



## **LEGAL ALERT: new regulation on virtual asset service**

According to the amendment to Recommendation 15 of the International standards on Combating money laundering and financing of terrorism & proliferation (FATF 40 recommendations), dated October 2018, the terms “virtual asset” and “virtual asset service providers” have been added to the general glossary of FATF recommendations and the “virtual asset” has become subject to anti-money laundering and counter-terrorist financing system of countries. The virtual asset, as defined in the glossary, is a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes. This includes cryptocurrencies that work through a distributed ledger technology.

Mongolians have already started trading cryptocurrencies of their choice such as bitcoin through websites, however, relations in connection with virtual assets, their services and licensing have not been regulated yet. That individuals and legal entities conduct activities related to virtual assets in the absence of a legal environment put Mongolia and the participants in this relation at risk, as well as it is potential of bringing negative consequences such as creating conditions for money laundering, terrorism financing and proliferation of weapons of mass destruction. These prerequisites show an urgent need to regulate this kind of relations.

Further, despite the fact that the Financial Action Task Force (the FATF) has removed Mongolia from its list of countries having strategic deficiencies in their regime on anti-money laundering and counter-terrorist financing on October 24, 2020, Mongolia is still obliged to implement the FATF 40 recommendations. One of the recommendations (Recommendation 15) is to create a domestic legal environment regulating virtual asset relations. On the basis of these legal grounds and practical urgencies, a new Law on Virtual Asset Service Providers has been developed.

### **Overview of the draft Law on Virtual Asset Service Providers**

This law regulates the registration of virtual asset service providers, supervision or monitoring of their activities and their rights and obligations. The law applies to for-profit legal entities registered in Mongolia and to their provision of virtual asset services in Mongolia and from Mongolia to overseas.

Additionally, virtual asset, virtual asset services, virtual asset service providers, their requirements, mandatory terms and conditions to be specified in agreements made with customers and measures to be taken in the event of violation of laws and regulations by the service providers are regulated under new draft law.



In connection with the new law, virtual asset service providers are added to the reporting entities under the Law on Combating Money Laundering and Terrorism Financing. In terms of taxation, virtual asset services are exempted from value added tax.

***Virtual asset means:***

- Intangible assets with digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes.

***Virtual asset service:***

- 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 forms of virtual assets;
  - c) Transfer of virtual assets (to conduct a transaction on behalf of another natural or legal person that moves a virtual asset from one virtual asset address or account to another)
  - d) Safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and
  - e) Participation in and provision of financial services related to an issuer's offer 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 *Financial Regulatory Commission of Mongolia (the FRC)* shall supervise, regulate and ensure the fulfillment of obligations of the service providers. Registration process is estimated to cost between 40,000 MNT (app 14 USD) and 80,000 MNT (app 28 USD).

***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 base management 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<sup>1</sup> of the service provider shall be legitimate.
8. Other requirements set by laws and Mongolbank or the FRC.

***Responsibilities of virtual asset service providers:***

1. Virtual asset service providers shall keep virtual assets and monetary assets of its customers fully available for transactions and transfers. The service providers shall be liable for any damages incurred due to the failure to keep the funds fully available.
2. In the event of audits by Mongolbank or the FRC, the virtual asset service providers shall provide complete and accurate information required by the authorities without delay.
3. Virtual asset service providers shall keep customers' monetary assets and virtual assets in separate accounts.
4. Virtual asset service providers shall not dispose of customers' monetary assets and virtual assets for purposes other than to provide its virtual asset service.
5. Virtual asset service providers shall keep paper and digital documents compiled in the course of its activities for at least 15 years from the receipt or compilation date of the documents in accordance with relevant laws.

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<sup>1</sup> Mongolbank and the FRC shall, jointly, approve a procedure for the amount of equity of virtual asset service providers and other requirements.



***Mandatory terms and conditions to be specified in an agreement between virtual asset service providers and its customers:***

1. In the event of difficulties arise in activities of the virtual asset service provider, a plan to terminate its activities;
2. Measures to be undertaken in the event of deregistration of the virtual asset service provider and its cease of operation;
3. Information that virtual assets are not fiat currencies or are not guaranteed by the Central Bank or the Government of Mongolia, and that virtual assets are not subject to any insurance to protect interests of the depositors and securities investors;
4. A condition that virtual asset transactions shall be considered to have been made at the time of registration in the registration system, regardless of the time of the transaction;
5. Rights and obligations of the virtual asset service provider and its customers;
6. A condition to provide the monetary assets of the customer related to the customer's virtual assets or to transfer the customer's virtual assets to the customer at its first request;
7. The risk of abrupt changes in the value and service of virtual assets due to international standards and domestic legislation on virtual assets;
8. The risk of non-compensation of damages or losses resulting from irreversible, fraudulent or mistaken transactions of virtual assets;
9. The risk of significant losses due to fluctuation in the value of virtual assets for that the value is determined by the market demand;
10. The higher risk of fraud and cyber-attacks to virtual assets and virtual asset services;
11. The risk that customer will not be able use her/his virtual assets in the event of technological difficulties with the virtual asset service provider; and
12. The risk that assets in an ownership and possession of the virtual asset service provider may not be sufficient to fully compensate the customer.

***The Mongolbank, or the FRC and their inspectors shall take the following actions considering the circumstances and deficiencies, in the event of violation in the activities of the virtual asset service providers, provided that it is not qualified as a crime or offence:***



1. To make formal demands, give warnings and time-bound assignments on elimination of the deficiencies;
2. To assign the virtual asset service provider to implement actions to improve and strengthen its organization, activities, risk management and internal control;
3. To oblige the virtual asset service provider to dismiss, suspend or replace its governing person;
4. To restrict the activities of the virtual asset service provider partially or in whole;
5. To terminate the activities of the virtual asset service provider and deregister it.

Used sources:

1. Draft law on virtual asset service providers – <https://mojha.gov.mn/wp-content/uploads/2021/01/VASP-Tusul-20200118.pdf>
2. Concept of the draft law on virtual asset service providers – <https://mojha.gov.mn/wp-content/uploads/2021/01/VASP-%D2%AF%D0%B7%D1%8D%D0%BB-%D0%B1%D0%B0%D1%80%D0%B8%D0%BC%D1%82%D0%BB%D0%B0%D0%BB.pdf>
3. Appendix of the draft law on virtual asset service providers – Accompanying laws – <https://mojha.gov.mn/wp-content/uploads/2021/01/VASP-dagah-huuli.pdf>

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