

# The Defacto Gazette

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Thursday, 2019.11.21 №8 (120)

A WEEKLY GLOBAL, NATIONAL, INDEPENDENT, ANALYTICAL NEWSPAPER COVERING THE POLITICS AND ECONOMICS OF MONGOLIA  
(IN ENGLISH, JAPANESE, RUSSIAN AND MONGOLIAN)

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WEEKLY



## DeFacto **ARTICLE** №504

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## FINTECH: LIKE A BIRD IN THE HAND



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*Gerelmaa Batchuluun  
Co-founder and the CEO of the US  
based STEPPE TECH*

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## FINTECH: LIKE A BIRD IN THE HAND

Fintech (or financial technology) is a hybrid sector that utilizes the advancement of information and communication technology to deliver brand new financial services to customers. Fintech involves wealth and property of individuals, thereby an adequate risk management is critical for the mitigation of possible risks.

In Mongolia, several Fintech companies such as LendMN, Ard Credit, and Hi-pay provide financial services and have already put their foot in the door of foreign markets. The Fintech startup Mobi Finance offers a candy system that provides services to 1,5 million users in total and facilitates almost 200,000 payments daily, amounting to 4 billion tugriks. Furthermore, the GSMA, an association that represents the interests of 750 mobile network operators worldwide, reported that Fintech services are emerging at greater speed in countries with lower GDP per capita and a higher population density.

## FINANCIAL TECHNOLOGY

The technological revolution immediately changes the course of the financial sector which aims to ensure economic growth through capital accumulation and investment mobilization, and as a result, the circulation of goods and services sharply increases.

An era of Fintech 1.0 begun when Alexander Graham Bell registered his telephone patent in 1876 and undeniably set the foundation for the development of financial technology. After 100 years, the scope and use of financial services expanded dramatically when Fintech 2.0 came to light along with the internet boom. Subsequently, Fintech 3.0 has been rising with smartphones and portable internet since 2008. The financial services are accessible to anyone and have notably contributed to the reduction of poverty worldwide as it became easier, cheaper, and faster. The Fintech 3.0 is increasing workforce productivity and certainly reshaping our lifestyle by offering various types of payments, savings, loans, and insurance services. Typically, the digital currency, a transaction tool, saves the 3 to 5 percent transaction fee charged by card companies.

Total investment activity (VC, PE and M&A) in fintech 2013-2018



Source: Pulse of Fintech 2018, Global Analysis of Investment in Fintech, KPMG International (data provided by PitchBook) January 4, 2019.

KPMG Pulse of Fintech report 2018 ▶▶

- ▶ Technology is not only driving Fintech, but also other new businesses such as big data, artificial intelligence, value chain, and blockchain.



## FINANCIAL SERVICES

M. Carney, a governor of the Bank of England, pointed out that Fintech is unbundling banking into its core functions of settling payments and adequately allocating capital.

Fortunately, as a phone number began serving as an account for transaction, millions of people who did not have prior access to banking services were now able to make quick payments and get loans. In East African countries, a digital platform called M-Pesa was placed on the market and is disrupting the financial sector. The World Bank reported that there are 110,000 M-Pesa agents, 40 times more than ATMs, provide financial services in Kenya. In developing countries, a new capital that is necessary for the development of manufacturing, infrastructure, and human capital, is being accumulated as several millions of

individuals are finally able to open accounts.

Ali Pay and WeChat Pay have introduced QR code-based Fintech in China, a country that accounts for over 50% of global e-commerce transactions. Similarly, Kakao Pay, Siam pay, Au wallet, and Apple pay have introduced their own Fintech services in South Korea, Thailand, Australia, and the US respectively. In Mongolia, a variety of point-collecting payment applications are being widely used. However, the Mobi Finance's candy is a single digital currency that is approved by the Bank of Mongolia and backed by cash. Users can make payments using candy systems at over 8000 locations not merely through smartphones but also cell phone messaging.

## CHALLENGES

The revolution in information and communication technology brought new initiatives and changes in the financial sector. Nonetheless, those changes are not accurately reflected in the country's legislation. For instance, the laws or regulations on privacy and protection of property have not been amended in a timely manner.

Consequently, the Fintech companies that collect private information and exchange the loan data have no guidelines on how to protect privacy, who is held accountable, and existing penalties. The Law on the National Payment System which is in effect since 2018 regulates payment and guarantee of digital currency. In order to offer payment services to the public, a private enterprise must meet certain requirements to get approval from the Bank of Mongolia. Just as commercial banks, a Fintech company is required to have both primary and backup data centers to ensure uninterrupted and safe payments. Nevertheless, Fintech companies are carrying out their operations without acquiring approval from the Financial Regulatory Commission and without fulfilling costly requirements set by the Bank of Mongolia. The Communications Regulatory Commission is eager to regulate Fintech companies because all Fintech services are based on communication technology.

In light of these circumstances, the Mongolian Fintech Association suggested regulating bodies to follow the best practices of other countries and adopt regulations in accordance with the "sandbox" principle. The Association and regulators have agreed to observe Fintech services,

support their initiatives, and set regulations suitable to their maturity by "fencing" all Fintech companies in the sandbox. Since then, they have not taken drastic actions in that regard for half a year.

If we keep wasting time, the space of digital currency will be taken over by foreign companies, the Bank of Mongolia will lose its control over monetary policies, and Mongolia will fail to seize a valuable opportunity again. Needless to say, Fintech hardly attracts foreign investments. Thus, if WeChat connects to Mongolian bank accounts or if Facebook introduces its Calibra, a digital wallet, into the market, Mongolia will inevitably lose its control over digital payments.

Nowadays, the market is demanding an adhesion of contract without the simultaneous physical presence of the parties. Hence it is time to endorse, create, and validate a digital signature. Yet, a notary service, which became obsolete a few hundred years ago, is primarily used for authentication in Mongolia. Surprisingly, the Ministry of Finance is far behind compared to commercial banks due to the fact that it still carries out transactions through papers.

To make the best possible use of the Fintech opportunities and increase competitiveness, Mongolia has to recognize the need to regulate companies in a sensible way instead of restraining operational initiatives.

If you hold a bird tightly it will die. If you hold it loosely, it will fly.

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### Gerelmaa Batchuluun

She is a co-founder and the CEO of the US based STEPPE TECH and working on multilevel projects focused on her native Mongolia to support its economic empowerment and growth through technology, education, innovation and carefully orchestrated system design made for private and public institutes.



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## FinTech regulatory Sandbox for Mongolia: EMBRACING NEW MARKET OPPORTUNITY WHILE PLAYING SAFE

Distributed Ledger Technology (“DLT”), including blockchain, is at the forefront of possibility of reshaping the society as we know it. Its application and utility are limitless; one of the well known example of its application is Bitcoin. Providing a solid growth-friendly environment in this fast growing digital technology sector would undoubtedly position Mongolia as the attractive destination for relevant businesses around the globe. This, in turn, will bring about positive impact on the majority of local industries such as financial services, education, logistics, and public administration as well as other important areas such as intellectual property and technology in general.

*“ Mongolia can be the hub of digital technology innovation attracting entrepreneurs and investors from all over the world. ”*

The key question is how much to regulate the usage of technology. As DLT’s application is versatile, it is inevitable that its usage could fall under the jurisdiction of existing laws. In fact, the biggest issue for any ICO (Initial Coin Offering) is determining whether it is a capital market product (“security”) or a simple utility token. If deemed as a security, then the token is to comply with the existing securities law. This is necessary for protecting the public from unscrupulous scammers, however, does hinder proliferation of ICOs and its related

technology and businesses. Therefore, striking up a balance between the protection of the public and promoting both the business and technology is of utmost importance. Especially, for a nation who is residing between the two giant markets, Mongolia should move smart and use certain innovative tools to protect its people from unwanted consequences.

Recently, after announcing worldwide to become the world’s most crypto and blockchain friendly nation Malta has actually passed three bills which delineate the government agencies and relevant laws around ICOs.

*“ In fact, Malta is the first country ever in the world to legislate laws relating ICOs. This motivated a few cryptocurrency exchanges, including Binance, OKEx, and BitBay to set up their operation in Malta and continued to stoke the interest of related businesses and ICOs. ”*

The Three bills are the Virtual Financial Assets Act (“VFA”), the Malta Digital Innovation Authority Act (“MDIA”), and the Innovative Technology Arrangements and Services Act (“TAS”). The MDIA Bill provides for the establishment of an Authority to be known as the Malta Digital Innovation Authority. The TAS Bill sets out the regime for the registration of Technology Service Providers and the certification of Technology Arrangements. The VFA Bill sets out the framework for ICOs and the regulatory regime

on the provision of certain services in relation to cryptocurrencies. The intermediaries subject to the VC Bill include brokers, exchanges, wallet providers, asset managers, investment advisors and market makers dealing in cryptocurrencies.

Other ICO friendly countries include Singapore and Switzerland. They have well developed financial system and corresponding regulations. They both regulate security like tokens under their existing securities law. However, both countries proactively support ICOs.

*“ Notably, Singapore operates “Fintech Regulatory Sandbox,” which encourages “financial institutions in addition to FinTech players to try out cutting-edge economic products or services” as well as providing “suitable safeguards to keep the total safety and strength of the economic system.” Switzerland harbors Crypto Valley to become the next Silicon Valley and the international center for crypto innovations.”*

From these, it can be surmised that a new ICO legislation calls for a government agency which administers the actual ICO procedures and registration of technology service providers including exchanges. Such government body should also be capable of coordinating existing laws such as securities law and anti-money laundering law. The clearer the guideline is the better for the businesses to confidently start their operation in Mongolia. In addition, a supportive attitude toward ICOs both in policy and action is a must.

Without a solid legislation and guidelines, many ICOs have failed because they were not able to pass muster with existing laws, especially securities law. For example, ICO issuer Black Cell Technology Limited (Black Cell) has halted its initial coin offering (ICO) to the Hong Kong public and agreed to unwind ICO transactions for Hong Kong investors by returning them the relevant tokens following regulatory action by the Securities and Futures Commission (SFC) over concerns that Black Cell had

engaged in potential unauthorized promotional activities and unlicensed regulated activities.

The issue at heart is whether ICOs could provide the public with investment opportunities as a security. The majority of countries sweepingly ban security type ICOs under their securities law. In addition to legislating the governing body and relevant laws regarding ICOs, if Mongolia legislates an exemption or a special provision for security type ICOs, it will be a magnet for DLT based businesses from all over the world. Even US has opened the door for a similar activity such as equity crowdfunding under the Jumpstart Our Business Startup Act. JOBS Act is a law intended to encourage funding of small businesses by easing many of the country's securities regulations.

Now is the time to act. The development of ICOs is at still an inchoate stage. As of February, 2018, there has been about 53 successful ICOs. Successful ICOs for the purpose of this report mean that it has raised more than 10 million in USD; and that it is perceived as stable in the market; and that is still in operation; and lastly should have not engaged in a fraudulent scheme. Specific ranking is as follows:

Countries with successful ICOs that raised more than 10 million USD and its number

1. Singapore: 11
2. Switzerland: 10
3. Cayman Islands: 7
4. USA: 6
5. UK: 3

As you can tell, small but proactive countries like Singapore and Switzerland did more ICOs than behemoths like USA and UK. Also note that the overall number of successful ICOs are still few. Mongolia should take part in this development; the sooner the better.

August 2018



**Host:**  
Namsrai Tsend

**Commentator:**  
Jargal Dambadarjaa

## DeFacto **REVIEW**

Every Sunday live at 7pm on MNB World television: 17th November, 2019

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## THE MONGOLIAN CONSTITUTION WAS AMENDED

Amendments to the Mongolian constitution were approved by Parliament on the 14th of November with unanimous support of the 63 Members of Parliament present in the session. Our constitution has 70 articles out of which 19 articles and 36 provisions were amended. The amendments have to gain approval from the President and the Constitutional Court but it is expected that this will take place. Following this, the amendments will come into effect on May 25th, 2020. Prior to rendering judgement on the amendments, we should contemplate on whether it strengthens parliamentary democracy as well as the changes that it will bring to executive power, judicial power and local administration.

**The judicial system** is the most critical issue facing the Mongolian democracy at the moment with widespread calls for reform. The current amendments shift the structure of the judiciary through the establishment of regional circuit courts rather than courts in every city, aimag and soum. Moreover, changes were made to the General Council of Courts whose membership will increase to 10 with 5 members being elected from lawyers with the Head of the Council being elected from among members. The rules and procedures governing its operation and that of the Judiciary Disciplinary Committee will be reflected in two of the 30 laws that are being amended.

These amendments also entail provisions for the **strengthening of parliamentary democracy** in

Mongolia through measures such as increasing parliamentary sessions from 50 days to 75, requiring two-thirds majority with 50% of Parliament voting for legislation to pass, open voting, removal of parliament members from office following offences, dissolution of parliament following a vote of no confidence supported by two-thirds of parliament and that the Prime Minister should call

elections within 10 days of dissolution of parliament with an election being held within 60 days during which the incumbent parliament will operate. Moreover, the amendments also include a provision whereby no more than 4 parliament members can serve as Ministers.



**Regarding executive power**, the prerogatives of the Prime Minister have been strengthened with the right to nominate and dismiss all cabinet members. Another provision that would enhance democracy is the provision allowing permanent committees to create temporary inquiry committees with the involvement of minority parties as in the UK parliament. Moreover, the amendments hold that referendums regarding sovereignty and territorial integrity shall not be brought before the public. Starting from 2028, political parties will require the membership of 1% of the electorate, currently around 20,000 individuals. Additionally, for the first time in our history, the constitution explicitly states that properties, revenues and expenses of political parties are to become public information.

The amendments also touched on **mineral resources** with Mongolian territory being named as state-public property rather than state property. Moreover, it holds that the state policy on the use of mineral resources should be long-term and that it shall be based upon the long-term development policy of Mongolia. The proceeds from natural resources are to be centralized in the sovereign wealth fund and directed towards the just consumption of the people. In addition, the majority of strategic deposits are to belong to the people.

These amendments don't bring all the reforms we wanted but the judiciary system is now more or less independent from the Office of the President. As statute of limitations are not covered in the constitution, it was not amended but it is still a source of great concern. The working group on the constitutional amendments mostly consisted of lawyers and it carried out exceptional work even though



the state-public status of land and properties may spark discussion in the future. It is also worth mentioning that Erdenet and Darkhan were bestowed the status of a city through these amendments. More importantly, Ulaanbaatar, cities and aimags were given more control over their economic policy and taxes, allowing them to for example, issue bonds for projects. There will be public outrage if these new-found powers are used to increase taxation, but it can be used to share existing taxes which almost exclusively go to Ulaanbaatar.

## NEW SCHOOL BUS SYSTEM

There are about 1.2 million people taking part in the traffic movement in Ulaanbaatar with 500,000 cars creating a significant amount of congestion. Therefore, an initiative of providing buses for approximately 3,000 primary school students is welcomed by the people. Almost 3,000 cars will be taken off the streets through this project so parents are very supportive of this. According to the city council, the project will cost about 30 million MNT a month. If this is accurate, it will cost around 10,000 MNT per child per month, substantially lower than alternative forms of transportation. This is also an issue of quality of education, as children in the periphery of the city have more access to quality schools in the city.

There were incidents of public officials utilizing state cars to bring their children to schools that was recently



uncovered, and it is unlikely that they will continue to do so. This is an ethical issue and the city even issued an ordinance whereby private use of public vehicles shall serve as grounds for termination. It is interesting that this coincided with the beginning of the new school bus service so those children can take advantage of this.

## STATE BUDGET FOR 2020 APPROVED WITH A DEFICIT OF 2 TRILLION MNT

The 2020 state budget was approved with a deficit of 2 trillion MNT. This budget is of course an election budget with everyone attempting to secure a bigger slice of the pie for their own constituencies reflected in plans to create a significant number of schools and hospitals in soums. It was approved on the premise that the budget will grow by 6% a year for the next three years and a threefold decrease in the budget deficit. The income of the budget is 11.8 trillion MNT, constituting 29% of GDP and the expenses are 34% of GDP with a deficit of 2.7 trillion MNT or 5.1% of GDP. This means that the Mongolian economy will be at 40 trillion MNT or 15 billion USD. The economy is growing but we must not forget that inflation is also growing.

82% of the budget will originate from taxes and 8% from non-tax revenue meaning that 90% of the budget shall be made up of taxes and non-tax revenue. 20% of the budget goes towards salary and 30% towards social care. This raises the question of increased social insurance taxes putting a strain on the operation of private companies while the state lost 104 billion MNT in social insurance taxes by keeping them in a bank that would go bankrupt. There is a tendency of increasing taxes while they are utilizing them in an incredibly irresponsible manner.

The new change in the mining royalty's legislation means that the deficit may even be more than 2 trillion MNT. We may need to borrow more money or issue bonds, but this budget is under the watchful eye of the IMF that creates some sense of relief. Significant repayments on our foreign debt are to begin in 2021 so this Finance minister who will be replaced following the election may not be inclined to pay much attention to the 2021 budget. While Mongolia has never approved a budget without a deficit, it has dropped from 19% in 2016 to 5.1% today.

A Constitutional Court decision struck down mining

royalties on the basis that it was unconstitutional to collect royalties while the minerals were raw and when they were processed. This served as a source of great confusion in the economy as well as the mining sector and will result in 1.3 trillion MNT that would have come from royalties leaving the budget if the issue is not resolved in an expedient manner. The issue will most likely drag on following the return of the Head of the Constitutional Court from Korea.

Budget deficits depend on foreign debt, inflation rate, nature of deficit and the overall vibrance of the economy. In the case of Mongolia, we are still reliant on commodities and 80% of the budget is derived from taxes so our economy is not competitive or diversified enough to replace the mining revenues. We need to introduce agricultural products to the international market and the Mongolian IT sector also has great potential. If the economy becomes diversified and less reliant on the mining sector, it will be in a much better state.

Also, vast differences in prices in the countryside and the cities mean that it is incredibly difficult to effectively evaluate the merits of government investments. Therefore, Mongolia also needs an auditing system that carries out professional auditing of all state investments. This will also in turn lead to less deficit. There is an IMF program that is pending on the increase of equity capital of commercial banks, but an independent auditing firm found that this was not carried out in accordance with banking rules. We are therefore in a state of limbo and the multitude of unsolved corruption cases have seen us in the grey list. Without leaving the grey list, resolving corruption cases and public money being returned to the people, there is little potential for economic stability in Mongolia.

*This review has been edited here for space and clarity. You can watch the full 30-minute review on the Defacto website [\[HERE\]](#).*

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