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RELEVANT PROCEDURES FOR VIRTUAL ASSET SERVICE PROVIDERS

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LEGAL ALERT: RELEVANT PROCEDURES FOR VIRTUAL ASSET SERVICE PROVIDERS HAVE BEEN APPROVED

In October 2019, Mongolia was placed on the list (*by the International Organization for Financial Action Task Force (FATF)*) of countries having strategic deficiencies in their regimes to combat money laundering, terrorist financing, and the financing of the proliferation of weapons of mass destruction. 1 year later in October 2020, it was successfully removed from the list.

In the process of delisting, number 15 of the 40 technical and professional recommendations issued by the FATF addressed the issue of “monitoring, regulating and registering virtual asset service providers, and providing a legal framework for this type of relations.”¹ In this context, countries are undertaken to assess the risks of money laundering, financing of terrorism and proliferation of weapons of mass destruction in connection with new technology-based products and services, more specifically virtual assets, and to establish a legal framework. Accordingly, the Parliament of Mongolia has adopted a “Law on Virtual Asset Service Providers” on December 17, 2021, and the law came into force on February 25, 2022. Upon entry into force of the law, the legal environment for the Financial Regulatory Commission of Mongolia /hereinafter referred to as the “FRC” or as referred to herein/ to register Virtual Asset Service Providers that meet the requirements under the law and the regulations issued in accordance with it, and to conduct risk-based inspections of their activities are established.

There are several cryptocurrency trading websites and one ATM in Mongolia, and the related services are neither recognized or accepted as payment services in Mongolia nor are under the supervision and regulation of any organizations such as the Bank of Mongolia and the Financial Regulatory Commission. In particular users trade bitcoins and other cryptocurrencies on an exchange basis only as per their discretion through websites. In other words, the auction is based on trading principles, market principles or the law of supply and demand, and the reactions of traders. Lately there has been an increase of raising capital from the domestic market through IEO and ICO. For instance, the number of tokens in the domestic market has increased from 4 to 41 in the last quarter of 2021 (Lemon Press, 2021) creating substantial risks in the market.

Therefore, in connection with the urgency to establish the legal framework without delay and to ensure the implementation of the law, the FRC has adopted the “**Procedure for Registration of Virtual Asset Service Providers**” and the “**Procedure for Operation of Virtual Asset Service Providers**” on April 6, 2022, and the “**Procedure for Remote and On-Site Inspection on Virtual Asset Service Providers**” and the “**Procedure for Restriction on, Suspension and Deregistration of Virtual Asset Service Providers**” on May 25, 2022. Hereupon, the pre-conditions for improvement of the legal environment of virtual asset service providers, elaborate determination of particular relations, protection of consumer rights, implementation of the FATF recommendations and enforcement of the law have been put in place. Specifically, the “Procedure for Registration of Virtual Asset Service Providers” regulates the registration and refusal to register as a virtual asset service provider,

¹ “The FATF Recommendations” 2022

and the “Procedure for Operation of Virtual Asset Service Providers” regulates the relations with respect to determination of the requirements for proper governance, operations, equity capital, and reporting requirements (FRC, 2022).

From June 25, 2022 or 4 months after coming into effect of the Law on Virtual Asset Service Providers, the Financial Regulatory Commission has started registering virtual asset service providers. ***On the other hand, the exchanges that started operations before the implementation of the law, must be registered by September 25, 2022.*** In connection with the start of registration of virtual asset service providers by the FRC, regulations under the above procedures are outlined in this article.

Virtual asset services:

- The following activities are regulated as virtual asset service which are related to virtual assets conducted on behalf of individuals, legal entities and parties to agreements upon their subscription or conducted for them:
 - a) Exchange between virtual assets and fiat currencies;
 - b) Exchange between one or more other forms of convertible virtual assets;
 - c) Transfer of virtual assets (to transfer, on behalf of others, virtual assets from one virtual asset address or account to another)
 - d) Safekeeping and/or administration of virtual assets or their related instruments; and
 - e) Participation in and provision of financial services related to public offering and/or sale of a virtual asset.

For the virtual asset services specified in paragraphs (a) and (b), the Mongolbank (the Central bank of Mongolia), while for the services specified in paragraphs (c), (d), and (e), the FRC shall supervise, regulate and ensure the fulfillment of obligations of the service providers. Registration fee is tentatively set between MNT 40,000 (app USD 14) and MNT 80,000 (app USD 28).

Virtual asset service providers:

- For-profit legal entities registered in Mongolia to provide one or more of the services specified above.

Requirements for virtual asset service providers:

1. The activities of the service provider shall be the above-mentioned virtual asset services.
2. The service provider shall use commonly used technologies worldwide that are accepted by Mongolbank and the FRC.
3. Information on the service provider and other persons related to its activities shall be definite.
4. The service provider shall have structure, organization and specialized workforce to carry out its activity(s).
5. The service provider shall have internal control system and data storage system.
6. The service provider shall have a structure and automatic control system to implement the requirements specified in the Law on Combating Money Laundering and Terrorism Financing and the Law on Combating Proliferation of Weapons of Mass Destruction and

Terrorism.

7. Source of equity of the service provider shall be legitimate.
8. Other requirements set by laws and the Mongolbank or the FRC.

I. Overview of the “Procedure for Registration of Virtual Asset Service Providers”

This procedure regulates the relations in connection with the registration and refusal of registration of applicants for registration as a virtual asset service provider by the Financial Regulatory Commission. The Procedure shall apply to for-profit legal entities registered in Mongolia, and their provision of virtual asset services in Mongolia and from Mongolia to foreign countries.

Requirements for an applicant for registration as a virtual asset service provider:

1. Meet the requirements for virtual asset service providers mentioned above;
2. The minimum amount of share capital contributed by the applicant for the above-mentioned virtual asset service shall be at least 400.0 million MNT;
3. Share capital should consist of monetary assets other than loan sources;
4. The virtual asset service provider, its executive management and authorized officials must meet the requirements specified in the procedure for determining suitable persons approved by the FRC;
5. The applicant shall have a board of directors with five or more members, at least two of whom shall be independent members;
6. The virtual asset service provider shall include regulations related to exchange and removal of trading of virtual assets on its own software;
7. The structure, organization, human resources and other requirements specified in this procedure;

The board of directors of the applicant for registration as a virtual asset service provider shall have adopted the following rules, regulations and policy documents:

1. Operating procedure of the Board of Directors;
2. Four-year business plan of the legal entity;
3. Implementation plans and internal control programs to reduce and manage the risk of money laundering and terrorist financing in compliance with the requirements under the Law on Combating Money Laundering and Financing of Terrorism
4. Information transparency and reporting procedures;
5. Operating procedures for IT security in accordance with the requirements under the **MNS ISO/IEC 27001** standard and the Law on Cyber Security;
6. Procedure for prevention from illegal insider trading;
7. Procedure for prevention from and monitoring of abusive trade;

8. A detailed action plan in the event of emergency situations such as suspension of and restriction on operation, liquidation, service suspension, cyber attack or aggression;
9. Operational procedures related to provision of virtual asset services;
10. Other necessary procedures.

The procedure related to the participation in and provision of financial services related to public offering and/or sale of a virtual asset shall include the following:

1. Requirements for the virtual asset issuer, the virtual asset to be offered to the public and its prospectus;
2. Obligations of the issuer of the virtual asset to be offered to the public, content and period of information to be delivered to the virtual asset service provider;
3. Conditions for deregistration of virtual assets issued by public offering;
4. Others.

Applicants for provision of virtual asset services shall have the following structure and organization and human resources specialized in the field:

1. To have a unit or employee in charge of implementation of internal control and risk management;
2. To have a unit or employee in charge of information technology and security;
3. To have a customer service unit or employee;
4. To have a unit or employee in charge of monitoring the implementation of the Law on Combating Money Laundering and the Financing of Terrorism and implementation of compliance control, and the person supervising the implementation shall be a board of directors;
5. To have a unit or employee in charge of activities related to the provision of virtual asset services.

The applicant shall have software suitable for characteristics of the activities and for the provision of virtual asset services in a swift, continuous manner. The software shall meet the following requirements:

1. Trade participants are unable to identify each other;
2. The customer's personal data shall be confidential from third parties;
3. To be able to develop and upgrade in accordance with market requirements;
4. To have a public information section or open board;
5. To have a trading control system;
6. To have an officially licensed security system.

REGISTRATION OF VIRTUAL ASSET SERVICE PROVIDER

1. The applicant shall submit the documents required for registration of the virtual asset service provider to the FRC in printed or electronic form, together with supporting documents.
2. The FRC shall resolve the request for registration within six /6/ months from the receipt of the request and sufficient and complete documents. This period may be extended for a period of up to six /6/ months, if required.
3. If the documents submitted for registration are incomplete or the evidence does not meet the requirements, the applicant may be notified in writing and additional documentation may be required.
4. The period for registration of the applicant shall be calculated from the date of submission of sufficient and complete documents.
5. If the FRC registers the applicant as a virtual asset service provider, it shall be registered in the unified registry of virtual asset service providers and a basic record shall be opened according to the appropriate instructions.
6. In case the applicant is registered as a virtual asset service provider, relevant entries shall be made in the company's charter and state registration certificate, and their copy shall be submitted to the FRC within 15 working days from the date of the registration.

REFUSAL OF REGISTRATION AS A VIRTUAL ASSET SERVICE PROVIDER

1. The documents submitted for registration have been forged;
2. The authorized official and the related person do not meet the criteria for suitable person set by the FRC;
3. The conditions and requirements stipulated in the Law on Virtual Asset Service Providers and the Procedure are not complied.

If the applicant does not complete the documents required under the Law on Virtual Asset Service Providers and resubmit its request within 30 working days after receiving the notification on incompleteness of the submitted documents, the request shall be returned and considered as not having been submitted.

In the event that the FRC refuses to register as a virtual asset service provider, reasonable explanation in this regard shall be notified to the applicant.

II. Overview of the Procedure for Operation of Virtual Asset Service Providers

In this Procedure, the relations in connection with determination of the requirements for proper corporate governance, operations, amount of equity capital of, and reporting by virtual asset service providers /hereinafter referred to as the "VASP"/ are regulated. The VASP shall protect the interests of customers and support fair competition in the virtual asset market.

The VASP, in order to prevent illegal insider trading and abusive trade, shall regularly implement internal controls and inspection on the orders and trades that are:

1. with high value;

2. with high fluctuation in increase and decrease in the price;
3. conducted in small quantities at a price that could affect the exchange rate;
4. conducted between related and affiliated persons for 5 or more times;
5. Others considered unusual or noteworthy.

After the completion of a virtual asset trading transaction, the customer shall be provided with the following information:

1. Name of the virtual asset;
2. The time the transaction has been completed;
3. Amount and price of traded virtual assets;
4. Other necessary information.

The VASP shall be available to organize trading in the following ways:

1. Market order;
2. Limit order.

The VASP shall submit the information on delisted virtual assets to the FRC in writing within 24 hours with an explanation.

The following provisions shall be enforced from July 1, 2023.

In the course of carrying out the transfer of virtual assets, the transferring VASP shall submit the following information to the recipient VASP if the transferred virtual assets worth three million MNT or more:

1. surname and first name of the transferor/name of the legal entity;
2. registration number of the transferor;
3. transfer number or transferor's wallet address;
4. registered address of the transferor;
5. purpose of the transfer;
6. Recipient's surname and first name / name of the legal entity;
7. Registered address of the recipient;
8. Name of the receiving country;
9. Name of the VASP of the recipient;
10. Others as necessary.

Requirements for the transfer of virtual assets:

1. In case of receiving transfers from non-registered wallets, the VASP shall have obtained the above-mentioned information.

2. The transferring VASP shall deliver the above information immediately prior to the transfer or during the transfer in a secure form.
3. Before transferring and receiving the above-mentioned information, the transferring and recipient VASPs shall identify the cooperating VASP, identify the customer, and make the transaction upon evaluation of the compliance with requirements of the confidentiality and security of information.
4. In case of transfer through a shared VASP, the transferring VASP shall also deliver the above information.
5. The transferring VASP shall check the accuracy of the information of the transferring customer and the recipient VASP shall check the accuracy of the information of the recipient customer.
6. The VASP shall implement risk-based approach to identify customers and shall not make transfers to or establish business relationships with persons considered to have high risk.
7. The transferring and the recipient VASP shall keep the above-mentioned information available for prompt submission to the competent authority.
8. The VASP shall conduct at least two-factor authentication and verify the accuracy and authenticity of the IP address and wallet address in the course of the transfer of virtual assets.

The following requirements must be complied when conducting safekeeping and/or administration of virtual assets or their related instruments.

1. The VASP shall keep and administer customers' virtual assets in the amount not exceeding 100 times of its own equity capital.
2. The VASP shall calculate the criteria of its own equity capital every quarter and comply with the above requirements.
3. The VASP shall conduct at least two-factor authentication and verify the accuracy and authenticity of the IP address and wallet address in the course of keeping and administration of virtual assets in accordance with customers' instruction.

Requirements for organization of, participation in and provision of financial services related to public offering and/or sale of virtual assets

1. Before organization of activities related to the public offering and sale of virtual assets, the VASP shall have concluded a cooperation agreement with the issuer of the virtual asset.
2. The VASP shall submit the prospectus of the virtual asset, relevant documents and information to the FRC within 10 working days before organizing the public offering and sales.
3. The VASP shall regularly monitor the implementation of the prospectus, tokenomics, and action plan, and take actions to reduce risks.

Before organizing activities related to the public offering and sales of virtual assets of the issuer, the VASP shall have made a decision based on the following information:

1. whether the virtual asset and its project are economically efficient, realistic and feasible;
2. whether the virtual asset issuer, its ultimate beneficial owner, or authorized official has been involved in economic crimes, has no overdue debts, has business reputation and professional team;
3. whether the the blockchain in which the virtual asset is maintained is fully developed and comply with cyber security;
4. Others.

The VASP shall demand the following information to be contained in the prospectus for the public offering and sale of virtual assets of the virtual asset issuer:

1. The prospectus must be written in Mongolian;
2. Use of the virtual asset, intended purpose, type of blockchain;
3. Name, postal and contact address of the virtual asset issuer, and the activities it is engaged in;
4. Information on the shareholder of the virtual asset issuer, its ultimate beneficial owner, the number and percentage of shares held;
5. The structure and organization of the virtual capital issuer, names, pictures, work experience and other additional information of authorized officials;
6. Financial statement of the virtual asset issuer for the last 1 year, and its audit opinion;
7. Quantity and price of the virtual asset to be offered to the public;
8. Disbursement and action plan for drawn funds;
9. Information on distribution and allocation of virtual assets;
10. Information on the risks that may occur in the activities of the virtual asset issuer;
11. Technological audit conclusion on the virtual asset;
12. Other information deemed necessary.

The VASP shall post the following information transparently and openly on its software and website:

1. Registration as a virtual asset service provider, and instructions, recommendations and manuals related to the use of the Virtual Trading Software;
2. Public contact phone number, e-mail address, social network address, operating address and location;
3. Prospectus of virtual assets offered and sold to the public domestically and traded on its software;
4. Information on premiums and fees for products and services;

5. Registration number, distinguishing mark on blockchain, total issued and traded quantity, value, exchange rate, and trade amount of virtual assets;
6. Virtual asset registration requirements, criteria, rules and regulations;
7. Information on receiving and resolving customer feedbacks and complaints;
8. Introduction of the primary business activities, financial statements, and transactions that have a direct impact on the business of the VASP;
9. Information on changes and upgrades of software, systems and information technology used in operations.

The VASP shall publish the following information regularly or from time to time in the software and on the website in a transparent and open manner in advance and inform the public:

1. Information on the trading conducted by the VASP in order to stabilize the price difference and increase liquidity in the event the price of virtual assets in the trading software is relatively lower or higher than the average price on the international market;
2. Information on repurchase by the issuer of the virtual asset in order to prevent a sudden drop in the price of the virtual asset on the basis of an agreement with the VASP.

Information and reporting

1. The VASP shall inform customers and the general public and submit the report to the FRC information stipulated in the law and this Procedure in a complete, accurate and unambiguous manner within the established period and in each case.
2. The VASP shall regularly submit its annual financial statements to the FRC by February 10 of the following year, and the semi-annual and quarterly financial statements by the 20th of the following month.
3. The VASP shall submit its annual financial statements and audit conclusions certified by an auditing entity to the FRC by May 1 of the following year.

The VASP shall regularly submit its annual report of operations containing the following information to the FRC by March 1 of the following year and inform the public:

1. Factors that have affected the income of the VASP in the reporting year;
2. Whether it is possible to fully cover the liabilities arising from business activities with financial resources and, if necessary, to draw funds from external and internal sources;
3. Innovation, diversification and change of products and services;
4. Quantitative indicators of virtual and monetary assets of customers that are stored and administered;
5. Risk assessment conclusions, risk reduction and preventive measures made for the continuous, reliable operation, confidentiality and security of the used software, systems, information and technological infrastructure;
6. Conflict-of-interest and major transactions, and parties to those transactions;

7. Risk management implementation and internal audit report;
8. Other information.

In order to protect the interests of customers, the VASP shall take the following actions:

1. keep a record of applications and complaints by customers and respond within 7 working days after receiving them;
2. quarterly organize activities aimed at improving the awareness of customers and the public about the risks of virtual assets;
3. obtain a guarantee from its employees on non-disclosure of customers' personal data and non-use of them for purposes other than work requirements.

III. Overview of the “Procedure for Remote and On-Site Inspection on Virtual Asset Service Providers”

Under this Procedure, relations in connection with inspections and issuing of conclusions on whether virtual asset service providers comply with the Law on Virtual Asset Service Providers, the Law on Combating Money Laundering and Financing of Terrorism, and the regulations and instructions issued in accordance therewith, and taking actions to eliminate any identified violations or deficiencies are regulated.

The FRC shall carry out the following types of inspections:

1. remote inspection;
2. on-site inspection

(1) Remote inspection: The purpose of remote inspection is to monitor, evaluate, and issue conclusions on whether the VASP complies with laws, relevant conditions, requirements, and procedures in order to prevent risks.

(2) On-site inspections: In the case of violations and deficiencies identified as a result of the on-site inspection, time-bound assignment shall be given under the inspection report and official request of the State Inspector, and if necessary, infringement case shall instigated, or in case of relating to nature of felony, it shall be transferred to the relevant authorities according to the jurisdiction.

On-site inspections shall be conducted on the following basis:

1. the result of the remote inspection specified in this Procedure;
2. proposals, conclusions and complaints with appropriate evidence submitted by competent government authorities and citizens;
3. to calculate the implementation of the assignment and tasks given under the previously conducted inspections;
4. audit conclusions and recommendations on the VASP's financial statements;
5. the VASP has failed to implement the assignment specified in the remote inspection report.

IV. Overview of the “Procedure for Restriction on, Suspension and Deregistration of Virtual Asset Service Providers”

This Procedure regulates relations in connection with establishing restrictions, temporary suspension, and deregistration of the activities of “VASPs” registered with the FRC.

ESTABLISHING RESTRICTIONS ON ACTIVITIES OF VIRTUAL ASSET SERVICE PROVIDERS

1. For the purpose of combating money laundering and terrorist financing, the FRC may establish restrictions on sending and receiving transactions, customers, customer limits, foreign countries to where transactions are carried out, or drawing funds from certain legal entities or foreign countries, and on specific virtual assets and related products.
2. Restrictions are based on remote and on-site inspections on the VASP, conclusions, recommendations, notifications, warnings, and statements of other competent authorities.
3. The VASP may submit its request for removal from restrictions to the FRC along with supporting documents, and the FRC shall review and resolve the request within 20 working days.

SUSPENSION OF SERVICES OF VIRTUAL ASSET SERVICE PROVIDERS

1. If the cause for the suspension has been removed, the VASP shall submit a request for resumption of its service to the FRC with supporting documents.
2. The FRC shall review and resolve the request within 20 working days.
3. The FRC shall publish its decisions on suspension and resumption services of the VASP available to the public.
4. The suspension of operations shall not limit the right of the VASP to carry out withdrawal transactions of virtual and monetary assets with the consent of the customer.

The FRC may temporarily suspend the operations of VASPs for a period of up to 3 months in the following cases:

1. The VASP has failed to comply with the official request provided by the FRC and to fulfill its obligations within the given period, regarding compliance with the conditions and requirements specified in the Law on Virtual Asset Service Providers and other relevant laws and regulations of the sector;
2. The FRC and its inspectors have provided notices and warnings in connection with the activities of the VASP twice or more times;
3. A competent person has submitted a reasonable request about the activity being conducted through committing a crime.

DE-REGISTRATION OF VIRTUAL ASSET SERVICE PROVIDERS

1. A request for re-registration of the VASP that has been deregistered shall not be accepted within one year after the decision on the deregistration becomes effective.
2. The company delisted from the register of VASPs shall take the relevant actions in accordance with the plan and the contract with customers and submit the report to the FRC within 20 working days.
3. De-registration of the VASP shall not limit the right of the VASP to carry out withdrawal transactions of virtual and monetary assets with the consent of the customer.

The FRC shall deregister the VASP in the following cases:

1. It has been determined that the VASP is no longer capable to meet the conditions and requirements specified in the Law on Virtual Asset Service Providers, other relevant laws and regulations of the sector;
2. The Virtual Asset Service has not been commenced within 3 months after the registration;
3. A request for removal from the register has been submitted to the FRC, or a decision of the shareholders' meeting or a court decision on liquidation has been issued;
4. It has been found that the documents were forged and registered with the FRC;
5. Causes for the temporary suspension and violation have not been eliminated within the period of suspension;
6. It has been found that the VASP has caused considerable damage to customers by committing a crime.

References:

1. "The FATF Recommendations" 2022.03. <https://bit.ly/39myJoG> - accessed 05/14/2022
2. Financial Regulatory Commission, "PROCEDURES FOR VIRTUAL ASSET SERVICE PROVIDERS HAVE BEEN APPROVED", <http://www.frc.mn/a/3959>
3. "Law on Virtual Asset Service Providers", <https://legalinfo.mn/mn/detail?lawId=16390242606091>
4. "Procedure for Registration of Virtual Asset Service Providers", Annex to Resolution No. 174 dated April 6, 2022 of the Financial Regulatory Commission, <https://legalinfo.mn/mn/detail?lawId=16468519009871>
5. "Procedure for Operation of Virtual Asset Service Providers" Annex to Resolution No. 175 dated April 6, 2022 of the Financial Regulatory Commission, <https://legalinfo.mn/mn/detail?lawId=16468526158811>
6. "Procedure for Remote and On-Site Inspection on Virtual Asset Service Providers", Annex to Resolution No. 305 dated May 25, 2022 of the Financial Regulatory Commission, https://legalinfo.mn/mn/detail?lawId=16530417750751&fbclid=IwAR1ESjJfcUdHhkyIGBFol6R_x0h1rRRfWcwcZKOWJ3SveQpve7uGzoP5Pps
7. "Procedure for Restriction on, Suspension and Deregistration of Virtual Asset Service Providers", Annex to Resolution No. 306 dated May 25, 2022 of the Financial Regulatory Commission, <https://legalinfo.mn/mn/detail?lawId=16530417896241&fbclid=IwAR0DzX7jvQZo0EbBAUUqO9EjH6a-gOkqcFetJnP8KlbBbySkAhyZDZiCfmQ>

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