

# LEGAL FRAMEWORK ANALYSIS

## within the ICA-EU Partnership

### National Report: Mongolia

ICA - Asia and Pacific (ICA-AP) is the voice of cooperative enterprises in the Asia Pacific region. ICA-AP, as a regional office of the ICA, is also a co-signatory of a Framework Partnership Agreement signed between the International Cooperative Alliance and the European Commission in March 2016, which aims at strengthening the cooperative movement and its capacity to promote international development. This agreement underpins the ‘Cooperatives in Development’ program and includes knowledge building activities at the global (harmonized) and regional (decentralized) level.

The activities planned within the framework of the program include diverse research activities conducted at the global and regional level. The primary activities undertaken at the global level include a Legal Framework Analysis (A2.2), which is led in a coordinated way by all ICA offices. Within this framework, ICA-AP oversees implementing the research in the Asia and Pacific region. The study on legal frameworks under the Legal Framework Analysis (A2.2) will evaluate jurisdictions and policy regulations according to their enablement of cooperative development. The document will present recommendations for the next steps in renewing the legal frameworks and helping to shape the policy agendas in a targeted way in the different regions and countries. It will evaluate the cooperative legal framework in place with common indicators, delivering on a scale of how ‘cooperative-friendly’ the legislation in a country is. In the same context, this report deals with the Legal Framework Analysis of Mongolia.

## Introduction

The national report on cooperative legal framework analysis for Mongolia is prepared by Mr. Tsagaan Myagmar-Ochir, Vice President of the Mongolian National Cooperative Association (ICA member). He is also the Executive Director of the Mongolian Cooperative Training and Information Center. The report also includes perspectives from a Canadian Cooperative Governance Consultant and representative of the Association of Asia Confederation Credit Union.

This overall objective of this report is to review the Cooperative Law of Mongolia, specifically the Credit and Savings Cooperative Law that regulated the credit and savings cooperatives; and other laws that regulates other types of cooperatives. The other laws are discussed in relation



to their impact on cooperatives and display a lack of coordination between all cooperative governing bodies and laws.

Cooperatives in Mongolia have a long history and have witnessed many political, economic and social changes. They are divided into two categories: (1) credit and savings cooperatives and (2) all other types of cooperatives (example- consumer, production, agriculture, etc.). The credit and savings cooperatives are regulated by the Financial Regulatory Commission while all other are regulated by the Ministry of Food, Agriculture and Light Industry. The laws that govern cooperatives follow this categorization with a few deviants, such as artisanal mining cooperatives, which are generally governed through the Cooperative Law of Mongolia but face mining taxation and regulations.

Cooperatives are defined as a legal person established by individuals on a voluntary basis for the purpose of satisfaction of their social, economic, and cultural needs, governed and supervised in a democratic manner and conducting its business based on common ownership of its members (Cooperative Law of Mongolia, Section 3.1). All cooperatives must register with the National Registry of Mongolia and apply for the appropriate certificate for operations, for example, financial, mining, working with certain chemicals, veterinarian, etc. Cooperatives are categorized as non-profit organizations (Civil, Commercial, and Family Law of Mongolia Section 33.2). As per the Taxation Law of Mongolia, cooperatives are taxed the same as other private for-profit business entities and partnerships. Cooperatives are unable to perform certain functions such as issuing financial instruments like loans, industrial mining, etc. Credit and savings cooperatives are unable to perform certain financial activities such as auditing or insurance.

The review of Mongolia's Cooperative Law suggests that the cooperative environment in the country is limitedly 'cooperative friendly'. However, one of the highlights of the Law is that it is reflective of all seven ICA Principles. This includes, policies on open-membership, one member one vote system; and a mention of second-tier cooperatives for better cooperation among cooperatives.

The Cooperative Law of Mongolia takes its inspiration from cooperative laws in other countries as well. For example, the general cooperative law for all other types of cooperatives is inspired by the German cooperative law; while the Credit and Savings Cooperative Law of Mongolia is inspired by the Canadian cooperative law. Germany and Canada. However, some aspects these foreign laws that were not adapted earlier can now prove useful in Mongolia. For example, in Canada, cooperatives can register as either non-profit or for-profit entities and function



accordingly. In the German cooperative system, there is a strong regulatory body that assesses, monitors, and builds the capacity of cooperatives.

Recommendations for Mongolian cooperative laws thus include, aligning all governing laws and regulatory bodies; a stronger, more cohesive regulatory system which assesses, monitors, and builds the capacity of cooperatives; a more suitable regulatory body for general cooperatives which reflects the needs of all non-credit and savings cooperatives, such as the Ministry of Labor; the ability of cooperatives to register as non-profit or for-profit entities and be taxed and regulated accordingly; more flexibility for credit and savings cooperatives to enact activities like auditing, insurance, and advertising; more clear regulations for secondary cooperatives; specific rules for investor members and non-member investors of cooperatives; and more clear financial support mechanism for cooperatives, such as a cooperative fund or a percentage of the SME fund allocated for cooperatives.

## National Cooperative Law of Mongolia

### General context

| Regulatory Provisions for Cooperatives         |  |                  |                        |   |
|--|--|------------------|------------------------|---|
| Relevant Law                                   | Relevant Sections  | Date of Approval | Revisions              | Regulatory Body                                   |
| Cooperative Law of Mongolia                    | All  | 1995             | 1998, 2002, 2006, 2011 | Ministry of Food, Agriculture, and Light Industry |
| Credit and Savings Cooperative Law of Mongolia | All  | 2011             |                        | Financial Regulatory Commission of Mongolia       |
| Civil, Commercial, and Family Law              | Cooperative shall be a legal person, established jointly on voluntary basis by several | 1994             |                        |   |

|             |  |  |  |  |
|-------------|--|--|--|--|
| of Mongolia | <p>persons to carry out activities aimed at satisfying common economic and social needs of its members, based on assets with corporate governance and control over joint assets.</p> <p>Cooperative foundation, registration, membership, termination of and control over its activities, and other relations relevant to cooperative shall be regulated by law.</p> <p>Article 33. Types of legal persons</p> <p>For-profit legal persons shall be established in the form of partnership or company.</p> <p>Non-profit legal persons shall be established in the form of association, foundation or cooperative.</p> |  |  |  |
|-------------|--|--|--|--|

## Specific elements of the cooperative law

### a) Definition and general characteristics

In the Cooperative Law of Mongolia, Section 3.1: A cooperative is a legal person established by individuals on a voluntary basis for the purpose of satisfaction of their social, economic, and cultural needs, governed and supervised in a democratic manner and conducting its business based on common ownership of its members. In the Civil, Commercial, and Family Law of Mongolia, Article 36.4: Cooperative shall be a legal person, established jointly on voluntary basis by several persons to carry out activities aimed at satisfying common economic and social needs of its members, based on assets with corporate governance and control over joint assets. There are several legal characteristics that distinguish cooperatives from other business entities.



Cooperatives hold a non-profit status, are democratically and member controlled, and distribute profit through dividends to members; whereas, business entities are considered for-profit entities controlled by external shareholders and distribute dividends to shareholders. In this way, the share capital of cooperative is made of the member's contributions and should be seen as an asset; whereas, other for-profit enterprise's share capital is made of external shareholders and should be considered a liability. Private companies require, by law, at least 1 million MNT capital to start their operations; whereas, cooperatives require no capital. Unlike the average business entities of Mongolia, cooperatives are focused on social, cultural as well as economic needs of members.

Non-members of the cooperative are able to transact with cooperatives; this is regulated by the individual by-laws and contracts of each cooperative. For credit and savings cooperatives, only members can interact with the cooperative.

## **b) Establishment, cooperative membership and governance**

The National Registry Office of Mongolia is the official register for cooperatives. Cooperatives must submit two signed copies of their 'Charter of Cooperative', a list of promoters and their personal identification information, and the meeting minutes which state the election of the managing board and auditing board. These conditions are stated in the Cooperative Law of Mongolia or the Credit and Savings Law of Mongolia. After registering, some cooperatives such as credit and savings cooperatives, must apply for a certificate from the appropriate regulatory body, such as the Financial Regulatory Commission. Other types of cooperatives that must be certified by another regulatory body are veterinary cooperatives, artisanal mining cooperatives, cooperatives working with certain classes of chemicals, etc.

Other legal requirements of cooperatives include the minimum number of members which is 9 individuals in a primary cooperative and 2 cooperatives for a secondary cooperative. The 'Charter of Cooperative' must state all relevant content as described in the law. Credit and Savings Cooperative Law lists the minimum number of members as 20. The Cooperative Law of Mongolia states that if cooperative membership falls below the minimum amount, the cooperative must dissolve. There is no official authority to monitor this, the regulation is implied to be the duty of relevant cooperative associations, regulatory bodies, and the cooperative itself. If the members do not voluntarily dissolve the cooperative, the case will be taken to a court of law. Due to this process, many cooperatives still exist where membership has fallen below minimum because all parties are unwilling to spend time and money on the legal processes.



The Law on Cooperative states that any individual can join a primary cooperative that meets the cooperative by-laws and a secondary cooperative can be joined by any legal entity including cooperatives, non-profit organizations, private businesses, partnerships, etc.

The Civil, Commercial, and Family Law of Mongolia states that cooperative members must be 18 years of age with legal capacity. Both primary and secondary cooperatives can make restrictions in their own by- laws related to region and activity, and in the case of secondary cooperatives, types of legal entities that are permitted to join. In a secondary cooperative, 51% of membership must be of primary cooperatives (Cooperative Law of Mongolia, Section 3.1).

Members are free to leave their cooperative voluntarily and get re-admitted to a cooperative (Cooperative Law of Mongolia, Section 14, 17). Withdrawal from membership is permitted on the following grounds: by members' own request, change in residence making cooperative activity impossible for the members, transfer of shares to another, and death of a member (Cooperative Law of Mongolia, Section 17). Members must give a written notice of intention to withdraw at least three months prior to the end of the fiscal year for the cooperative (Cooperative Law of Mongolia, Section 17.3). Each cooperative member receives one vote regardless of their contributions or activity with the cooperative (Cooperative Law of Mongolia, Section 23.7). This is not permitted to be changed for individual by-laws of cooperatives.

Cooperative must have a member elected Board of Directors (Management Board) (Cooperative Law of Mongolia, Section 27) and an Auditing Board (Cooperative Law of Mongolia, Section 32). The Management Board shall preside cooperative activities between the member meetings; it must have a Chair and no less than 2 members; shall convene not less than once in two months; shall keep records in compliance with the legislation; shall inform the auditing board immediately on the receipt of the annual report and present this report at member meetings for consideration; and shall announce immediately to the members if the annual or interim report states or by the approximate calculation the losses are exceeding 50% of a cooperative's assets; and these losses cannot be recovered by safety funds, and present the issue for a member meetings consideration (Cooperative Law of Mongolia, Section 27). The Management Board member deems to have broken their liabilities to the cooperative if they use cooperative shares or income for personal purposes, are paid from the cooperative assets, cause insolvency or bring cooperative to bankruptcy, or extend credits from the assets of the cooperative (Cooperative Law of Mongolia, Section 28). In these cases, the Auditing Board who supervises the Management Board's actions must convene a member meeting to make a decision (Cooperative Law of Mongolia, Section 35; Section 23.4.3-4). The Auditing Board must

comprise of no less than three members who cannot be Management Board members; their duties include appointing the head and deputy of this board and participate and give advice in Management Board meetings (Cooperative Law of Mongolia, Section 32-33). Cooperatives members decide if the auditing board will be financially compensated (Section 33). Other powers of the Auditing Board include inspecting all relevant documents and issuing recommendations, and consultations about the annual or interim report, distribution of income and losses (Cooperative Law of Mongolia, Section 35.1); the Auditing Board may hire an external expert if necessary (35.2). All Management Board and Auditing Board members must be cooperative members (Cooperative Law of Mongolia, Section 13.4).

### c) Cooperative financial structure and taxation

The Cooperative Law of Mongolia does not specify the amount required as share capital by members, but the cooperative by-law must state a minimum and maximum amount (Cooperative Law of Mongolia, Section 9.3.5-6). Different amounts based on transaction are not regulated in the Law. When a cooperative dissolves the capital is returned based on the initial report of dissolution (Cooperative Law of Mongolia, Section 47.2); if a member contributed an additional amount they are entitled to receive that amount (Cooperative Law of Mongolia, Section 47.3); the remainder of cooperative assets are distributed as equal shares after all original shares are distributed (Cooperative Law of Mongolia, Section 47.4); the by-laws of a cooperative may differ and cooperatives can decide their own order or enactment of distribution of shares (Cooperative Law of Mongolia, Section 47.5). If a member exits the cooperative, they must make their part of payment to the cooperative counterpart business entities, organizations, and individuals as the other members (Cooperative Law of Mongolia, Section 19.3)

The profits of a cooperative must be distributed as dividends to member; a cooperative may distribute its income based on the grand total of the contributions of members (Cooperative Law of Mongolia, Section 16.5); the members of a cooperative with the Management Board and Auditing Board decide the distribution of profit (Cooperative Law of Mongolia, Section 16.6). The cooperative decision may be based on member transactions, member participation, member share capital, or a mixture of the three mentioned methods of distribution. This decision is revisited every year during the Annual General Meeting (Section 23.4.8). Financial reserves are regulated by the Cooperative Law of Mongolia. It states that at the end of a fiscal year, some percentage of profit must be saved; the specific decision is decided individually by cooperatives (Cooperative Law of Mongolia, Section 8.3) Generally, cooperatives serve their members first. However, it is permitted for non-members to transact with the cooperative.

Credit and Savings Cooperative Law states that only members of the cooperative may participate in the cooperative activities.

Only credit and savings cooperatives are permitted to issue financial instruments; they are not permitted to issue insurance or audits. Cooperatives, although unable to give official loans with interest, are known to practice lending with the members. Due to the seasonal work of agricultural cooperatives, herders may sell their cashmere in March but require financial assistance before that. Cooperatives often give a non-interest loan to these members which is returned. Investor members are regulated in cooperative by-laws.

In the case of dissolution, after satisfaction of all claims of the counterparts against cooperative assets, the remains of cooperative assets shall be distributed amongst the members; shares to be distributed amongst members shall be determined based on the initial report of dissolution; if a member contributed an additional amount in accordance to section 44 of the present law he is entitled to receive that amount first of all; the remains of cooperative assets shall be distributed as an equal shares after all distributions of shares to the members are made; a charter may prohibit a distribution of shares or set up order of distribution other than specified in the present law (Cooperative Law of Mongolia, Section 47). If there are remains of cooperative assets not subject to distribution and there is no provision governing for its allocation, these must be transferred for public use into the property of the Capitol, aimag<sup>1</sup>, sum or district in which a head quarter of a cooperative used to be situated (Cooperative Law of Mongolia, Section 48).

Cooperatives are taxed the same as all other business entities, at a 10% rate. This is not a good system for cooperatives because along with cooperatives being taxed, the members are also taxed on their dividends. This double taxation is a burden on cooperatives and a disincentive to join or form cooperatives. Since the approval of the Cooperative Law of Mongolia in 1995, there have been various incompatible laws regulating cooperatives. For example, the Cooperative Law states that they are non-profit entities, but the Taxation Law considers them in the same bracket as for-profit entities.

However, at the end of the fiscal year when cooperatives allocate a certain percentage of profit to the financial reserve, this financial reserve is not taxed.

#### d) Other specific features

<sup>1</sup> The Mongolian word aimag which means "tribe", is an administrative subdivision in Mongolia and in inner Mongolia.



Cooperatives are regulated by the Ministry of Food, Agriculture and Light Industry (MOFALI) and credit and saving cooperatives are regulated by the Financial Regulatory Commission of Mongolia. Other associations, such as the Mongolia National Co-operator's Association (MNCA, ICA member), National Association of Mongolian Agricultural Cooperatives (NAMAC), Mongolian Confederation of Credit Unions (MOCCU), and Central Union of Mongolian Consumer Co-operatives CUMIC, are in place to inspect cooperative structure and assist with cooperative development. Unless cooperatives or associations are in violation of law, the state cannot intervene or control their activities. If in violation of law, the state must end their activities.

The concept of secondary cooperatives is mentioned in the Cooperative Law of Mongolia. For example, the minimum number of members is 2 cooperatives (Cooperative Law of Mongolia, Section 6.1), and 51% of membership must be of cooperatives and any legal entity is permitted to join.

## **Degree of “cooperative friendliness” of the national legislation**

The cooperative legal environment of Mongolia is only limitedly ‘friendly’ to cooperative development. Various barriers which inhibit cooperative development are mentioned below:

1. Incompatibility of laws, such as cooperative and taxation law explained above.
2. Lack of consistent governing body has made cooperative law hard to understand.
3. General cooperatives are currently regulated under MOFALI. This is only suitable for agricultural cooperatives and hampers the development of other types of cooperatives.
4. Credit and savings cooperatives are regulated in a way that they cannot compete with commercial banks. For example, credit unions cannot advertise their services.
5. Generalization of cooperatives as non-profits inhibits their activities and social perception or barriers from reaching higher economic potential of profitability. Cooperatives are limited in their functions due to this status, such as not being able to issue financial instruments, while not receiving the benefits of this status in taxation.
6. Non-members cannot invest in cooperatives.
7. There are no specific provisions set for investing members.
8. There are not enough regulations for secondary cooperatives.
9. Including the mention of the Accounting Law in Cooperative Law of Mongolia, Section 8.2 may allude to Owner’s Equity undisputedly counting as a liability, rather than capital.

The best practices in the Cooperative Law of Mongolia are seen where the legislation reflects



the seven ICA cooperative principles. This includes, the democratic member structure which gives one vote to each member; and the mention of secondary cooperatives which has allowed this activity to ensue with some guidance. There are very clear and precise rules regarding the distribution of roles and responsibilities between the member's meeting, the board of directors and its committees (Cooperative Law of Mongolia, Section 10). The registration timeline and requirements are provided in adequate detail in the Cooperative Law of Mongolia (Cooperative Law of Mongolia, Section 11).

The Mongolian cooperative movement has been supported throughout time by both the German and Canadian cooperative movements. For this reason, these legislations from these countries have acted as guiding documents when writing Mongolia's legislation. Some of the well-working components are reflected in the cooperative laws of Germany and Canada. The Canadian legislation provided framework for the Credit and Savings Cooperative Law. However, in the case of Canada, the credit and savings cooperatives are able to act and compete with banks, and cooperatives have a non-profit and for-profit status as per the general cooperative law. More specifically, the Quebec cooperative law provides clear distinctions, definitions, and parameters for different types of cooperatives based on member activity, provisions for types of primary cooperatives, 2nd and 3rd tier cooperatives, and so on. The German legislation provided the framework for the Cooperative Law of Mongolia. However, the German law encompasses more specific rules for the all cooperative supervisory committee. This is something Mongolia is working to adapt into the next revision of the Law.

## Recommendations for the improvement of the national legal framework

1. Cooperative should be divided into two groups- non-profit social purpose cooperatives which are taxed as non-profits and for-profit economic purpose cooperatives which are taxed like businesses.
2. Cooperative should be governed under a ministry with a wider scope such as the Ministry of Labour.
3. Credit and savings cooperatives should be permitted to function like banks, issue audits and insurance, and advertise their services.
4. Secondary cooperatives should have more clear regulations.
5. There should be a supervisory association of cooperatives to oversee all cooperatives-how many cooperatives exists, how many of them are active, how many members are there in cooperatives, which activities are pursued by cooperatives, and so on.

- a. In the new draft of cooperative law<sup>2</sup>, there will be a set of standards for cooperatives created with the support of state government agencies. The state government agencies or an association (MNCA) will monitor if those standards are followed by cooperatives.
6. There should be a clear financial support mechanism for cooperatives, such as a cooperative fund or a percentage of the SME fund allocation for cooperatives.
- a. At present, cooperatives in Mongolia cannot develop due to the lack of financial support. If a cooperative wants to acquire a loan, they need to give collateral which they don't have. The bank will give loan to an individual but usually that individual is not willing to take a loan on behalf of other members. Cooperative capital is made of all members' share capital and commercial banks do not recognize cooperatives like a business.
  - b. Non-members should be permitted to invest. This should be defined in the law.
  - c. There should be regulations for investor-members of cooperatives.

## Conclusion

MNCA and Mongolian Co-operative Training and Information Center (MCTIC) are trying to strengthen their institutions to account for the unfavourable legal environment. They want to set clear cooperative standards to create a strong foundation for cooperative development; and be able to gather realistic data and statistics for improving the current state of legal environment for cooperatives in Mongolia.

---

<sup>2</sup> To be submitted in Spring 2019.