OWNERSHIP, MANAGEMENT, AND GOVERNANCE

A. Ownership

1. Khan Bank was established in 1991 and was previously known as the Agriculture Bank of Mongolia. It was owned by agricultural cooperatives, herdsmen, and farmers. It was privatized in 2003 and renamed Khan Bank in a post-Soviet effort to privatize the banking sector. Although privatized, it continues to maintain a focus on reaching the underserved in rural areas with inclusive finance as a priority in strategy and planning. Khan Bank is Mongolia's largest bank in terms of total assets, loans, and deposits—with market shares of 23% (total assets), 23% (loans), and 26% (deposits) as of the end of December 2013.

The largest shareholder of Khan Bank is Sawada Holdings Co. Ltd. (SHC), which holds 41.3%. SHC is a Japan-based holding company engaged in securities, banking, commodities, real estate, and venture capital. SHC is listed on the Osaka Stock Exchange and had total assets of $3.0 billion at the end of December 2013. Tavan Bogd Trade Co. Ltd. owns 23.0% of Khan Bank. The Tavan Bogd Group is one of the largest private conglomerates in Mongolia, with 12 affiliated companies, engaged in retail and wholesale, travel and tourism, manufacturing, and food production.

B. Management

2. Khan Bank's management team is comprised of seasoned bankers—14 senior management staff with extensive knowledge and experience in banking both locally and internationally. The bank has an executive management committee, comprising the chief executive officer (CEO), the deputy CEO, the chief financial officer (CFO), and the chief risk officer (CRO). A management committee includes top and second-tier management. Both committees meet weekly. The management is supported by different executive committees for day-to-day management and has sound internal controls. Current branch management consists of a director and line managers responsible for finance, customer relations, and credit operations, with corresponding teams under these managers.

The bank has about 5,000 employees (of which 63% are female), with 14 senior management professionals, 33 middle management professionals, and a network of 528 branches and 335 ATMs.

3. **Compliance**. The bank's compliance unit has responsibility for handling all customer due diligence regarding combatting money laundering and know your customer requirements, as stipulated in its customer due diligence policies and procedures—creating awareness on combatting money laundering and know your customer matters among the bank's employees, clients, and relationship institutions. The unit is the bank's watchdog on global money laundering developments, trends, and patterns in financial crimes. It reviews the bank's policy documents on combatting money laundering and know your customer requirements with respect to prevention, detection, monitoring, and reporting of suspicious transactions. Suspicious transactions are identified, and findings on key items (such as the transaction amount, politically exposed persons, and checks against watch lists) are regularly reported to the financial information unit of the Bank of Mongolia (BOM). The compliance unit provides feedback to the audit board committee.

4. **Risk management.** Khan Bank has a solid risk management function. With 51 staff, the Risk Management Unit consists of four sub-divisions: (i) a credit and risk policy regulation division that handles policies and procedures; (ii) a credit risk division responsible for loan analysis, monitoring, and reporting; (iii) an operational and market risk division that determines limits for market risk; and (iv) a special assets division that deals with recovery and collection efforts. The Risk Management Unit provides feedback to the risk management committee on risk management processes and risk exposure, including credit, market, liquidity, operational, reputational, and other risks.

5. **Credit Risk Division.** The Credit Risk Division has 22 officers split into four teams: (i) credit analysis, (ii) credit monitoring, (iii) real estate appraisals, and (iv) reporting. It evaluates loans that exceed the authority of the branches and presents them to the relevant credit committee. Credit risk specialists do not have veto power, but participate in all credit committees at the head office level, where decisions are made by a majority vote.

6. The BOM stipulates limits on credit policy (limits on loan growth, nonperforming loan [NPL] classification, provisioning), single borrower exposure, capital adequacy requirements, market limits, and liquidity risk. However, Khan Bank's board sets more stringent internal limits.[1] Khan Bank's loan portfolio is secured by leased assets; cash (property, plant, and machinery); inventory; personal guarantees; and gold.[2] Khan Bank evaluates borrowers according to credit history, analysis of the borrower's income, employment status, existing financial commitments and liabilities, age of borrower, value of loan or asset to be purchased, borrower's ability to make payment based on current commitments, and their standing in the credit bureau. Approval limits are linked to a facility risk rating that is determined by taking into account the credit rating of the borrower and the security provided. Khan Bank has a rating system for business and MSME loans, developed with technical assistance from the European Bank for Reconstruction and Development. The CRO has overall responsibility for risk management, and ensuring implementation of common principles and methods to identify, measure, and report financial and nonfinancial risks. The management team is responsible for the monitoring and implementation of risk mitigation measures, and ensuring that the bank operates within established risk parameters.

C. Governance Structure

7. Khan Bank's board of directors comprises seven members who bring extensive international banking and other professional experience to Khan Bank. The board has two independent nonexecutive directors and five nonexecutive directors. It is chaired by H. Saweda, who is the president and CEO of SHC, the bank's largest shareholder, and has held various executive positions within the group of companies.

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[1] Internal limits: minimum capital adequacy ratio of 15% (versus the BOM requirement of 14%); NPL classification more stringent where full repayment is uncertain even if loans are current but the risk is higher, hence classified at 70 days rather than 90 days. Additionally, NPLs are calculated per International Financial Reporting Standards (IFRS) – International Accounting Standards 39, which is not a BOM requirement.

[2] Khan Bank. 2013. *Due Diligence.* Ulaanbaatar.