights has given reason to believe that another person was the administrator of his property, he is liable towards third persons who in good faith have contracted with that other person, as though the property had been under administration.

Article 406¹². Inventory, Security, And Insurance

406¹².1. An administrator is not bound to make an inventory, to take out insurance or to furnish other security to guarantee the performance of his obligations unless required to do so by law or by the constituting act of administration, or, again, by the court on the application of the beneficiary or any interested person. Where the constituting act of administration creates these obligations, the administrator may apply for an exemption if circumstances warrant it.

406¹².2. In making its decision upon an application, the court takes account of the value of the property administered, the situation of the parties and the other circumstances. It may not grant the application if that would, in effect, call into question the terms of the initial agreement between the administrator and the settlor or beneficiary.

406¹².3. An administrator bound to make an inventory shall include in it a faithful and exact enumeration of all the property entrusted to his administration or constituting the administered property. Such an inventory shall contain the following in particular:

1) the description of the immovables, and a description of the movables, with indication of their value and, in the case of a universality of movable property, sufficient identification of the universality;

2) a description of the currency in cash and other securities;

3) a listing of valuable documents.

It also contains a statement of liabilities and concludes with a recapitulation of assets and liabilities.

406¹².4. The inventory is made by a private writing before two witnesses. In the latter case, the author and the witnesses sign it, indicating the date and place of execution.

406¹².6. The property described in the inventory is presumed to be in good condition on the date of preparation of the inventory, unless the administrator appends a document attesting the contrary.

406¹².7. The administrator shall furnish a copy of the inventory to the person who entrusted him with the administration. He shall also, where required by law, file the inventory or notice of the closure of the inventory in the indicated place, specifying in the latter case where the inventory may be consulted.

406¹².8. An administrator may insure the property entrusted to him against ordinary risks such as fire and theft at the expense of the beneficiary or trust. He may also take out insurance guaranteeing the performance of his obligations; he does so at the expense of the beneficiary or trust if his administration is gratuitous.

Article 406¹³. Joint administration.

406¹³.1 Where several administrators are charged with the administration, a majority of them may act unless the act or the law requires them to act jointly or in a determinate proportion. Where the administrators are prevented from acting by a majority or in the specified proportion, owing to an impediment or the systematic opposition of some of them, the others may act alone for conservatory acts; they may also, with the authorization of the court, act alone for acts requiring immediate action.

406¹³.2. Joint administrators are jointly liable for their administration unless their duties have been divided by law or by the constituting act of administration. An administrator is presumed to have approved any decision made by his co-administrators. He is liable with them for the decision unless he immediately indicates his dissent to them and notifies it to the beneficiary within a reasonable time.

406¹³.3. administrator is presumed to have approved a decision made in his absence unless he makes his dissent known to the other administrators and to the beneficiary within a reasonable time after becoming aware of the decision.

406¹³.4. An administrator may delegate his duties or be represented by a third person for specific acts; however, he may not delegate generally the conduct of the administration or the exercise of a discretionary power, except to his co-administrators.

406¹³.5. He is accountable for the person selected by him if, among other things, he was not authorized to make the selection. If he was so authorized, he is accountable only for the care with which he selected the person and gave him instructions.

406¹³.6. A beneficiary who suffers prejudice may repudiate the acts of the person mandated by the administrator if they are done contrary to the constituting act or to usage. The beneficiary may also exercise his judicial recourses against the mandated person even where the administrator was duly empowered to give the mandate.

Article 406¹⁴. Prudent Investment

406¹⁴.1. An administrator shall invest income, proceeds and other revenues of the property in accordance with the provisions of the constituting legal act of administration, and in the absence of such provisions shall invest prudently. Investments in the following are presumed prudent:

1) titles of ownership in immovable property located in Mongolia which is valued by a licensed valuer who is not affiliated with the administrator;

2) securities, bonds or other evidences of indebtedness issued or guaranteed by the Government of Mongolia, the United States of America or any Government of the European Union, or the International Bank for Reconstruction and Development,

3) collateralized mortgage bonds issued under a law on collateralized mortgage bonds;

4) loans, bonds or other evidences of indebtedness of a company secured by a hypothec ranking first on an immovable property located in Mongolia, provided that the amount of the debt does not exceed 75% of the value of the immovable property as determined by a licensed valuer who is not affiliated with the administrator;

5) other debts secured by hypothec ranking first on immovable properties located in Mongolia, provided that the amount of the debt does not exceed 75% of the value of the immovable property as determined by a licensed valuer who is not affiliated with the administrator

6) shares of an investment fund or investment trust, provided that 60 % of its portfolio consists of prudent investments under this article.

406¹⁴.2. An administrator who acts in accordance with this article is presumed as a matter of law to act prudently. Other investments are not presumed to be prudent, but the administrator may prove them to be prudent investments.

406¹⁴.3. An administrator may deposit the sums of money entrusted to him in or with a bank, a savings and credit union or any other financial institution, if the deposit is repayable on demand or on 30 days' notice.

406¹⁴.4. Investments made in the course of administration shall be made in the name of the administrator acting in that capacity. Such investments may also be made in the name of the beneficiary, if it is also indicated that they are made by the administrator acting in that capacity.

Article 406¹⁵. Apportionment of profit and expenditures

406¹⁵.1. Apportionment of profit and expenditure among the beneficiaries is made in accordance with the provisions of the constituting legal act. Failing sufficient indication in the constituting act, apportionment is made equitably, taking into account the object of the administration, the circumstances that gave rise to it and generally recognized accounting practices.

406¹⁵.2. All reasonable expenses of preserving the value of the property and carrying out the purposes of the administration, including the costs of rendering accounts and delivering the property, are payable from the income and capital of the property. Permitted expenses may be defined in the constituting legal act.

406¹⁵.3. The beneficiary of the administration is entitled to the net income of the administered property from the date determined in the constituting legal act giving rise

to the administration or, if no date is determined, from the date of the beginning of the administration or that of the death which gave rise to it.

406¹⁵.4. At the extinction of his right, the beneficiary of the administration is entitled to the amounts that have not been paid to him and to the portion earned but not yet collected by the administrator.

Article 406¹⁶. Annual Account

406¹⁶.1. Unless otherwise provided in the constituting legal act, an administrator shall render a summary account of his administration to the beneficiary at least once a year. The account shall be made sufficiently detailed to allow verification of its accuracy. Any interested person may, on a rendering of account, apply to the court for an order that the account be audited by an expert. An administrator shall at all times allow the beneficiary to examine the books and vouchers relating to the administration.

Article 406¹⁷. Termination of Administration

406¹⁷.1. The duties of an administrator terminate upon his death, resignation or replacement or his becoming bankrupt or being placed under receivership or conservatorship. The duties of an administrator are terminated where the beneficiary becomes bankrupt or is placed under receivership or conservatorship only to the extent that such affects administration of the property.

406¹⁷.2. Administration is terminated:

- 1) by extinction of the right of the beneficiary in the administered property;
- 2) by expiry of the term or fulfillment of the condition stipulated in the constituting legal act giving rise to the administration;
- 3) by achievement of the object of the administration or disappearance of the cause that gave rise to it.

406¹⁷.3. An administrator may resign by giving written notice to the beneficiary and, where such is the case, his co-administrators or the person empowered to appoint an administrator in his place. Where there are no such persons or where it is impossible to give notice to them, the notice is given to the Minister of justice who, if necessary, shall provide for the provisional administration of the property and cause a new administrator to be appointed in place of the administrator who has resigned.

406¹⁷.4. The resignation of the administrator takes effect on the date the notice is received or on any later date indicated in the notice.

406¹⁷.5. An administrator is bound to cure any damage caused by his resignation where it is submitted without a serious reason and at an inopportune moment or where it amounts to failure of duty.

406¹⁷.6. A settlor or beneficiary who has entrusted the administration of property to another person may replace the administrator or terminate the administration, particularly by exercising his right, if any, to require that the property be returned to him on demand. Any interested person may apply for the replacement of an administrator who is unable to discharge his duties or does not fulfill his obligations.

406¹⁷.7. Obligations contracted towards third persons in good faith by an administrator who is unaware that his administration has terminated are valid and bind the beneficiary or the trust property; the same rule applies to obligations contracted by the administrator after the end of the administration that are its necessary consequence or

are required to prevent a loss. The beneficiary or the trust patrimony is also bound by the obligations contracted towards third persons who were unaware that the administration had terminated.

Article 406¹⁸. Rendering of account and delivery of property

406¹⁸.1. Unless otherwise provided in the constituting legal act, on the termination of his administration, an administrator shall render a final account of his administration to the beneficiary and, where that is the case, to the administrator replacing him or to his co-administrators. The account shall be made sufficiently detailed to allow verification of its accuracy; the books and other vouchers pertaining to the administration may be consulted by interested persons.

406¹⁸.2. An administrator shall deliver over the administered property at the place agreed upon or, failing that, where it is. An administrator shall deliver over all that he has received in the performance of his duties, even if what he has received was not due to the beneficiary or to the trust property; he is also accountable for any personal profit or benefit he has realized by using, without authorization, information he had obtained by reason of his administration.

406¹⁸.3. Unless otherwise provided by the constituting legal act, an administrator is entitled to deduct from the sums he is required to remit anything the beneficiary or the trust property owes him by reason of the administration, and may retain the administered property until payment of what is owed to him.

Comment: Trust relationships are widely used in modern financing structures, particularly for secured bonds and asset backed securities. The present law has an ambiguous definition of trust relationships. The intention of the proposed amendment is to further define the nature of the legal trust and the obligations of persons who are entrusted with management of the property of others. The proposal is an adaptation of the Civil Code of the Province of Quebec, Canada. Note that this material could be included in a separate law on trust and administration of property of others.

**ANNEX H: MEMORANDUM ON AMENDMENTS TO THE PROPOSED LAW OF
MONGOLIA ON REAL ESTATE COLLATERAL (MORTGAGE LAW)**

ANNEX H: MEMORANDUM ON AMENDMENTS TO THE PROPOSED LAW OF MONGOLIA ON REAL ESTATE COLLATERAL (MORTGAGE LAW)

COMMENTS AND RECOMMENDATIONS FOR THE DRAFT LAW OF MONGOLIA ON COLLATERALIZATION OF REAL ESTATE

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May 2007

General Comments

1. These comments and recommendations are based on an English language translation of the Draft Law of Mongolia on Collateralization of Real Estate dated November 13, 2006. The translation was very difficult to understand, which may have resulted in misinterpretations by the author of the present report.
2. There are many instances in which the draft seems to re-state general principles of law which can be found in other laws such as the Civil Code or Code of Civil Procedure. This could lead to conflicts and interpretive problems. In general, it is not necessary to re-state established principles of the law of contracts and obligations, and this should be avoided.
3. A good illustration of point 2 is the entire chapter on registration of collateral agreements, most of which can already be found in the law on registration. An attempt should be made to eliminate all provisions which duplicate or restate the law on registration, and leave only those provisions which are unique to mortgages.
3. There are instances in the law where the same principles are stated two or more times using different words. An attempt should be made to eliminate duplicative provisions.
4. There are too many provisions which give to the courts the ability to intervene in mortgage enforcement proceedings on the side of the debtor, allowing suspension or delay of enforcement for vaguely defined reasons. The ability of courts to delay or suspend enforcement should be limited to clearly defined circumstances which are established in the Code of Civil Procedure. Courts should not have the discretion to delay or suspend enforcement on grounds which would not constitute a valid legal defense to the claim.
5. The non-judicial enforcement procedures of the draft are inadequate and may not be effective. In particular, it is inadvisable to permit non-judicial procedure only on the basis of a new agreement between the debtor and the creditor made after the default has occurred, at which time the debtor has no incentive to cooperate. The right to non-judicial procedure should be established in the collateral agreement.
6. Decisions on the choice of methods of sale, agency of sale and property valuation should be left with the creditor, and not require the consent of the debtor. The debtor has no incentive to cooperate with the creditor and can use these provisions for delay and obstruction.
7. There is too much emphasis on auction and competitive bidding procedures. Auctions and competitive bidding can be shown to be the least efficient methods of selling the property, resulting in lower prices and less money for the debtor. Creditors should have the option to sell the property at or near market values in negotiated market transactions, either directly or using the services of professional property brokers.

8. The provisions on auction starting prices, failure of auctions, subsequent auctions, and creditor rights to acquire the collateral property seem to be particularly vague, but this may be a matter of translation,
9. The "collateralizer" should be intended as a simple financial instrument which is easily transferred by endorsement and ownership of which depends primarily on physical possession, not registration of transfer. The models for the collateralizer are promissory notes and bills of exchange. The collateralizer described in this draft is a complex instrument which duplicates every provision of the loan and collateral agreements, allows attachments of extraneous documents, and requires registration of transfers. Other questionable aspects of the collateralizer include the requirement that an amendment be made each time the principal balance is reduced. Clearly this is impractical in a market where the principal balance of housing loans is reduced every month for a period of up to 10 years.
10. The law should anticipate the licensing of independent property appraisers, which can provide important protections to borrowers in the enforcement process.
11. The law should provide more guidance on notices which must be given to borrowers before steps can be taken to declare the entire debt payable before maturity, and appropriate time periods for borrowers to cure their defaults.
12. The law should place the burden on borrowers to initiate court action to stop or suspend a non-judicial sale, and provide guidance to courts on when a non-judicial sale may be stopped or suspended. Courts should be permitted to require surety or bond to be provided by a borrower as a condition of suspending a non-judicial sale.
13. It is recommended that the law establish a "consumer protection" framework to require disclosure of adequate information by creditors to borrowers concerning the details of the loan and the mortgage.

Specific Comments and Recommendations

Article 2

Modify paragraph 2.1 as follows:

2.1. The legislation on the collateralization of real estate is a part of the Civil Code. *In the event of a conflict between this law and the Civil Code, the provisions of this law shall govern.*

Comment: The statement that the law is "part of the Civil Code" has no meaning in light of paragraph 3.3 of the Civil Code, which states that a more detailed law of later vintage shall govern in the case of conflicts.

Article 3

1. Modify paragraph 3.1.4 as follows:

3.1.4. "Housing unit" means a private or public residential building or a separate housing, or an apartment ~~or its part~~ in a detached house or building designed for a permanent residential purpose;

Comment: Parts of real estate objects which cannot obtain a cadastre number and be registered as a legal object of property cannot be mortgaged.

2. Modify subparagraph 3.1.6 as follows:

3.1.6 “Competitive bidding activity” means an activity organized by an independent and professional legal body specialized on trading real estate or its related entitlements as stated in Article 197 of Civil Code *by the agreement entered by the pledger and pledgee*;

Comment: Selection of means of sale should be specified in the collateral agreement and selection of the agencies to carry out the non-judicial sale should be in sole discretion of the creditor. The debtor has no incentive to agree to this selection and will use this for delay and obstruction.

3. Add a new definition 3.1.8 as follows:

3.1.8. "State registry" means the state registry of ownership right of property and other entitlements related to it.

Comment: The term state registry occurs throughout the law and is not used with precision (e.g. "consolidated state registry," "state registry of entitlements," etc.). There should be one defined term, consistently used.

4. Add a new definition of "independent property valuer" as follows:

3.1.9. "Independent property valuer" means a professional valuer who is not an employee of the pledgee or of any legal entity which is affiliated with or a subsidiary of the pledgee, and who is licensed to carry out valuation activity if required by law.

Article 4

Modify paragraph 4.2 as follows:

4.2 The pledgee of the primary obligation secured by collateral under the collateral agreement of real estate and its related entitlement (hereinafter as the “collateral agreement”) shall have a prerogative right to have its monetary claim satisfied from the price of real estate of the pledger ~~in a priority order before its other customers/execute~~ of the obligation prior to any person whose claim against the real estate arises after the effective date of the collateral agreement, or any person whose claim against the real estate arises prior to the effective date of the collateral agreement but fails to register notice of such claim in the state registry prior to the effective date of the collateral agreement.

Comment: The purpose of a mortgage is to give priority over interests which arise after the effective date of the mortgage, or which are unregistered. The current draft is too broad and suggests that a mortgage gives a priority over all other creditors.

Article 6

Modify paragraph 6.4 as follows:

6.4. If the collateral agreement specifies a fixed amount for the monetary value of the claim of the pledgee, then the pledger shall not be liable for the part in excess of this amount, except the cases specified in articles 6.1.2, 6.2.3, 6.2.4 and 7 of this Law.

Comment: It should be clarified that a "fixed amount" does not include interest which may accrue on the unpaid debt. This may be done by including paragraph 6.1.2 in the list of exclusions. The amount of interest due depends on how long the debt remains unpaid, and cannot be determined at the time the loan agreement is made. The "fixed amount" should refer only to the principal obligation of the debt, not the interest.

Article 8

1. Modify paragraph 8.1 as follows:

8.1. An item of the collateral may be ~~the following~~ any object of real estate or ~~their its~~ related entitlements registered under a unique cadastre number in the state registry, which ~~are~~ is allowed in civil transactions according to the procedures specified by legislations.

2. Delete sub-paragraphs 8.1.1 through 8.1.5.

Comment: There is no reason to enumerate the types of real estate that may be mortgaged; all real estate may be mortgaged, subject to the further provisions of this law. The law should require that the real estate object be registered as a unique real estate object; that is, the object must be eligible to receive a cadastre number.

Article 9

Modify paragraph 9.4 as follows:

9.4. Except as provided in paragraph 66.2 of this law, The right to lease a real estate may be an item of the collateral with the permission of lessor.

Comment: To promote development of land markets, holders off long term rights of use or lease of state and municipal land should be permitted to mortgage without consent of the land owner.

Article 12

1. Modify subparagraph 12.1.3 as follows:

12.1.3. An item of the collateral, its ~~appraisal,~~ characteristics ~~and size as well as the obligations secured with this property and time for their fulfillment~~ and a description of the collateral sufficient to identify it as a unique object of real estate. For purposes of this paragraph a reference to the cadastre number of the real estate assigned by the state register is sufficient.

Comment: It is not necessary to include appraised value of the collateral in the agreement, and to do so could cause confusion. The value of the real estate is relevant only in the case of enforcement of the mortgage, which can occur years after the mortgage is made. The value of the property at the time of sale may have no relationship to the value at the time the property is sold.

The requirement for a description should be broad and assure that the property can be distinguished as a unique real estate object. A cadastre registration number, if it exists, should be sufficient to meet the requirement as a matter of law.

2. Modify subparagraph 12.1.4 as follows:

12.1.4 ~~The name of an item of the collateral, its location and characteristics,~~ A description of ~~specific features, image as well as~~ the document evidencing the authenticity of the pledger's ownership of this property and the name of the organization that registered the entitlement to this property.

Comment: This is duplicative of subparagraph 12.1.3.

3. Delete subparagraph 12.1.5.

Comment: Appraised value is not relevant at the time the mortgage is created. The appraised value changes frequently.

Article 13

1. Modify paragraph 13.1 as follows:

13.1. The collateral agreement must be concluded in a written form, certified by a notary and registered in the state registry ~~of ownership right of property and other entitlement related to it (hereinafter as "state registry")~~.

Comment: See comments on consistent use of defined term "state registry." The law does not clearly provide anywhere else that the collateral agreement must be certified by a notary.

2. Modify paragraph 13.2 as follows:

13.2. The collateral agreement shall be considered as a valid between the parties from the moment of its execution, but as between the parties and any third party only upon the registration in the state registry.

Comment: The proposed change states the intention of the law. Registration of the mortgage is intended only as a protection to third parties, not to validate the collateral agreement between the parties.

3. Modify subparagraph 13.3. as follows:

13.3. An agreement that violates article 16.4 and the procedure of the state registry, or does not contain the information specified in article 12 of this Law shall not be registered in the state registry ~~of entitlements~~.

Comment: See comment on consistent use of defined term "state registry."

4. Modify paragraph 13.4 as follows:

13.4. Collateral agreement that violates the procedure related to the registration in the state registry shall not be valid with respect to the rights of third parties.

Comment: A collateral agreement should remain valid between the parties to the agreement even if improperly registered.

5. Modify paragraph 13.5 as follows:

13.5. A loan or other agreement which includes obligations secured by the collateral should ~~meet the requirements on the format of the collateral agreement specified in 13.1 of this Law~~ be in written form.

Comment: Paragraph 13.1 requires registration. A loan agreement does not have to be registered.

Article 14

1. Modify paragraph 14.1 as follows:

14.1 The ~~registration of the~~ collateral agreement in the state registry ~~of entitlements~~ shall be the ground for making an appropriate recording in the state registry ~~of entitlements~~.

Comment: See comment on consistent use of the defined term "state registry."

2. Modify paragraph 14.2 as follows:

14.2. If collateral entitlement is created in accordance with law, it shall be the ground for making an appropriate recording on the creation of the collateral in the state registry ~~of entitlements~~.

Comment: See comment on consistent use of the defined term "state registry."

3. Delete paragraph 14.3.

Comment: Waivers of registration fees undermine creation of the cadastre and state registry. It is unusual to waive registration fees for mortgages. A better approach would be to assure that the fee charged for registration is a flat amount necessary only to cover the cost of registration.

4. Delete paragraph 14.4

Comment: The right of the pledgee arises on execution of the agreement; registration is necessary only to determine the rights of third parties.

The phrase "when said obligation is created" is undefined, ambiguous and open to wide interpretation. Use of this term can interfere with establishment of priorities for loans that are disbursed to the pledger in installments over time, such as loans for construction of buildings, or revolving credits for trade financing. This problem would arise if the phrase "when said obligation is created" is interpreted to mean when loan amounts are actually disbursed to the pledger. The better rule is that a pledgee's rights under the collateral agreement arise when the agreement is executed, regardless of whether any disbursements have yet been made to the pledger. There is no risk here, as if there is no debt there is no mortgage right to be enforced.

Article 15

Modify paragraph 15.1 as follows:

15.1. The pledger is obligated to notify the pledgee in writing of the entitlements (pledged as collateral, lifetime use, lease, limited use of others' property) that were known to him/her with respect to this specific property during the registration of the collateral agreement concluded with third parties in the state registry. If such notification is not made, the pledgee shall have the right to demand to make an amendment in the agreement or to fulfill the obligation before its deadline, unless such information could have been found by the pledgee upon inspection of the state registry.

Comment: Creditors should be obliged to inspect the state registry in every case; they should not rely on representations from the debtor. It is an extreme remedy to allow the creditor to terminate the loan because of information which the creditor could have discovered by a simple inspection of the registry.

Article 16

1. Modify paragraph 16.1 as follows:

16.1. Unless this law states otherwise, the obligation secured by the collateral and the rights of the pledgee created by law or the agreement ~~must~~ may be determined by a collateralizer as a document evidencing the real estate collateral.

Comment: Use of the collateralizer should be a choice of the parties to the transaction; in many transactions a simple loan and collateral agreement should be sufficient.

2. Modify paragraph 13.3 as follows:

16.3. A collateralizer shall not be executed and issued if ~~the items of the collateral are the land owned by individuals, an industry as a property complex, or rights to lease them or other rights. This procedure shall equally apply in cases where~~ the amount of the monetary payment obligations secured by collateral is not specified at the time of concluding the agreement or the procedure to determine such amount whenever required is not specified in the agreement. In cases provided in this clause, any condition of the collateralizer determined in the collateral agreement shall not be valid.

Comment: There is no apparent reason why a collateralizer should not be used in the case of land, or property complexes, or rights to land; all of these objects/rights can be mortgaged, and their characteristics do not affect the nature of the collateralizer.

Article 17

1. Modify paragraph 17.1 as follows:

17.1. The pledger shall ~~produce~~ execute the collateralizer. If the pledger is a third party, then it shall be produced executed with the executor of the obligation secured by such collateral.

Comment: The pledger executes the collateralizer but it is produced by the pledgee.

2. Modify paragraph 17.2 as follows:

17.2 After registration of the collateral agreement in the state registry ~~of entitlements~~, the registering organization shall issue the collateralizer to the first pledgee.

Comment: See comment on consistent use of the defined term "state registry."

Article 18

1. Modify paragraph 18.2 as follows:

18.2. If the obligation secured by the collateral is ~~partially fulfilled~~ modified, then the executor of obligation, the pledger and the legal owner of the collateralizer shall conclude an agreement on amending the conditions specified previously in the collateralizer, which shall be certified by a notary and shall include the followings:

Comment: Partial fulfillment is not good reason to formally amend a collateralizer. All modern mortgage loans are partially fulfilled every month.

2. Modify subparagraph 18.2.2 as follows:

18.2.2. Except with respect to obligations which by their terms are to be paid in installments, changes in the secured amount if the amount of the claim arising out of loan or other contracts has increased or decreased compared to the previous secured amount.

Comment: It is unnecessary and impractical to modify the collateralizer each time the principal obligation changes, as all modern mortgage loans pay some principal every month. This provision would require a monthly modification of the document, which is simply not done anywhere.

3. Modify subparagraph 18.3.1 as follows:

18.3.1. amendment to the content of the collateralizer ~~by attaching the original copy of this transaction to it, or the fact of recording in the collateralizer by executing in writing and attaching to it as a separate document as an integral part of such collateralizer in accordance with the procedure specified in article 20 of this Law;~~

Comment: Attachment of extraneous documents to the collateralizer should not be permitted; it undermines the purpose of the instrument, which is to create a simple, standardized and reliable financial instrument.

3. Modify paragraph 18.4 as follows:

18.4. The registration of the amendments to the content of the collateralizer must be accomplished within three days from the date of submission of the request by concerned person. ~~No fee shall be charged for registration.~~

Comment: Waivers of registration fees should be considered in the context of an overall review of registration fees.

Article 19

1. Delete paragraph 19.1.9.

Comment: Appraised value is not relevant to the collateralizer; it is relevant only if the collateral rights are enforced, and the property must be appraised at that time.

2. Delete paragraph 19.6 and replace with the following new paragraph 19.6:

19.6. If the legal owner of the collateralizer did not know and could not have known at the time the collateralizer was acquired that the collateralizer was created in violation of the law, or of any other defect in the collateralizer that would render it unenforceable, such defect or violation of the law may not be raised against such owner as a defense against demand for payment of the claim; provided, however, that this provision shall not apply to the benefit of the first pledgee of the collateralizer.

Comment: The current provision is a mis-statement of the general legal principle governing the rights of bona fide acquirers of a collateralizer without notice of a legal defect or defense. The proposed language states the law correctly.

3. Delete paragraphs 19.7 and 19.8.

Comment: These provisions are no longer necessary if paragraph 19.6 is corrected as proposed above.

Article 20

1. Modify paragraph 20.1 as follows:

20.1. Documents determining the conditions of the collateral or required documents for the pledgee to implement his/her rights under the collateralizer may not be attached to the collateralizer.

Comment: The purpose of the collateralizer is to create a simple document which is transparent on its face, in a standardized form and easily transferable. Permitting the attachment of documents undermines the purpose of the collateralizer. Makers of collateralizers should be required to include all relevant information in the body of the document. Note that in general it is not permitted to attach other documents to bills of exchange or promissory notes, which are the instruments on which the collateralizer is modeled.

2. Delete paragraph 20.2.

Comment: These provisions are no longer necessary if attachments are not permitted.

Article 21

Modify paragraph 21.1 as follows:

21.1. The ~~legal owner~~ *first pledgee* of the collateralizer shall register in the consolidated state registry ~~of entitlements/rights~~ his/her family name, father's (mother's) name and given name and residence address if an individual, and if the owner is a legal entity, its

name and location address. Any subsequent legal owner of the collateralizer may be registered as owner in the state registry upon request.

Comment: The purpose of the collateralizer is that it can be easily transferred by endorsement without registration of the new owner; rights to the collateralizer are based on physical possession. This provision of the draft seems to require registration of each new owner. If that is the case, why not simply transfer the loan agreement and mortgage? At the same time, the current legal holder of the collateralizer should have the right to request registration.

Article 22

1. Modify paragraph 22.1 as follows:

~~22.1. When implementing the entitlements represented in the collateralizer, the owner of the collateralizer shall be obligated to submit the collateralizer to the person under the obligation secured by the collateralizer at his/her demand except in the cases other than the collateralizer is transferred to a notary to be kept or pledged as collateral. A transferor of a collateralizer shall be obligated to notify the pledger in writing of the transfer of the collateralizer, providing the name and address of the new legal holder of the collateralizer and the place to which subsequent payments on the obligation should be made.~~

Comment: Delivery or presentation of an original document to each debtor is impractical and unnecessary, even if the collateralizer is not pledged as collateral. Notice of the transfer from the current holder should be sufficient. Alternatively, it could be required that a copy of the collateralizer be sent to the debtor.

2. Modify paragraph 22.2 as follows:

22.2. The pledgee shall be obligated to transfer the collateralizer to the person under the obligation secured by the collateralizer after the complete fulfillment of the obligation secured by the collateral by such person. However, if the obligation has been partially fulfilled, ~~its complete fulfillment must be assured by a~~ comprehensive and clearly understandable record of partial payments means to must be provided by the pledgee to the pledger and all persons that may ~~stay potential become~~ future owners of the collateralizer. However Except for obligations which by their terms are to repaid in installments, an appropriate entry should be made in the collateralizer about the partial fulfillment of the obligation, ~~and relevant financial document needs to be attached.~~

Comment: The legal holder of the collateralizer should be obligated to maintain accurate records of partial payment and provide those records periodically to debtors and upon transfer to transferees. Entries directly on the collateralizer regarding partial payment should not be required for loans which are repaid by multiple installments.

3. Modify paragraph 22.3 as follows:

22.3. If the collateralizer is with the pledgee ~~or if an appropriate entry regarding the partial fulfillment of the obligation secured by the collateral has not been made in the collateralizer,~~ such obligation shall be considered as unfulfilled except the cases specified in article 53.4 of this Law.

Comment: Notations directly on the collateralizer are not necessary. Instead of notations the holder should be obliged to keep accurate records and provide records of payments to the

debtor. In addition, there is a legal presumption for the benefit of the debtor that in the absence of a claim payments due on the collateralizer are current.

4. Modify subparagraph 22.6.2 as follows:

22.6.2. The executor of the obligation are not be bound by the obligation in the case when ~~the collateralizer becomes invalid due to the provision that the legal owner of the collateralizer lost it, or~~ the procedure on issuance of the collateralizer or issuance its copy is violated;

Comment: Mere loss of a collateralizer does not nullify the debtor's obligation. The law should provide for issuance of a substitute collateralizer in most cases if ownership can be proved by the person who lost the document. Remember, the collateralizer is a registered document, so there is no argument that it does not exist.

5. Modify subparagraph 22.6.3 as follows:

22.6.3. The executor of the obligation is considered as having *partially* fulfilled his/her obligation ~~as stipulated in article 53.5 of this Law.~~

Comment: Partial fulfillment is not relevant here; complete fulfillment is the issue.

6. Add a new subparagraph 22.6.4 as follows:

22.6.4. The collateralizer is a legally void or voidable obligation under the provisions of the Civil Code.

Comment: Fraud, duress, and lack of legal capacity are typical defenses to payment of a debt instrument such as the collateralizer.

7. Modify paragraph 22.8 as follows:

22.8. Unless this law specifies otherwise or the legal holder proves otherwise, the collateralizer is with the person with an obligation under it or with the registering organization, then the obligation secured by the collateral shall be ~~considered~~ presumed as fulfilled. The person obtained such collateralizer into his/her possession shall immediately inform the other bodies mentioned above of this event.

Comment: These rules should establish legal "presumptions" which may be disproved by the parties.

Chapter 4

Comment: Many of the provisions of this chapter are already found in the law on registration of real estate rights and are therefore unnecessary in this law. I would be concerned that including these provisions in this law using different language can lead to contradictions and conflicts. I suggest that a close look be taken at which of these provisions are specifically related to mortgage and collateralizer registration and are not found in the law on registration, retaining those and eliminating the remainder as unnecessary and a departure from the principles for drafting legislation.

Article 24

1. Modify paragraph 24.1 as follows:

24.1. The ~~consolidated~~ state registry of ~~the real estate collateral (hereinafter as the "state registry of the collateral")~~ shall be maintained by the organization of state registration of the real estate.

Comment: Technical modification.

Article 25

1. Modify paragraph 25.1 as follows:

25.1. The collateral created by the agreement shall be registered based on an joint application by either the pledgee ~~and~~ or pledger.

Comment: These are notary certified documents. It should not be necessary to require joint applications.

2. Delete subparagraph 25.5.2.

Comment: See comments above recommending against attachment of additional documents to the collateralizer.

3. Modify paragraph 25.6 as follows:

25.6. If the pledgee is changed due to transferring the primary obligation or contract right, the registration shall be done based on the joint application of the ~~previous and~~ new pledgees. ~~The agreement on transfer of rights, evidence of payment of the state stamp fee and the collateral agreement that was registered before shall be attached to this application.~~

Comment: The collateralizer is simply transferred by endorsement; no agreement on transfer is necessary. It is not necessary to accompany the registration application with the collateral agreement; the collateral agreement is a registered document and presumably it has not changed. Finally, it is not necessary to have a joint application of the transferor and transferee. All of these requirements make using the collateralizer more complicated than it needs to be and undermine its purpose.

Article 27

Modify subparagraph 27.1.3 as follows:

27.1.3. Amount of ~~payment~~ the principal obligation secured by collateral.

Comment: Registration should include only the original principal amount of the debt.

Article 30

Modify paragraph 30.1 as follows:

30.1. The collateral shall be terminated based on the request of the legal owner of the collateralizer or on the joint request of the pledgee and the pledger, or on the decision of the court, arbitration court, or independent court. The pledgee shall be obligated to provide to the pledger a written document in recordable form agreeing to termination of the collateral agreement no more than 30 days after the date on which the obligation secured by the collateral agreement is paid in full.

Comment: To protect debtors creditors should have an affirmative obligation to deliver a termination agreement upon satisfaction of the loan.

Article 34

Modify paragraph 34.1 as follows:

34.1. The pledger of the collateralized property by the agreement shall retain his/her rights to use it. ~~Any provision of the collateral agreement that restricts such right of the pledger shall be considered as explicitly illegal.~~ subject to the obligations of the pledger

to preserve and maintain the property established by this law. The pledger and pledgee may agree that the property will be used for a specific purpose.

Comment: The right to use the property is subordinated to the pledger's obligation to preserve and maintain the property. Moreover, creditors and debtors should be permitted to agree that the property would be used for a specific purpose. For example, if a creditor makes a loan to build a hotel the property cannot be converted to block apartments without the consent of the creditor.

Article 39

Modify paragraph 39.1 as follows:

39.1. Upon prior notice to the pledger ~~The~~ the pledgee shall have the right to inspect the quality, state and conditions of maintenance of the collateralized property through a documentary or physical inspection conducted during normal business hours. This right of pledgee shall equally apply to the property, if the pledger has temporarily transferred it into the possession of third parties.

Comment: The proposal provides more guidance on how to carry out property inspections.

Article 40

Modify paragraph 40.2 as follows:

40.2. The pledgee shall have the right to demand from the collateralized property, if the pledger refuses to satisfy the aforementioned claims within the period specified in the agreement, or within the period of one month following written notice from the pledgee describing the specific nature of the violation given as provided in paragraph 55-1.1 of this law, if the agreement does not state a particular period.

Comment: The law should specify that appropriate notice must be given to debtors before the creditor may proceed with a demand for repayment. This is particularly true with respect to non-monetary defaults, which the creditor should be required to describe in detail so that they can be corrected. The provision should refer to the specific paragraph of the law which requires written notice to the debtor in cases of default.

Article 41

Modify paragraph 41.3 as follows:

41.3. If the pledgee and pledger have made a written agreement on the restoration or replacement of the damaged or destroyed property and if the pledger has ~~not~~ fulfilled in a proper way the provisions of such agreement, the pledgee shall not be entitled to the rights specified in 41.2 of this Law.

Comment: The pledger's obligation should be expressed affirmatively - that is, if the pledger has fulfilled his obligations under the agreement the pledgee may not use the insurance proceeds to repay the loan, but must use them for restoration.

Article 43

1. Modify paragraph 43.1 as follows:

43.1. A person who acquires the collateralized property ~~by the collateral agreement~~ as a result of transfer into ownership of others, inheritance including reorganization of the legal entity or inheritance, shall become ~~as a pledger and shall be~~ liable for all the obligations created by the collateral agreement, but inheritors shall be liable for such

~~obligations only with the collateralized property, including the obligations of the first pledger unfulfilled in a proper way.~~

Comment: This follows the rule of the Civil Code, that successors do not become personally liable on the debt of their predecessor but liable only with the property.

2. Modify paragraph 43.3 as follows:

43.3. If the collateral item, as specified in 43.1 of this Law has been transferred into ownership of several persons, then each receiver, ~~who received the first pledger's right shall be liable for the liabilities incurred from the failure to fulfill the obligations secured by the collateralized real estate shall be responsible under paragraph 43.1 in proportion to the amount of allocated obligation his allocated portion of the property. If such property is indivisible or is transferred by other reasons into the shared ownership of the receivers of the rights of the pledger, the recipients of such rights shall become as joint pledgers.~~

Comment: Exception should be made for the limited liability of inheritors by referring to paragraph 43.1.

Article 49

Modify paragraph 49.4 as follows:

49.4. Unless the previous collateral agreement specifically provides for an increase of the amount of the claim secured by the collateral agreement or extension of the collateral agreement to new claims of the previous pledgee, the amendments regarding the satisfaction of a new claim of the previous pledgee or the increase of amount of claim secured by this agreement shall be made only with permission of the pledgee of the next agreement.

Comment: The previous collateral agreement may specifically permit increases in the amount secured or extension of the collateral agreement to other debts of the pledger, in which case the next pledgee is aware of that possibility and cannot claim the right to consent.

Article 51

1. Modify paragraph 51.1 as follows:

51.1. The claims of the next pledgee are to be satisfied in advantage from the sum of the property pledged as collateral only after the claims of the previous pledgee satisfied. The collateral agreement of the previous pledgee and rights against the collateralized real estate shall remain in full force and effect until the claim of the previous pledgee is paid in full.

Comment: It should be clarified that the previous pledgee's mortgage remains in effect until he is paid in full.

2. Delete paragraph 51.2.

Comment: The first pledgee should not be required to affirmatively exercise any rights or actions; this places burdens on the first pledgee which should be on the second pledgee, who assumes the risk of the first pledge. It is the responsibility of the second pledgee to assure that the first pledgee is paid, and the rule that the first pledge remains in effect until paid in full assures this result.

Article 53

1. Modify paragraph 53.1 as follows:

53.1. The transfer of rights specified in the collateralizer can be done by ~~a casual written contract~~ endorsement (notation) of the legal owner made directly on the collateralizer. The right to claim (cession) shall be accompanied with the transfer of rights specified in the collateralizer.

Comment: The intention of the collateralizer is that it can be transferred by endorsement and does not require a contract of transfer. All references to a "record" made in the collateralizer should be made references to an "endorsement." Endorsement is a standard legal term meaning a signed notation of transfer.

2. Modify 53.2 as follows:

53.2. The person transferring the rights specified in the collateralizer shall make ~~a record~~ the endorsement in the collateralizer about the new owner. If a new owner is an individual, then the family name, father's (mother's) name and given name, if a legal entity, the name ~~and in both reasons for transferring the rights~~ shall be included fully in the collateralizer.

Comment: This is too broad. The reasons for transferring the collateralizer are irrelevant unless it is specifically for pledge, and that should be addressed separately.

Modify paragraph 53.5 as follows:

53.5. Unless ~~the contract stated in 53.1. of this Law states~~ otherwise disclosed in writing by the transferor of the collateralizer to the transferee, with the transfer of rights in the collateralizer related to the primary obligations to be fulfilled partially and secured by the collateral, the completion of relevant obligations that need to be fulfilled until the transfer of the collateralizer shall be ~~considered as presumed~~ satisfied.

Comment: If transfer is by endorsement there is no contract of transfer. There is a legal presumption that the transferred collateralizer is current and not in default.

3. Modify paragraph 53.6 as follows:

53.6. If the right of the owner in the collateralizer is based on the ~~contract on transfer of rights or the~~ last record made by the previous owner of the collateralizer, then the new owner shall be considered as a legal owner. If the collateralizer was obtained from the possession of the person who produced the record of transfer against the will of its owner or by its exploitation, such person shall not be considered as a legal owner of the collateralizer without regard to whether he/she knew or was supposed to know.

Comment: A contract on transfer of the collateralizer is not necessary; transfer by endorsement.

4. Add a new paragraph 53.9 as follows:

53.9. A transfer of the collateralizer by endorsement may be made solely for purposes of pledge of the rights under the collateralizer as provided in article 54 if such limitation is noted in the endorsement.

Comment: It should be possible to endorse a collateralizer for pledge only.

Article 54

1. Modify article 54.3 as follows:

54.3. When collateralizer is ~~transferred~~ pledged to the pledgee, the parties may stipulate following provisions in the ~~collateral~~ pledge agreement:

Comment: The provision confuses transfer of the collateralizer with pledge of the collateralizer.

2. Modify subparagraph 54.3.3 as follows:

54.3.3. The special record shall be made in the collateralizer that provides the pledgee with the right of selling the collateralizer and satisfying ~~from the amount of the monetary value of the obligation secured by the collateral after expiration of an applicable time period~~ from the proceeds of sale or retaining the collateralizer, collecting the payments of the pledger and applying such payments toward repayment of the obligation.

Comment: The pledgee of a collateralizer should have the right of selling the collateralizer or retaining ownership of the collateralizer and collecting payments to be credited toward the pledger's obligation.

Article 55

1. Delete paragraph 55.3.

Comment: This paragraph does not reflect the typical rule. The typical rule states that the debtor can cure his default at any time prior to actual sale of the property by paying the overdue installments and expenses of the creditor, but can exercise this right only once in any 12 month period and twice over the entire term of the loan. If this allowance is exceeded the debtor can prevent sale of the property only by paying the entire loan amount. See further proposed changes.

2. Delete paragraph 55.4.

Comment: This says only that the property can't be sold if the debtor has a legal defense to enforcement. It is duplicative and unnecessary, and will therefore cause confusion.

New Articles 55-1 through 55-3

1. Add a new article 55-1 as follows:

Article 55-1. Notice of Default and Demand for Payment

55-1.1. as a condition of demanding repayment of the entire claim prior to maturity and taking action to terminate the pledger's rights to the collateralized property the creditor shall send to the a notice of default which shall include:

55-1.1.1. identification of the mortgage contract and the mortgaged property;

55-1.1.2. a description of the specific nature of the default; actions that must be taken by the debtor to cure the default;

55-1.1.3. a statement that failure to cure the default will result in a demand that the entire claim be repaid and steps to enforce the pledgee's rights under the collateral agreement;

55-1.1.4. the time allowed to cure the default before the repayment of the claim is demanded;

55-1.1.5. the name and contact information of a representative of the creditor that the debtor may contact to obtain further information; and

55-1.1.6. such other material as the pledgee deems relevant.

55-1.2. The debtor shall have not less than 30 days in which to respond to the notice of default.

55-1.3. If the pledger has not responded to the notice of default within the time allowed the pledgee shall record with the state registry and send the pledger and all third parties holding registered interests in the property a notice of intention to enforce the collateral agreement which shall include all of the information included in the notice of default and in addition:

55-1.3.1. a statement that the entire claim is due and payable;

55-1.3.2. the precise amount due; the time in which the claim must be paid;

55-1.3.3. a statement that failure to pay the claim will result in termination of the debtor's right to the mortgaged property;

55-1.3.4. a description of actions that must be taken by the debtor, if any, to prevent termination of his interest in the mortgaged property;

55-1.3.5. a description of the methods that may be used to sell the property;

55-1.3.6. the name and contact information of a representative of the creditor with whom the debtor may request a meeting; and

55-1.3.7. such other information as may be deemed relevant by the creditor.

55-1.4. If within 30 days of the date notice is given under paragraph 57.3 the pledger has not responded to the notice of intention to enforce the collateral agreement, the pledgee may commence steps to sell the collateralized property as provided in this law.

Comment: The law should tie the right to enforcement to an obligation to give notice to the debtor of the default and what the debtor must do to protect his rights, including specific time periods.

2. Add a new article 55-2 as follows:

Article 55-2. Notices Given and Received

55-2.1. For purposes of this chapter a notice is considered received if it is sent by certified mail to the address of the collateralized real estate, or to the address of the person liable for repayment of the collateralized obligation provided in the collateral agreement if that is different than the address of the collateralized real estate. For purposes of this law any notice sent to the person liable for repayment of the collateralized obligation shall be sent also to the pledger of the real estate if that is a different person.

55-2.2. Notice is considered received by the creditor if it is sent certified mail to the creditor at the creditor's address set out in the mortgage contract or in any notice given by the creditor to the debtor which invites a response from the debtor.

55-2.3. Notice is considered received by any third party if sent by certified mail to the third party's address as found in the state registry, or if no such address can be found or notices are returned undelivered if publication of the notice is made in the local organ for publication of legal notices in accordance with the applicable procedures. For purposes of this law, third parties holding a registered interest in the collateralized property include any person or legal entity registered in the state registry as the holder of an interest in the collateralized property.

Comment: Unless already addressed in the Law on Civil Procedure, the mortgage law can establish rules for determining when a notice has been received so that time periods can be calculated.

3. Add a new article 55-3 as follows:

Article 58. Right to a Meeting

Within 10 days of receipt of a notice of intention to enforce the collateral agreement the debtor may request a meeting with a representative of the pledgee, and the shall provide such meeting at its offices during normal business hours prior to proceeding with sale of the collateralized property. The debtor may be represented at such a meeting by a third party. The rights of the creditor to proceed with sale of the collateralized property shall not be prejudiced or delayed for failure to agree to an accommodation proposed by the debtor at such a meeting.

Comment: To further protect debtors it is possible to require that a creditor provide opportunity for a face-to-face meeting to discuss alternatives.

Article 59

1. Delete the entire paragraph 59.1.

Comment: These provisions give the court too much discretion to suspend enforcement, and contradict the intention to allow a creditor to demand repayment of the entire debt in the case of repeated failures of the debtor to meet the payment schedule. By definition, every missed installment payment is only a small part of the overall debt and these provisions could lead to denial of rights of enforcement in practically every case.

2. Modify subparagraph 59.2.4 as follows:

59.2.4. The initial price of selling the collateralized property by public auction shall be determined ~~by the contract established between the — and the pledger. Any dispute arising in this regard shall be decided by the court; in accordance with an appraisal of the value of the property performed by a licensed property valuer chosen by the pledgee.~~ The initial price may not be lower than 80% of the appraised value of the property.

Comment: It is not possible to determine an accurate selling price at the time the collateral agreement is signed, and it is not appropriate to require the pledger to agree to the selling price when the pledger is in default; this provides the pledger with an opportunity for delay and obstruction. The selling price should be established by on the basis of an appraisal made by a valuer chosen by the pledgee, and should not be less than 80% of the appraised value. The figure of 80% is chosen because a starting price of full market value is unlikely to elicit any bids.

3. Modify paragraph 59.3 as follows:

59.3. The court shall have the right to postpone the sale of the property ~~on a period up to six months by the request of the pledger in case of the following significant circumstances when deciding the satisfaction from the collateralized property:~~

59.3.1. ~~A pledger is an individual pledged his/her property as collateral for the purpose of a satisfaction of a personal need; in accordance with the provisions of the Code of Civil Procedure; or~~

59.3.2. in accordance with the provisions of article 74.2 of this law if the Item of the collateral is land for agricultural purposes.

Comment: There is no definition of "personal needs." This provision would allow the court to postpone execution in every case, as presumably a home for one's family is a "personal need." Postponement should be authorized by law only for agricultural land and only to the extent provided in paragraph 74.2 of this draft. Other reasons for postponement or suspension of execution should be limited those specified in the Code of Civil Procedure.

4. Modify paragraph 59.4 as follows:

59.4. The court shall determine the monetary amount of claims of the pledgee that needs to be satisfied from the collateralized property ~~considering the impossibility of it being higher than the price of the property pledged as collateral by the agreement~~ at the moment of expiration of postponement period of claims when determining the period of postponement of claims to sell the collateralized real estate.

Comment: The deleted phrase states the obvious and will lead to confusion.

5. Delete paragraph 59.6.

Comment: This provision provides no limitation on the number of times a debtor can seek postponement and have his debt reinstated despite repeated failures to comply with the terms of the obligation. Courts should not have the discretion to repeatedly suspend execution.

6. Delete the entire paragraph 59.7.

Comment: Providing these cases in which postponement may not be permitted suggests that postponement may be permitted in all other cases. As a general rule of law courts should not be authorized or encouraged to postpone rights of execution except in clearly specified cases, which should be addressed in the Code of Civil Procedure.

Article 60

1. Modify paragraph 60.1 as follows:

60.1. The activities on satisfying the claims of the pledgee from the collateral item by non-judicial procedures shall be regulated by the law and by the collateral agreements concluded between parties. Non-judicial procedure may include sale of the collateralized real estate by the pledgee by competitive bidding activity or direct sale by the pledgee. Election of sale by competitive bidding activity does not prevent subsequent sale by other permitted methods.

Comment: Whether non-judicial methods are permitted should be specified in the collateral agreement, and not in a separate later agreement of the parties. After a default has occurred there is no incentive for a debtor to agree to non-judicial methods.

Non-judicial methods should not be limited to auction sale. Auction sale is the least efficient form of sale, and does not result in the best price for the property. Modern mortgage markets rely on selling the property in negotiated transactions, or by listing with professional property brokers, which typically have better results than auctions.

2. Modify paragraph 60.2 as follows:

60.2. With regard the next collateral agreement, the ~~contract on satisfaction of claims non-judicial sale of the collateralized property~~ shall be considered as valid if it was concluded with ~~participation~~ notice to and consent of the pledgee of the previous collateral agreement.

Comment: The permission for non-judicial sale of the property should be included in the original collateral agreement, and that agreement does not need the participation of the previous pledgee. The point is that any non-judicial sale by a subsequent pledgee must have the consent of the previous pledgee.

3. Delete subparagraphs 60.3.2 and 60.3.3.

Comment: Practically all mortgages include land to some extent; this provision would exclude practically all loans for free standing houses. There is no good reason to exclude land

mortgages from non-judicial procedure. There is also no apparent policy reason to prohibit sale of a property complex by non-judicial means. In fact, it is likely that the more complex the collateral property the better result will be achieved by negotiation and private sale.

4. Delete subparagraphs 60.5.1 and 60.5.2.

Comment: These paragraphs assume that the non-judicial enforcement will proceed under a separate contract between the parties which is made after the default occurs. The right to non-judicial procedure should be specified in the original collateral agreement. In that case, it is not necessary to provide additional description of the property (60.5.1) and not possible to determine the amounts to be paid to the pledgee.

5. Modify paragraph 60.6 as follows:

60.6. The collateral agreement for satisfying the claims of the pledgee ~~concluded in accordance with article 60.1. of this Law~~, shall include the following additions to those specified in article 60.5 of this Law:

Comment: It should be clarified that the agreement on non-judicial enforcement is included in the original collateral agreement.

6. Modify subparagraph 60.6.1 as follows:

60.6.1. Sale of the collateralized property by competitive bidding activity in accordance with the procedure specified in Article 63 of this Law;

Comment: There is a definition of "competitive bidding activity" in the law and this should be used.

7. Modify subparagraph 60.6.2 as follows:

60.6.2. Negotiated sale of the collateralized property directly by the pledgee, which may include Transfer of the collateralized property to the possession of a third party as a professional legal entity that specialized on trading real estate ~~by calculating the fulfillment of the obligations at the current market prices, if the pledger fails to fulfill the obligations. If the current market price exceeds the fulfillment of obligations, the difference shall be given to the pledger. for purposes of selling the property.~~

Comment: There should be a general concept of negotiated sale directly by the pledgee. Auction is the least efficient method of selling the property, and frequently does not produce the best result for the debtor. The main point should be that the creditor can retain the services of a professional property broker to sell the property; the remainder of this paragraph is excess verbiage with little apparent meaning.

The debtor's right to excess proceeds of sale is a general principle of the mortgage law which exists regardless of the method of sale. This paragraph suggests that it exists only if the property is sold by a professional broker.

8. Delete paragraph 60.7.

Comment: The right of non-judicial sale should be established at the time of the original collateral agreement.

This paragraph is unnecessary as it states the obvious - that violation of the rights of third parties will result in nullification of the non-judicial sale. Statements of the obvious in legislation are duplicative and result in interpretive problems.

9. Add a new paragraph 60.7 as follows:

60.7. Prior to any sale of the collateralized property by non-judicial methods the pledgee shall establish the value of the property by valuation prepared by an independent property valuer.

Comment: A condition of all non-judicial sales should be that the property is valued by an independent valuer before sale.

Article 61

1. Modify paragraph 61.4 as follows:

61.4. The court may issue the decision on the satisfaction from the property pledged as collateral by the request of the pledgee ~~and pledger~~ to sale the collateral item by a procedure stipulated in Article 63 of this Law.

Comment: It is inadvisable to require the consent of the pledger to procedural steps at this point, as the pledger has no incentive to cooperate and can use these rights for purposes of delay and obstruction. The court is capable of evaluating a request of the pledgee without the consent of the pledger.

2. Delete paragraph 61.5.

Comment. This paragraph states the obvious and is duplicative.

Article 62

Delete the present article 62 and replace with the following new article 62:

Article 62. Negotiated Sale

62.1. A pledgee may sell the collateralized property to an unaffiliated third party by negotiated sale for a reasonable price under current market conditions.

62.2. After payment of the obligation and all costs and expenses permitted to be claimed by the pledgee under this law, the pledgee shall be liable to the pledger or to next pledgees, in their orders of priority, for the difference between the actual sale price of the property and 90% of the market value of the property as determined by the independent property valuer, less any surplus proceeds of the sale actually paid to the pledger or such next pledgees.

62.3. Any claim of the pledgee against the pledger for payments in excess of amounts obtained from negotiated sale of the property shall be reduced by the difference between the actual sale price of the property and the property valuation as determined by the independent property valuer.

62.4. Sale may be by advertisement or listing with a firm licensed to trade in real estate. If sale is made through a broker a broker's commission not exceeding the usual and customary amounts for such commissions may be included in the costs of sale.

62.5. Not less than 30 days prior to completion of the sale the pledgee shall give to the pledger and to any third party holding an interest in the collateralized property which is registered in the state registry a notice of the sale which shall include a statement of the amount of the pledgee's claim; the valuation of the property; the material terms of the contract of purchase and sale to be executed by the pledgee; the date for completion of the sale; the intended distribution of proceeds of the sale; and a statement of the

recipient's right to terminate the sale of the property within the permitted time in accordance with the provisions of this law.

Comment: The present article 62 duplicates paragraph 61.3. In its place it is proposed to provide further guidance on the forms of a negotiated sale by a creditor. The two main forms are direct sale by the creditor and sale by a property broker - either form should be permitted. The sale must be at a price which is at least 90% of the appraised value of the property, or the creditor will be liable to the debtor or next pledgees for the loss, but only if there is a surplus of proceeds of sale after payment of the debt and all associated costs. Prior to the sale all interest parties must be notified of the pending sale and be given an opportunity to intervene.

Any claim remaining against the pledger after sale of the property is reduced by the difference between the sale price and 90% of the market value of the property.

Article 63

1. Modify paragraph 63.1 as follows:

63.1. Public auction of the collateralized property shall be organized by an independent professional legal entity specialized on trading real estate matters ~~on the basis of the contract by the mutual agreement of pledgee and pledger and chosen by them~~ chosen by the pledgee.

Comment: The creditor should have the right to choose the auction agency. The debtor has no incentive to cooperate in this choice and can use this for purposes of delay and obstruction.

2. Delete subparagraph 63.4.2.

Comment: Most frequently the starting price is not exceeded at an auction. There are typically very few bidders and there is no incentive to exceed the starting price if it is established at or near market value. This paragraph will possible result in invalidating most auctions.

3. Modify paragraph 63.6 as follows:

63.6. The pledgee has the right to obtain the collateralized property calculated by its initial selling price within ten days since the announcement ~~of the~~ that any auction has not been conducted ~~by the agreement entered with the pledger. But the final calculation needs to be made by the amount of claims or price secured by the collateral. The pledgee has the right to credit against the purchase price the amount of the outstanding obligation.~~

Comment: The creditor should have the right to acquire the property at the designated price upon failure of any auction, first, second or third. For the sake of efficiency, this right should not depend on agreement with the pledger. Auction failures are typical and delaying the right of the creditor to acquire the property is often not justified. The final sentence is a clarification of the deleted original final sentence.

Modify paragraph 63.7 as follows:

63.7. If the pledgee stated in article 63.6. of this Law does not enter an agreement to obtain the collateral item for him/herself, the auction shall be reorganized no further than one month since the organization of the first auction. If the auction is reorganized by provisions stated in 63.4.1 ~~and 63.4.2~~ of this Law, the price of the item of collateral ~~determined in article 60.5.1~~ shall be the auction starting price reduced by ten percent. The reorganization of the sale shall proceed in accordance with 63.2 of this Law.

Comment: It is recommended that paragraphs 60.5.1 and 63.4.2 be deleted, as they are no longer relevant. The starting prices at auctions should be determined on the basis of

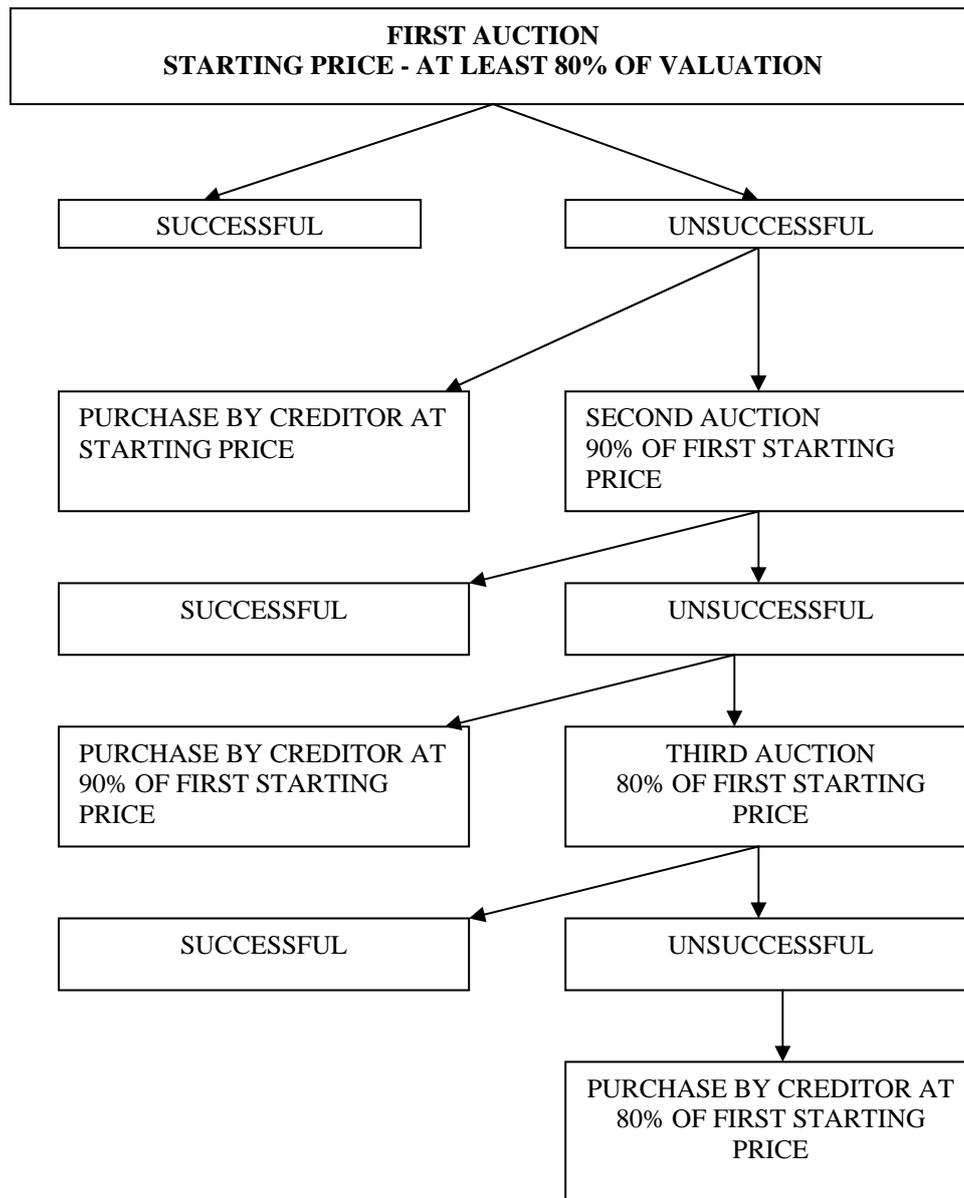
independent valuation, not agreement of the creditor and debtor. If a second auction is held, the starting price should be the starting price of the first auction reduced by 10%.

4. Modify paragraph 63.8 as follows:

63.8. The creditor may bid at auction sale and be credited with the amount of its claim. An auctioneer other than the creditor may not bid for its own account but may bid on behalf of the creditor. If the auction stated in ~~63.6~~ 63.7 of this Law was held unsuccessful, the pledgee shall have the right to obtain the collateralized property instead of his/her claims by the starting price of the first auction reduced no ~~higher~~ more than 20 percent ~~of the price determined in 60.5.1 of this Law but the final calculation needs to be made by the price of claims secured by the collateral.~~

Comment: It is a standard provision of mortgage law that the creditor be permitted to bid at the sale and be credited with the amount of the claim. In developed mortgage markets the creditor is frequently the only bidder at the sale.

The reference to paragraph 63.6 should be a reference to paragraph 63.7, which discusses a second auction. The initial price should be established on the basis of an independent valuation, not by agreement of the pledger and pledgee, and if the second auction fails the pledgee should have the right to obtain the property at 20% less than the initial starting price.



New Articles 63-1 through 63-5

1. Add a new article 63-1 as follows:

Article 63-1. Rights of third parties prior to sale

63-1.1. At any time up to 5 days prior to the announced date of the auction sale or completion of the negotiated sale of the property, and at any time prior to the date on which the pledgee takes title to the property under paragraphs 63.6 or 63.8 of this law, the pledger or any party holding an interest in the property registered in the state registry may terminate the sale of the property by tendering to the pledgee in cash or other good funds the full amount of its claim. In the event that more than one party tenders payment to the creditor, the pledger shall be preferred over third parties, and third parties shall be preferred in the order of their registered priorities. Except for the pledger, any party which terminates sale of the property by paying to the pledgee the

amount of its claim shall succeed to the rights of the pledgee under the collateral agreement.

Comment: In non-judicial procedure there must be a procedure for other parties holding an interest in the property to pay the debt and protect their rights.

2. Add a new article 63-2 as follows:

Article 63-2. Contract of Purchase and Sale

63-2.1. Upon completion of the auction or negotiated sale the pledgee shall execute and deliver a contract of purchase and sale to the collateralized property, together with an affidavit suitable for recordation in the state registry which shall include: the names and addresses of the pledgee and pledger; the address and land registry recordation data of the collateralized property; the land registry recordation data of the pledgee's collateral agreement; and a statement that a sale was conducted in accordance with the provisions of this law. The contract of purchase and sale is deemed to be executed by the pledgee as attorney in fact for the pledger and shall have the same legal effect as if issued by the pledger.

63-2.2. The registered title of a purchaser in good faith under this law shall be conclusive and shall not be disturbed. The pledger's sole remedy for illegal sale off the property shall be against the creditor for losses and damages incurred by the pledger.

Comment: Upon completion of any non-judicial procedure the creditor must have the authority to issue a deed to the purchase which will allow registration of the purchaser's interest in the state registry. The purchaser at a non-judicial procedure who is bona fide should be protected against any claims. This is necessary to protect the integrity of the non-judicial process and assure that there are willing buyers. The debtor's only remedy should be to make a claim against the creditor for damages.

3. Add a new article 63-3 as follows:

Article 63-3. Rights of pledger prior to sale

63-3.1. At any time up to actual sale of the property by the pledgee a pledger shall have the right to terminate the pledgee's action to sell the property by payment of the amount of any unpaid installments due on the obligation, any fees or penalties due for late payment under the collateral agreement, and the costs and expenses incurred by the pledgee on account of the pledger's default; provided, however, that this right may be exercised only once in any period of 12 consecutive months, and only 2 times over the entire term of the loan, and otherwise the sale of the property may be terminated by the pledger only upon payment of the entire outstanding principal balance of the obligation, together with all interest due, any fees or penalties due for late payment under the collateral agreement, and the costs and expenses incurred by the pledgee on account of the pledger's default.

Comment: A pledger should have the right to "cure" his default by payment of overdue amounts and penalties and costs any time up to sale of the property, but this right can be exercised only once in any 12 month period or twice over the life of the loan. If the debtor exceeds the permitted occurrences, the creditor may demand repayment of the entire loan and the debtor may then terminate the sale only by full repayment.

4. Add a new article 63-4 as follows:

Article 63-4. Termination of the Mortgage and Other Interests in the Property

63-4.1. Issuance of a contract of purchase and sale by the pledgee to a purchaser (including the pledgee where the pledgee purchases the title) or public sale of the mortgaged property by the court terminates the collateral agreement, all rights of the pledger to the collateralized property, unregistered interests in the collateralized property, and rights of any third parties which were registered subsequent to the collateral agreement. Interests in the collateralized property which are registered in the state registry prior to registration of the collateral agreement survive unless satisfied or otherwise terminated prior to registration of the contract of purchase and sale.

Comment: The law should have a general statement of the legal result of sale of the collateralized property.

5. Add a new article 63-5 as follows:

Article 63-5. Appeals to court to suspend or terminate non-judicial sale

63-5.1. A pledger may bring an action in the court of first instance to stop or delay non-judicial sale of the mortgaged property by the creditor only on the grounds that:

- 1) the claim is legally void or voidable;
- 2) the collateral agreement is legally void or voidable;
- 3) the claim is not due for payment or is paid in full;
- 4) the procedures for sale provided in this law have been violated.

63-5.2. The debtor bears the burden of presenting evidence in support of its challenge.

63-5.3. A challenge to the valuation of the collateralized property or a starting sale price shall not be grounds for suspending or terminating the sale, but shall be grounds for claim of damages against the pledgee.

63-5.4. Upon request of the pledgee, the court in its discretion may require that a person challenging a non-judicial sale of property provide a bond or other surety, in an amount to be determined by the court, but not to exceed the value of the claim, to protect the pledgee against loss or damage caused by suspension or termination of the sale.

Comment: The grounds for challenging the non-judicial sale proceeding should be described. The grounds described here encompass all legal defenses to enforcement of the claim and the collateral right, by reference to the Civil Code provisions on void and voidable obligations. It is noted that dispute over a valuation or sale price is not sufficient grounds to suspend the sale, as such disputes cannot be resolved quickly and the pledgee remains liable for inadequate valuations.

The court may require the challenger to post a surety to protect the pledgee against damages caused by delay or suspension of sale.

Article 64

Delete article 64.

Comments: The issues of this article are better addressed under proposals for new article 63-1 through 63-5, above.

Article 65

Modify subparagraph 65.2.2 as follows:

65.2.2. *The pledgee or professional* Organizer of the auction, if collateralized real estate was sold by non-judicial procedure.

Comment: The pledgee should be responsible for distributions if the pledgee sells the property directly.

Article 66

Modify paragraph 66.2 as follows:

66.2. If the land is transferred by a rent contract or by other entitlement contracts to citizens or legal entities, the person who obtained such entitlement may pledge the land within the period of the entitlement under the permission of land owner. Notwithstanding the foregoing sentence, any right of lease for a term exceeding [10] years or right of land use for an indefinite term may be mortgaged by the holder of the right without the consent of the state or municipal entity which owns the land, but only for the remaining term of such lease or right of land use. In such case the holder of the right of lease or land use shall provide to the owner written notification of the collateral agreement within 30 days of its execution.

Comment: To develop efficient land markets, holders of long term rights of land use and lease from the state or municipalities should not be required to obtain the consent of the land owner to mortgage their rights. Requirements for consent to alienate or mortgage diminish the quality of the land use right and state leases and interfere with market processes. Freedom to alienate and mortgage long term use rights and leases is essential if a true land market is to develop in the absence of land ownership.

Article 68

Comment: It is the consultant's firmly held view that mortgage of a land plot should not be permitted without mortgage of all buildings and structures located on the land plot, and that if borrowers want to exclude structures from the mortgage they should first be required to subdivide the land under the structures and thereby create new land plots as unique objects. It is my view that the courts are ill-equipped to resolve the types of disputes that may arise under this article, and that the exclusion of undefined rights of land use from the mortgage will work to the disadvantage of creditors. I believe that ultimately creditors will recognize this disadvantage and require subdivision of the land before a mortgage is made.

Article 69

Modify paragraph 69.1 as follows:

69.1. Unless the law and the contract state otherwise, the land obtained by credit assets of a bank and other credit organizations or by assets of a purposeful borrowing for land provided from other legal entities for the purpose of obtaining such land shall be considered pledged as collateral from the moment of registration in the state registry of the borrower's entitlement to such land provided that the registered document or ownership clearly refers to the existence of the collateral right, the identify of the pledgee and the amount of the credit. If this land is rented, or unless the rent contract and the law state otherwise, the renting right shall be considered pledged as collateral.

Comment: The existence of the pledge right should be clear to any user of the registry; this requires that the entitlement document clearly identifies the pledge.

Article 73

Rename article 73 as follows and delete paragraph 73.1.

Article 73. Appraisal of the land during the transfer of such land as collateral Requirement for land border map

~~73.1. The appraisal of the land shall be determined by mutual agreement entered by parties. If such determination can not reach, the appraisal shall be made by an independent professional appraiser.~~

73.1 The copy of the land border map and plan of the land organization issued from the organization in charge of land resources and organization shall be attached to the agreement on collateralization of land on a mandatory basis.

Comment: Appraisal is irrelevant when the collateral agreement is made; it is only relevant when the collateral agreement is enforced. An appraisal made when the collateral agreement is made is soon outdated.

Article 74

Delete paragraph 74.1.

Comment: Mortgages of land should be treated the same way as mortgages of other real estate. Auction and negotiated sale should be permitted.

Article 80

Modify paragraph 80.4 as follows:

80.4. If a housing unit ~~or a part of a housing unit that consists of one or several rooms~~ becomes an item of collateral, the procedure specified in this Chapter shall apply to this collateral.

Comment: A part of a housing unit cannot be mortgaged. To be mortgaged it is necessary that the mortgaged object have a cadastre number and be registered in the cadastre. Rooms in a housing unit cannot have a cadastre number.

Article 83

Modify paragraph 83.1 as follows:

83.1. Unless the law and the agreement state otherwise, the ownership rights of the borrower owning a housing unit acquired or built by credit assets of a bank or other credit organization or by a purposeful credit assets provided from other legal entity with the purpose of obtaining or building such housing unit or by their participation shall be considered as collateralized at the moment of registration of the ownership right in the consolidated state registry provided that the registered document or ownership clearly refers to the existence of the collateral right, the identify of the pledgee and the amount of the credit. The bank and other credit organization or legal entity who provided a credit or purposeful borrowing for the purpose of obtaining and building such housing unit shall be the pledgee of the collateral.

Comment: It is unclear whether this refers to registration of the ownership right or some other document. The intention should be that the collateral right arises on registration of the ownership right. It is important for the protection of third parties using the register that they have sufficient information on the nature of the collateral right.

New Chapter 13-A

Add a new chapter 13-A as follows:

CHAPTER 13-A
PROTECTION OF CONSUMERS

Article 84-1. Protection of Consumers

84-1.1. At least five days prior to making a loan secured by a mortgage on a housing unit for purposes of acquiring, improving or constructing the housing unit, a pledgee shall provide the executor of the loan obligation in writing and in plain language the following information:

- (a) Identification and address of the pledgee and any intermediary acting for the pledgee;
- (b) The purposes for which the loan may be used;
- (c) A description of the payment terms of the loan, including the amount and frequency of payments, the allocation of payments to principal and interest, respectively, and the place and method of payment;
- (d) With respect to loans on which the interest rate may be changed from time to time (variable interest rate loans), a description of the formula by which the interest rate will be changed and the frequency of change;
- (e) A calculation of the entire cost of the loan to the borrower over the stated duration of the loan, assuming no prepayment, distinguishing between principal and interest and in the case of variable interest rate loans a description of the assumptions underlying the interest calculation and a statement that actual interest paid could be more or less than disclosed;
- (f) A good faith estimate of other costs related to the loan to be paid by the borrower, including the pledgee's administrative costs, insurance premiums, legal, notary and registration fees, and appraisal fees;
- (g) Whether the borrower has the right of early repayment (prepayment) of all or any portion of the loan, and if so, any conditions imposed on early repayment;
- (h) Whether a valuation of the property is necessary and, if so, by whom it will be carried out;
- (i) A summary of the main terms of the collateral agreement securing the loan, including any restrictions on use or disposition of the property and the obligations of the borrower for maintenance and insurance of the property;
- (j) An unambiguous statement that failure to repay the loan could result in loss of the mortgaged property and a description of the steps may be taken by the creditor to enforce the collateral agreement in the event of the borrower's failure to meet his obligations.

84-1.2. The Financial Regulatory Committee and the Bank of Mongolia may by joint regulations prescribe the form and content of the written notice to be provided to consumers under this article, and where so prescribed a notice provided under this article shall be in that form and shall be considered void if not in that form, provided that no such notice shall be considered void on the grounds of technical defects alone in the absence of material harm to the recipient. No notice given under this article shall be considered defective

because of discrepancies between costs estimated diligently and in good faith under subparagraphs (e) and (f) of paragraph 84-1.1 of this article and costs actually incurred.

Comment: It is our view that the best protection against abusive lending practice is an appropriate and standardized regulatory regime governing pre-contract disclosures of the economic and legal terms and conditions of the mortgage loan.

THE LAW OF MONGOLIA ON COLLATERALIZATION OF REAL ESTATE

Date:

Ulaanbaatar

CHAPTER ONE GENERAL PROVISIONS

Article 1. Purpose of the Law

The purpose of this law is to regulate the relations concerning the collateralization of real estate or its related entitlements as a security of fulfillment of obligations and conclusion and execution of a real estate collateral agreement (hypothec) as well as fulfillment of an obligation thereof.

Article 2. Legislation on collateralization of real estate

- 2.1 The legislation on the collateralization of real estate is a part of the Civil Code. In the event of a conflict between this law and the Civil Code, the provisions of this law shall govern.
- 2.2 This law shall regulate the relations concerning the collateralization of land, industrial and residential buildings/housing units¹ as well as other real estate or its related entitlements and other relations concerning the collateralization of real estate not specified in this Law shall be regulated by the Civil Code.
- 2.3 If an international treaty of Mongolia provides otherwise than the procedures specified in this Law, then the provisions of the international treaty shall prevail.

Article 3. Definition of terms in the Law

- 3.1 The following terms specified in this Law shall be interpreted and used in the meanings below:
 - 3.1.1 “Pledgee” means a person who holds the real estate or its related entitlement of the executor pledged as collateral in order to have its claims satisfied in the priority order if the executor fails to fulfill his/her obligation of the agreement .
 - 3.1.2 “Pledger ” means the executor of the obligation who submitted his/her real estate or its related entitlement as a collateral to guarantee the fulfillment of the obligation or a third person who has done so on behalf of the executor of the obligation.
 - 3.1.3 “Real estate” as defined in 84.3 of the Civil Code of Mongolia;
 - 3.1.4 “Housing unit” means a private or public residential building or a separate housing, or an apartment in a detached house or building designed for a permanent residential purpose;
 - 3.1.5 “Forced auction” means an activity of a sale of real estate pledged as collateral organized by an execution authority of court decisions based on a court decision.
 - 3.1.6 “Competitive bidding activity” means an activity organized by an independent and professional legal body specialized on trading real estate or its related entitlements as stated in Article 197 of Civil Code ;

¹ The term of “housing unit” is used in this law. (note from translator)

- 3.1.7 “Collateralizer” means a security certifying the right to be satisfied from the execution of the monetary obligation secured by collateral without evidencing the existence of collateral entitlement for the legal owner, and the obligation secured by such collateral.
- 3.1.8 "State registry" means the state registry of ownership right of property and other entitlements related to it.
- 3.1.9 "Independent property valuer" means a professional valuer who is not an employee of the pledgee or of any legal entity which is affiliated with or a subsidiary of the pledgee, and who is licensed to carry out valuation activity if required by law.

Article 4. Grounds for creation of collateral entitlement to the real estate

- 4.1. The collateral entitlement to real estate or its related entitlement (hereinafter as “collateral”) shall be created by an agreement entered between the pledgee and the pledger or the law.
- 4.2. The pledgee of the primary obligation secured by collateral under the collateral agreement of real estate and its related entitlement (hereinafter as the “collateral agreement”) shall have a prerogative right to have its monetary claim satisfied from the price of real estate of the pledger prior to any person whose claim against the real estate arises after the effective date of the collateral agreement, or any person whose claim against the real estate arises prior to the effective date of the collateral agreement but who fails to register notice of such claim in the state registry prior to the effective date of the collateral agreement.
- 4.3. A pledger may be the executor of the primary obligation (hereinafter as “executor”) or a third party that is not part of the obligation.
- 4.4. A collateralized real estate item shall remain under the pledger’s possession and use.
- 4.5. Unless the law states otherwise, the relevant provisions of the collateral agreement shall be applied to the collateral created by the law.

Article 5. Obligations secured by the collateral

- 5.1. Real estate may be pledged as collateral in order to secure the fulfillment of obligations arising out from loan, borrowing, lease, sale and purchase agreements as well as other contracts on execution of works, including those obligations related to elimination of damages.
- 5.2. If one or all parties of the agreement are legal entities, the obligation secured by the collateral shall be recorded in the accounting books of such legal entity according to the procedures stipulated by law.

Article 6. Claims secured by the collateral

- 6.1. The following claims shall be secured by the collateral:
- 6.1.1. Ensure the fulfillment of obligations secured by the collateral in full or in the amount indicated in the agreement;
 - 6.1.2. Ensure the interest payments agreed by a loan contract or a borrowing contract established with such condition of an interest payment.
- 6.2. Unless specifies in the agreement otherwise, the following claims shall be satisfied by the collateral:

6.2.1. Damages caused by the past-due fulfillment of the obligation secured by the collateral or by any other improper fulfillment, or fines agreed upon the agreement and default interest payment if stated in law;

6.2.2. Income or interest earned by illegal use of monetary assets of others related to the obligations secured by the collateral;

6.2.3. Judicial expenses and other equivalent expenses incurred during the submission of a claim to a court in relation to the fulfillment of relevant obligations of the collateralized real estate;

6.2.4. Expenses incurred during the sale of a particular property.

6.3. Unless the agreement states otherwise, the claim of the pledgee shall be satisfied from the sale of collateralized real estate in the amount that was outstanding at that time; and appraised at that time.

6.4. If the collateral agreement specifies a fixed amount for the monetary value of the claim of the pledgee, then the pledger shall not be liable for the part in excess of this amount, except the cases specified in articles 6.1.2, 6.2.3, 6.2.4 and 7 of this Law.

Article 7. Satisfying other additional expenses from the collateralized real estate

7.1. Additional expenses of the pledgee incurred in accordance with the conditions specified in the collateral agreement during the maintenance and protection of the collateralized property, as well as such liabilities as taxes, fees and public service payments related to this property shall be satisfied from such property.

Article 8. Items of the collateral

8.1. An item of the collateral may any object of real estate or its related entitlements registered in the state registry, which are allowed in civil transactions according to the procedures specified by legislations.

8.2. A building and structure owned or possessed on the conditions specified in Article 70 of this Law, and an unfinished building and structure that meets the requirements specified in Article 150 of the Civil Code and Article 70 of this Law, and any other property which is registered in the state registry in accordance with appropriate procedures but is not specified in this Law may be an item of the collateral.

8.3 Unless the agreement states otherwise, the real estate as the item of the collateral shall be considered to be collateralized together with its components.

8.4. Real estate, which is removed from civil transactions, prohibited by the law from making payments, is a subject to a decision to privatization issued by an authorized agency, or included in the list of assets ineligible for privatization, shall not be an item of the real estate collateral.

Article 9. Right to pledge as collateral by an agreement

9.1. A pledger shall have the right to pledge the real estate in his/her ownership specified in article 8 of this Law as collateral under the agreement.

9.2. An authorized state agency that administer state- or municipally-owned real estate shall issue a decision on pledging such real estate as collateral except those prohibited by the law.

9.3. If the law specifies that the administration of the real estate requires permission from others, such permission must be obtained from the relevant bodies in order to pledge this property as collateral.

9.4. Except as provided in paragraph 66.2 of this law, The right to lease a real estate may be an item of the collateral with the permission of lessor.

9.5. The real estate collateral shall not exempt the executor of the obligation from fulfilling such obligation.

9.6. Unless the law and the agreement state otherwise, the real estate collateral shall apply to such real estate in a whole.

Article 10. Pledging a shared property as collateral

10.1. In case of pledging collectively-owned shared real estate as collateral, the written permissions of all owners must be obtained on a mandatory basis.

10.2. A party to collectively-owned shared property may pledge his/her share in shared property as collateral without permission of other owners; however if such share of shared property is to be sold at the demand of the pledgee in accordance with articles 108.6-108.8 and 490 of the Civil Code, other owners of shared property shall have a prerogative right to purchase that share in a priority order.

CHAPTER TWO CONCLUSION OF A COLLATERAL AGREEMENT

Article 11. General procedure for conclusion of an agreement

11.1. The general procedure of the Civil Code for conclusion of an agreement and the grounds and related articles of this Law shall be applied to the conclusion of a collateral agreement.

Article 12. Content of the collateral agreement

12.1. The collateral agreement shall include following items:

12.1.1 Names and residential addresses of parties

12.1.2 The agreement shall specify the value, condition of occurrence, and fulfillment time of the obligation secured by the collateral. If this obligation is based on another agreement, then the parties involved, date and location of conclusion such agreement must be specified. If the value and the amount of payment of the obligation secured by the collateral are not specified in advance, the agreement must specify the procedures and other conditions to determine them in the future.

12.1.3. An item of the collateral, and a description of its characteristics sufficient to identify the collateral as a unique object of real estate. For purposes of this paragraph a reference to the cadastre number of the real estate as found in the consolidated state register is sufficient.

12.1.4 A description of the document evidencing the authenticity of the pledger's ownership of this property and the name of the organization that registered the entitlement to this property.

12.1.6. If the obligation secured by the collateral is to be partially fulfilled, then the collateral agreement shall specify the time and amount for execution of payments as well as the conditions for determining such amount.

12.1.7. The procedure settling the satisfaction of claims from the collateralized property.

12.1.8 Whether the pledgee right is certified by the collateralization.

12.1.9. Other items agreed by parties that are not contracting the law.

12.2 If collateral item is an entitlement related to this property, then basic conditions and time of obtaining such entitlement shall be specified in the agreement.

Article 13. State registration of collateral agreement and conditions for entry into effect

13.1. The collateral agreement must be concluded in a written form, certified by a notary and registered in the state registry.

13.2. The collateral agreement shall be considered as a valid between the parties from the moment of its execution, but as between the parties and any third party only upon the registration in the state registry.

13.3. An agreement that violates article 16.4 and the procedure of the state registry, or does not contain the information specified in article 12 of this Law shall not be registered in the state registry.

13.4. Collateral agreement that violates the procedure related to the registration in the state registry shall not be valid with respect to third parties.

13.5. A loan or other agreement which includes obligations secured by the collateral should be in written form.

13.6. If the collateral agreement specifies that the rights of the pledgee must be certified by the collateralizer in accordance with Article 16 of this Law, the pledgee must submit to the notary such collateralizer together with the collateral agreement.

13.7. The notary shall record in the collateralizer the date and place where the agreement was concluded and, the pages of the collateralizer shall be numbered, and signed and put stamp (seal) on each page conforming to the requirements specified in 19.3 of this Law.

Article 14. Creation of the collateral

14.1 The collateral agreement shall be the ground for making an appropriate recording in the state registry.

14.2 If collateral entitlement is created in accordance with law, it shall be the ground for making an appropriate recording on the creation of the collateral in the state registry.

Article 15. Notification to the pledgee about the rights of third parties regarding the collateralized item

15.1. The pledger is obligated to notify the pledgee in writing of the entitlements (pledged as collateral, lifetime use, lease, limited use of others' property) that were known to him/her with respect to this specific property during the registration of the collateral agreement concluded with third parties in the state registry. If such notification is not made, the pledgee shall have the right to demand to make an amendment in the agreement or to fulfill the obligation before its deadline, unless such information could have been found upon inspection of the state registry.

CHAPTER THREE COLLATERALIZER

Article 16. Collateralizer

16.1. Unless this law states otherwise, the obligation secured by the collateral and the rights of the pledgee created by law or the agreement may be determined by a collateralizer as a document evidencing the real estate collateral.

16.2. The executor of the obligation secured by the collateral and the pledger are persons that undertook obligations under the collateralizer.

16.3. A collateralizer shall not be executed and issued if the amount of the monetary payment obligations secured by collateral is not specified at the time of concluding the agreement or the procedure to determine such amount whenever required is not specified in the agreement. In cases provided in this clause, any condition of the collateralizer determined in the collateral agreement shall not be valid.

Article 17. Execution of Collateralizer

17.1. The pledger shall execute the collateralizer. If the pledger is a third party, then it shall be executed with the executor of the obligation secured by such collateral.

17.2 After registration of the collateral agreement in the state registry, the registering organization shall issue the collateralizer to the first pledgee.

Article 18. Transfer of entitlement represented by collateralizer and amendments to the collateralizer

18.1 The procedures provided in articles 53 and 54 of this Law shall be applied when the collateralizer is pledged or the entitlements certified by this collateralizer is transferred as collateral.

18.2. If the obligation secured by the collateral is modified, then the executor of obligation, the pledger and the legal owner of the collateralizer shall conclude an agreement on amending the conditions specified previously in the collateralizer, which shall be certified by a notary and shall include the followings:

18.2.1. amendments to the item of collateral if a certain part of such item was previously pledged as collateral by the collateral agreement is independent item of civil transactions;

18.2.2. except with respect to obligations which by their terms are to be paid in installments, changes in the secured amount if the amount of the claim arising out of loan or other contracts has increased or decreased compared to the previous secured amount.

18.3. The collateralizer may be replaced or changed when transferring or fulfilling obligation partially secured by the collateral or replacing damaged or liquidated property by following means:

18.3.1. amendment to the content of the collateralizer;

18.3.2. issuance of a new collateralizer, indicating appropriate changes and invalidation of the old document.

18.4 The registration of the amendments to the content of the collateralizer must be accomplished within three days from the date of submission of the request by concerned person.

18.5 The registering organization shall replace the invalidated document and issue a new document, and the old document shall be taken and kept in the archives until the expiration of registration period of the entitlement to this collateral.

Article 19. Content of the collateralizer

19.1. The following information should be included in the collateralizer when the registering organization that registered the collateral issues it to the first pledgee:

- 19.1.1. Title: “Collateralizer”, a document evidencing pledge of real estate as collateral;
- 19.1.2. Family name, father’s (mother’s) name and given name and residence address of the pledger, and if the pledger is a legal entity, its name and location address;
- 19.1.3. Family name, father’s (mother’s) name and given name and residence address of the first pledgee, and if the pledgee is a legal entity, its name and location address;
- 19.1.4. The title of the obligation or monetary obligation of a loan agreement secured by the collateral, date and location of conclusion, and grounds for creation of such obligation secured by the collateral;
- 19.1.5. If the executor of the obligation is not the pledger, then the family name, father’s (mother’s) name and given name and residence address of the executor of the obligation, and if it is a legal entity, its name and location name and address;
- 19.1.6. Sum of the amount of the obligation secured by the collateral and amount of interest to be paid under this obligation, or conditions for determining the amount of the payment and interest when required;
- 19.1.7. Deadline for making the payment according to the obligations secured by the collateral, or a schedule and amount if payments are to be made partially, or conditions for determining such deadline and payment amount, or a debt payment conditions ;
- 19.1.8. Name of the property that is an item of the collateral, a scheme that provides a sufficient description of its qualities, its location address;
- 19.1.10. If an item of the collateral is pledger’s leasing right, the name of the property that is a lease item, a description specified in 19.1.8 of this Law and the term of validity of such right;
- 19.1.11. Indication of either existence of the third party rights that must be registered regarding the collateralized real estate such as lifetime use, lease or servitude, or absence;
- 19.1.12. Signature of the pledger, or of the executor of the obligation secured by the collateral if the pledger is a third party;
- 19.1.13. In cases other than those the collateral is created and the collateralizer is issued in accordance with law, the information on the date and place of the collateral agreement as well as the information on the state registration of the collateral as stated in article 27.2 of this Law;
- 19.1.14. Date when the collateralizer was issued to the first pledgee. If the collateralizer is issued due to the creation of the collateral entitlement to real estate in accordance with this Law, the information specified in 19.1.10 must be recorded in the collateralizer by the registering organization. The procedure specified in article 28 of this Law shall be applied when recording such information in the collateralizer;
- 19.1.15. Procedure on satisfying the claims from the collateralized property

19.2 A “collateralizer” with omission any of the information specified in articles 19.1.1-19.1.15 shall not be considered as collateralizer and shall not be issued to the first pledgee.

19.3. Other information and conditions not specified in 19.1 of this Law may be included in the collateralizer by an agreement entered between the pledgee and the pledger.

19.4. Additional pages shall be attached if the pages of the collateralizer are not sufficient for including about a new owner in the collateralizer, or records on the partial fulfillment of the obligation, or other entries that should be in the collateralizer. In doing so, the entries or the beginning of the information must be on the collateralizer and the end should be on the attached pages.

19.5. All pages of the collateralizer shall be bound and numbered and each page must be notarized with a stamp. Any unbound page of the collateralizer shall not be an item of the deal.

19.6. If the legal owner of the collateralizer did not know and could not have known at the time the collateralizer was acquired that the collateralizer was created in violation of the law, or of any other defect in the collateralizer that would render it unenforceable, such defect or violation of the law may not be raised against such owner as a defense against demand for payment of the claim; provided, however, that this provision shall not apply to the benefit of the first pledgee of the collateralizer.

Article 20. Attachments to the collateralizer

20.1. Documents determining the conditions of the collateral or required documents for the pledgee to implement his/her rights under the collateralizer may not be attached to the collateralizer.

Article 21. Registration of the owner of the collateralizer

21.1. The first pledgee of the collateralizer shall register in the consolidated state registry his/her family name, father's (mother's) name and given name and residence address if an individual, and if the owner is a legal entity, its name and location address. Any subsequent legal owner of the collateralizer may be registered as owner in the state registry upon request.

21.2. The registering organization shall register the legal owner of the collateralizer within three days after the receipt of the request to register as a legal owner of the collateralizer based on the following grounds:

21.2.1. Recording the transfer in the applicant's name done by the legal owner of the collateralizer or pledgee of the collateralizer that the collateralizer has been transferred to the applicant by making an entry about its transfer in accordance with the procedure specified by law;

21.2.2. An document evidencing that the entitlement expressed in the collateralizer has been transferred to the applicant due to reorganization of the legal entity or by inheritance;

21.2.3. A court decision recognizing the right of the applicant represented in the collateralizer.

Article 22. Implementation of the entitlements represented in the collateralizer and fulfillment of the obligation secured by the collateral

22.1. A transferor of a collateralizer shall be obligated to notify the pledger in writing of the transfer of the collateralizer, providing the name and address of the new legal holder of the collateralizer and the place to which subsequent payments on the obligation should be made.

22.2. The pledgee shall be obligated to transfer the collateralizer to the person under the obligation secured by the collateralizer after the complete fulfillment of the obligation secured

by the collateral by such person. However, if the obligation has been partially fulfilled, a comprehensive and clearly understandable record of partial payments must be provided by the pledgee to the pledger and all persons that may become future owners of the collateralizer. Except for obligations which by their terms are to repaid in installments, an appropriate entry should be made in the collateralizer about the partial fulfillment of the obligation.

22.3. If the collateralizer is with the pledgee such obligation shall be considered as unfulfilled except the cases specified in article 53.4 of this Law.

22.4. A person under the obligation secured by the collateralizer shall be obligated to properly fulfill the obligation secured by the collateralizer or the partial payment obligation along with the schedule before the legal owner of the collateralizer or the person who informed in a written way of his/her power to implement the legal owner's rights.

22.5. If the collateralizer pledged as collateral, the executor of the obligation shall fulfill his/her obligation as stated in article 52 of this Law.

22.6. A person under the obligation secured by collateralizer has right to refuse from implementing such obligation on the following grounds:

22.6.1. The court is proceeding with the claim to consider the deal of transferring the entitlement to the collateralizer as invalid or to regulate the consequences arising out of such invalidity;

22.6.2. The executor of the obligation are not be bound by the obligation in the case when the procedure on issuance of the collateralizer or issuance its copy is violated;

22.6.3. The executor of the obligation is considered as having fulfilled his/her obligation.

22.6.4. The collateralizer is a legally void or voidable obligation under the provisions of the Civil Code.

22.7 The executor of the obligation secured by the collateralizer shall have no right to refuse the implementing obligations other than the grounds stated in article 22.6 and in the collateralizer.

22.8. Unless this law specifies otherwise or the legal holder proves otherwise, the collateralizer is with the person with an obligation under it or with the registering organization, then the obligation secured by the collateral shall be presumed as fulfilled. The person obtained such collateralizer into his/her possession shall immediately inform the other bodies mentioned above of this event.

22.9. If the collateralizer becomes invalid according to this Law, the registering organization shall take measures to prevent it to enter in any transactions other than its liquidation by putting a notice "expired" and put stamp on the front side when receives such collateralizer.

Article 23. Restoration of the entitlement to a lost collateralizer

23.1. A person under the obligation secured by the collateralizer shall restore the entitlement to the lost collateralizer on the following grounds:

23.1.1. The rights of the legal owner of lost collateralizer can be restored, when the person registered in the state registry as a pledgee as stated in article 21 shall send an application on the name of the person stated in 23.1 of this Law;

23.1.2. By the court decision discussed and issued by a special procedure on determining the legally significant documents in accordance with the Civil Procedure Code.

23.2. A person under the obligation secured by the collateralizer shall produce a copy of the collateralizer with a notice "copy" and submit it immediately to the registering organization.

23.3. The registering organization shall provide an official copy of the collateralizer to the person who lost the collateralizer.

23.4. The copy of the collateralizer must be fully consistent with the lost collateralizer and the person who produced such copy shall be liable for the damages caused by the requirements.

23.5. A person under the obligation secured by the collateralizer does not have the right to refuse to fulfill the claims made by the legal owner of the collateralizer to implement his/her rights on the grounds that the copy of the collateralizer is inconsistent with its original.

CHAPTER FOUR STATE REGISTRATION OF THE COLLATERAL

Article 24. Registration of the collateral in the state registry

24.1. The state registry shall be maintained by the organization of state registration of the real estate.

24.2. The collateral agreement shall be registered by the state registration agency of the place where the real estate is located.

Article 25. Procedure for registration of collaterals in the state registry

25.1. The collateral created by the agreement shall be registered based on an application by either the pledgee or pledger.

25.2. The following documents shall be submitted to the state registration agency for the registration of the collateral created by the agreement:

25.2.1. Collateral agreement and its copy;

25.2.2. Documents listed as attachments to the collateral agreement;

25.2.3. Evidence of payment of state stamp fee;

25.3. The registration of the collateral created by law shall be done without a special application and without payment of state stamp fee.

25.4. State registration of the collateral created by law shall be done simultaneously with the registration of ownership rights that are secured as an obligation by the collateral of the specific real estate. The right of the pledgee created by law can be evidenced by the collateralizer.

25.5. If the right of the pledgee is evidenced by the collateralizer, the following documents shall be submitted to the state registration agency in addition to those specified in 25.2 of this Law:

25.5.1. Collateralizer or its copy satisfying the requirements specified in 19.1 of this Law other than the information on the registration of the collateral in the state registry;

25.6. If the pledgee is changed due to transferring the primary obligation or contract right, the registration shall be done based on the joint application of the previous and new pledgees.

25.7. The state registration agency shall register the collateral in the state registry within 3 working days after the receipt of the documents specified in 25.2, 25.5 and 25.6 of this Law. Such date of recording shall be deemed as the date of the registration of the collateral in the consolidated state registry.

25.8. The sequence of the entitlements registered in the state registry shall be in order of submission of applications for registration.

25.9. The collateral with regard to third parties shall be deemed as created from the moment of the registration in the consolidated state registry.

Article 26. Refusal or postponement of the registration of the collateral

26.1. In case of the grounds specified in this Law and Law on State Registration of property ownership rights and related entitlements, the state registration agency may refuse the registration of the collateral.

26.2. The registration of the collateral may be postponed for no more than one month in the following cases:

26.2.1. Failure to submit to the state registration agency any of the documents specified in 25.1, 25.2, 25.5, and 23.6 of this Law;

26.2.2. The agreement, collateralizer, and their attachments do not meet the requirements specified in the legislations;

26.2.3. There is a need for verification of the authenticity of submitted documents.

26.3. In case of the decision to postpone the registration, the state registration agency shall demand the submission of the required documents or the correction of identified violations and if its claims are not fulfilled during the specified period shall refuse the registration of the collateral.

26.4. If the ownership rights related to the property as collateral item or the issue on whether to allow it in transactions is disputed at the court, the state registration shall be postponed until the court decides the dispute.

26.5. The state registration agency shall inform the pledger the reasons for refusal to register the collateral within the period established by law to register it.

Article 27. Entries for the registration of the collateral and proof of the registration

27.1. The following information must be included in the entries for the registry of the collateral:

27.1.1. The first pledgee;

27.1.2. Item of the collateral;

27.1.3. Amount of principal obligation secured by collateral.

27.2. If the collateral agreement provides that the rights of the pledgee are to be determined by the collateralizer, the entry for the registration of the collateral must include this fact.

27.3. The state registration of the collateral shall be made by making an appropriate entry in the collateral agreement or, if the entitlements to the collateral were created in accordance with law an appropriate entry shall be made in the document evidencing the status of the pledger obligated by the collateral as the owner. This entry must include the full name of the organization registered in the state registry, registration date, location, and registration number and officials completing them shall sign on this document and put the stamp (seal).

27.4. If the rights of the pledgee are certified and evidenced by the collateralizer, the state registration agency shall enter the full information specified in 19.1.10, 19.1.13 and 27.3 of this Law in the collateralizer.

27.5. The state registration agency shall keep in its archives the copy of the real estate collateral agreement, if the entitlements to the collateral were created by law, copy of the

document evidencing the creation of ownership rights of the pledger, and, if the rights of the pledgee are certified by the collateralizer, the copy of collateralizer and its attachments.

Article 28. Procedure for making corrections, amendments and changes in the state registration of the collateral

28.1. If mistakes of a technical nature occurred in the entries of the state registry of the collateral do not cause damages to third parties and do not damage their legal interests, they can be corrected based on an application from either of the pledger or pledgee after sending mutual notifications.

28.2. If any changes or amendments in the conditions of the agreement of the collateral are introduced, the state registration agency shall make relevant changes or amendments in the entries of the registry of the collateral based on the agreement entered by the pledgee and pledger.

28.3 If the pledgee and pledger entered into the collateral agreement after registering the collateral created by law in the state registry, relevant amendments must be made in the previous registry of the collateral.

28.4. In the cases other than those specified in 18.2 of this law, if the rights of the pledgee are certified by the collateralizer, then any amendments or changes in the state registry of the collateral shall be prohibited.

Article 29. Service fee

29.1. Unless this Law states otherwise, the state stamp fee according to the Law on the State Stamp Fee shall be paid for the registration of the collateral agreement in the state registry and obtaining of an appropriate document on the registration in the state registry.

Article 30. Closing the state registration

30.1. The collateral shall be terminated based on the request of the legal owner of the collateralizer or on the joint request of the pledgee and the pledger, or on the decision of the court, arbitration court, or independent court. The pledgee shall be obligated to provide to the pledger a written document agreeing to termination of the collateral agreement no more than 30 days after the date on which the obligation secured by the collateral agreement is paid in full.

30.2. When the entries of the state registry on the collateral are closed due to the termination of the collateral, the collateralizer shall be considered as invalidated. Such invalidated collateralizer shall be transferred to the person who was obligated before by it at his/her demand.

Article 31. Public openness of the state registry of the collateral

31.1. The state registry of the collateral shall be open to the public.

31.2. Any interested person shall have the right to obtain from the state registration agency information on the existence of entries of the registration of the collateral as well as obtain official copies of the entries of the registration of the real estate.

31.3. The state registration agency shall not disclose a copy of the collateralizer stored in the archives.

Article 32. Submission of claims related to the state registry of collateral

32.1. An interested party may submit the claim to the administrative court if the state registration agency refuses or avoids registering the collateral in the state registry, refuses to provide the collateralizer to the first pledgee, or refuses to introduce corrections, amendments and changes in the entries of the registry of the collateral, or closes the entries of the collateral by violating the established procedure, or registers nonexistent items as the collateral, or refuses to implement the procedures specified in Article 28 of this Law, or takes other actions incompatible with the Law on the State Registration Agency.

Article 33. Liabilities of the state registration agency

33.1. The state registration agency that registered or was obligated to register the collateral shall be obligated to rectify the damages caused by its illegal actions or non-actions such as:

- 33.1.1. Ungrounded refusal to register the collateral in the state registry;
- 33.1.2. Ungrounded refusal to enter corrections, changes or amendments in the entries of state registration;
- 33.1.3. Exceeded delay of the time established for completion of state registration by law;
- 33.1.4. Violation of the requirements specified by law on the content of entries of state registry, and other mistakes;
- 33.1.5. Failure to issue a collateralizer or a substitute;
- 33.1.6. Illegal closing of the registration entries;
- 33.1.7. Ungrounded refusal to take actions specified in Article 31 of this Law.
- 33.1.8. If a false registration was made or if there are other lawful grounds.

CHAPTER FIVE PROTECTION OF THE COLLATERALIZED PROPERTY BY THE AGREEMENT

Article 34. Use of the collateralized property by a pledger

34.1. The pledger of the collateralized property by the agreement shall retain his/her rights to use it *subject to the obligations of the pledger to preserve and maintain the property established by this law. The pledger and pledgee may agree that the property will be used for a specific purpose.*

34.2. Unless the agreement states otherwise, the pledger shall use the collateralized property according to its purposes and shall be prohibited from impairing the property during use and reducing its value in excess of normal depreciation and wear.

34.3. The pledger shall have the right to obtain income and benefits of the collateralized property. Unless the collateral agreement states otherwise, the pledgee shall not have a right to acquire such income and benefits.

Article 35. Maintenance and repair of the collateralized property

35.1. Unless the collateral agreement states otherwise, the pledger shall maintain and protect the collateralized property and be responsible for the costs incurred to the current and capital repair of it until the termination of the collateral according to law and other legal acts and if the term of such service is not specified, it shall be provided in an appropriate term.

Article 36. Insurance of the collateralized property and liability insurance of the executor of obligations

36.1. If the law states, the collateralized real estate shall be covered by property insurance and the executor of obligations shall be covered by liability insurance on a mandatory basis.

36.2. In all cases except specified in 36.1 of this Law, whether the collateralized real estate to be insured under property insurance and the executor of obligations under liability insurance shall be determined by the agreement of parties.

36.3. If the event stated in the agreement of property insurance of collateralized real estate or in the agreement of liability insurance of the executor of the obligations happens, the insurer shall take measures according to articles 170.3 and 170.4 of Civil Code and the pledgee shall have the prerogative right to have its claims satisfied from the insurance compensation in a priority order.

Article 37. Measures to prevent damage or destruction of the collateralized property

37.1. The pledger shall be obligated to take measures specified in law and other legal acts and the collateral agreement to ensure the protection of the insured property, including the protection from illegal actions by other persons and unexpected contingencies. If such measures are not specified, he/she shall be obligated to take measures that suit to the regular claims.

37.2. The pledger must immediately notify the pledgee about the emergence of a real danger of destruction or damage to the collateralized property.

Article 38. Protection of the collateralized property from threats of third parties

38.1. If the claims made by independent parties regarding the recognition of ownership and other entitlements to the collateralized property or the release and separation (under their possession) of the property, or other claims lead to such consequences as reduction of the value or deterioration of the property, the pledger shall be obligated to immediately inform the pledgee of such events.

38.2. The pledger who has received relevant claims submitted to the court, arbitration shall be obligated to involve the pledgee in the case.

38.3. In case specified in 38.1 of this Law, the pledger shall protect his/her rights as specified in 9.4 of the Civil Code. If the pledger refuses to protect or does not protect his/her rights to the insured property, the pledgee shall have the right to use the aforementioned means on behalf of the pledger without a special power-of-attorney and demand the compensation of costs incurred in its regard.

38.4. If the collateralized property by the agreement has gone under illegal possession of third parties, the pledgee shall have the right to act on his/her behalf and demand, in accordance with 90.2, 106.1 and Article 95 of the Civil Code, in order to transfer the property from the illegal possession of others into the possession of the pledger.

Article 39. Right to inspect the collateralized property

39.1. Upon prior notice to the pledger the pledgee shall have the right to inspect the quality, state and conditions of maintenance of the collateralized property through a documentary or physical inspection conducted during normal business hours. This right of pledgee shall equally apply to the property, if the pledger has temporarily transferred it into the possession of third parties.

39.2. The pledgee shall not cause improper obstructions to the rights of the persons owning the collateralized property to use this specific property during inspection.

Article 40. Creation of rights of the pledgee resulting from improper protection of the collateralized property

40.1. The pledgee shall have the right to demand the fulfillment of the obligations secured by the collateral before the deadline in the following cases:

40.1.1. The pledger has violated the procedure for the protection, maintenance, repair and use of the collateralized property;

40.1.2. The item of the collateral is under threat of destruction due to failure to take measures to prevent such destruction and damage;

40.1.3. The collateralized property is not insured and ungroundedly refused to have the collateral item to be inspected.

40.2. The pledgee shall have the right to demand from the collateralized property, if the pledger refuses to satisfy the aforementioned claims within the period specified in the agreement, or within the period of one month following written notice from the pledgee regarding the specific nature of the violation given as provided in paragraph 55-1.1 of this law, if the agreement does not state a particular period.

Article 41. Consequences of destruction and damage of the collateralized property

41.1. Unless the agreement states otherwise, the pledger shall be liable for the risk of accidental destruction and damage of the collateralized property.

41.2. If the collateralized property is insured according to the law or the agreement but the conditions of the obligations secured by the collateralized property deteriorate considerably due to damage or destruction of this property, the pledgee shall have the right to demand to fulfill the obligation secured by the monies of insurance compensation before the deadline.

41.3. If the pledgee and pledger have made a written agreement on the restoration or replacement of the damaged or destroyed property and if the pledger has fulfilled in a proper way the provisions of such agreement, the pledgee shall not be entitled to the rights specified in 41.2 of this Law.

CHAPTER SIX

**TRANSFER OF ENTITLEMENT TO COLLATERALIZED PROPERTY AND
CREATION OF OBLIGATION ON THIS PROPERTY BY RIGHTS OF OTHER
PERSONS**

Article 42. Transfer of the item of the collateral into the ownership of others

42.1. Unless the agreement states otherwise, the pledger may transfer the collateralized property by the agreement to other persons through selling, bestowing, trading, investing ways only with the permission of the pledgee.

42.2. In case if the collateralizer was issued, the collateralized property may be transferred in accordance with the provision specified in this collateralizer.

42.3. The pledger shall have the right to bequeath the collateralized property, and any provision of the collateral agreement and other agreements restricting such rights shall be considered as explicitly illegal.

Article 43. Unchanged status of the collateral in the case of transferring entitlement for collateralized property to others

43.1. A person who acquires the collateralized property as a result of transfer into ownership of others, inheritance including reorganization of the legal entity or inheritance, shall become liable for all the obligations created by the collateral agreement but inheritors shall be liable for such obligations only with the value of the collateralized property.

43.2. A new pledger may be exempt from any of these obligations only in accordance with an agreement entered with the pledgee.

43.3. If the collateral item, as specified in 43.1 of this Law has been transferred into ownership of several persons, then each receiver shall be responsible under paragraph 43.1 in proportion to the amount of his allocated portion of the property.

43.4. The collateral of the property shall remain unchanged regardless of any breaches on such transfer during the transfer of the collateralized property by the collateral agreement to others.

Article 44. Consequences of violations on the procedure for transfer the collateral item to others

44.1. If the procedures stipulated in 42.1 and 42.2 of this Law are violated during the transfer of the collateral item to others, the pledgee shall have the right to submit the following claims based on his/her preferences:

44.1.1. consider the transaction on the transfer of the collateralized property to others as invalid and apply the articles 56.5 and 56.6 of the Civil Code;

44.1.2. fulfill the obligation secured by the collateral before deadline and satisfy from it regardless of who possesses the collateralized item.

44.2 In case specified in 44.1.2 of this Law, the person who obtained the collateral item knew or was capable of knowing during such acquisition that the item has been transferred with violation of article 42 of this Law shall be liable jointly with the executor of the obligation to the extent of the amount of the sum of the said property for the liabilities occurring from failure to fulfill the obligations secured by it in a proper way.

44.3 If the pledger, not the executor of the obligation secured by the collateral, transferred the item of collateral by violating the procedure stipulated by law, he/she shall take responsibility jointly with the executor of the obligation, new owner of the property and the previous pledger for such violation.

Article 45. Creation of obligations on the property pledged as collateral by rights of other persons

45.1. Unless the law and the collateral agreement state otherwise, during the period of fulfillment of obligations secured by collateralized property with the provision to use it for original purpose, the pledger shall have the right to lease it without permission of the pledgee, or to transfer to other persons' possession for temporary use without charge, or provide the right to the contract party to use the property on a limited basis (servitude).

45.2. If the pledgee claims for the satisfaction from the collateralized property as specified in law and the agreement, the leasing and other rights provided by the pledger without the permission of the pledgee as specified in 45.1 shall be terminated after effective sale of said property satisfied the claim.

45.3. If the pledger uses the collateralized property longer than the period for fulfillment of the obligations secured by the collateral or uses for purposes other than its original purpose the pledger shall obtain permission from the pledgee.

45.4. Unless the collateral agreement states otherwise the use of the collateralized property by third parties shall not exempt the pledger from the obligations by the agreement.

45.5. The procedure stipulated in Chapter 7 of the Law shall apply to the obligations on the property by other collateral.

Article 46. Consequences of enforced satisfaction from the collateralized property

46.1. If the ownership right of the pledger regarding the property end in accordance with grounds and procedures specified by law due to mobilization, confiscation or nationalization for the state and regional needs of the real estate collateral, the pledger is awarded another property or a relevant compensation, and in such case, the entitlement for the collateral shall apply to such awarded property, and the pledgee shall have the advantage of satisfying his/her claims from the amount of the compensation awarded to the pledger.

46.2. The pledgee whose interests are not fully protected by the rights specified in 46.1 of this Law shall have the right to demand the fulfillment of the obligations secured by the collateral before the deadline, or demand the satisfaction from the property awarded to the pledger instead of confiscated property.

46.3. If the item of collateral is confiscated for state property by a court decision due to a crime or other acts of violation of law by the pledger, the collateral shall remain valid and the procedures specified in Article 43 of this Law shall apply in such cases. However the pledgee whose interests are not fully protected by the application of this procedure shall have the right to demand the pledger to fulfill the obligations secured by the collateral before the deadline, or appeal for a court for the satisfaction from the seized property.

Article 47. Consequences of satisfaction from the collateralized property from illegal possession

47.1. If the real owner of the collateral item released it from the illegal possession of the pledger due to the violation specified in the article 33.8 of this Law by the state registration agency, the entitlements to the collateral regarding such property shall end. In this case, the pledgee shall have the right to demand the fulfillment of obligations secured by the collateral and the pledger and state registration agency shall jointly be obligated to fulfill such obligations after the effectiveness of a relevant decision of the court.

CHAPTER SEVEN SEVERAL COLLATERALS OF ONE REAL ESTATE

Article 48. Several collaterals of one real estate and their provisions

48.1. The collateralized real estate (previous collateral) by the agreement with the purpose of securing the fulfillment of one obligation may be pledged as collateral (next collateral) to secure the fulfillment of obligations of the previous or the next executor shall take responsibility to fulfill the obligations before the previous or the next pledgee.

48.2. The sequence of pledgees shall be determined based upon the state registry of the dates of creation of entitlements to the collateral, according to 25.6 of this Law.

48.3. The next agreement can be concluded if it is not prohibited by the previous collateral agreement.

48.4. If provided that the next collateral agreement must be concluded by conditions specified in the previous collateral agreement, then the said conditions shall be applied.

48.5. By the claim of the previous pledgee, the court may consider the next agreement as an invalid if conclusion of such agreement prohibited in the article 48.3 of this Law without regard to knowledge of the next pledgee.

48.6. If the next collateral agreement contravened the conditions specified in the previous agreement, but there is no prohibition to make the next collateral agreement, the court shall satisfy the claims of the previous pledgee by the provision of the amount specified in the previous collateral agreement.

48.7. If the pledgee and pledger of the previous and the next agreement are same persons, the procedure stipulated in 48.5. and 48.6. of this law shall not apply.

48.8. The collateralizator shall not be an item of the next collateral.

Article 49. Notification of the previous and next collaterals, amendments to the previous agreement

49.1. The pledger shall be obliged to inform to each next pledgee of all effective collaterals specified in 12.1. of this Law when making the agreement.

49.2. If the pledger does not fulfill this obligation and in all other cases except the pledger proves that the next pledgee knew or was allowed to know about the previous collateral, the next pledgee shall have the right to terminate the agreement of collateral and demand compensations for incurred damages.

49.3. The pledger who makes a next collateral agreement shall be obliged to immediately inform of this to the pledgees of the previous agreements and inform about the next agreement stated in 12.1. of this Law by their requests.

49.4. Unless the previous agreement specifically provides for an increase of the amount of the claim secured by the collateral agreement or extension of the collateral agreement to new claims of the previous pledgee, the amendments regarding the satisfaction of a new claim of the previous pledgee or the increase of amount of claim secured by this agreement shall be made only with permission of the pledgee of the next agreement.

49.5. If the pledgee and pledger of the previous and the next agreement of collateral are same persons, the procedure stipulated in this Article shall not apply.

Article 50. State registration of the next collateral

50.1. The state registration of the next collateral shall proceed in accordance with the procedures specified in Chapter Four of this Law.

50.2. A record on entries of the previous collateral registration of a particular real estate shall be put in the next collateral agreement. All following collaterals of this property shall be recorded in the entries of registration of the previous collateral.

Article 51. Satisfaction of claims of pledgees regarding the previous and next collaterals

51.1. The claims of the next pledgee are to be satisfied in advantage from the sum of the property pledged as collateral only after the claims of the previous pledgee satisfied. The collateral agreement of the previous pledgee and rights against the collateralized real estate shall remain in full force and effect until the claim of the previous pledgee is paid in full.

51.3. The obligation secured by the previous and next collaterals may be demanded simultaneously for satisfaction from the property pledged as collateral before the schedule for satisfaction of claims secured by the next collateral.

51.4. The pledgee of one real estate with several collaterals shall be obliged to inform in a written way to other pledgees about his/her intention before demanding from the property pledged as collateral.

51.5. If the previous and the next pledgee and pledger are same persons, the procedure stipulated in articles 51.1-51.4 of this Law shall not apply.

51.6. Unless the law and the agreement state otherwise, the claims are set forth to satisfy from each collateral, the sequence of the schedule to fulfill the obligation shall be applied.

CHAPTER EIGHT

ALLOTMENT OF COLLATERAL ENTITLEMENTS

COLLATERALIZATION AND TRANSFER OF COLLATERALIZER

Article 52. Allotment by entitlements by the collateral agreement or the transfer of obligations secured by the collateral

52.1. Unless the agreement prohibits, the pledgee may transfer his/her rights to others by the collateral agreement or by the obligation secured by this collateral.

52.2. The person who receives the rights by the collateral agreement shall implement the rights and obligations of the previous pledgee of such agreement. Unless proven otherwise, the allotment of entitlements by the collateral agreement shall be considered as the allotment of rights of obligations secured by the collateral.

52.3. Unless the agreement states otherwise, the person who receives the rights of obligations shall receive the right to demand satisfaction of fulfillment of obligations. Such person shall implement rights and obligations of the previous pledgee of the collateral agreement.

52.4. The contract on transfer of right of obligations secured by the collateral shall be completed in a same format as the contract that determines the primary obligations secured by the collateral as specified in 123.8 of the Civil Code.

52.5. The norms stipulated in 123.2.-123.4. of the Civil Code on the transfer of the rights to claim shall be applied in the relations arising between a person who receives the right and the pledgee.

Article 53. Transfer of rights by the collateralizer

53.1. The transfer of rights specified in the collateralizer can be done by endorsement (notation) of the legal owner made directly on the collateralizer. The right to claim (cession) shall be accompanied with the transfer of rights specified in the collateralizer.

53.2. The person transferring the rights specified in the collateralizer shall make the endorsement in the collateralizer about the new owner. If a new owner is an individual, then the family name, father's (mother's) name and given name, if a legal entity, the name shall be included fully in the collateralizer.

53.3. Such endorsement shall be signed by the pledgee documented in the collateralizer. If the entries of the collateralizer are not original, the owner of collateralizer documented in the previous record shall put signature on this record.

53.4. With the transfer of rights in the collateralizer to other persons, all entitlements verified by this the collateralizer, including the rights of the pledgee and creditor (executee of obligations) of the obligation secured by the collateral shall be considered as being transferred to such persons without regard to the rights of the first and next owners of such collateralizer.

53.5. Unless otherwise disclosed by the transferor of the collateralizer to the transferee, with the transfer of rights in the collateralizer related to the primary obligations to be fulfilled partially and secured by the collateral, the completion of relevant obligations that need to be fulfilled until the transfer of the collateralizer shall be presumed satisfied.

53.6. If the right of the owner in the collateralizer is based on the last endorsement made by the previous owner of the collateralizer, then the new owner shall be considered as a legal owner. If the collateralizer was obtained from the possession of the person who produced the endorsement of transfer against the will of its owner or by its exploitation, such person shall not be considered as a legal owner of the collateralizer without regard to whether he/she knew or was supposed to know.

53.7. The entries in the collateralizer that prohibit the transfer to others shall be considered as explicitly illegal.

53.8. If an independent body completed fully the obligations of the executor secured by the collateral as specified in 210.4. of the Civil Code, such person shall have the right to demand the transfer of the rights in the collateralizer to himself/herself. If the pledgee refuses such demand, the independent body may apply for a court to satisfy his/her demand.

53.9. A transfer of the collateralizer by endorsement may be made solely for purposes of pledge of the rights under the collateralizer as provided in article 54 if such limitation is noted in the endorsement.

Article 54. Collateral of the collateralizer

54.1. The legal owner of the collateralizer may pledge it as collateral to others (pledgee of the collateralizer) as a guarantee to fulfill his/her obligations.

54.2. If the collateralizer is pledged without a transfer to the pledgee, then its transaction shall be done by the procedure specified in article 158 of the Civil Code.

54.3. When collateralizer is pledged to the pledgee, the parties may stipulate following provisions in the pledge agreement:

54.3.1. Satisfaction from the collateralized property by the procedure stipulated in article 158 of the Civil Code;

54.3.2. Transfer of rights in the collateralizer in accordance with provisions and procedure specified in Article 51 of this Law;

54.3.3. The special record shall be made in the collateralizer that provides the pledgee with the right of selling the collateralizer or retaining the collateralizer, collecting the payments of the pledger and applying such payments toward repayment of the obligation to which the collateralizer was pledged.

CHAPTER NINE SATISFACTION FROM THE COLLATERALIZED PROPERTY

Article 55. Grounds for satisfaction from the collateralized property

55.1. The pledgee shall have the right to apply for satisfaction of the claims occurred from failure to fulfill or improper fulfillment of obligations secured by the collateral specified in

Article 6 of this Law, including unpaid or not fully paid monetary payments are to be paid fully or partially from the collateralized property unless the contract states otherwise.

55.2. If the provisions of the claims applied for a satisfaction from the collateralized property do not correspond with provisions of the collateral agreement, the provisions of that agreement shall apply.

55.5. The pledgee shall have the right to demand the fulfillment of obligations secured by the collateral before the deadline in conditions specified in articles 40, 44 and 46 of this Law. If such demand is not satisfied, the right to claim from the collateralized property shall be applied even when the obligation secured by the collateral of is being fulfilled.

Article 55-1. Notice of Default and Demand for Payment

55-1.1. As a condition of demanding repayment of the entire claim prior to maturity and taking action to terminate the pledger's rights to the collateralized property the creditor shall send to the pledger a written notice of default which shall include:

55-1.1.1. identification of the mortgage contract and the mortgaged property;

55-1.1.2. a description of the specific nature of the default and actions that must be taken by the debtor to cure the default;

55-1.1.3. a statement that failure to cure the default will result in a demand that the entire claim be repaid and steps taken to enforce the pledgee's rights under the collateral agreement;

55-1.1.4. the time allowed to cure the default before the repayment of the claim is demanded;

55-1.1.5. the name and contact information of a representative of the creditor that the debtor may contact to obtain further information; and

55-1.1.6. such other material as the pledgee deems relevant.

55-1.2. The debtor shall have not less than 30 days from the date of receipt to respond to the notice of default.

55-1.3. If the pledger has not responded to the notice of default within the time allowed the pledgee shall record with the state registry and send the pledger and all third parties holding registered interests in the property a notice of intention to enforce the collateral agreement which shall include all of the information included in the notice of default and in addition:

55-1.3.1. a statement that the entire claim is due and payable;

55-1.3.2. the amount due, including the amount of interest on the debt which will accrue for each day that the claim remains unpaid;

55-1.3.3. the time in which the claim must be paid;

55-1.3.4. a statement that failure to pay the claim will result in termination of the debtor's right to the collateralized property;

55-1.3.5. a description of actions that must be taken by the debtor to prevent termination of his interest in the collateralized property;

55-1.3.6. a description of the methods that may be used to sell the property;

55-1.3.7. the name and contact information of a representative of the pledgee with whom the pledger may request a meeting; and

55-1.3.8. such other information as may be deemed relevant by the pledgee.

55-1.4. *If within 30 days of the date notice is given under paragraph 55-1.3 the pledger has not responded to the notice of intention to enforce the collateral agreement, the pledgee may commence steps to sell the collateralized property as provided in this law.*

Article 55-2. Notices Given and Received

55-2.1. *For purposes of this law a notice is considered received by the pledger if it is sent by certified mail to the address of the collateralized real estate, or to the address of the executor of the collateralized obligation provided in the collateral agreement if that is different than the address of the collateralized real estate. Any notice sent to the executor of the collateralized obligation shall be sent also to the pledger of the real estate if that is a different person.*

55-2.2. *Notice is considered received by any third party if sent by certified mail to the third party's address as recorded in the state registry, or if no such address can be found or notices are returned undelivered, if publication of the notice is made in the local organ for publication of legal notices in accordance with the applicable procedures. For purposes of this law, third parties holding a registered interest in the collateralized property include any person or legal entity registered in the state registry as the holder of an interest in the collateralized property.*

Article 55-3. Right to a Meeting

At any time prior to completion of sale of the collateralized property the debtor may request a meeting with a representative of the pledgee, and the pledgee shall provide such meeting at its offices during normal business hours prior to proceeding with sale of the collateralized property. The debtor may be represented at such a meeting by a third party. The rights of the creditor to proceed with sale of the collateralized property shall not be prejudiced or delayed for failure to agree to an accommodation proposed by the debtor at such a meeting.

Article 56. Procedure of bringing claims to the court on satisfaction from the property pledged as collateral

56.1. In cases other than those stated in article 60 of this Law, as the claims to be satisfied without bringing the matter to the court, the claims of satisfaction from the collateralized property by the collateral agreement may be brought to the court.

Article 57. Jurisdiction of the dispute regarding the satisfaction from the collateralized property by the collateral agreement

57.1. Claims regarding the satisfaction from the collateralized property by the collateral agreement shall be brought in accordance with the case jurisdiction stated in the Civil Procedure Code.

Article 58. Protection of interests of the pledgee, absent pledger and other persons

58.1. If the pledger claims for a satisfaction from the collateralized property by two or more contracts, the proof of fulfillment of duty to inform other pledgees stated in 51.4. of this Law shall be submitted to the court, where the claims are brought.

58.2. The court received the claims on satisfaction shall inform relevant persons and organizations that are known from the materials of the case submitted by the parties the fact that the collateral had to be done or be permitted by other persons and organizations and summon them to the hearings of the case.

58.3. Persons authorized by the law and the agreement on usage of the collateralized property (renters, tenants, family members of the owner of the apartment, and other persons) and

persons with material authorization regarding the property (servitude, lifetime use and other) shall have the right to participate in the court hearings of the case to satisfy from the property pledged as collateral.

Article 59. Matters to be decided at the court hearings of the case to satisfy from the collateralized property

59.2. The court decision on the satisfaction from the collateralized property by the collateral agreement shall specifically include the following matters:

59.2.1. The monetary sum, payment share, amount of money and payment schedule required to pay to the pledgee from the price of the collateralized property other than expenditures incurred from the protection and sale of the property until the complete sale of the collateralized property.

59.2.2. The name, type and appraisal of the collateralized property from which the claims of the pledgee can be satisfied;

59.2.3. Means of sale of the collateralized property required to satisfy payments;

59.2.4. The initial price of selling the collateralized property by public auction, which shall be determined on the basis of a valuation of the property performed by an independent property valuer chosen by the pledgee and shall not be less than 80% of such appraised value.

59.2.5. If there is an urgent need, the measures and costs to protect the collateral item until the retail, shall be paid from the price of disposal of such property.

59.3. The court shall have the right to postpone the sale of the property 59.3.1. in accordance with the provisions of the Code of Civil Procedure; or. in accordance with the provisions of article 74.2 of this law if the Item of the collateral is land for agricultural purposes.

59.4 The court shall determine the monetary amount of claims of the pledgee that needs to be satisfied from the collateralized property at the moment of expiration of postponement period of claims when determining the period of postponement of claims to sell the collateralized real estate.

59.5. The rights and obligations of parties secured by the collateralized real estate shall not change during the postponement of the period to sell the property pledged as collateral. The executor of the obligation shall not exempt from the obligation of compensating the interests and penalty fees to the executee of the obligation for the damage incurred during the postponed period.

Article 60. Settling the claims of satisfaction from the collateralized property by non-judicial procedures

60.1. The activities on satisfying the claims of the pledgee from the collateral item by non-judicial procedures shall be regulated by the law and by the collateral agreement concluded between parties. Non-judicial procedure may include sale of the collateralized real estate by the pledgee by means of competitive bidding activity or direct sale by the pledgee. Election of sale by competitive bidding activity does not prevent subsequent sale by other permitted methods.

60.2. With regard the next collateral agreement, the non-judicial sale of the collateralized property shall be considered as valid if it was concluded with participation notice to and consent of the pledgee of the previous collateral agreement.

60.3 The claims of the pledgee can not be satisfied by non-judicial procedure in an existence one of the following grounds:

60.3.1. There was a requirement to obtain a permission from other persons or organizations when pledging the property as collateral;

60.3.4. State and socially important historical, artistic, cultural and other valuable items that registered or need to be registered in the state registry are items of collateral;

60.4. The court shall decide the question of satisfying from the collateralized property in the cases specified in 60.3.1-60.3.4 of this Law.

60.5. The parties need to include the following matters when making the contract on the satisfaction of the claims of the pledgee as stated in article 60.1. of this Law:

60.5.3. Means to sell the collateralized property or conditions of the pledgee to obtain such property;

60.5.4. Previous and next collaterals of a particular property that was apparent to the parties at the moment of making the deal, material and exploitation rights of third parties regarding this property.

60.6. The collateral agreement for satisfying the claims of the pledgee shall include the following additions to those specified in article 60.5 of this Law:

60.6.1. Sale of the collateralized property by competitive bidding activity in accordance with the procedure specified in Article 63 of this Law;

60.6.2. Negotiated sale of the collateralized property directly by the pledgee, which may include Transfer of the collateralized property to the possession of a third party as a professional legal entity that specialized on trading real estate for purposes of selling the property.

60.7. Prior to any sale of the collateralized property by non-judicial methods the pledgee shall establish the value of the property by valuation of an independent property valuer.

CHAPTER TEN

SALE OF THE COLLATERALIZED PROPERTY BY DEMAND OF A RELEVANT PERSON

Article 61. Sale of the collateralized property

61.1. In order to satisfy the claims of the pledgee from the collateralized property, the process of the sale of such property shall be proceeded by the court decision or by the non-judicial (contract) procedure in accordance with the grounds specified in law.

61.2 In cases other than those specified in this Law, the collateralized property shall be sold by the court decision by a forced auction.

61.3. Unless this law states otherwise, the forced auction shall be organized by the procedure stipulated in the Civil Code, the Civil Procedure Code and Law on Enforcement of Court Decisions.

61.4. The court may issue the decision on the satisfaction from the property pledged as collateral by the request of the pledgee to sale the collateral item by a procedure stipulated in Article 63 of this Law.

61.6 The article 197 of the Civil Code and this Law shall determine the procedure of a sale of collateralized property by an auction. However, if the laws state otherwise, the agreement on satisfying the claims of the pledgee by non-judicial procedure shall determine such procedure.

61.7 If collateral item is an entitlement related to real estate, such entitlement shall be sold and allotment of such entitlement shall be formalized by the procedure stipulated in this Law.

Article 62. Negotiated Sale

62.1. A pledgee may sell the collateralized property to an unaffiliated third party by negotiated sale for a reasonable price under current market conditions.

62.2. After payment of the obligation and all costs and expenses permitted to be claimed by the pledgee under this law, the pledgee shall be liable to the pledger or to next pledgees, in their orders of priority, for the difference between the actual sale price of the property and 90% of the market value of the property as determined by the independent property valuer, less any surplus proceeds of the sale actually paid to the pledger or such next pledgees.

62.3. Any claim of the pledgee against the pledger for payments in excess of amounts obtained from negotiated sale of the property shall be reduced by the difference between the actual sale price of the property and the property valuation as determined by the independent property valuer.

62.4. Sale may be by advertisement or listing with a firm licensed to trade in real estate. If sale is made through a broker a broker's commission not exceeding the usual and customary amounts for such commissions may be included in the costs of sale.

62.5. Not less than 30 days prior to completion of the sale the pledgee shall give to the pledger and to any third party holding an interest in the collateralized property which is registered in the state registry a notice of the sale which shall include a statement of the amount of the pledgee's claim; the valuation of the property; the material terms of the contract of purchase and sale to be executed by the pledgee; the date for completion of the sale; the intended distribution of proceeds of the sale; and a statement of the recipient's right to terminate the sale of the property within the permitted time in accordance with the provisions of this law.

Article 63. Auction of the collateralized property

63.1. Public auction of the collateralized property shall be organized by an independent professional legal entity specialized on trading real estate matters chosen by the pledgee.

63.2. Unless the contract states otherwise, the auction shall be organized open and relations concerning to this auction shall be regulated by the procedure stipulated in article 197 of the Civil Code.

63.3. The record specified in article 197.20 of the Civil Code and the contract specified in article 197.23 of the Civil Code shall be the grounds for registration of the rights of the new owner in the state registration.

63.4. The auction stated in article 63.2 of this Law shall be announced as not conducted on the following conditions:

63.4.1. There has been no competition;

63.4.3. The winner has not transferred the price of purchase to the specified account within the period specified in the contract;

63.5. The announcement of the auction that has been not conducted shall be published in the same newspaper, where published the first announcement within the next two working days after completion of any one of the aforementioned conditions.

63.6. The pledgee has the right to obtain the collateralized property calculated by its initial selling price within ten days since the announcement of the any auction that has not been

conducted by the agreement entered with the pledger. But the final calculation needs to be made by the amount of claims or price secured by the collateral. The pledgee has the right to credit against the purchase prices the amount of the outstanding obligation.

63.7. If the pledgee stated in article 63.6. of this Law does not enter an agreement to obtain the collateral item for him/herself, the auction shall be reorganized no further than one month since the organization of the first auction. If the auction is reorganized by provisions stated in 63.4.1 of this Law, the price of the item of collateral shall be the auction starting price reduced by ten percent. The reorganization of the sale shall proceed in accordance with 63.2 of this Law.

63.8. The creditor may bid at auction sale and be credited with the amount of its claim. An auctioneer other than the creditor may not bid for its own account but may bid on behalf of the creditor. If the auction stated in 63.7 of this Law was held unsuccessful, the pledgee shall have the right to obtain the collateralized property instead of his/her claims by the starting price of the first auction reduced no more than 20 percent.

63.9. The pledgee who purchased the real estate as collateral item or obtained from the calculation satisfying his/her claims in accordance with articles 63.2, 63.6-63.8 of this Law shall apply the procedure of a sale and purchase contract stipulated in the Civil Code and the collateral entitlement shall cease by this contract

63.10. If the pledgee does not implement the right specified in article 63.8 of this Law, the collateral entitlement shall cease.

Article 63-1. Rights of third parties prior to sale

63-1.1. At any time up to 5 days prior to the announced date of the auction sale or completion of the negotiated sale of the property, and at any time prior to the date on which the pledgee takes title to the property under paragraphs 63.6 or 63.8 of this law, the pledger or any party holding an interest in the property registered in the state registry may terminate the sale of the property by tendering to the pledgee in cash or other good funds the full amount of its claim. In the event that more than one party tenders payment to the creditor, the pledger shall be preferred over third parties, and third parties shall be preferred in the order of their registered priorities. Except for the pledger, any party which terminates sale of the property by paying to the pledgee the amount of its claim shall succeed to the rights of the pledgee under the collateral agreement.

Article 63-2. Contract of Purchase and Sale

63-2.1. Upon completion of the auction or negotiated sale the pledgee shall execute and deliver a contract of purchase and sale to the collateralized property, together with an affidavit suitable for recordation in the state registry which shall include: the names and addresses of the pledgee and pledger; the address and land registry recordation data of the collateralized property; the land registry recordation data of the pledgee's collateral agreement; and a statement that a sale was conducted in accordance with the provisions of this law. The contract of purchase and sale is deemed to be executed by the pledgee as attorney in fact for the pledger and shall have the same legal effect as if issued by the pledger.

Article 63-3. Termination of the Mortgage and Other Interests in the Property

63-3.1. Issuance of a contract of purchase and sale by the pledgee to a purchaser (including the pledgee where the pledgee purchases the title) or public sale of the mortgaged property by the court terminates the collateral agreement, all rights of the pledger to the collateralized

property, unregistered interests in the collateralized property, and rights of any third parties which were registered subsequent to the collateral agreement. Interests in the collateralized property which are registered in the state registry prior to registration of the collateral agreement survive unless satisfied or otherwise terminated prior to registration of the contract of purchase and sale.

63-3.2. The registered title of a purchaser of the collateralized property in good faith under this law shall be conclusive and shall not be disturbed.

Article 63-4. Rights of pledger prior to sale

63-4.1. At any time up to actual sale of the property by the pledgee a pledger shall have the right to terminate the pledgee's action to sell the property by payment of the amount of any unpaid installments due on the obligation, any fees or penalties due for late payment under the collateral agreement, and the costs and expenses incurred by the pledgee on account of the pledger's default; provided, however, that this right may be exercised only once in any period of 12 consecutive months, and only 2 times over the entire term of the loan, and otherwise the sale of the property may be terminated by the pledger only upon payment of the entire outstanding principal balance of the obligation, together with all interest due, any fees or penalties due for late payment under the collateral agreement, and the costs and expenses incurred by the pledgee on account of the pledger's default.

Article 63-5. Appeals to court to suspend or terminate non-judicial sale

63-5.1. A pledger may bring an action in the court of first instance to stop or delay non-judicial sale of the mortgaged property by the creditor only on the grounds that:

- 5) the claim is legally void or voidable;*
- 6) the collateral agreement is legally void or voidable;*
- 7) the claim is not due for payment or is paid in full;*
- 8) the procedures for sale provided in this law have been violated.*

63-5.2. The debtor bears the burden of presenting evidence in support of its challenge.

63-5.3. A challenge to the valuation of the collateralized property or a starting sale price shall not be grounds for suspending or terminating the sale, but shall be grounds for claim of damages against the pledgee.

63-5.4. Upon request of the pledgee, the court in its discretion may require that a person challenging a non-judicial sale of property provide a bond or other surety, in an amount to be determined by the court, but not to exceed the amount of the claim, to protect the pledgee against loss or damage caused by suspension or termination of the sale.

Article 65. Distribution of monetary assets that emerge from the sale of the collateralized property

65.1. The claims of the pledgee stated in article 6 of this Law shall be distributed in accordance with articles 216 of the Civil Code and 51 of this Law after the deduction expenditures related to the sale of such collateralized property and remaining monetary assets shall be given to the pledger.

65.2. The distribution stated in article 65.1 of this Law shall be administered by following authorities:

- 65.2.1. The organization enforcing the court decisions, if collateralized real estate was sold by judicial procedure*

65.2.2. The pledgee or professional Organizer of the auction, if collateralized real estate was sold by non-judicial procedure.

65.3. If the item of real estate collateral that is demanded for satisfaction is the state- or municipally owned local property, the monetary assets emerging from its sale shall be distributed in accordance with article 65.1 of this Law and remaining shall be transferred to the relevant budget.

CHAPTER ELEVEN SPECIFIC NATURE OF COLLATERALIZATION OF LAND

Article 66. Land that can be an item of collateral

66.1 According to the law, land other than those prohibited or restricted from entering the civil transactions, land owned by Mongolian citizens and entitlement for land possession may be pledged as collateral and it can be pledged as collateral only by the Mongolian citizens and legal entities on the conditions specified by law.

66.2. If the land is transferred by a rent contract or by other entitlement contracts to citizens or legal entities, the person who obtained such entitlement may pledge the land within the period of the entitlement under the permission of land owner. Notwithstanding the foregoing sentence, any right of lease for a term exceeding [10] years or right of land use for an indefinite term may be mortgaged by the holder of the right without the consent of the state or municipal entity which owns the land, but only for the remaining term of such lease or right of land use. In such case the holder of the right of lease or land use shall provide to the owner written notification of the collateral agreement within 30 days of its execution.

66.3. If the land or its possession entitlement specified in 66.1. of this Law is in a shared ownership of collective owns, such share owner may pledge the part allocated to him/her as collateral.

Article 67. Land prohibited from collateral

67.1. Land being in a state or local ownership shall be prohibited from collateral. In addition, the land of private ownership can not be pledged as collateral to foreign citizens, stateless persons and foreign legal entities and foreign countries.

Article 68. Collateral of land of buildings and structures owned by the pledger

68.1. Unless the collateral agreement states otherwise, the entitlement to collateralization of land shall not apply to buildings and structures or being built buildings and structures that are located on that particular land owned by the pledger or third parties.

68.2. In case of a claim for satisfaction from land if the contract provides that the pledger is an owner or possessor of buildings and structures or being built buildings and structures located on this particular land which are not collateralized, shall have the right to use a part of the land required for exploitation of such buildings and structures according to their purposes on a limited basis. The contract made between the pledgee and pledger shall determine the provisions of limited use of the aforementioned part of the land. The court shall settle the disputes.

68.3. The pledger of land shall have the right to exploit without the permission of the pledgee the buildings and structures of his/her ownership on such land to which the entitlement to collateral does not apply as specified in 68.1. of this Law.

68.4. If the land from the agricultural land pledged as collateral, on which located buildings and structures including the objects of the collateral that are firmly connected with such land belong to the owner of such land, then the collateralization of such land shall be recognized only if those objects are pledged as collateral concurrently.

Article 69. Collateral of the land obtained by assets of a loan or a purposeful borrowing

69.1. Unless the law and the contract state otherwise, the land obtained by credit assets of a bank and other credit organizations or by assets of a purposeful borrowing for land provided from other legal entities for the purpose of obtaining such land shall be considered pledged as collateral from the moment of registration in the state registry of the borrower's entitlement to such land provided that the registered document or ownership clearly refers to the existence of the collateral right, the identify of the pledgee and the amount of the credit. If this land is rented, or unless the rent contract and the law state otherwise, the renting right shall be considered pledged as collateral.

69.2. The pledgee of the land may be a bank, other credit organization or other legal entity that provides purposeful borrowing for obtaining the land or its renting right.

69.3. The collateral of land and its renting rights created by the grounds specified in 69.1. of this Law shall be implemented in accordance with the procedure specified in the collateral agreement or the contract of its renting rights as collateral.

Article 70. Collateral of the land of buildings and structures obtained or built by asset of a loan or a purposeful borrowing

70.1. Unless the law and the contract state otherwise, the collateral of the land of buildings and structures and its renting rights obtained or built by assets of a loan from a bank or other credit organization or by assets of a purposeful borrowing provided from other legal entity with the purpose of construction of buildings and structures shall be considered as created on the following grounds:

70.1.1 The ownership right of the owner as the borrower of buildings and structures built or being built is registered in the state registry.

70.1.2. The state registration agency accepts along with the contract the notification on the establishment of a credit or a purposeful borrowing contract between the pledgee and pledger.

70.2. The pledgee stated in 70.1. of this Law shall be the bank, other credit organization, or the legal entity that provides credit or purposeful borrowing for the construction of a building and structure.

Article 71. Construction of a building and structure by a pledger on the collateralized land

71.1. Unless the relevant contract states otherwise, the pledger shall have the right to construct buildings and structures on the collateralized land by the collateral agreement without the permission of the pledgee. Unless the collateral agreement states otherwise, such collateral shall not apply to those buildings and structures.

71.2. If the buildings and structures built by the pledger on the land pledged as collateral worsen or have the possibility to worsen the guarantees provided to the pledgee by the collateralization of such land, the pledgee shall have the right to demand the amendments to the collateral agreement or demand the application of the collateral to such buildings and structures.

Article 72. Collateralization of the land under the buildings and structures owned by third parties

72.1. If the collateralized land belongs to the pledger, but the buildings and structures on it do not belong to the pledger, but to the ownership of a third party, then in case of a claim of the pledgee to satisfy from the land and sell such land, the ownership rights and duties of the pledger as a owner shall be transferred to the person who obtained such land.

Article 73. Requirement for land border map

73.1 The copy of the land border map and plan of the land organization issued from the organization in charge of land resources and organization shall be attached to the agreement on collateralization of land on a mandatory basis.

Article 74. Specifics of satisfaction from the collateralized land and its sale

74.1. The collateralized land for agricultural purpose shall be prohibited to be satisfied until the completion of the relevant periodical phases of agricultural works required to process and reprocess products of agriculture are over. Unless the collateral agreement states another date, this requirement shall be valid until the first of November of the year adopted to fulfill the obligation or its relevant part secured by the collateral.

CHAPTER TWELVE

SPECIFICS OF COLLATERALIZATION OF INDUSTRY, ITS BUILDINGS AND STRUCTURES

Article 75. Collateralization of an industry, its buildings and structures with the land

75.1. If an industry as a property complex (hereinafter as “industry”) is pledged as collateral, the entitlements to such collateral shall apply to all properties that belong to that particular industry.

75.2. Particular buildings and structures shall be considered pledged as collateral if the land on which located such buildings and structures or the renting rights of the pledgee for such land or a part of such land that satisfies the purpose of objects are concurrently pledged as collateral by one agreement.

75.3. If the pledgee possesses the entitlement to regularly use the land on which located buildings and structures, the entitlement to the collateral shall not be applied to him/her. If the person who acquires into his/her ownership such industry, its buildings and structures as property claims for satisfaction, the entitlement to use the land, on which located industry with conditions and amounts exercised by the previous real estate owner or the pledger shall be obtained.

Article 76. Collateralization of an industry as a property complex

76.1. The industry with assets belonging to it may be pledged as collateral as a property complex under the permission of the owner or its competent organization. If the agreement on collateralization of the industry contravenes this requirement shall be considered as explicitly illegal.

76.2. Unless the agreement states otherwise if an item of the collateral is an industry, its material and non-material properties (assets), including buildings, structures, equipment, furniture, raw materials, finished products, rights to claims and exclusive rights shall belong to the property complex pledged as collateral.

76.3. A composition of the property complex that belongs to particular industry that is transferred as collateral and its appraisal shall be determined based upon the complete registration of such property. The inventory act, accountancy balance sheets, and the conclusion and appraisal of property complex belonging to the industry made by an independent auditor shall be attached to the agreement on a mandatory basis.

76.4. If the law provides that the making appraisal is obligatory, the report on the appraisal of the properties belonging to the industry shall be attached to the agreement on a mandatory basis.

Article 77. Obligations that may be secured by collateralized industry

77.1. An industry may be pledged as collateral as a property complex on the following grounds:

77.1.1. The monetary amount of obligation that needs to be satisfied shall equal to the monetary sum no less than fifty percent of the appraisal of properties of the industry;

77.1.2. An industry shall be pledged as collateral to secure the relevant monetary obligation that needs to be fulfilled after the period of no less than one year since making of the collateral agreement;

77.2. If the agreement provides that an industry is pledged as collateral to secure the obligations to be fulfilled in a period shorter than one year, the pledgee shall have the right to demand the satisfaction from the item of collateral to secure the obligations that are unfulfilled or not fulfilled in a proper way after expiration of one year since making of the collateral agreement.

Article 78. The right of the pledger regarding the collateralized industry

78.1. The pledger shall have the following rights regarding the industry pledged as collateral:

78.1.1. Sale, trade, rent, give for a borrowing and other administration of properties belonging to the industry transferred as collateral;

78.1.2. If the price of property complex specified in the collateral agreement belonging to the industry is not decreased or other conditions of the agreement are not contravened, the amendments can be made to such property complex.

78.2. Unless the collateral agreement states otherwise, the pledger shall not have the right to transfer the properties belonging to the industry as collateral and to make the deal on the transfer of real estate into the ownership of others without permission of the pledgee.

78.3. If the value of the industry decreases due to failure of the pledger of the industry to take measures to protect the collateralized property and use it effectively, the pledgee shall have the right to demand the satisfaction of the obligation secured by the collateral before the deadline or demand the adoption of supervision on the collateral regarding the activities of the pledger, and appeal to the court.

78.4. The pledgee may be provided with following authorities by the court decision regarding the supervision of the collateral:

78.4.1. Request to submit regularly the documents of accountancy and other reports and agree in advance on the matters relating to the making of the deals relevant to the properties belonging to the industry as collateral;

78.4.2. Demand to terminate the labour contracts made between the owner of the properties belonging to the industry or its authorized organization and the administration of the industry;

78.4.3. Claim to a court on the invalidation of deals made with the pledger;

78.4.4. Other rights provided by the law and the agreements regarding the supervision of the collateral on the pledger's activity.

Article 79. Satisfaction from the collateralized industry

79.1. If the pledger does not fulfill or does not properly fulfill the obligations secured by the collateralized industry, satisfaction of claims on the fulfillment of obligations from the collateralized property shall be decided only by the court.

79.2. The buyer of the industry through a forced auction shall receive the rights and obligations of the last owner of the industry since the registration of ownership rights of the acquired property in the state registry.

CHAPTER THIRTEEN SPECIFIC NATURE OF COLLATERALIZATION OF A HOUSING UNIT

Article 80. Collateralization of a housing unit

80.1. The procedure stipulated in this Charter shall be applied for collateralization of housing units owned by individuals and legal entities.

80.2. State- or municipally-owned housing units shall not be pledged as collaterals.

80.3. Hotels, rest houses, summer dwellings, and garden houses as well as other buildings and structures that are not designed for permanent residence may be pledged as collateral according to the general procedure. The procedure specified in this Chapter shall not apply to pledging such buildings and structures as collaterals.

80.4. If a housing unit becomes an item of collateral, the procedure specified in this Chapter shall apply to this collateral.

80.5. While pledging as collateral a housing unit owned by a person in care and support who is not legally capable fully or whose legal capability is limited or by an underage person, who is entitled to care and sustain, the procedure specified by the law of Mongolia shall be applied in making transactions related to the property owned by such person receiving care.

Article 81. Collateralization of a housing unit in a multi-units residential building

81.1. While pledging as collateral a housing unit in a multi-units residential building, which is under partial and shared ownership of the pledger and other persons, the part in shared ownership right of the pledger shall be considered pledged as collateral in addition to this housing unit .

Article 82. Collateralization of a housing unit under construction

82.1. The collateral agreement may specify that the fulfillment of the obligation to be secured by an unfinished building or by materials and equipment of the pledgee for construction of such building while issuing a loan and purposeful borrowing for construction of a housing unit. The collateral shall not end after the completion of the construction of such housing unit.

Article 83. Collateralization of a housing unit acquired by a loan of a bank or other credit organization

83.1. Unless the law and the agreement state otherwise, the ownership rights of the borrower owning a housing unit acquired or built by credit assets of a bank or other credit organization

or by a purposeful credit assets provided from other legal entity with the purpose of obtaining or building such housing unit or by their participation shall be considered as collateralized at the moment of registration of the ownership right in the consolidated state registry. The bank and other credit organization or legal entity who provided a credit or purposeful borrowing for the purpose of obtaining and building such housing unit shall be the pledgee of the collateral.

83.2. The procedure on the collateral created by the agreement shall be accordingly applied as adopted in 82.1. of this Law when pledging the housing unit as collateral .

83.3. The sponsors and sustainers of an organization of support and sustenance shall have the right to provide the permission to transfer or give to ownership as collateral the housing unit where a family member of the owner or underage person left without a parental supervision resides and he/she being supervised and sustained by sponsors and sustainers if the rights and interests protected by the law of such person are not contravened.

83.4. The decision on the issuance or refusal of the permission with reasons specified in 83.3. of this Law shall be informed in a written way to the person who requested the permission within thirty days since the receipt of the request to obtain the permission. If there are disputes on such decisions, shall be decided by the court.

Article 84. Claims on the satisfaction from the collateralized housing unit

84.1. The satisfaction from the collateralized housing unit and its sale follows occurrence of following legal consequences:

84.1.1. The entitlement to use the housing unit by the pledger and other persons residing in this housing unit shall be terminated if the collateral of the housing unit was created by the agreement or by the law as a guarantee to pay back the credit or the purposeful borrowing provided for the purposes of obtainment, building, major repair, or other means of improvement of such housing unit from the bank, other credit organization or other legal entity;

84.1.2. Credits and purposeful borrowings previously provided for obtainment and construction of the housing units shall be repaid.

84.2. The housing unit that is under the satisfaction shall be vacated in accordance with the procedure stipulated by law.

84.3. The demand to satisfy from the collateralized housing unit shall be decided by judicial or non-judicial procedures specified in Chapter Nine of this Law.

84.4. The contract to rent or lease the housing unit established under the permission of the pledger before or after the occurrence of collateral shall be valid after the sale of such housing unit. Such contract may be terminated by the grounds and procedure specified in the Civil Code and housing legislations.

CHAPTER 13-A

PROTECTION OF CONSUMERS

Article 84-1. Protection of Consumers

84-1.1. At least five days prior to making a loan secured by a mortgage on a housing unit for purposes of acquiring, improving or constructing the housing unit, a pledgee shall provide the executor of the loan obligation in writing and in plain language the following information:

(k) Identification and address of the pledgee and any intermediary acting for the pledgee;

(l) The purposes for which the loan may be used;

- (m) A description of the payment terms of the loan, including the amount and frequency of payments, the allocation of payments to principal and interest, respectively, and the place and method of payment;
- (n) With respect to loans on which the interest rate may be changed from time to time (variable interest rate loans), a description of the formula by which the interest rate will be changed and the frequency of change;
- (o) A calculation of the entire cost of the loan to the borrower over the stated duration of the loan, assuming no prepayment, distinguishing between principal and interest and in the case of variable interest rate loans a description of the assumptions underlying the interest calculation and a statement that actual interest paid could be more or less than disclosed;
- (p) A good faith estimate of other costs related to the loan to be paid by the borrower, including the pledgee's administrative costs, insurance premiums, legal, notary and registration fees, and appraisal fees;
- (q) Whether the borrower has the right of early repayment (prepayment) of all or any portion of the loan, and if so, any conditions imposed on early repayment;
- (r) Whether a valuation of the property is necessary and, if so, by whom it will be carried out;
- (s) A summary of the main terms of the collateral agreement securing the loan, including any restrictions on use or disposition of the property and the obligations of the borrower for maintenance and insurance of the property;
- (t) An unambiguous statement that failure to repay the loan could result in loss of the mortgaged property and a description of the steps may be taken by the creditor to enforce the collateral agreement in the event of the borrower's failure to meet his obligations.

84-1.2. The Financial Regulatory Committee and the Bank of Mongolia may by joint regulations prescribe the form and content of the written notice to be provided to consumers under this article, and where so prescribed a notice provided under this article shall be in that form and shall be considered void if not in that form, provided that no such notice shall be considered void on the grounds of technical defects alone in the absence of material harm to the recipient. No notice given under this article shall be considered defective because of discrepancies between costs estimated diligently and in good faith under subparagraphs (e) and (f) of paragraph 84-1.1 of this article and costs actually incurred.

CHAPTER FOURTEEN CLOSING GROUNDS

Article 85. Effectiveness of this Law

84.1. This law shall become effective on

Signature

**ANNEX I: POWER POINT PRESENTATION: MORTGAGE BOND AND ASSET
BACKED SECURITIES LAWS FOR MONGOLIA**

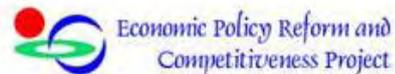
ANNEX I: POWER POINT PRESENTATION: MORTGAGE BOND AND ASSET BACKED SECURITIES LAWS FOR MONGOLIA



MORTGAGE BOND AND ASSET BACKED SECURITIES LAWS FOR MONGOLIA

Steve Butler
Legal Advisor

June 28, 2007
Ulaanbaatar, Mongolia

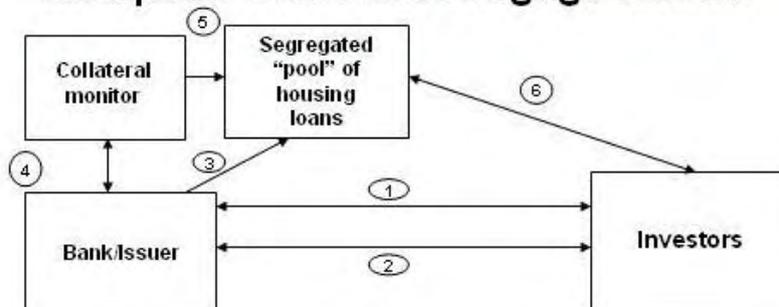


“European Style” Covered Mortgage Bonds

- General obligation of the issuer
 - Loans remain on balance of issuer – no capital relief
- Separation of mortgage collateral assets from other assets and operations of issuer; collateral registers
 - Independent trustees/auditors supervise collateral pool
- Legal pledge of loan collateral - absolute preference for bond holders
- Automatic removal of collateral from the bankruptcy estate of issuer
 - Modern trend: assurance of continuation of collateral pool and servicing of bonds even after bankruptcy of issuer
 - Quality standards for loan assets
- “Balance Principles” – value, yield and duration of collateral must equal value, yield and duration of bonds



European Covered Mortgage Bonds



1. Bank sells bonds, assumes general liability for payment of principal and interest
2. Bondholders purchase bonds, receive principal and interest payments from bank
3. Housing loans remain on balance of mortgage bank but are segregated in separate register or "pool" which is equal in value to the amount of the bonds
4. Bank or banking regulator appoints independent "trustee" to monitor compliance with law
5. Trustee periodically audits value of the collateral pool
6. Bondholders have direct, preferred access to collateral in case of failure to pay or bankruptcy of issuer

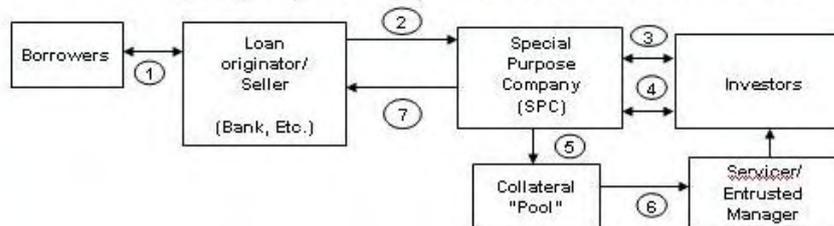


Mortgage (Asset) Backed Securities

- "Non-recourse" to issuer – depends solely on assets for repayment
- Sale of assets to special purpose company – restricted activities
 - "Off balance sheet" treatment for assets, subject to accounting conventions – capital relief for banks
 - "Pass through" accounting and taxation
- "Self liquidating" assets and securities – principal repayments "passed through" to investors as received
- Not just housing loans – credit card and trade receivables, auto loans, equipment leases, etc.
- Limited asset quality standards – not as high quality as covered bonds
 - Assets excluded from bankruptcy estate of issuer – accounting conventions
- Special bankruptcy and liquidation procedures – supervised by FRC



Mortgage (Asset) Backed Securities



1. Originating bank makes housing loans, borrowers pay principal and interest
2. Originating bank sells loans to special purpose company, "without recourse"
3. SPC sells securities (bonds, equity certificates, notes, limited partnership interests, etc.) to investors; SPC obligated to pay principal and interest on securities from cash flow of loans
4. Investors pay for securities, receive principal and interest payments from cash flow from loans
5. SPC pledges loans to investors as collateral, or sells common ownership (participation) interests
6. Servicer/Entrusted manager takes possession of and manages collateral for benefit of investors
7. SPC pays originator/seller of loans from proceeds of sale of securities



Why two laws?

- Similar instruments, but enough differences to make two laws necessary
- Convenience and transparency
- Special status of the collateralized bond



Other needed initiatives – primary market

- Is the civil code sufficient to support mortgage lending?
- Non-judicial power of sale – does it violate civil rights?
- Law on valuation – is it necessary?
- Law on credit reporting



Other needed initiatives – secondary market

- Law of trust ownership – third party administration of property
- Law on secured transactions with moveable property – intangibles, contract claims, rights, etc.
- Concept of collateralized bonds – not tied to company capital – simple amendments
- Concept of “pass through” securities – FRC regulation