

MONGOLIA

Diagnostic Review of Consumer Protection and Financial Literacy

Volume I Key Findings and Recommendations

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A World Bank mission visited Mongolia from June 4-14, 2012 to prepare a Diagnostic Review of Consumer Protection and Financial Literacy (CPFL)¹. As the second part of the overall CPFL assessment, a nationally representative Financial Literacy Survey was launched end of June 2012 providing information on saving and borrowing behavior of individuals, prevailing levels of understanding of basic financial concepts, awareness of financial consumer rights, patterns of household budget management, and usage of financial services.

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¹ The CPFL Review is part of the World Bank Program on Consumer Protection and Financial Literacy, which seeks to identify key measures in strengthening financial consumer protection to help build consumer trust in the financial sector—and expand the confidence of households to wisely use financial services. CPFL Reviews against Good Practices have been conducted by the World Bank in both middle as well as low income countries. These include Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Kazakhstan, Latvia, Lithuania, Malawi, Mozambique, Nicaragua, Romania, the Russian Federation, South Africa, Slovakia, Tajikistan and Ukraine.

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Abbreviations and Acronyms

AFCCR	Agency for Fair Competition and Consumer Rights
AMI	Association of Mongolian Insurers
ATM	Automatic Teller Machine
BoM	Bank of Mongolia
BIS	Bank for International Settlements
BSD	Banking Supervision Department of the BoM
CCB	Code of Conduct for Banks of the MBA
CGAP	Consultative Group to Assist the Poor
CP	Consumer Protection
CPFL	Consumer Protection and Financial Literacy
DGF	Deposit Guarantee Fund
DPSLA Law	Law on Deposits, Payment Settlements and Loan Activities
EC	European Commission
ETT	Erdenes Tavan Tolgoi
EU	European Union
FI	Financial Institution
FRC	Financial Regulatory Commission
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPO	Initial Public Offering
IT	Information Technology
LSE	London Stock Exchange
MASD	Mongolian Association of Securities Dealers
MBA	Mongolian Bankers Association
MCA	Mongolian Consumers Association
MNT	Mongolian Tughrik
MoE	Ministry of Education
MoF	Ministry of Finance
MoJ	Ministry of Justice
MoU	Memorandum of Understanding
MSCH&CD	Mongolian Securities Clearing House and Central Depository
MSE	Mongolia Stock Exchange
NGO	Non-governmental organization
OECD	Organization for Economic Cooperation and Development
POS	Point of Sale
SME	Small and medium sized enterprise
SML	Securities Markets Law
SRO	Self regulatory organization
T+3	3 days after trade date
UK	United Kingdom
WB	World Bank
YoY	Year-on-year

Currency Equivalents

US\$1 = 1,370.35 MNT (August 26 2012)

Executive Summary

1. The Diagnostic Review for Consumer Protection and Financial Literacy (CPFL) provides a detailed assessment of the institutional, legal and regulatory framework in three segments of the financial sector: banking, securities and insurance. The mission took place in response to a request for WB technical assistance in the field of financial consumer protection made by the Ministry of Finance (MoF) in January 2012. The field assessment has focused on the banking and securities sectors. In addition, a desk review of the insurance sector was conducted with follow-up validation of the findings with the Insurance Department of the Financial Regulatory Commission (FRC).

2. CPFL is particularly relevant to Mongolia, where access to formal financial services has been growing fast over the past decade, and particularly accelerating in the last two years. CPFL also plays an important role in ensuring the prudent growth of the financial system. This is relevant to Mongolia where recent credit growth has been rapid despite the history of banking crises, and may well continue along the present steep trajectory following the discovery of large mineral deposits. Moreover, government's recent decision to distribute shares of Erdenes Tavan Tolgoi (ETT) to the population of Mongolia highlights the importance of a robust CPFL framework.

3. The Review consists of two Volumes. Volume I summarizes the key findings and recommendations of the Review and Volume II presents a detailed assessment of each financial segment compared to the Good Practices for Financial Consumer Protection². The key findings and recommendations presented in Volume I cover six areas: 1. Institutional Arrangements, 2. Legal and Regulatory Framework, 3. Disclosure, 4. Business Practices, 5. Dispute Resolution Mechanisms, and 6. Financial Education. Priority recommendations are outlined in Table 1, while a full list of key recommendations is included in Chapter VII.

4. Regarding the institutional arrangements, the capacity of Bank of Mongolia (BoM) and FRC in financial consumer protection needs to be further strengthened to ensure improved monitoring of financial institutions' compliance with legal requirements and enforcement in case of violations of market conduct regulations. Furthermore, a coordination mechanism for financial consumer protection is needed to provide for effective coordination between all regulatory and supervisory agencies in order to arrive at a clear consensus among all concerned of the appropriate rights and responsibilities of all agencies in respect of consumer protection in the banking, insurance and securities sector.

5. The legal and regulatory framework for financial consumer protection should be further strengthened and overlaps between general consumer protection provisions and sector-specific legislation need to be addressed. As the existing financial consumer protection framework is fragmented and unclear further detailed financial consumer protection provisions should be introduced through amendments of the sector specific laws with relevant provisions. In order to address overlapping jurisdiction over financial consumer protection, considerations should be given to

² Good Practices for Financial Consumer Protection were developed by the World Bank in 2010. They provide a set of good practices using international benchmarks, such as the principles released by the Basel Committee, IOSCO and IAIS, as well as the OECD recommendations for financial education and awareness on pensions, insurance, and credit products. The Good Practices incorporate provisions of directives, laws, regulations and codes of business practices from the EU, United States, Australia, Canada, France, Ireland, Malaysia, Mexico, New Zealand, Peru and South Africa. The Good Practices are used in assessing a country's financial consumer protection regime. Consumer Protection and Financial Literacy Reviews against Good Practices have been conducted by the World Bank in both middle as well as low income countries. These include Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Kazakhstan, Latvia, Lithuania, Malawi, Mongolia, Mozambique, Nicaragua, Romania, the Russian Federation, South Africa, Slovakia, Tajikistan, Ukraine and Zambia.

amending the Consumer Protection Law and the Law on Advertising to exclude the financial sector from their application.

6. Regarding consumer disclosure, consumers should be provided with clear, understandable and timely information. For example, consumers could be provided with a standardized ‘key facts statement’ that summarizes in plain language the key terms and conditions of any financial product or service. In addition, a glossary of standard financial terms developed by BoM and FRC in cooperation with the industry associations would be helpful. The BoM and FRC could also ensure that useful comparative information is made available for consumers by establishing a price comparison webpage.

7. In the area of business practices, a number of measures could be taken to ensure fair treatment of consumers. Consumer loan application requirements should be carefully analyzed and considerations should be given to reducing possible unnecessary thresholds for small lending transactions to consumers. Improper conduct of brokers needs to be prevented through higher licensing standards and capitalization for brokers as well as the implementation of strong sanctions for unauthorized trading and misrepresentations by brokers as to their status and the characteristics, profitability and suitability of investments. Moreover, consideration should be given to prohibit coercive tied selling of insurance products.

8. Financial institutions should set up an internal dispute resolution mechanism. They should be required by law to provide for a contact person or unit in charge of receiving and handling complaints, and to ensure that the identity of this person or unit is disclosed to every consumer. The implementation of the provision in the new draft Securities Markets Law (SML) to establish a Dispute Review Board will be extremely important to the fair resolution of retail customer disputes.

9. A coordination mechanism for financial literacy and education is needed. A financial education committee should be set up under the leadership of the MoF consisting of a broad range of stakeholders. The committee should develop a national program on financial education, including tailored financial education programs focusing on reaching low income and also rural populations. Most urgently, the partial privatization of ETT should be accompanied by an extensive information campaign to improve the public knowledge of how the securities market operates.

Table 1: List of Key Recommendations³

Key Recommendations	Responsible	Priority
Strengthen the role of BoM and FRC in financial consumer protection by establishing a new financial consumer protection unit within the BoM separate from prudential regulation and supervision and designated financial consumer protection teams within each supervisory department of FRC	BoM, FRC	High
Establish a financial consumer protection coordinating group consisting of all regulatory and supervisory agencies as well as MoF to provide for effective information sharing and coordination regarding examination, enforcement, and rulemaking of cross-sectoral activities	BoM, FRC, MoF,	Medium
Strengthen the legal framework for financial consumer protection and address overlapping jurisdiction through (1) the issuance of regulations (bylaws) under the existing legislation and/or amendments of the sector specific laws with relevant provisions (2) amending the Consumer Protection Law and the Law on Advertising to exclude the financial sector from their application.	BoM, FRC, MoF	High
Require Key Facts Statements for all basic consumer finance products	BoM, FRC	High
Require banks, insurers and brokers and dealers to have a contact person or unit in charge of receiving and handling complaints, and to ensure that the identity of this person or unit is disclosed to every consumer	BoM, FRC	High
A financial education committee under the leadership of MoF consisting of a broad range of stakeholders should develop a national program on financial education, including tailored financial education programs focusing on reaching low income and rural populations	MoF, BoM, FRC, AFCCR and other stakeholders	Medium
Develop and implement a tailored investor education program dealing with the distribution of ETT shares to the population	MoF, FRC, MASD	High

³ See Chapter VII for a full list of recommendations.

I. Context for CPFL in Mongolia

10. Consumer protection and financial literacy are key to increasing responsible access to financial services. Strong consumer protection ensures that households have access to clear and transparent information about costs, risks and rewards of financial products. Financial literacy equips consumers with the tools needed to make complex financial decisions. Together consumer protection and financial literacy build public confidence in financial institutions, thus encouraging savings and long-term financial investments that promote depth in the financial system. Strong financial consumer protection can also empower the public to demand improved transparency and efficiency in the financial system and thus help to increase competition.

11. CPFL is particularly relevant to Mongolia, where access to formal financial services has been growing fast over the past decade. According to Global Findex Database 2012 already 78 percent of Mongolia's adult population has an account at a formal financial institution. Compared to other countries in East Asia and Pacific, Mongolia far exceeds the regional average (see Table 2). For example, Findex survey results showed that around 61 percent of the Mongolian population has a debit card, compared to around 35 percent in East Asia and Pacific and 10 percent in lower middle income countries.

Table 2: Access to Financial Services in Mongolia

	Adults with Account at a Formal Financial Institution (% , age 15+)
South Korea	93.0
Mongolia	77.7
Malaysia	66.2
China	63.8
Russia	48.2
Kazakhstan	42.1
Azerbaijan	14.9
East Asia & Pacific	54.9
Lower middle income	28.4

Source: Global Findex, 2012

12. CPFL also plays an important role in ensuring the prudent growth of the financial system. This is relevant to Mongolia where credit growth has been rapid and may well continue along the present steep trajectory following the discovery of large mineral deposits. Loans to households increased at the staggering pace of 80 percent from 2010 to 2011, accounting for a third of total loans. In comparison, loans to small and medium sized enterprises (SMEs) have increased by some 65 percent yoy in 2011. Large-scale investments in the mining sector have led to increased capital inflows, resulting in cheap external funding for banks and rapid credit expansion. However, the legal and regulatory framework and enforcement have not kept pace with the expansion of lending.

13. Moreover, government's recent decision to distribute shares of Erdenes Tavan Tolgoi (ETT) to the population of Mongolia highlights the importance of a robust CPFL framework. Although stock market capitalization has been growing by 58 percent by the end of 2011 compared to 2010⁴, a few stocks account for nearly all of the market capitalization and active trading. Retail

⁴ The stock market capitalization has been growing by MNT 794.6 billion or by 58 percent compared to 2010, reaching MNT 2.2 trillion by end-2011.

participation in the securities market remains low. The distribution of wealth to the population through distribution of ETT shares is an important objective. However, it is imperative that all recipients, many of them financially unsophisticated, understand the true value of the assets being distributed.

14. Although the general insurance market in Mongolia has been growing fast (albeit from a low base) the population is facing barriers in their access to insurance products and services. The insurance penetration ratio for Mongolia, which measures premiums written as a share of GDP, accounted for only 0.44 percent in 2011 which is considered low compared to international standards. So far, only one fourth of total population of Mongolia uses insurance services due to lacking household savings as well as incomplete understanding of citizen's regarding insurance products.⁵ However, the new legislation on mandatory motor third party liability insurance, which came into effect on January 1, 2012, will lead to a significant increase in market size. Starting in 2005, the Index-based Livestock Insurance Project⁶, a microfinance program that is now being expanded from pilot to a nationwide initiative attracts a number herder households as new policyholders.

15. It is, therefore, timely for Mongolian authorities to begin to recognize the need to address consumer protection and financial literacy. As a first step, the February 2008 Millennium Development Goals-Based Comprehensive National Development Strategy of Mongolia identifies two major objectives for the financial system: (1) establishing a sound and reliable banking sector and overall financial system; and (2) ensuring a sustainable, healthy and transparent environment for this system in the future. Furthermore, the State Monetary Policy Guidelines adopted in 2011 include the following four objectives, namely (i) to ensure disclosure and transparency of operations of the banking sector; (ii) to further enhance bank supervision; (iii) to enforce good governance principles; and (iv) to tighten financial discipline in the banking sector. In January 2012, the MoF requested the World Bank's assistance with assessing the current legal, regulatory and institutional framework for consumer protection in financial services as well as financial education programs in order to further deepen the financial sector reform and enhance transparency as well as market access for individuals.

⁵ FRC Annual Report 2010

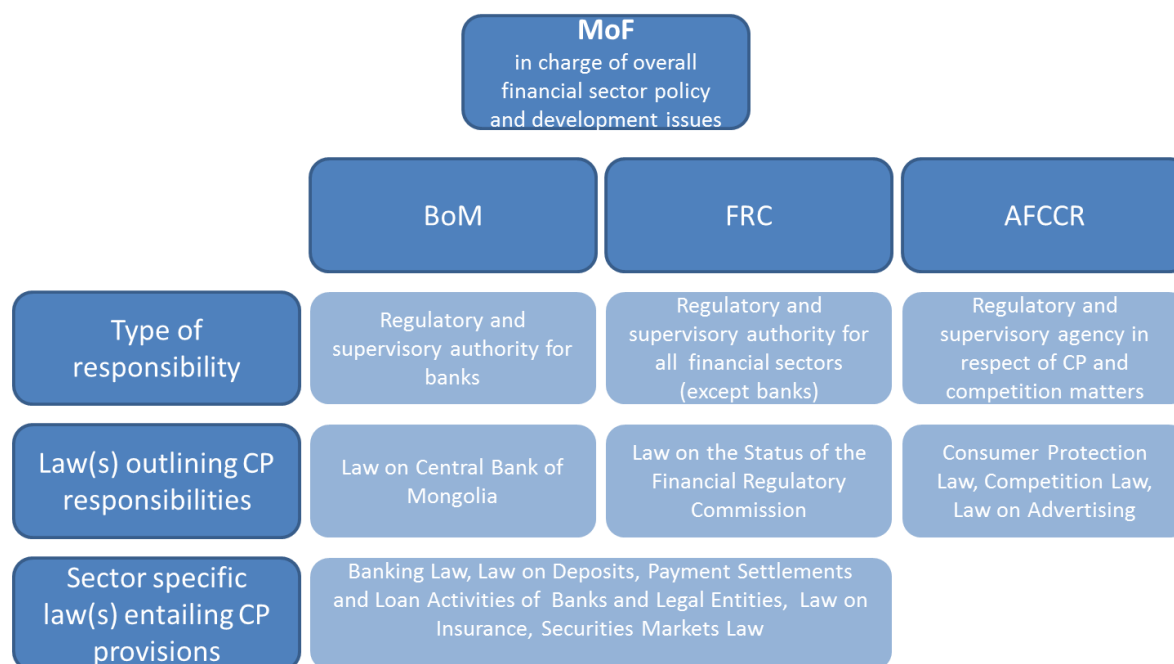
⁶ The Index-based Livestock Insurance Project – supported by the WB - is an indexed life insurance used to cover livestock instead of applications like agricultural yields or weather risks. It is specifically tailored to the country's unique needs and extreme environment.

II. Framework for Financial Consumer Protection in Mongolia

Institutional arrangements for financial consumer protection supervision

16. There are currently three institutions dealing with financial consumer protection in Mongolia. The BoM is the regulatory and supervisory authority for prudential requirements within the banking sector. The FRC regulates and supervises the other sectors of the financial system, including the securities and insurance markets. The Agency for Fair Competition and Consumer Rights (AFCCR)⁷ has the power to issue regulations providing for obligations of institutions, including financial institutions, regarding their treatment of consumers. Furthermore, it has been monitoring banks to assess the degree to which they comply with provisions of various laws and regulations that pertain, in its view, to consumer protection (see Figure1). In addition, the MoF has the responsibility for the overall financial sector policy.

Figure 1: Division of financial consumer protection responsibilities in Mongolia



17. The Law of the Central Bank of Mongolia requires BoM to fulfill its supervisory activities for the purpose of protecting the interests of depositors and customers which – interpreted broadly – gives BoM responsibility for market conduct regulation and enforcement of these rules.⁸ While this provision has traditionally been interpreted narrowly as requiring the BoM solely to ensure financial stability, safety and soundness of the banking sector some seek now to re-interpret this mandate to allow BoM to be *the* agency properly authorized not only to devise rules by means of regulations pertaining to banks’ business conduct towards consumers, but also to supervise the proper application of these rules by all banks. This re-interpretation was even further emphasized by senior BoM counterparts acknowledging

⁷ Mid 2012 the former Authority for Fair Competition and Consumer Protection (AFCCP) was renamed Agency for Fair Competition and Consumer Rights (AFCCR). AFCCR is subordinated directly to the Deputy Prime Minister.

⁸ Article 19 of the Law of the Central Bank of Mongolia.

the need for an enhanced financial consumer protection framework and the establishment of a separate financial consumer protection unit within BoM. While the BoM has responsibility for enforcing the entire spectrum of banking legislation, so far only a few banking-related legal and regulatory provisions deal explicitly with aspects of protecting consumers of banking products or services. However, the BoM's Monetary Policy and Banking Supervision Departments have very recently conducted joint on-site inspections in respect of at least certain standards banks maintain in their dealings with their individual customers. Although, BoM has no explicit statutory power to handle consumer disputes, it has been dealing with individual consumer complaints by providing consumers with a response/advice letter.

18. FRC has a strong mandate to protect consumer rights and interests. The Law on the Legal Status of the Financial Regulatory Commission provides FRC with an explicit mandate to solve disputes between securities dealers/insurance companies and their clients. Moreover, the Law on Insurance of 2004 establishes the protection of the interests of insured persons from malpractice and dishonest actions as a responsibility of FRC. Also, the Securities Markets Law of 2002, and even more so the new draft Securities Markets Law⁹ (draft SML) provide for strong mandates for FRC to protect investor's rights and interests. However, the specific provisions setting forth this mandate in the existing securities law are not well developed. The draft SML contains stronger, more explicit investor protection provisions and gives the FRC the authority to promulgate implementing regulations.

19. The AFCCR is a state agency vested with general authority in respect of matters of consumer protection. However, activities in the area of financial consumer protection have been limited. The AFCCR is vested with explicit powers of enforcement over the Consumer Protection Law, the Law on Competition and the Law on Advertisement. In addition, the AFCCR is allowed to monitor the application of any provision of the Constitution and the Civil Code and any other legislative act issued in conformity with them.¹⁰ Powers of the AFCCR include accepting and resolving consumers' requests and complaints, issuing regulations as indicated above, that set forth obligations of institutions regarding their treatment of consumers, and monitoring the performance of various kinds of institutions in complying with their statutory and regulatory obligations in these respects. Activities of AFCCR in the financial sector have so far concentrated on monitoring of banks in respect of fees and interest rates they charge on consumer and mortgage loans. Although AFCCR has explicit power to deal with complaints it has so far apparently not dealt with the task regarding consumers of financial products and services.

20. Powers of BoM, FRC and AFCCR as regards to consumer protection of financial institutions are overlapping and the division of responsibilities between agencies remains unclear. In line with its very broad enforcement powers, the AFCCR has begun to monitor all banks in respect of such matters as the commitment fees and interest rates they charge on consumer and mortgage loans, and banks contractual compliance with consumer protection provisions.¹¹ The Consumer Protection Law states that the Constitution, the Civil Code *and other acts pertaining to these laws and regulations* have force and effect in relation to protecting consumer rights. Some interpret these words as including any consumer protection or business conduct requirement in any financial services law or regulation. Others, however, maintain that these words should not be interpreted so broadly. Under the Consumer Protection Law "state authorities and specialized inspection agencies have the responsibility to monitor the implementation of consumer rights protection laws and regulations". This wording allows the AFCCR to monitor the implementation of consumer rights protection laws and regulations, but questions have arisen

⁹ Based on the November 2011 draft that was provided by FRC to the mission team.

¹⁰ Competition Law, Article 2.

¹¹ In late 2011, the AFCCR took the questionable position that commitment fees being charged by banks on their consumer and mortgage loans were illegal as being contrary to the Civil Code. The issue of legality was then litigated in the Administrative Court with the result, on appeal, being a vindication of the position of the banks which maintained that such fees were entirely proper.

as to whether it also allows the BoM to do the same, since the BoM supervisor has powers of a state inspector¹².

21. The monitoring and enforcement of the existing financial consumer protection rules are weak due to a limited number of specialized staff and insufficient resources. The AFCCR is under-resourced and underfunded. Its entire staff consists of 33 employees, three of whom are deployed - at least on a part-time basis - in respect of all AFCCR jurisdictional matters concerning Mongolia's financial services industry. With some 50 employees, the existing Banking Supervision Department (BSD) of the BoM has one third more staff than the entire staff complement at the AFCCR. The BoM has, however, no separate unit explicitly charged with responsibility for formulating business conduct regulations, supervising their application and applying penalties, as appropriate, for transgressions. The supervision of securities and insurance markets remains relatively weak, as the capacity of the FRC to supervise these institutions is constrained by a limited number of experienced staff and insufficient resources. The rapid modernization of the securities markets and the enhanced mandate FRC will be provided with under the new draft SML leads to an even increasing workload.

22. Enhanced coordination between the regulatory and supervisory authorities dealing with financial consumer protection will be required to face new regulatory and supervisory challenges. There exists no formal - or even informal - coordination mechanism regarding financial consumer protection. However, as a first step a *Comprehensive Program to Develop the Market Environment for Reducing the Interest Rate* was approved by a Joint Decree of the Governor of BoM, the Minister of Finance, and the Chairman of the FRC. The program entails several goals, some aiming to improve consumer protection and financial education. Moreover, as part of the ongoing upgrade of the regulatory structure of the securities sector, the Law on Banking allows banks to engage in securities markets activity after obtaining a license from the FRC. This will significantly increase the number of brokers operating in the market posing significant regulatory and supervisory challenges.

23. The Mongolian Bankers Association (MBA), the Mongolian Association of Securities Dealers (MASD) and the Association of Mongolian Insurers (AMI) have taken first steps in supporting financial consumer protection. However, all industry associations are lacking financial and human resources to play a strong role. The MBA was established on 1993 but has only been active since 2005. All Mongolian banks are MBA members even though there is no statutory requirement. As of December 2011, 49 securities companies were members of MASD. However, membership is voluntary. As to the insurance sector, the majority of licensed insurers are members of AMI. All three associations have devised voluntary code of conducts. However, the associations reportedly face capacity constraints preventing them from playing a stronger role.

Key Recommendations

24. Consideration should be given to reforming the current institutional set-up for financial consumer protection. The institutional arrangements for financial consumer protection vary across countries. At least a few favor to have prudential and consumer protection supervision allocated within the same supervisory agency.¹³ Others adopt a so-called "twin peaks" approach that entirely separates the functions of prudential supervision from business conduct rule-making and its monitoring and

¹² Law of the Central Bank of Mongolia, Article 25.1.

¹³ This is the case in *Kazakhstan*, where the Agency on Regulation and Supervision of Financial Market and Financial Organizations is statutorily responsible for both the stability of the financial sector and maintenance of financial consumer protection. In *Malaysia*, the Bank Negara Malaysia (central bank) is responsible for both prudential and consumer protection oversight of financial institutions (except securities).

enforcement by establishing a specialized financial consumer protection agency.¹⁴ A third approach is for a general consumer protection agency to also deal with financial products and services.¹⁵ The best model in any given country will depend on country-specific characteristics such as the size and structure of the financial system, its stage of development, specific regulatory and supervisory activities, and prevailing political traditions. Especially in many small and low-income countries capacity and resource constraints call for a flexible and practical approach forward in strengthening consumer protection capacity and oversight.

25. It is of critical importance to further strengthen the capacity of BoM and FRC in financial consumer protection. Given the current capacity constraints the AFCCR faces in terms of resources and financial sector expertise early consideration should be given to strengthen the role of BoM and FRC in financial consumer protection in order to ensure improved monitoring of financial institutions' compliance with legal requirements and enforcement in case of violations of market conduct regulations.¹⁶ This is particularly relevant for FRC where the current acute lack of capacity as well as the planned upgrade of the regulatory structure for the securities sector under the new draft SML needs to be matched by a reasonable level of human and financial resources in the FRC.

26. A suitable and practical way to ensure proper market oversight in Mongolia would be to establish a new financial consumer protection unit within the BoM separate from prudential regulation and supervision¹⁷ and - as an interim step - designated teams within each supervisory department of FRC. Considering the broad range of supervisory responsibilities of FRC and the differences in the legal and regulatory framework as regards to financial consumer protection of the securities and insurance sector, designated teams within each supervisory department responsible for financial consumer protection would be helpful as an intermediate step. In the longer term, FRC should consider establishing separate consumer protection divisions for each department. A training program on consumer protection should be developed for the staff of this new units/designated teams. Having in mind budgetary and human resource constraints, initially these units/designated teams might be established with a limited number of staff and gradually expanded.

27. The unclear delineation of responsibilities between BoM, FRC and AFCCR should be addressed. As a first step, a clear consensus among all concerned of the appropriate rights and responsibilities of the BoM, FRC and AFCCR in respect of consumer protection in the banking, insurance and securities sector should be reached by the signing of comprehensive Memorandum of Understanding (MoU). Secondly, further considerations should be given to allocating all regulatory and supervisory powers for financial consumer protection including the handling of financial sector related consumer

¹⁴ Australia was the first country to set up a so-called 'twin peak' structure where the Market Conduct Regulator is responsible for overseeing the way in which market participants behave, while the other peak – the Prudential Regulator – is charged with overseeing the financial health, safety and soundness of market participants. This approach was followed by the Netherlands. Recent trends in financial consumer regulation point to the development of such specialized agencies, as seen in the creation of the Financial Consumer Agency of Canada (2001), the establishment of the Consumer Financial Protection Bureau in the United States (2011).

¹⁵ This is the case in Brazil, where many basic consumer protection rights are guaranteed in the Consumer Protection Code. The Department for Consumer Protection and Defense (housed at the Ministry of Justice) has oversight over consumer protection in general, including financial consumer protection issues, although the Central Bank of Brazil covers some financial services issues not mentioned in the Code.

¹⁶ International experience shows that general consumer protection agencies typically lack sufficient resources as well as specialized staff with sector-specific knowledge, expertise and experience in order to handle financial services issues properly.

¹⁷ International experience shows that, if a supervisory agency adopts consumer protection as part of its mandate, business conduct supervision should be separated from prudential supervision and have adequate specialized staff and resources to perform its specialized responsibilities effectively in order to avoid conflicts of interest.

complaints among the BoM and FRC. The reason for proposing existing financial sector regulators to house this function is due to their highly specialized expertise and institutional focus on the financial sector.

28. Supervision and enforcement of financial consumer protection provisions need to be further enhanced by using a variety of supervisory tools while at the same time considering the capacity constraints that the supervisory authorities currently face. BoM and FRC should enhance the use of supervisory tools such as market monitoring and off/onsite inspections to monitor and supervise financial consumer protection provisions. Due to capacity constraints a risk-based approach focusing on financial institutions with a high relevance in retail markets could be considered. Periodic monitoring and analysis of complaints received by financial institutions as well as by the BoM and FRC are important tools to help supervisors identify priority areas in which supervisory and regulatory actions deem necessary. In addition, there exist several other supervisory techniques for financial consumer protection such as mystery shopping exercises¹⁸ that check compliance with disclosure, advertising and responsible lending provisions, media monitoring, as well as the analysis of internal reports and procedures of financial institutions¹⁹.

29. In order to streamline the measures that BoM and FRC should undertake individually, a coordination mechanism for financial consumer protection is needed to provide for effective information sharing and coordination regarding examination, enforcement, and rulemaking of cross-sectoral activities. Consideration could be given to the establishment of a financial consumer protection coordinating group, comprising BoM, FRC and MoF to introduce a more strategic perspective on financial consumer protection, define joint priorities and coordinate proposed legal and regulatory changes.

30. Industry associations should play an important role in ensuring that financial institutions comply with a set of standards of service and quality when dealing with their consumers. All industry associations should consider reformulating and updating their respective code of conducts, with regard to actions that its member financial institutions would agree to do voluntarily over and above all statutory requirements in the area of disclosure of information, complaints, product appropriateness, and other areas of business practice. Moreover, it needs to be ensured that all existing Code of Conducts are published widely so that consumers know the standards to which financial institutions have agreed to adhere and therefore, can be held accountable for failure to comply. The draft SML even provides for the creation of formal self regulatory organizations (SROs) with specific statutory powers which can be augmented by the FRC. Many regulatory functions, such as training, qualification tests and disciplinary action can be taken on by these entities.

31. The MCA also needs to be strengthened so that it can play a more effective role in matters of financial consumer protection. Due to its wide focus and lack of resources and specialized training, the MCA is not yet effective in supporting a proper financial consumer protection environment. The MCA could, however, play an important role in raising awareness of financial consumers' rights, monitoring business practices by mystery shopping, and giving advice to consumers, among other tasks. This organization should be involved in consultative processes in consumer protection activity, for

¹⁸ Mystery shopping or a mystery consumer is a tool externally used by market research companies or watchdog organizations or internally by regulators themselves to measure quality of service or compliance to regulation, or to gather specific information about products and services. The mystery consumer's specific identity is generally not known by the establishment being evaluated.

¹⁹ For example reports of internal auditors and compliance officers, complaints statistics and procedures and lending policies.

example drafting regulations, in order to ensure that the voice of consumers is heard during the formulation of financial services policies as well as of the rules that flow from them.

Legal and regulatory framework

32. A minimal legislative and regulatory basis exists for financial consumer protection in Mongolia. A general Consumer Protection Law was enacted in 2003 and then amended in 2008. While this Law makes no explicit reference to the protection of consumers who acquire or seek to acquire a financial product or service, as indicated above, the definitions of “consumer”, “seller” and “contractor” employed in it are broad enough to cover financial institutions and their individual customers. The Consumer Protection Law, however, is very general in scope and focuses mainly on “traditional goods and services.” The Civil Code of Mongolia also includes financial consumer protection provisions in its Chapters on loan and brokerage contracts. The Law on Advertisement (2002) requires the advertisement of activities to be truthful and based on actual indicators. In addition, if an advertisement pertains to a deposit account, the advertisement must include the main terms and conditions of the applicable contract.²⁰ According to the Law on Competition, business entities are prohibited from using commercial methods that are illegal or that unlawfully harm consumers.²¹

33. However, the pertinent general legal framework is fragmented and unclear with overlaps found between general consumer protection provisions and financial sector-specific legislation. For example, the Law on Advertising and the Competition Law have specific provisions dealing explicitly with advertisements by financial institutions and grant the AFCCR power to monitor and enforce the application of these requirements. At the same time, sector-specific legislation prohibits financial institutions from making false or misleading advertisements or statements relating to their activities.²² The Law on Competition provides general prohibitions for any entity, including any bank, to engage in anti-competitive practices and grants power to the AFCCR to monitor the application of this law and to sanction offenders. At the same time, however, the Banking Law prohibits a bank from carrying out or participating in any activity aimed at providing the bank a position of dominance in the financial market, or creating unfair advantage.²³ Although this provision adds nothing of substance to what exists in the Law on Competition, the BoM is empowered to enforce it.

34. The provisions dealing with the protection of consumers of banking products and services lack clarity and detail. There are some provisions regarding financial consumer protection in the Law on Deposits, Payment Settlements and Loan Activities (DPSLA Law) and the Banking Law. For example, the DPSLA Law requires lenders to publicly disclose terms and conditions of loans, and states that the BOM shall determine methods for the calculation of loan interest. In addition, the Banking Law states that banks shall provide customers with true and fair information in accordance with the principles and standards set by the BoM. However the rules lack detail and are not well developed.

35. Under the temporary blanket deposit guarantee, all monetary deposits placed by a citizen in any current or deposit account are guaranteed by the State, regardless of the size of the deposit. However, the blanket guarantee, which is set to expire by the end of November 2012, is to be replaced by a limited deposit insurance scheme. For this purpose, the BoM and the MoF have established a working group to develop an appropriate design and level of coverage for the new deposit insurance system.

²⁰ Art. 17 of the Law on Advertisement.

²¹ Art. 12.1.10 of the Competition Law.

²² Banking Law, Article 7.4.8, SML, Article 16.1.1 and Law on Insurance, Art. 58.

²³ Banking Law, Article 7.4.1.

36. So far, there exists no legislation/regulation on internet banking or mobile phone banking in Mongolia. Given Mongolia's low population density, mobile phone banking is very promising, offering wide access and low costs, as well as increased speed. As of end-2011, the number of mobile phone users increased to 2.75 million with a penetration rate of 98 percent.²⁴ While being used country-wide, mobile banking services are particularly attractive to clients living in remote and rural areas. In the past few years, the mobile banking service has greatly expanded with nine banks providing mobile services.²⁵

37. Investor protection is currently regulated under the Securities Markets Law of 2002. The law contains a number of investor protection provisions in Chapter 3 such as the disclosure of licenses of the broker, the disciplinary history of the broker and its officers and its financial condition. In addition, the broker cannot give out false and misleading information or engage in manipulative activities. Information concerning customer accounts must also be kept confidential. The FRC has the authority to issue regulations setting forth investor protection provisions in furtherance of these statutory duties. The current legal regulatory system is somewhat basic and not well developed which is generally recognized by market participants.

38. Under the current law, investor protection by other institutions in the capital markets is limited. The Mongolian Association of Securities Dealers (MASD) has developed a Code of Conduct for members but membership is not mandatory. In addition, there is no dispute resolution mechanism at MASD. The Mongolian Stock Exchange (MSE) has rules regarding trading on the market but does not have a Code of Ethics or arbitration system for broker-customer disputes. The Mongolian Securities Clearing House and Central Depository (MSCH&CD) does not resolve disputes between customers over ownership of securities which is handled by the FRC.

39. Mongolia is in the process of significantly upgrading its regulatory structure for the securities sector. The legal framework for the securities markets will undergo a significant change when the new securities law is enacted, possibly as early as November 2012. In addition, the assistance given to the MSE by the London Stock Exchange (LSE) will also change the rules for the listing and trading of securities.

40. Under the current trading and custodial system based on cash settlement, customer assets are held in the central depository and well segregated. However, the introduction of the new trading system supplied by LSE will significantly increase the regulatory responsibilities of the FRC and BoM regarding the supervision of the segregation and safe keeping of customer assets which will now be held in bank accounts in their broker's name.

41. The legal framework of insurance does not adequately address consumer protection issues. The Law on Insurance of 2004 establishes "protection of the interests of insureds and other persons engaged in insurance business...from malpractice or dishonest actions" as a responsibility of the regulator. The law²⁶ empowers the regulator to establish rules for market conduct that are binding on the insurer. However, there do not appear to be many specific rules covering areas of consumer protection. A similar provision is found in Chapter Seven of the Law on Insurance Intermediaries which sets out licensing requirements and other provisions related to the activities of insurance intermediaries. There exists a regulation (Code of Ethics to ensure Prudent Operations of Insurers and Insurance Intermediaries) that establishes some principles and requirements to be followed by insurers, their employees, loss

²⁴ FSAP Development Module for Mongolia – Access to Finance Technical Note, June 2012.

²⁵ Clients can make account transfers within their banks (for example pay for goods and services) using their cell phone; make deposits and withdrawals without going to the bank branch through the authorized agents; and send SMS messages to their bank in order to access their accounts for transactions.

²⁶ Art. 59 of Law on Insurance.

adjusters, and agents in the conduct of their business. However, this regulation is very general and does not address many areas affecting consumers. In addition, the Civil Code establishes some rudimentary requirements for insurance contracts but provides little guidance on acceptable contractual provisions for consumer protection.

42. The policies of insurers are approved by the FRC. However, without guidance from the legislation it is not clear what criteria are used to conduct such reviews. The FRC does not oblige insurers to have a consumer protection system in place that provides for policies, procedures and controls including the handling of conflicts of interest, mechanisms for proper consumer information disclosure, the handling of complaints within insurance companies as well as the statistical analysis of consumer complaints.

Key Recommendations

43. The legal framework for financial consumer protection needs to be clarified and strengthened while ensuring consistent enforcement of existing provisions. In order to ensure an adequate basic framework for financial consumer protection, further detailed financial consumer protection provisions should be introduced through the issuance of regulations under the existing legislation and/or amendments of the sector specific laws with relevant provisions.

44. Overlaps between general consumer protection provisions and sector-specific legislation need to be addressed. The statutory obligations on financial service providers in respect of their advertisements should be restricted to provisions contained in an expanded and amended sector-specific legislation, with the BoM and FRC thereby becoming the sole monitoring and enforcement authorities in these respects. Considerations should therefore be given to amending the Consumer Protection Law and the Law on Advertising to exclude the financial sector from their application so as to ensure that regulation and supervision of financial consumer protection rests with the existing financial sector regulators. Also the Competition Law should be amended to exclude financial institutions from the application of its provisions on advertisement. On the other hand, the Banking Law should be revised so as to leave the enforcement of provisions on unfair competition and market dominance solely to AFCCR.

45. With internet and mobile phone banking services becoming increasingly important in Mongolia, there is a need for a clear regulatory framework for these services, as well as for electronic fund transfers and e-money services. A specific regulation on e-money should be issued in order to provide a level-playing field between branchless banking providers that encourages healthy competition, but also sets minimum operational and conduct standards that protect customers, particularly low-income consumers.

46. As a matter of priority, the authorities should enact enabling legislation and regulations to establish a new well-defined deposit insurance system. Consideration should be given to limiting the extent of coverage to a reasonable limit which will still ensure full protection to the vast majority of depositors. In order to have a successful transition. The BoM and MoF should prepare a plan that includes a clear timeline for the transition as well as a strong public relations campaign informing the public about the new deposit insurance scheme.

47. Clear provisions on segregation of customer assets need to be introduced. The segregation rules and legal framework will need to clearly provide that customer funds cannot be used by the broker or settlement bank for their own activities and that the funds are not part of the bankruptcy estate of the broker or settlement bank in the event of their insolvency.

48. The body of the insurance law should be amended to establish a more comprehensive set of consumer protection standards for insurers. In the short term new regulations could be implemented through the use of existing regulatory powers under the Law on Insurance and the Law on Insurance Intermediaries. Changes to the Civil Code to enhance requirements for contracts of insurance would also be advisable but could likely be accomplished in the short term through the review of retail insurance contracts by the FRC against clearer consumer protection criteria. At a minimum these standards should cover product design - the appropriateness of products for particular consumers, requirements regarding the timing, delivery and content of information provided at the point of sale (POS), management of real and potential conflicts of interest (e.g. disclosure of remuneration), the servicing of policies and claims in particular, protection of confidential consumer information and the handling of records and complaints by insurers.

49. Moreover, a regulation or a legally enforceable code of conduct for insurance industry participants, particularly insurance intermediaries should be developed by the FRC in consultation with the industry. At a minimum such a code should require the intermediary to (i) evaluate clients' needs; (ii) disclose material information relevant to the purchasing decision; (iii) conduct all insurance activities in a competent manner; (iv) protect clients' interests and privacy; and (v) carry on the business of insurance in good faith - act with honesty and decency of purpose and a sincere intention to represent the client's best interest.

III. Consumer Disclosure

Key Findings

50. There are a number of provisions in Mongolia that oblige financial institutions, especially banks, to disclose information on financial products or services to consumers. The Consumer Protection Law gives consumers the statutory right to have “access to objective and truthful information related to the consumer product [so as to] help [them] make sound choices and informed decisions”.²⁷ By the DPSLA Law, a bank is obliged to provide consumers accurate information with respect to the term of the deposit, the applicable interest rate, the amount of the funds to be deposited, the calculation of interest on the deposit, the grounds for cancellation of the deposit agreement and the liabilities of the parties to the agreement in case the parties fail to comply with the conditions set out in the deposit agreement.²⁸ Furthermore banks have the duty to disclose the conditions on which loan shall be granted such as the purposes for which loan shall be granted, the interest rate, and the terms and other conditions of the loan.

51. However, the existing regulatory framework on disclosure requirements still lacks specific guidance to financial institutions on the type and form of information that should be provided to retail customers. Although most banks produce small, single sheet or folded brochures, these are for purposes of advertising, and do not include all essential terms and conditions. According to the SML²⁹, an investor has the right during the process of purchasing and selling of securities to request any information specified in the law from an issuer or from the professional participant institution in the securities market. However, the investor must initiate this inquiry to obtain the information as the broker and dealer is not obligated to disclose it. The Law on Insurance³⁰ establishes an obligation on the insurer to ‘introduce the insured persons to the insurance contract’. There is, however, no comprehensive set of consumer

²⁷ Consumer Protection Law, Art 7.1.

²⁸ DPSLA Law, Art 4.2.

²⁹ SML, Art 14.4.

³⁰ Law on Insurance, Art 9.1.6.

protection standards or processes associated with this requirement. It is therefore not clear if insurers are held accountable for this activity or not.

52. In addition, there is a remarkable gap between the very basic requirements on disclosure of information to financial consumers and the actual practice and the enforcement of these obligations. The obligations incumbent upon financial institutions do not seem to be effectively applied by these institutions or enforced by the BoM and FRC. In practice, provision of information to consumers seems to vary widely among financial institutions, and detailed information in an easily understandable form is not always available.

Key Recommendations

53. Consumers should be provided with a standardized ‘key facts statement’ that summarizes in plain language the key terms and conditions of any financial product or service. In other countries, standardized key facts statements have proven effective in promoting the ability of consumers to compare products and services within the same financial institution, as well as across a range of financial institutions, while, at the same time, improving consumer understanding of financial services and terms.³¹ By means of a regulation, BoM and FRC should require financial institutions to provide a 1 page (or even 1 box) key facts statement typed in easy-to-read print and written in plain language for each product or service on offer to consumers. Each key facts statement should clearly indicate all fees and charges related to the financial product or service in question, as well as the mechanisms for recourse available to the consumer in the event of any complaint. Consideration should be given to using consumer testing to ensure a high level of consumer understanding of the formats and contents disclosed in these statements before they are finalized, published and made available in each financial institution branch for wide distribution.

54. In addition, a glossary of standard financial terms should be developed by BoM and FRC in cooperation with the industry associations. All in the financial sector, including consumers of financial products and services, would benefit greatly if the BoM and FRC would institute a glossary of common financial services terminology and require all financial institutions to employ the standard defined terms on a consistent basis regardless of the product or service being offered to consumers.

55. The BoM and FRC should ensure that useful comparative information is made available for consumers by establishing price comparison websites. Such tools will provide consumers with the means to compare the cost (or return) and terms of similar financial products, and to provide an incentive for providers to compete to improve product design and pricing. As a complement to that webpage, price comparison tables could also be made available through newspapers and the MCA and through suitable outlets in rural areas (such as health clinics and retail stores). National price comparison websites have increased competition and reduced consumer prices, for example in the case of the website established by the financial regulator in Peru.³² The regulators’ websites could also include easy-to-use financial tools, for example to compare similar products, or to plan for expenditures (such as the birth of a child, or for health insurance).

³¹ E.g. Hoja de Resumen (Summary Sheet) in Peru, Standardized European Consumer Credit Information in the EU, South Africa’s Pre-Agreement Statement & Quotation for Small Credit Agreements, Ghana’s Pre-Agreement Truth in Lending Disclosure Statement.

³² The Superintendence of Banking, Insurance and Private Pension Funds of Peru found that online publication of consumer loan rates reduced the average consumer lending rate by 1000 basis points (or ten percentage points) at the time of stable interest rates – see <http://www.sbs.gob.pe>.

IV. Business Practices

Key Findings

56. Currently there is no cooling-off period for any financial product or service in Mongolia. This is of particular concern in Mongolia given the lack of standard and comparable information on product pricing and other terms.

57. Predatory lending practices and excessive loan application requirements affect especially vulnerable segments of the population. The *Comprehensive Program to Develop Market Environment for Reducing Interest Rate* emphasizes the need to review commercial banks' credit regulation and implementation in order to reduce pressure for interest rate increases and for the application of other charges on customers. Reportedly, consumers do complain about the practice of at least some banks in requiring a wide range of documents, including police clearance and statements from district units certifying the number of family members as part of the process of assessing a consumer's capacity to repay a loan.

58. Mongolians who borrow typically enter into loan agreements with their banks without the benefit of information on competing terms on offer by other banks. Typical bank practice is to charge various up-front costs to any consumer who seeks a loan, for example, a set-up or application fee, and, in some cases also, appraisal and legal fees, and/or an initial premium on a policy that insures the collateral. There is, however, no statutory or regulatory obligation on banks to disclose the above to a consumer. This is of particular concern in respect of variable rate consumer loans, where clear statements of when, the precise basis upon which, and the extent that, interest charges will vary over the life of the loan, are routinely not provided.

59. The activities of securities intermediaries ("brokers") have been the subject of numerous complaints as far back as the privatization period in the early 1990s. Customers complained that brokers sold shares in their accounts without authorization. Secondly, customers complained that brokers purchased shares from them based on false representations as to the value of the shares and predictions as to future prices. Finally, customers complained that people were using falsified and forged documents to have shares transferred to their accounts for resale. These documents included forged documents related to inheritance or authorization to act on behalf of the customers. The FRC 2011 Annual Report indicates the primary complaint still relates to this holdover problem from the era of mass privatization.

60. The FRC, MSE and Depository are acutely aware of this negative experience and the problems that may arise in the upcoming privatization of ETT (see Box 1). They have issued a joint warning against improper conduct on the part of brokers, particularly in the area of purchasing shares before they can be traded (after the IPO) and the price offered for the shares. The warning states that severe sanctions will be taken against brokers who violate the sale rules.

Box 1: Consumer protection challenges of ETT share distribution

Background: The Government of Mongolia will privatize a tranche of shares in Erdenes Tavan Tolgoi (ETT) coal mine by transferring shares to citizens. Each citizen will receive 1072 shares in the company. Citizens had the right to request cash instead of shares which would be effectuated by their selling their shares to the government for 1 million MNT (933 USD) per share. The deadline for the request was May 20, 2012, after which no requests would be granted. Approximately 1.5 million citizens have asked for cash.

If a citizen did not make a request for cash, then the citizen will receive shares. Over 1 million citizens will receive shares. A list of all citizens and the shares they own will be sent to the Central Depository as record of their ownership. If the citizens wish to trade their shares, they will need to open a brokerage account to do so. However, trading in the secondary market cannot begin until the IPO is launched. The MSE, FRC and MSCH&CD have issued warnings to brokers and citizens that any transactions in the shares prior to the date they are available for secondary trading will be considered illegal.

Risks and challenges of ETT share distribution from consumer protection angle:

Notwithstanding the wide publication to Mongolian citizens that they were going to receive 1 million MNT cash, many are not aware of the consequences of receiving securities in ETT instead of the cash, such as the value of the securities, how to sell them and the possible prices that can be obtained from selling the shares depending on how long the citizens decide to wait before selling them. Consequently, an extensive financial education campaign will be needed in order to fully inform the citizens of all of the facts related to the ETT transfer of shares.

Of great concern to the government is that unscrupulous brokers and other individuals will purchase citizens' shares for less than the price established by the government prior to secondary trading. Although the citizens are better educated in securities now as a result of their experiences during the mass privatization, the regulators and market institutions will need to maintain an especially strong surveillance and enforcement program during the privatization of ETT to prevent broker misconduct.

As before there is concern that brokers will engage in misconduct with their clients' accounts, such as selling customers' shares without authorization. Maintaining a high entry level for brokers and a vigorous examination program should reduce the risk of the recurrence of this activity.

61. However, the enforcement record of the FRC in the area of fraudulent sales has been mixed. Several cases, brought after the FRC was created but concerning events that occurred before the creation, were reversed by the Administrative Court of Appeals. The reversal had to do with an interpretation of how restitution of the shares should be made, particularly if there were multiple customers who were victims. The commonly used remedy whereby the broker goes to the securities market and purchases shares to give back to the defrauded customers did not appear to be available since the brokers had become insolvent. Consequently, the multiple customers all claimed to have title to a specific group of shares, resulting in each of them not receiving the full value of their loss.

62. There is no specific provision in insurance law that would prevent bundling and tying³³ of insurance products even though the practice has already appeared in the sale of mortgage insurance and in automobile financing. In particular, given the nascent stage of development of the Mongolian insurance sector, when a policy of insurance is a pre-requisite for obtaining a loan, banks are reluctant to allow their consumers freedom to choose their own insurance provider since some insurance companies are generally not yet deemed strong enough financially to provide the sort of loss protection that banks require.

³³ Tying occurs when two or more products are sold together in a package and at least one of these products is not sold separately. Bundling occurs when two or more products are sold together in a package, although each of the products can also be purchased separately on the market.

Key Recommendations

63. A mandatory ‘cooling-off period’³⁴ for financial products should be considered. Individuals who want to borrow may enter into loan agreements with their banks without the benefit of being provided information on competing terms on offer by other banks. A cooling-off period of, three to five days for consumer loans would be a useful safeguard in allowing consumers to withdraw from a loan agreement without penalty on repayment of all of the principal received.

64. Consumer loan application requirements should be carefully analyzed by BoM with the view to reducing possible unnecessary thresholds for lending transactions. As a consequence, all unnecessary thresholds for lending transactions should be prohibited in order to reduce the many bureaucratic steps required by banks in their loan application process for consumers.

65. Furthermore, rather than merely approving the different methodologies employed by the various banks to arrive at their own charges, fees, commissions and interest rates, BoM should, itself, develop a methodology for these purposes and require that it be applied consistently by all banks. A future BoM Regulation should specify a standard methodology required to be applied by all banks and the BoM should then monitor compliance in using it. Banks should be required to disclose their effective interest rates, or the interest rate spread (that includes fees in the calculation) over a reference rate such as the BoM Reserve Rate, and to use that percentage in all of their advertising, marketing and sales materials.³⁵

66. A number of steps will need to be taken to prevent improper conduct of brokers, one of the most important of which will be higher licensing standards and capitalization for brokers. This should reduce the number of brokers and result in stronger, more disciplined and compliant brokers. In addition, it will reduce the work load of the supervisory staff so that they can concentrate on the supervision of the most important brokers.

67. Additional steps to be taken will include the implementation of strong sanctions for unauthorized trading and misrepresentations by brokers as to their status and the characteristics, profitability and suitability of investments in order to deter misconduct. A closer surveillance over trading by brokers will also be necessary. In addition, it will be critical to introduce an advanced risk-based supervision system for identifying the brokers that are at highest risk for non-compliance and misconduct.

68. Due to the prevalence of complaints about fraud and the untried character and possible financial weakness of a number of new brokers, in the longer run the authorities should consider the creation of an investor protection fund which will secure the assets of investors in the event of a broker’s insolvency and fraudulent conduct. In the event of an unauthorized trade which a broker cannot cover in the open market due to insolvency, the protection fund would be available to restore the investor’s assets. Such a compensation fund would be mandatorily funded by all registered brokers on an annual basis. In the event of an insolvency, these funds usually provide that each broker will be liable to the extent of their contributions to the fund and then the fund itself can use any excess funds available to pay any additional amounts that are needed.³⁶ Any new investor compensation/guarantee arrangements

³⁴ This implies the right to withdraw from a financial product agreement/contract within a certain period of time without penalty.

³⁵ For example, Peru’s Regulation of Transparency requires banks to disclose the “TCEA”, or Annual Effective Cost Rate, which is expressed as an interest rate, but includes all costs associated with a consumer credit.

³⁶ This compensation fund is required in the European Union and exists in various forms in the United States, Turkey, Malaysia, Hong Kong and South Korea, among many other countries.

for Mongolia should be discussed and evaluated thoroughly in order to ensure that the structure does not create significant moral hazards³⁷ while leveraging on the use of insurance in order to minimize any additional cost to the industry. In addition, market-based commercial risk management mechanisms and incentives within the arrangement should be employed.

69. Consideration should be given to developing a prohibition against coercive tied selling. Such a prohibition would be intended to address situations where the consumer is forced to purchase a bundled or tied product in order to receive a specific financial service (e.g. credit insurance). Whenever borrowers are obliged to purchase an insurance policy as a pre-condition for receiving a loan, the consumer should be able to choose among a group of independent insurance providers. That freedom should be communicated to the prospective borrower orally and in writing prior to the signing of the loan agreement.

V. Dispute Resolution Mechanisms

Key Findings

70. There is no legal requirement for banks to have an internal procedure for customer complaints in place. Although some banks do have “hot line” numbers for consumers to call, no bank discloses its own internal procedures in writing to consumers in the event that a customer has a complaint or a dispute. In addition, there is no regulatory framework regarding any role for the BoM in receiving and dealing with complaints of consumers regarding any banking product or service.

71. While the BoM has no explicit statutory power to collect and analyze data in respect of consumers’ inquiries, complaints and disputes with their banks, it has, for some time, been dealing with individual consumer complaints, at least on an informal basis. The BoM reportedly receives up to 1000 such complaints per year, with its Supervision Department providing these consumers with a response/advice letter. However, consumers are always encouraged at least to attempt to resolve their disputes on an amicable basis internally with their banks and the BoM has not yet begun to analyze this data.

72. The current Law on the FRC provides that the FRC should handle disputes between license holders and customers. In 2011, FRC received a total of 316 complaints related to investor protection issues compared to 322 in 2010. The majority of complaints referred to limiting shareholders rights to vote and receive dividends and the selling or transferring of shares without the consent of the shareholder. In 2011, around 30 complaints were received by the FRC regarding the violation of citizens’ rights and insurance re-compensation (compared to 18 in 2010).³⁸ However, it is not clear how effective the current efforts of FRC at dispute resolution are.

73. Under the new draft securities law the FRC will receive powers to act as an Ombudsman for investors. The draft SML provides that the FRC shall establish a Dispute Review Board which shall “settle disputes between the regulated persons, issuers, investors and clients” pursuant to procedures to be established by the FRC. In this regard, the FRC has the power to act as an Ombudsman for investors under the new law and a more formal procedure should be put in place under the new draft securities law. If the parties do not agree with the decision of the Board, they can appeal to court.

³⁷ Moral hazard refers to the danger that brokers and investors might lower their attention to risk due to an overreliance on the compensation arrangement.

³⁸ FRC Annual Reports 2010 and 2011.

74. **Finally, although the AFCCR does have explicit power to deal with complaints it has so far apparently not dealt with this task, at least in respect of the concerns of consumers of financial products and services.** That said, the AFCCR does receive some 118 consumer complaints, on average, per year dealing in one way or other with financial products or services. No analysis is made of this data, however.

Table 3: Responsibilities of consumer complaint handling across supervisory agencies

Agency	Law outlining responsibility	Type of responsibility as provided for in the law	Actual activities in dealing with consumer complaints regarding financial services
BoM	None	None	Issuance of advice/response letter to consumer
FRC	Law on the FRC	Handling of disputes between license holders and customers	Handles disputes through dispute mediation (non binding mediation role)
AFCCR	Competition Law	Accepting and resolving the requests and complaints within the scope of powers	None

Recommendations

75. **Financial institutions should be required to have a contact person or unit in charge of receiving and handling complaints, and to ensure that the identity of this person or unit is disclosed to every consumer.** For example in Malaysia, all institutions regulated by the central bank, including banks and insurance companies, are required to set up a complaint unit to handle customers' complaints. BoM and FRC should also establish guidelines on the internal procedure for financial institutions in their handling of complaints. All financial institutions should be required to centralize data on complaints and share the data with the BoM and FRC. Based on the analysis of complaint statistics, the BoM and FRC could also propose guidelines, instructions, or awareness campaigns that address the problems identified in the complaint reports.

76. **The implementation of the provision in the new draft SML to establish a Dispute Review Board will be extremely important to the fair resolution of retail customer disputes.** The development of this Review Board should receive high priority from the FRC. In addition, the government of Mongolia may want to consider making the decision of the Board binding and even non-appealable in the case of small disputes involving retail investors in order to reduce the costs of resolving disputes.

77. **Institutional responsibilities for complaints handling need to be further clarified while making the existing external dispute resolution mechanisms within BoM and FRC more efficient.** Due to AFCCR's lack of capacity and interest in dealing with consumer complaints regarding financial services, considerations should be given to formally allocate the responsibilities for complaints handling exclusively with the BoM and FRC. This can be accomplished through the signing of a comprehensive MoU (as referred to in paragraph 27 of this report). As one of the best ways to get an early warning of misconduct in the market is through customer complaints, BoM and FRC should be responsible for collecting and analysing complaints in their respective sectors. In order to address cross-sectoral complaints, a central complaint handling number (switch) which routes complaints to FRC and BoM depending on the nature of the complaint could be helpful. Considerations should be given to formalizing BoM's activities in the area of dispute resolution by amending the Law of the Central Bank of Mongolia.

78. In the long term, consideration should be given to the establishment of a financial services ombudsman, based on an assessment of the most appropriate institutional set-up for Mongolia. The analysis should take into account issues of independence, sustainability, accessibility for consumers, and capacity to make binding decisions to ensure the effectiveness of the system. Several institutional options can be evaluated, following on successful international experiences. Whatever the model adopted, it should be clear that the relevant activities (e.g. to award compensation to a consumer) are within the functions and powers of the relevant entity (see Box 2 for further information).

Box 2: Models of Financial Ombudsman Structures

To further improve access to justice for citizens, governments often take further steps to provide alternative dispute resolution systems. These systems are designed to allow for an out-of court-decision to be taken when parties fail to arrive voluntarily to a conclusion to a complaint. Generally, there are three models of financial ombudsman applied:

Ombudsmen established by financial services associations: Decision by such an ombudsman is not legally binding but his findings are usually respected by financial institutions voluntarily as a part of self-regulation of the market, sometimes with financial companies even publicly declaring to be bound by the ombudsman's decisions. In countries, such as *Germany*, an industry-based ombudsman structure for each part of the financial sector has proven effective. However, in the case of such an ombudsman structure established by professional association, attention should be paid to the presence of conflicts of interest. Also, consumers may perceive the ombudsman as someone who will always decide in favor of the financial institution and against the consumer.

Statutory independent ombudsmen: In this approach, the ombudsman has functions and powers set up by national laws and members appointed by government authority. For example, the *UK* established a scheme by law to function as an independent institution, while *Armenia* legally requires financial institutions to join a central bank-approved ombudsman scheme with binding rules for all member institutions. In *Malaysia*, the Financial Mediation Bureau (FMB) was set up as an independent body to deal with disputes between the public and its members including all commercial banks and insurance companies. The service is free of charge for consumers and binding on financial institutions. A single statutory ombudsman would make it easy for consumers to identify to which agency they should submit their inquiries and complaints. While this model has the advantage of clearly defined objectives and mandates the challenge is to provide the new ombudsman with sufficient authority and resources.

Ombudsman structure established within the regulatory and supervisory agency: A third model is the set-up of a financial ombudsman structure within a regulatory and supervisory agency. For example in the case of *Spain* the ombudsman role is filled by complaints departments in the banking regulators. While this model has the advantage of using existing institutional arrangements to build upon, the challenge is to ensure independence of such an ombudsman structure and avoid conflicts of interest.

VI. Financial Education

Key Findings

79. There are a couple of public and private initiatives on financial literacy that are ongoing or in planning stage. Initiatives have been taken by some banks in respect of improving consumers' financial literacy, with perhaps one of the more noteworthy being pilot projects in various schools. The FRC, MSE, and market participants have individually developed and put into practice some financial education initiatives regarding securities markets for Mongolian citizens. This is done through weekly training programs at brokerage houses and public awareness seminars by the FRC, MSE and MSCH&CD. The MSE has prepared an education booklet where the information is told in picture stories. To improve the understanding³⁹ of the general population regarding insurance products and services, FRC officials participate in some consumer protection initiatives each year (e.g. press interviews and television

³⁹ According to the FRC Annual Report 2010 only one fourth of total population of Mongolia uses insurance services due to lacking household savings as well as incomplete understanding of citizen's regarding insurance products. Many consumers reportedly mistake insurance for some sort of additional tax payment.

broadcasts). The Ministry of Education (MoE) plans to introduce a new civic studies course for high school students this fall which includes financial education concepts. However, there is general agreement that extending this education to the rural areas has been very difficult.

80. However, coordination is lacking between those initiatives and there is no over-arching strategy. Financial education activities are fragmented across multiple public and private institutions. The lack of an over-arching strategy bears the risks of increased inefficiency in identifying gaps and needs of the population and in allocating overall resources.

81. These programs have mainly been carried out in Ulaanbaatar and several other major cities in Mongolia and have made general education regarding the securities markets broadly available. This is done through weekly training programs at brokerage houses and public awareness seminars by the FRC, MSE and MSCH&CD. The MSE has prepared an education booklet where the information is told in picture stories.

82. Financial institutions face challenges to provide consumers with sufficient information so as to enable them to select what is most suitable and affordable as front-retail staff reportedly lacks awareness and capacity to convey relevant information effectively to consumers. For the banking sector, the MBA has recently established a Banking Training Academy in Ulaanbaatar to which the general training responsibilities of BoM in respect of retail bank staff have been transferred. Eventually at least, the aim is to ensure a basic minimum level of training for bank staff at all levels, including tellers, loan officers and others who deal directly with individual depositors and borrowers. The AMI also organizes domestic and international professional training courses for members' employees and agents.

83. A national household survey of financial literacy is being conducted by the World Bank in 2012, in conjunction with CPFL review, to provide the first comprehensive set of data and insights on the levels of financial literacy (and broader financial 'capability') in Mongolia. The survey will provide country-specific information regarding the saving and borrowing behavior of individuals, prevailing levels of understanding of basic financial concepts, awareness of financial consumer rights, patterns of household budget management, and use of financial services. Specific emphasis will be laid on the upcoming distribution of ETT shares and the population's financial literacy and awareness in this regard. Furthermore, the results will provide valuable inputs on the main financial literacy issues of the population and inform the development of a national strategy and program on financial education, as well as the regulator's work on financial consumer protection.

Key Recommendations

84. A national program on financial education should be developed under the joint leadership of MoF, FRC and BoM. The Comprehensive Program to Develop Market Environment for Reducing Interest Rate envisages the preparation and implementation of a program on public financial education as one of the key goals to ensure fair and proper operations of banks. A financial education committee consisting of a broad range of stakeholders such as members of the MoF, BoM, FRC, MoE, AFCCR, MBA, media and the MCA should be established under the financial consumer protection coordination group (see paragraph 28) - to bring together various ongoing and planned initiatives into a coordinated program that has resources to extend to the rural areas. The effective implementation of national program would require able leadership at the Government level, which could hopefully come from the MoF.⁴⁰

⁴⁰ For example in Malaysia, the central bank (Bank Negara Malaysia) established a Financial Education Working Committee (FEWC). This comprised the Credit Counselling and Debt Management Agency, the Financial Mediation Bureau, the Malaysia Deposit Insurance Corporation and the Securities Commission Malaysia. The main objectives

85. Proper training of retail agents needs to be ensured. BoM and FRC in consultation with industry associations should establish/agree on a minimum curriculum for financial education for financial institutions to provide to their staff to pass on to their customers. Financial industry associations could be encouraged to develop financial education activities and materials and coordinate financial education programs among their members, reporting to the working group on activities in their respective sector.

86. The planned financial education programs could also focus on ‘teachable moments’. Besides general financial education that should focus on explaining individuals' rights as consumers of financial services with the aim of increasing the trust of the public in financial institutions, specific programs can seek and focus on education during teachable moments. For example, child birth, retirement, unemployment, house purchase, and marriage could be key moments for making tailored information about relevant financial services available.

87. The partial privatization of ETT will require a special and extensive financial education program. Although many citizens are aware of the ongoing privatization through government announcements and the media, it is not clear that there is wide spread knowledge as to what their options are in the privatization and the pros and cons of each option. In order to avoid recriminations against the government after the privatization, an extensive investor education program will be needed as soon as possible, including wide-reaching TV and radio programs and easy-to-understand news releases issued in national as well as local media, development of a dedicated financial education website on the ETT privatization and through outreach programs delivered through workshops, road shows, exhibitions, drama, games and via mobile phones. In addition, seminars and trainings for journalists and other media should be facilitated in order to ensure more informed reporting on the privatization throughout the country.⁴¹

88. Financial education programs should adopt appropriate methods to reach low income and rural populations, especially low income nomadic herders. Mongolia's unique country characteristics such as nomadic lifestyle and low population density in remote areas pose specific challenges to financial education programs tailored to low income and rural populations. Techniques to consider therefore include the training of “knowledge duplicators” such as local teachers, and strengthened curriculum content in schools to teach children about earning, spending, sharing, and saving money.

89. The financial literacy survey results could serve as a baseline to measure the impact of financial education and consumer awareness initiatives going forward. The results of the survey should be used by the proposed working group to inform the design of financial education programs and to evaluate them later. By administering key questions in the survey periodically such as every 3 years or so, progress in financial education can be assessed, policies reformed, and financial education approaches revised to better meet the outstanding challenges. The results should be widely disseminated and the data should be made available to all relevant stakeholders.

of the FEWC are to foster greater collaboration among these agencies in implementing financial education initiatives, through concerted efforts to maximise outreach to a wider range of consumers; and to facilitate the more efficient allocation of resources among the agencies, for example through avoiding duplication of effort.

⁴¹ In Kazakhstan, an extensive public education and information program for mass privatization was conducted in 1995/96. In 1998/99 a mass privatization program in Mongolia was complemented with a successful *Public Information and Investor Outreach Campaign*. The Ukraine Market Reform Education Program (1998-2002) also provided a broad number of effective financial education initiatives.

VII. List of Recommendations

A full set of Recommendations, classified as short, medium and long term, are listed in the table below:

Recommendations	Responsible	Term⁴²	Priority
<i>Institutional Arrangements</i>			
Strengthen the role of BoM and FRC in financial consumer protection by establishing a new financial consumer protection unit within the BoM separate from prudential regulation and supervision and - as an interim step - designated financial consumer protection teams within each supervisory department of FRC	BoM, FRC	ST	High
Clarify division of powers between BoM, FRC and AFCCR by signing of comprehensive Memorandum of Understanding	BoM, FRC, AFCCR	ST	High
Establish a financial consumer protection coordinating group consisting of all regulatory and supervisory agencies as well as MoF	BoM, FRC, MoF,	MT	Medium
Strengthen regulatory activities and responsibilities of industry associations, including the creation of formal SROs	FRC, BoM, industry associations	MT	Medium
Strengthen capacity of consumer associations and include them in consultative processes	Government, BoM, FRC	LT	Medium
<i>Legal and Regulatory Framework</i>			
Strengthen and clarify the legal framework for financial consumer protection through the issuance of regulations under the existing legislation and/or amendments of the sector specific laws with relevant provisions	BoM, FRC, MoJ, MoF	MT	High
Address overlaps between general consumer protection provisions and sector-specific legislation by (1) amending the Consumer Protection Law, the Law on Advertising and the Competition Law to exclude the financial sector from their application, (2) revising the Banking Law to leave the enforcement of unfair competition provisions solely to AFCCR	BoM, FRC, MoJ, MoF, Parliament	MT	Medium
<i>Banking Sector</i>			
Provide for a clear regulatory framework for mobile phone banking services, as well as for electronic fund transfers and e-money services	BoM, MoF	MT	Medium
Enact enabling legislation and regulations to establish a new well-defined deposit insurance system	Parliament, BoM, MoF	MT	High
<i>Securities Sector</i>			
Introduce clear provisions on the segregation of customer assets	FRC	MT	Medium
<i>Insurance Sector</i>			
Amend the body of insurance law to establish a more comprehensive set of consumer protection standards for insurers	FRC	MT	High
Develop regulation or a legally enforceable code of conduct for insurance industry participants, particularly insurance intermediaries	FRC in consultation with industry	MT	Medium
<i>Disclosure</i>			
Require Key Facts Statements for all basic consumer finance products	BoM, FRC	ST	High
Develop and require the application by all financial institutions of a glossary of standard financial terms	BoM, FRC, industry associations	MT	Medium
Provide price comparison information for standard financial products on regulators' websites, with complementary dissemination mechanisms for those without internet access	BoM, FRC	MT	Medium
<i>Business Practices</i>			

⁴² ST, short term, indicates action can be undertaken in 0-6 months. MT, medium term, indicates 6 months-1 year. LT, long term, indicates 1+ years.

Allow for a cooling-off period during which new customers are allowed to revoke their contract without any penalty	BoM, FRC	MT	Medium
Banking Sector			
Analyze loan application process requirements and reduce unnecessary thresholds for lending transactions	BoM, MBA	MT	High
Develop and require the application by all banks of a standard methodology for financial institutions on a total price or cost of financial products to consumers ('effective interest rate')	BoM	MT	High
Securities Sector			
Ensure higher licensing standards and capitalization requirements for brokers	FRC	ST	High
Implement strong sanctions for unauthorized trading and misrepresentations by brokers as to their status and the suitability of investments	FRC	ST	High
Consider the creation of an investor guarantee fund	Government	LT	Medium
Insurance Sector			
Ensure prohibition of tying and bundling of insurance products	FRC	MT	Medium
Dispute Resolution Mechanisms			
Require banks, insurers and brokers and dealers to have a contact person or unit in charge of receiving and handling complaints, and to ensure that the identity of this person or unit is disclosed to every consumer	BoM, FRC	ST	High
Require that all financial institutions centralize data on complaints received and share the data with BoM and FRC	BoM, FRC	ST	Medium
Strengthen existing external dispute resolution mechanisms within BoM and FRC by (1) providing BoM with a formal mandate for complaint handling through an amendment of the Law of the BoM, (2) require BoM and FRC to collect and analyze complaints	BoM, FRC	ST	Medium
Consider establishing an independent ombudsman for retail financial services	BoM, MoF, MoJ	LT	Medium
Securities Sector			
Ensure implementation of the foreseen Dispute Review Board once the new SML is enacted and consider making the decision of the Board binding and even non-appealable in the case of small disputes involving retail investors	FRC	MT	Medium
Financial Education			
A financial education committee consisting of a broad range of stakeholder should develop a national program on financial education, including tailored financial education programs focusing on reaching low income and rural populations	MoF, BoM, FRC, AFCCR and other stakeholders	MT	High
Implement surveys and regular evaluations to assess the impact of financial literacy initiatives	MoF, BoM, FRC	LT	Medium
Develop minimum curriculum for financial education for retail staff	BoM, FRC, industry associations	MT	Medium
Securities Sector			
Develop a tailored investor education program dealing with the distribution of ETT shares to the population	MoF, FRC, MASD	ST	High