

Provisional translation

DECREE OF THE GOVERNOR OF
THE BANK OF MONGOLIA

Date: June 02, 2008

No. 239

Capital Ulaanbaatar

Regarding guideline approval

In accordance with the Article 28.1.2 of The Law on Central Bank (The Bank of Mongolia), it is hereby decreed:

1. "Liquidity risk management guideline" is approved as shown in the annex to this decree
2. This guideline shall be effective from September 1, 2008.
3. Chairmen of the bank board of directors are hereby obliged to approve and submit to the Bank of Mongolia the Liquidity risk management strategy, internal rules and codes of the strategy and "Crisis recovery and resolution plan" in line with the requirements stated in article 3.1, article 3.2 and article 3.6. of this guideline respectively within August 1, 2008.
4. Chief executive officers of banks are hereby obliged to develop the information system consistent with requirements in the article 3.3, to develop the net cash flow measuring and monitoring system as stated in the article 3.4, to implement the development of the internal control system consistent with the requirements in the article 3.7 of this guideline and shall submit the progress to the Supervision Department of the Bank of Mongolia within August 1, 2008.
5. The Supervision Department (Mr. Ganbaatar. J) and Bank training center (Mr. Lhagvasuren. B) are hereby obliged to conduct the training to commercial banks as regards this guideline before June 20, 2008.
6. Compliance and fulfillment to this decree are to be reviewed by the Supervision Department (Mr. Ganbaatar. J).

THE GOVERNOR OF
THE BANK OF MONGOLIA

BATSUKH. A

GUIDELINE ON THE LIQUIDITY RISK MANAGEMENT

ONE. GENERAL PROVISION

The objective of this guideline is to comply with the provisions stated in the article 4.2 of the Law on Central Bank /Mongolbank/ to ensure the stability in the banking sector and with the regulation issued in line with the article 15.1 of the Banking law to ensure the bank liquidity and to pay out depositor and customers' money on their first demand.

TWO. TERMINOLOGIES

Terminologies used in this regulation shall have the following meaning:

- 2.1. "Liquidity risk" is the situation where a bank is either unable to perform its duties for the costumers on demand or is too costly or impossible, despite the capital adequacy ratio is not deteriorated.
- 2.2. "Asset and liability maturity mismatch" is expected cash flows of asset and liability classified by their maturity.
- 2.3. "Scenario" means the forecast on the cash flow and maturity of assets and liability.
- 2.4. "Stress sscenario" is real threat where a bank unable to perform its duties to its customers.
- 2.5. "Recovery and contingency plan" is a document detailing the series of actions to implement in the stress scenarios to raise funding.

THREE. QUALITY REQUIREMENTS

- 3.1. Bank shall have strategy on the liquidity management to protect its financial standing and to overcome stress scenarios. Following policy and principles shall be included in the strategy:
 - 3.1.1. Policy on liquidity management including qualitative and quantitative goals,
 - 3.1.2. Principle on liquidity risk modeling taking into account both the historical data and potential events in the future,
 - 3.1.3. Principle of lowering liquidity risk and maintaining it at the required level by taking into account asset and liability structure, operational restrictions and asset liquidity,

- 3.1.4. Principle of using various financial instruments for liquidity risk management¹,
 - 3.1.5. Principle of managing liquidity risk in terms of foreign currencies,
 - 3.1.6. Principle of ensuring the stability of the funding and its distribution,
 - 3.1.7. Principle of resolving both short and long term liquidity problems,
 - 3.1.8. Principle of developing and renewing “Recovery and contingency plan”
- 3.2. Following points shall be addressed in bank’s internal regulations and rules regarding the strategy on the liquidity risk management.
- 3.2.1. To develop the efficient corporate governance system that includes clearly written associated employees’ rights and duties and is able to implement liquidity management strategy,
 - 3.2.2. Cooperation and information exchange of unit in charge of liquidity risk management with other units,
 - 3.2.3. To develop methodology to review liquidity risk by both individual and total foreign currencies,
 - 3.2.4. To develop method on monitoring, imposing constraints over quantitative data applied for liquidity management,
 - 3.2.5. Measures to enforce for breaching pre-set limits,
 - 3.2.6. Step by step guidance on granting permission to operate beyond the pre-set limits,
 - 3.2.7. Approach to measure liquidity risk, methods to develop scenarios and the requirements set for reviewing and validating the predictions and parameters used in the calculations,
 - 3.2.8. Information communication process for bank management, employee in charge of liquidity risk management and other relevant employees,
 - 3.2.9. List of information on the bank liquidity to the public on a regular basis,

¹Calculation of size, limits and the cash flows of each financial instrument

- 3.2.10. Method for reviewing the accuracy and credibility of the liquidity risk management systems,
- 3.3. For the purpose of managing liquidity risk, bank shall develop an information system which facilitates information that is applicable for estimating, monitoring, managing and reporting the liquidity status and communicate them effectively to the bank management and employees. This information system shall be able to perform following procedures:
 - 3.3.1. Calculate liquidity for a given period on a daily basis,
 - 3.3.2. Calculate liquidity in terms of major foreign currencies and as a whole,
 - 3.3.3. Validate and review scenarios in line with the requirements stated in the article's 3.2.7 of this guideline
 - 3.3.4. Compare calculated liquidity indicator with pre-set limit,
 - 3.3.5. Assess bank's liquidity trend.
- 3.4. Bank shall create the system that measures and monitors net cash flow in line with the following requirements:
 - 3.4.1. Provide all necessary quantitative data for effective liquidity management in a timely manner
 - 3.4.2. To classify both on- and off-balance sheet items, compare and measure income increase and decrease in funding,
 - 3.4.3. Calculate and review net cash flows in a daily, weekly (5 working days), monthly or any other time bands on daily basis,
 - 3.4.4. Set up a liquidity limit based on calculated values,
 - 3.4.5. Set up a separate limit for largely foreign currency positions,
 - 3.4.6. To define all possible stress scenarios that a bank or banking system may be exposed to and calculate liquidity needs in case of risk event.

3.5. In order to ensure the stability of the funds raised and reduce concentration, a bank shall keep a good communication with significant customers, monitor funding stability and have a enough set of information information at its disposal. In the case stressed scenario, a bank need to explore the possibilities to sell assets effectively.

3.6. Banks shall have “Recovery and contingency plan” detailing the actions to be taken in order to maintain an adequate amount of liquidity in times of stress.

3.6.1. “Recovery and contingency plan” shall include the following items:

- Provide all necessary information for the internal decision making process in a timely manner,
- Clearly define related employees’ rights and duties,
- Ways of affecting the changes in assets and liabilities,
- Approach to Communicate with borrowers, customers and general public,
- Necessary funding source to maintain its liquidity during the expected scenarios, and calculation of amounts of the liquid assets.

3.6.2. “Recovery and contingency plan” shall be renewed when bank’s internal and external conditions significantly change.

3.7. Banks shall develop an internal control system which monitors the completeness of the liquidity risk management system and which also shall be part of the overall internal control system.

3.7.1. Internal control system for liquidity contains the following:

- Control environment,
- Process of identifying and assessing liquidity risk,
- Introduce control procedures regarding the policies and processes,
- Information system,
- Ongoing supervision on the status on policies and processes being implemented.

3.7.2. Internal audit department shall monitor and ensure the compliance of the measures taken and approaches implemented by the management and the employees of the bank on the liquidity with internal rules and procedures as well as the effectiveness of the liquidity management and subsequently shall include the outcome in its reports.

3.7.3. If mistake or wrongdoing has been detected during internal audit process, it shall check if the following measures were properly implemented:

- If the measures to rectify the mistakes and violations have been taken,
- If the system has been changed or repaired in a timely manner,
- If the official in charge of the liquidity risk management was informed on the issue.

FOUR. QUANTITATIVE REQUIREMENT

- 4.1. Banks shall estimate both incoming and outgoing cash flows on a daily, weekly (5 working days), and monthly basis. Calculation of cash flows shall take into account both on and off balance sheet cash flows and shall be done as shown in Appendix 1.
- 4.2. At the end of each the cash flow ratio for daily, weekly (5 working days) and monthly basis shall be no less than 5%.
- 4.3. Associated unit shall report the ratio of incoming and outgoing cash flows to unit in charge of assets and liability management and treasury department on a daily basis.
- 4.4. A unit in charge of a bank risk management shall carry out monthly comparison of projected cash flow ratio to the actual cash flow ratios and if necessary it may improve its calculation method. (Example shown in appendix 3.)

FIVE. MISCELLANEOUS

- 5.1. Quantitative and qualitative requirements in this guideline may be exempt for a foreign bank branch if it fulfills following requirements:
 - 5.1.1. An agreement on the cooperation and information sharing arrangement has been concluded by the Bank of Mongolia and supervisory authority of the parent bank,
 - 5.1.2. Liquidity management system by the branch has been fully integrated with centralized liquidity management system of the parent bank,
 - 5.1.3. The official letter of the parent bank to the Bank of Mongolia asserting the that it will ensure the liquidity of its branch
 - 5.1.4. The permission to apply the liquidity management system of the parent bank by the Bank of Mongolia was issued.