Mongolia
Financial Regulatory Commission

Data Collecting Survey for Development of Financial and Capital Market, and Capacity Building of its Regulation and Supervision in Mongolia

Final Report

March 2014

Japan International Cooperation Agency (JICA)

Japan Economic Research Institute Inc.
Tokyo Stock Exchange, Inc.

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Abbreviation

FRC	Financial Regulatory Commission
MSE	Mongolian Stock Exchange
MSCH & CD	Mongolian Securities Clearing House & Central Depository
BOM	Bank of Mongolia
DBM	Development Bank of Mongolia
MOF	Ministry of Finance
SWF	Sovereign Wealth Fund
LSE	London Stock Exchange
SPC	State Property Committee
SRO	Self-Regulatory Organization
CCP	Central Counterparty Clearing House
CSD	Central Securities Depository
JASDEC	Japan Securities Depository Center Inc.
KSD	Korea Securities Depository
HKSCC	Hong Kong Securities Clearing Company Limited
ETT	Erdenes Tavan Tolgoi LLC
TDB	TDB Capital LLC
MICC	Mongolia International Capital Corporation
MBS	Mortgage Backed Securities
MONICPA	Mongolia Certified Public Accountant Association
GDR	Global Depositary Receipt
KOFIA	Korea Financial Investment Association
TOCOM	Tokyo Commodity Exchange

1. Introduction

Growth of Mongolian economy has been accelerating in recent years (17.5% in 2011 and 12.3% in 2012) on the back of capital flows into the development project in the mining sector, as well as the international market conditions for coal and copper. At the same time, the government of Mongolia ('GOM') is striving for macroeconomic stability through fiscal discipline under the Fiscal Stability Law (2013), which requires fiscal deficit and official government debt to stay less than 2% and 40% of GDP, respectively. They are also trying, with a view to meeting the growing demand for infrastructure, to diversify their financing toward government bonds in addition to the traditional donor financing, the first lot of which was issued in November 2012.

One of the major concerns on Mongolian economy is its heavy dependence on abundant mineral resources, which calls for more diversified industrial structure through vitalizing small and medium scale businesses. Majority of their financing, however, has been through the banking sector, and the capital markets have not provided enough financing opportunities to these businesses. In Mongolia, more than 90% of the listed companies are the former state owned enterprises ('SOEs') listed in the process of shifting to the market economy, but the market liquidity is still very low, due to the lack of enough disclosure, problems of corporate governance and compliances., insufficient investor base. The capital market itself is still immature, with insufficient level of regulation and supervision, which needs to be addressed as the financing needs through IPO grow in line with the economic expansion. To guide the economy to a stable growth path, it will be substantially important to provide wider range of financing options through facilitating the financial and capital markets which are open not only to the domestic but also to the foreign investors.

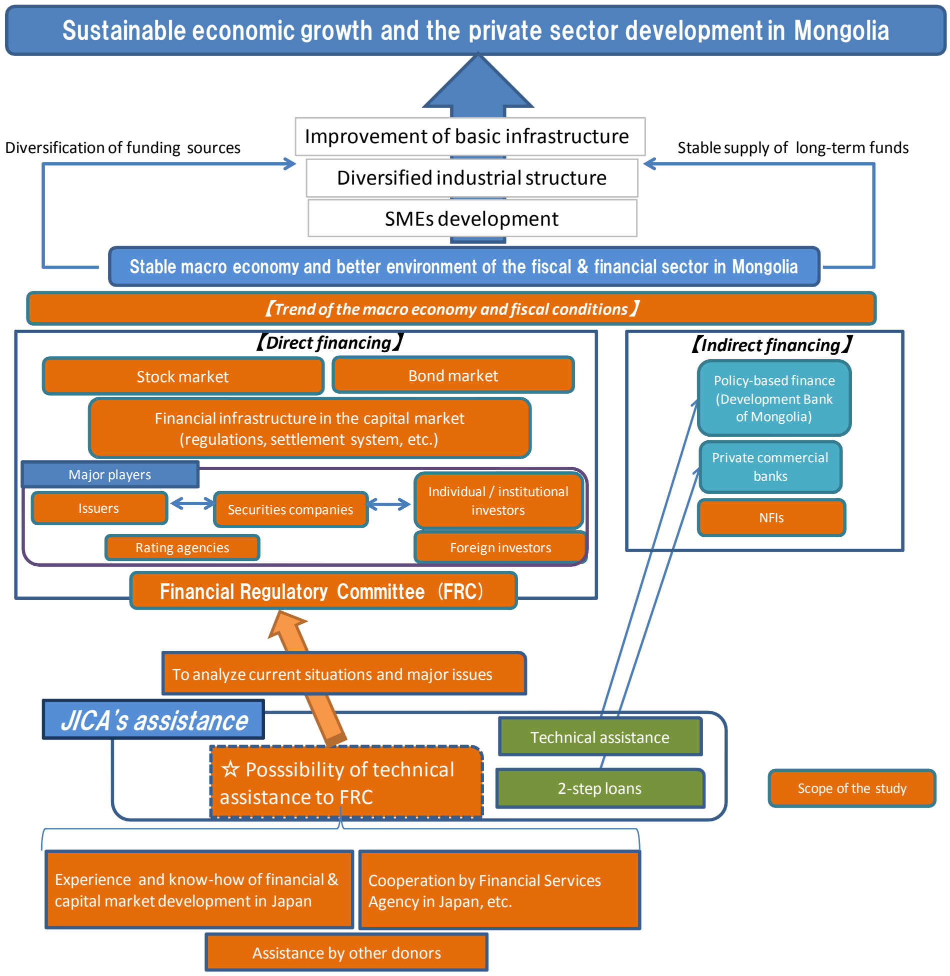
Financial Regulatory Commission ('FRC'), a government entity and a counterpart organization of this study, supervising the non-bank sector including capital markets (i.e. security brokers, insurance companies and non-bank lending entities such as microfinance institutions (MFIs)), is still a young organization established in 2006. It is in tremendous need for human capital/organizational developments and institutional design. Especially they are desperate for preparing the regulatory rules and strengthening the implementation framework, for which the request for a support has been made to JICA.

JICA has been extending support for the Bank of Mongolia ('BOM') in its bank supervision, an establishment of the Development Bank of Mongolia ('DBM'), facilitating two-step loans for SMEs through designing the framework and capacity building for the commercial banks. Also in the country analysis paper (2011) and assistance strategy (April 2012), 'sustainable development of the mining sector and strengthening the governance structure' have been identified as key areas, for further developing the private sector through stabilizing the macro economy and improving the conditions for fiscal/financial sectors.

In that context, this study particularly focuses on the role the capital markets can play in Mongolia, as a new attempt by JICA. Based on the comprehensive observation on fiscal/financial sectors, macroeconomic conditions and direction of the medium-term fiscal/financial policies, the study team collects and analyzes the current status, challenges and assistance needs for the financial/capital markets in Mongolia, for proposing potential projects that can be supported through utilizing the resources from Japan.

With that purpose, this study is addressed to the relevant entities such as FRC, Financial Market & Insurance, Ministry of Finance, Mongolian Stock Exchange ('MSE'), Mongolian Securities Clearing House & Central Depository ('MSCH&CD'), etc. In parallel with JICA's existing in banking sector support, this study assumes the future technical cooperation to FRC, with a view to supporting the capital market development through utilizing the experiences in Japan.

Figure 1-1 Framework for the financial sector support



Source: Study Team

In conducting this study, the team has been paying a special attention on the following issues.

- To provide the best menu for cooperation based on Japanese experiences, through making the best use of existing studies, and having full understanding of the ongoing assistances, by JICA and other development partners.
- To apply forward-looking approach in identifying the bottlenecks for further development of financial/capital markets, as well as necessary assistances. More specifically, the study team will identify the critical obstacles that can cause the gap between the desirable status and the likely one (if nothing is done to address relevant issues).
- To consider what kind of resources can be mobilized from Japan in taking full advantage of the experiences accumulated in the past.

In the course of this study, it turned out that overarching examination for the mapping of outstanding issues/challenges as well as efficient donor coordination has not been fully explored in designing the assistances for the capital market development. It is therefore a great pleasure for the Study Team if the result of this survey would be fully utilized as a guide to better organize the assistance strategy not only for JICA but also for the counterpart institutions as well as the whole donor community.

2. Current situation of macro economy and financial/capital markets in Mongolia

2.1 General situation of the macro economy

Current situation

Mongolia maintained high level of economic growth, led mostly by the foreign direct investment (FDI) in the mining sector. Per capita GDP increased to more than USD 3,000 in 2011 and is expected to grow further. The economy grew at a slower pace of 12.3 percent in 2012 but still maintained double-digit growth.

Table 2-1 Basic economic indicators

	2008	2009	2010	2011	2012	
Population	2.7	2.7	2.8	2.8	2.8	million
Unemployment	9.2	11.6	9.9	7.7	7.9	%
GDP (nominal)	5.1	4.6	6.6	8.6	10.3	USD billion
GDP growth (real)	8.9	−1.3	6.4	17.5	12.3	%
Per capita GDP	2,108	1,688	2,267	3,045	3,575	USD
Inflation	23.2	1.9	14.3	9.4	14.2	%
Exchange rate (eop*)	1,268	1,443	1,257	1,396	1,392	MNT/USD

* end of period

Sources: IMF, World Bank, National Statistics Office

GDP in the first quarter of 2013 showed a 7.1 percent year-on-year (yoy) increase in real terms. This number shows that Mongolian economic growth gradually slowed. Especially, there was a substantial slowdown in FDI and foreign trade. FDI was down as several projects are either finished or near completion. Exports also declined, due to falling commodity prices as well as slowing Chinese economy. Coal exports fell due to lower prices. There was a three-month halt of Tavan Tolgoi (TT) coal delivery to its biggest customer, Chalco, China’s biggest producer of aluminum. The price of copper also fell because of disappointing Chinese growth and increase in world inventories.

In the second quarter, however, the economy grew at 14.3 percent yoy, resulting in an 11.3 percent increase in the first half of 2013. The double-digit growth in the first half became possible due to the strong rebound in the non-mining sector. Among them, construction sector expanded rapidly, fueled by supportive measures like the Construction and Housing Development Program.

Inflation peaked at around 40percent in 2008, but stabilized afterwards because the global economic crisis drove down the commodity prices. In the first half of 2012, inflation soared due to pre-election cash transfers, salary/pension increases and public capital investments; however, severe revenue shortfalls forced legislators to limit spending in the latter half of 2012. Inflation decelerated in 2013, following the economic deceleration, welfare payment reduction and meat products’ price fall.

Monetary policy had been tightened. The Bank of Mongolia (BOM) increased its policy rate and reserve requirements over the past years. Following the deceleration in growth, inflation eased to be single digit (8.3

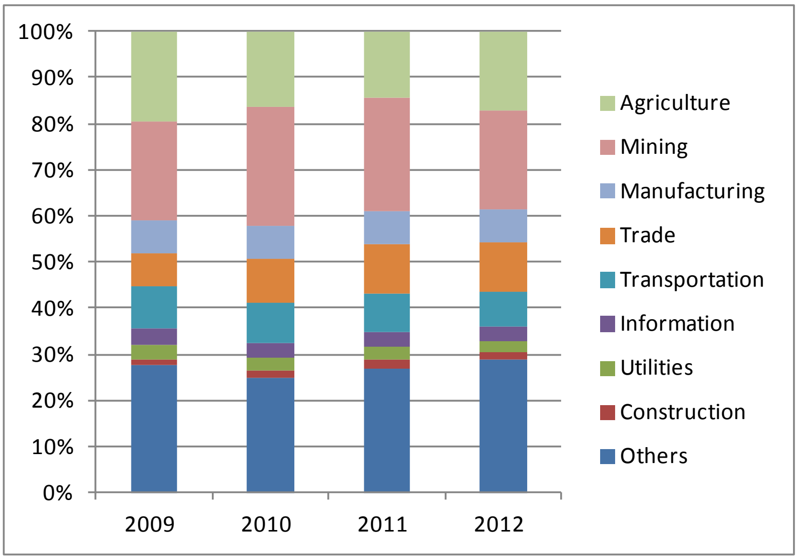
percent in July, 9.4 percent in August and 9.9 percent in September, yoy). Nevertheless, prices started to soar afterwards, up 12.0% in November. Inflation remains to be a concern due to MNT depreciation, expansionary fiscal policy and recent monetary loosening.

Mongolian Tugrik (MNT) was obliged to depreciate over the long period. During the crisis from late 2008 into spring 2009, MNT fell drastically against USD. MNT appreciated in 2010 through mid-2011, but lost much of the gains in the latter half of 2011. Since 2012 MNT is weak, and many expect no strengthening until future commodities surge. An influx of capital will yield a resilient MNT, but a strengthening currency might prove a mixed blessing (Dutch Disease); strong MNT may hinder growth of the non-minerals export industries.

The exchange rate was on a moderately depreciating trend throughout 2013. The depreciation accelerated in the third quarter due to deteriorating market sentiment over the economic prospects. Large external imbalances from the trade deficit and declining capital inflows due to a drop in FDI put continuous pressure on MNT's value. The debate over Oyu Tolgoi (OT) issues and remaining high uncertainty over the regulatory framework for foreign investment further weakened the market sentiment. Inflationary pressure is continued and Mongolia's fundamentals seem vulnerable. As a result of MNT depreciation, import prices are rising, affecting normal people's lives.

Mining and agriculture are still dominant, occupying more than one third of the GDP by sector. Manufacturing, services, etc. should be further developed in order to diversify the industrial structure.

Figure 2-1 GDP by sectors



Source: National Statistical Office

Balance of payments

In 2012 the current account deficit widened to USD 3.2 billion, equivalent to 31 percent of GDP. Total exports dropped by 9 percent, while total imports increased by 2 percent. The deficit of the service balance reached USD 1.2 billion due to a decline in the tourist and transportation service activities.

The reduction in total exports was largely generated by the sharp contraction of major mineral exports (coal and copper), reflecting the weak demand from China. Non-mineral exports also declined due to weaker export of meat products.

Import growth slowed from almost doubling in the previous year. This was mainly due to stagnant imports of heavy machineries for mining industry as the OT mine completed most of its construction.

Table 2-2 Balance of payments

	2009	2010	2011	2012	
Current account balance	−342	−887	−2,759	−3,215	USD million
Goods	−189	−180	−993	−1,529	
Exports	1,855	2,887	4,795	4,383	
Imports	−2,044	−3,068	−5,788	−5,911	
Services, net	−143	−295	−1,161	−1,248	
Income, net	−196	−599	−843	−678	
Current transfers	186	187	238	239	
Capital and financial account	769	1,744	2,864	4,794	
Financial account	608	1,592	2,750	4,673	
Foreign direct investment	569	1,630	4,620	3,835	
Portfolio investment	−82	894	77	2,335	
Other investment	121	−933	−1,947	−1,497	
Capital account	161	152	114	120	
Errors and omissions	129	16	−78	−210	
Overall balance	556	873	28	1,369	
Gross official reserves	1,328	2,288	2,457	4,091	
In months of next year's imports	4.0	4.2	4.9	5.8	months

Sources: IMF, World Bank

The issuance of the overseas sovereign bonds (Chinggis bond) significantly contributed to the massive surplus in capital and financial account. In December 2012, the Government successfully issued a USD 500 million tranche as a five-year bond at 4.125 percent, and another USD 1 billion tranche with a ten-year maturity at 5.125 percent. The proceeds were deposited at the BOM as concrete plans to use the fund are yet to be determined. The gross official reserves rose significantly, largely reflecting the proceeds from the bond.

The balance of payments (BOP) pressure on gross official reserves was also offset by BOM through the swap line with the Central Bank of China (USD 0.2 billion), and BOM's deposit taking from the Development Bank of Mongolia (DBM) (USD 0.4 billion) and commercial banks (USD 0.2 billion). Thus, the gross official reserves remained over five months of the next year imports.

For the first nine month in 2013, the trade deficit reached USD 1.7 billion. While the import demand remains large, mineral exports are still stagnant. Abundant coal supplies in China and growing competition with other major coal exporting countries put down the coal prices and volumes. The current account had a USD 2.4 billion deficit for the first eight months of 2013, due to large trade deficit and continuous deficits in service and income accounts.

The large decline in foreign capital inflows occurred in both FDI and portfolio investments. FDI for the first eight months in 2013 was USD 1.8 billion, only about half of the same period in the last year. The portfolio investment in 2013 recorded a net outflow of USD 22 million for the first eight months of the year.

The international reserve level steadily declined reflecting the growing BOP deficits. The gross reserve level peaked at USD 4.1 billion at the end of 2012. Since then, the reserve steadily declined throughout 2013, dropping to USD 2.7 billion (four months of import) in September.

Monetary policy

BOM set the single-digit inflation targets at 8 percent for 2013-14 and at 6 percent for 2015-16. To stabilize the monetary situation, BOM utilizes such monetary tools as policy rate, reserve requirements, open market operations and foreign exchange market operations.

Money supply growth slowed after the 62.5 percent growth in 2010, reflecting efforts by the BOM for the last two years to curb rising inflation. BOM maintained tight monetary policy throughout 2012 in an attempt to curb soaring inflation: its policy rate was raised up to 13.25 percent and the reserve requirement ratio was also strengthened to 12 percent.

Table 2-3 Monetary policy

	2008	2009	2010	2011	2012	
Money supply (M2)	2,270	2,880	4,680	6,412	7,617	USD billion
M2 growth	−5.5	26.9	62.5	37.0	18.8	%
M2/Nominal GDP	37.0	43.7	55.6	57.8	54.6	

Source: Bank of Mongolia

However, M2/Nominal GDP is much less than one, keeping the financial deepening still shallow. Monetary policy turned accommodative since early 2013, in the wake of slower economic growth. In 2013, the Monetary Policy Committee of BOM gradually cut the policy rate down to 10.5 percent. This is a significant turnaround of the monetary policy stance. An underlying assumption behind the decision seems to be an expectation on the effect of the on-going price stabilization program.

Fiscal balance

Fiscal policy remains expansionary, and overall fiscal balance tends to be in deficit. Efforts were made to surge revenue, e.g. the value added tax and customs duties collected on imports of capital goods for mining sector development. But this was more than offset by an increase in government spending, civil servants' wages and capital expenditures. The expansionary fiscal policy is causing inflation and BOP pressures through import increase. Public spending needs to be reined in, in order not to risk undermining stability and growth prospects.

Table 2-4 Fiscal balance

	2009	2010	2011	2012	2013	
Total revenue and grants	30.3	37.1	40.3	34.9	41.1	% of GDP
Total expenditure and net lending	35.5	36.6	45.1	39.1	42.2	
Overall balance	−5.2	0.5	−4.8	−4.2	−1.1	

Source: IMF, World Bank

In 2012, the overall fiscal balance stayed negative at more than 4 percent of GDP. Even during the financial crisis period in 2009, the level of fiscal deficit was about 5 percent of GDP. According to the World Bank, the Mongolian authorities tend to continue the revenue over-estimation and excessive spending.

The 2013 budget is the first annual fiscal plan prepared under the fully effective Fiscal Stability Law (FSL). The 2013 budget plans to reduce the structural balance to 2 percent of GDP. However, this assumes the real GDP grow 18.5 percent in 2013, well over IMF's projection. Moreover, the World Bank considers the revenue projections are potentially over-estimated. This includes the extra revenue expected from re-negotiating the 2009 OT investment agreement (MNT 445 billion) and certain privatization receipts (MNT 20 billion). On the other hand, total expenditure and net lending is planned to rise to more than forty percent of GDP. Much of the increase relates to a sharp increase in capital expenditure. Thus, the structural balance is projected to reach 2 percent of GDP, the maximum level set by the FSL.

Table2-5 Structural balance

	2011	2012	2013	
Structural revenue and grants	38.1	34.3	40.2	% of GDP
Tax revenue	33.1	30.5	36.6	
Other revenue	5.0	3.8	3.6	
Structural expenditure and net lending	45.1	39.1	42.2	
Current expenditure	29.2	28.6	27.8	
Capital expenditure and others	15.9	10.5	14.4	
Structural balance	−6.9	−4.8	−2.0	

Source: IMF, World Bank

However, the World Bank still expects some additional spending components that will eventually have to be added to the budget, and considers the planned fiscal target is hard to achieve. This includes the possible spending of the USD 1.5 billion sovereign bond proceeds and the DBM's infrastructure lending. Also, the Price Stabilization Program is expected to spend MNT 718 billion over the three years to address supply bottlenecks (e.g. transportation) in meat, flour, oil and housing industries. Thus, the World Bank forecasts the overall deficit may reach over 6 percent.

Debt sustainability

IMF in recent years expressed that Mongolia's risk of debt distress was low. However, the large international bond issuances by the sovereign and DBM pushed up Mongolia's external debt. Moreover, negative shocks to FDI and coal exports are compounding balance of payments pressures caused by expansionary fiscal and monetary policies. As a result, the exchange rate continued to depreciate.

However, the Mongolian authorities took some steps to reverse the situation. The Government is reducing the budget spending starting from 2013. Moreover, DBM's pace of spending is to be slowed during the last quarter of 2013. With regard to monetary policy, BOM is planning to unwind some of the monetary stimulus provided during the first half of 2013.

Therefore, IMF sets the baseline scenario assuming substantial tightening of fiscal and monetary policies. GDP growth is projected to average eight percent per annum over the medium term (2013-18). Inflation will stay above ten percent in 2013-14, but will gradually become stabilized. Fiscal deficit and public debt will be moderate, too.

Table2-6 If fiscal policies are tightened

	2013	2014	2015	2016	2017	2018	
GDP growth (real)	11.8	9.6	7.0	5.2	8.5	6.0	%
Inflation	11.7	11.0	7.4	6.7	6.6	5.5	%
Fiscal balance	−13.5	−7.4	−3.8	−1.7	−1.8	−2.0	% of GDP
Public debt	67.3	65.8	60.4	55.9	52.4	50.1	% of GDP
External debt	51.8	50.7	44.9	39.6	36.2	33.4	% of GDP
Domestic debt	15.5	15.1	15.5	16.3	16.2	16.6	% of GDP

Source: IMF (Article IV Consultation)

Risk assessment

The World Bank points out the following risks concerning the Mongolian economy in the future.

- **Further dampening of the global minerals market**.
  While recent minerals production indicates the signs of a moderate recovery, abundant global supplies and growing competition pose uncertainty over the prospect of Mongolia's major mineral production and exports.

- **Moderating economic growth in China**.
  The reform efforts of Chinese authorities to curb excessive credit growth and to rebalance to more consumption-based economy may dampen investment and further soften economic growth in China.

- **Adverse impact from tapering of global quantitative easing**.
  Tightening of monetary policies in the advanced economies may lead to declining capital inflows and increasing borrowing costs to emerging economies.

- **Continuation of expansionary economic policies**.
  If the current large current account deficit continues with the continuation of weakening foreign investment, the economy would have to undergo a harsh adjustment process to absorb the BOP imbalance eventually through exchange rate depreciation and domestic demand decrease.

Furthermore, IMF identifies diverse risks as below.

Table 2-7 Risk assessment by IMF

Possible risks	Likelihood of realization	Impact if realized	Notes
Significant fall in non-oil commodity prices	Medium	High	Heavy reliance on copper makes the economy vulnerable to price changes
Overly expansionary fiscal policy	Medium to High	High	Overly loose fiscal policy would raise inflation, drag-down non-mining growth, and undermine competitiveness
Financial stability risk	Medium to High	Medium to High	The surge in bank credit has pushed up real estate prices, increased leverage, and hightened financial sector risk
Inflation to interest rate and exchange rate risks	Medium	High	Inflation can affect the real value of assets and liabilities, creating severe problems for the stability
Regulatory forbearance (uneven implementation and enforcement of existing regulations)	High	Medium	The continued lack of proper oversight of under-capitalized banks could potentially lead to a loss of confidence in BOM and financial instability
Concentration risk of banks (exposure to large borrowers)	Medium	Medium	The threat of a failure of a large company would directly affect the banking system, thus endangering the stability of the financial sector due to interconnected risks of conglomerates
Socio-economic and political risks	Medium	Medium	The mining sector boom could raise income inequality and social tensions could increase; political instability is an additional risk factor

Source: IMF

2.2 Stock/bond markets

Financial/capital markets overview

The financial market is basically dominated by the banking sector. The nonbank financial sector constitutes only 4 percent of the total assets in the financial sector. Mongolia needs to develop non-mineral, domestic-demand-oriented industries (e.g. food & beverage, light industry, construction, real estate, trade, hotel & restaurant, tourism and other service industries) to diversify the industrial structure. However, fund sources are insufficient in terms of long-term/large-scale financing, and there is a need for a diversified financial market.

Table 2-8 Overview of the financial sector

	2008		2009		2010	
	Institutions	Assets MNT billion	Institutions	Assets MNT billion	Institutions	Assets MNT billion
Banks	16	3,630	15	4,422	14	6,246
Nonbanks	379	179	455	196	430	266
Securities	35	26	48	13	52	33
Insurances	15	35	18	41	17	55
SCCs	192	46	212	45	179	49
NBFIs*	137	72	177	97	182	129
Total	395	3,988	470	4,617	444	6,511

	2011		2012 Q3		
	Institutions	Assets MNT billion	Institutions	Assets MNT billion	%
Banks	14	9,372	14	10,969	95.6
Nonbanks	472	416	452	508	4.4
Securities	98	68	78	96	0.8
Insurances	17	81	18	101	0.9
SCCs	162	62	151	66	0.6
NBFIs*	195	205	205	245	2.1
Total	486	9,788	466	11,477	100.0

* Nonbank financial institutions

Sources: Bank of Mongolia, Financial Regulatory Commission

The capital market is undeveloped, and the bond markets remain quite small, too. Instruments available for long-term investment remain limited. The growth of both the retail and institutional investor bases (e.g. pension funds) stay lagged.

Stock market

The Mongolia Stock Exchange (MSE) was established in 1991, following the privatization of state-owned enterprises. Ex-state enterprises were almost automatically listed on the stock exchange. The State Property Committee mostly holds their stocks; some were distributed among the people. Those unqualified to maintain the listed status were delisted one by one; still, ome 300 companies are listed on the MSE. However, the market remains illiquid and small.

The price index, turnover and market capitalization grew in general over the past years, except during the crisis in 2008-09; however, the stock market is inactive since 2012. An efficient capital market is needed to raise capital for large development projects, including initial public offerings by state-owned mining companies. Improvements in the institutional, regulatory and supervisory framework are required to develop a domestic capital market.

Table 2-9 Capital market

	2008	2009	2010	2011	2012	
Registered companies	376	358	336	332	329	companies
Top 20 index	5,583	6,190	14,331	19,847	16,839	points
Trading value	62	23	93	350	145	MNT billion
Securities	60	23	63	109	145	
Government bonds	1	0	30	237	0	
Corporate bonds	1	0	0	4	0	

Sources: Mongol Stock Exchange, Association of Security Dealers, Bank of Mongolia

Government bond market

Improvements are still required to develop a robust government bond market. MOF has no predetermined auction schedule and issues government bonds on an irregular basis. Banks tend to buy and hold government bonds, so trading is inactive in the secondary market. Corporate bond market is very small; most Mongolian companies prefer to seek financing either from banks or abroad.

As a result, the market lacks a reference yield curve. Yield curve is viewed as a necessary condition to establish reasonably priced hedging instruments.

2.3 Banking sector

Domestic credit provided by banking sector in Mongolia stayed around thirty to forty percent to GDP, which tends to be mostly less than other developing countries in Asia.

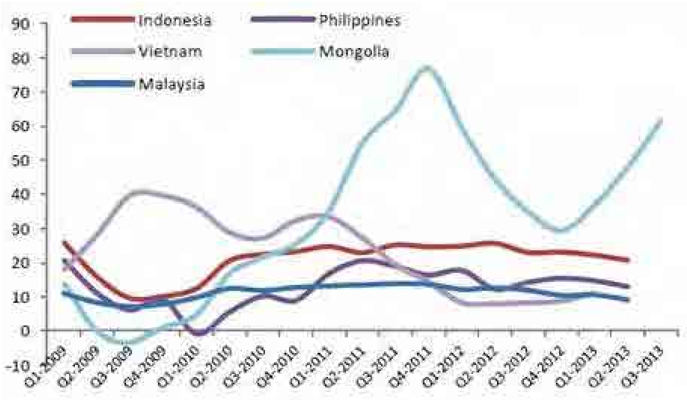
Table 2-10 Domestic credit provided by banking sector

	2008	2009	2010	2011	2012	
Mongolia	31.8	29.8	30.1	40.3	30.8	% of GDP
Indonesia	36.8	37.0	36.4	38.6	42.6	
Philippines	47.4	48.7	49.2	52.0	50.9	
Vietnam	86.9	112.8	124.7	110.2	104.9	
Malaysia	110.8	131.1	127.0	128.2	134.0	

Source: World Bank

However, Mongolia’s loose monetary policy led to accelerating growth in domestic credit. The year-on-year growth of total outstanding domestic credit (including claims to general government) rose to 61.6 percent in September 2013. The speed of Mongolia’s credit growth in recent months is the highest among the major economies in the region. The outstanding domestic credit now reached 67.8 percent of GDP in September, up from 48.6 percent in March.

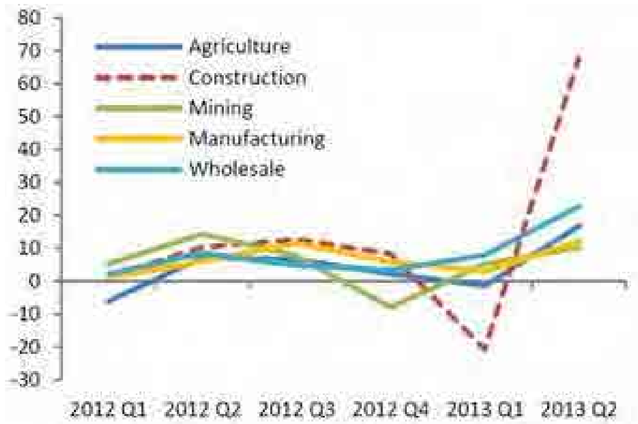
Figure 2-2 Domestic Credit Growth (%)



Source: World Bank

Credit growth was mainly concentrated in construction industries, though bank loans to most industries showed robust growth in the second quarter of 2013. On a quarter-on-quarter basis, loans to construction industries jumped by 67.7 percent, followed by wholesale industry (22.8 percent).

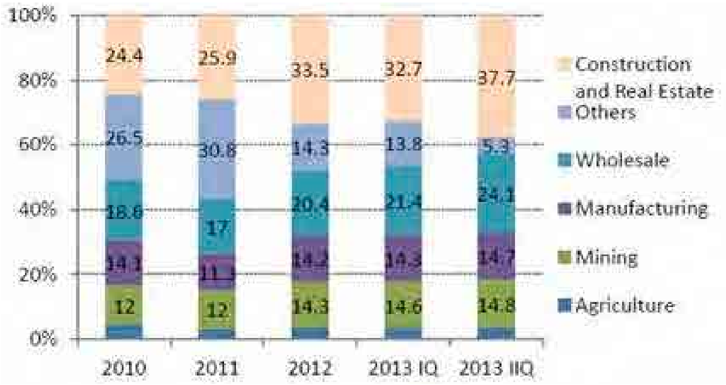
Figure 2-3 Bank credit growth by Sectors (%)



Source: World Bank

As a result, the share of construction and real estate related loans accounted for 37.7 percent in the second quarter. The increasing exposure to construction and the real estate sector reflects the concentration of policy lending programs (e.g. Price Stabilization Program).

Figure 2-4 Sectoral Distribution of Outstanding Loans (%)



Source: World Bank

Bank supervisory authorities need to closely monitor the development of construction and real-estate sectors as well as the quality of loans to these sectors. A significant portion of construction loans likely were used to finance residential construction. The construction and real-estate sectors are known to be more vulnerable to economic downturns and the boom-bust cycle of the economy, especially when the construction and real-estate boom is spurred by speculations or excessive policy stimulus. Increasing lending exposure to these sectors implies that the banking sector may become more vulnerable to a possible downturn in the construction and real-estate sectors.

Looking at the domestic aspect, Mongolia's banking sector accounts for more than 90 percent of financial sector assets. Banks are supervised by BOM.

Aggregate financial soundness indicators for the banking system showed a recovery from the 2008 crisis. NPLs and capital adequacy ratio substantially deteriorated during the crisis, but improved thereafter, excluding the two banks (Zoos Bank and Anod Bank) under conservatorship. NPL ratio improved to 3.7 percent in June 2013. Banks' returns on asset (ROA) and returns on equity (ROE) were deeply negative, but recovered after the crisis.

However, the NPL ratio jumped to 5.0 percent in July and 5.3 percent in September, as the bad loans of the Savings Bank were added. In July 2013, BOM intervened in the Savings Bank's insolvency. The Savings Bank accounted for 8 percent of total banking assets (fifth-largest in the country). According to the World Bank, the Savings Bank failed as a result of poor corporate governance and defaults on insider loans to affiliated companies. The Savings Bank was put into receivership and almost all the assets and liabilities were transferred to the State Bank, together with the staff.

Table 2-11 Banking sector

	2008	2009	2010	2011	2012	
NPL to gross loans	7.1	17.4	6.7	5.8	4.2	%
Capital Adequacy Ratio	8.7	5.5	11.9	15.0	16.1	
ROA (before tax)	−1.5	−5.6	1.8	2.9	2.3	
ROE (before tax)	−21.2	−131.9	11.2	18.6	15.2	
Loans by term (private):						
Up to 1 year	43.8	35.9	28.1	22.0	27.6	
1−5 years	52.7	54.0	66.2	71.5	64.7	
5 years or longer	3.6	10.1	5.6	6.6	7.7	
Loans by sector:						
Agriculture	2.6	5.8	4.4	3.0	2.7	
Construction	14.5	14.4	10.8	11.8	11.8	
Manufacturing	14.5	15.5	14.1	11.3	10.8	
Mining	6.4	13.2	12.0	12.0	12.9	
Real estate	5.4	7.1	13.6	14.1	13.9	
Wholesale/retail	22.7	18.0	18.6	17.0	16.8	
Others	33.8	26.0	26.5	30.8	31.1	

Sources: IMF, Bank of Mongolia

The banking system is highly concentrated, with the top 3 banks accounting for about 70 percent of market share. The largest bank, Khan Bank, accounted for a quarter of banks' total assets. Other large banks include the Golomt Bank, Trade and Development Bank (TDB) and Xac Bank. The bulk of bank lending is concentrated in Ulaanbaatar, and in five sectors of the economy (trade, real estate, mining, manufacturing and construction). Banks' financing basically depends on short-term deposits (six months on average, mostly within one year, two years at most). Larger banks can borrow long-term from donors and foreign institutions, but only TDB could issue bonds (overseas). Bank lending is limited to 3-5 years; overall, long-term financing is insufficient.

2.4 Nonbank sector

The nonbank sector is still small, comprising only 4 percent of the financial sector's assets. FRC supervises more than 400 companies including security/insurance companies, savings and credit cooperatives (SCCs) and nonbank financial institutions (NBFIs) with limited number of staff.

Securities companies

Total asset size of the security companies increased overall, according to the Association of Security Dealers. Commercial banks set up security subsidiaries one after another, which led to the increase in total capital/asset in 2011.

Table 2-12 Security companies

	2010	2011	2012	
Total capital	13	228	281	MNT billion
Total asset	33	2,198	2,625	

Source: Association of Security Dealers

The activities of securities companies include brokerage, stock/bond dealing, initial public offerings, and bond issuance on behalf of customers. Many of them are brokers and dealers. It is said only 30-40 firms are active. Some firms employ only a few (a manager and a broker/dealer, for instance). The largest firm (BD

Sec) is listed on MSE and accounts for much of the MSE transactions. There are also some “boutique” firms that provide niche types of services. However, many of the rest are said to be either marginally profitable or loss-making.

There are hundreds/thousands of trading participants in some of the Asian countries, while the number remains very few in Mongolia. Share trading value or market capitalization per participant in Mongolia is one of the lowest in Asian stock exchanges.

Table 2-13 Trading participants in Asia’s major stock exchanges

Stock exchange	Trading participants	Per trading participant	
		Share trading value	Market capitalization
	Licenses	USD million	USD million
Singapore	4,148	63	184
Bombay	1,362	78	928
National (India)	1,349	378	915
Taiwan	1,171	556	628
Taiwan (OTC)	1,084	90	55
Hong Kong	550	1,958	5,149
Shanghai SE	384	6,848	6,633
Malaysia	222	557	2,102
Philippines	184	194	1,246
Shenzhen	133	18,027	8,648
Tokyo	92	34,936	37,813
Osaka	92	1,438	2,197
Mongolia	80	1	16
Korea	60	26,411	19,657
Thailand	38	6,286	10,257
Colombo	28	60	606

Data: 2012
(Participants: end 2012; trading value & market capitalization: 2012)
Sources: World Federation of Exchanges, Mongolian Stock Exchange

Insurance companies

The life insurance industry is in its infancy. The non-life insurance industry grew gradually, following the passage of the new Insurance Law in 2004. The first life insurer commenced business in 2008, but still operates in deficit, and does not function as an institutional investor yet, as it deposits the insurance assets in banks.

Table 2-14 Insurance sector

	2008	2009	2010	2011	2012	
Insurance premium income	21.5	23.4	31.8	47.5	79.0	MNT billion
Accumulated loss/profit	−0.1	1.8	3.3	10.4	8.1	

Source: Financial Regulatory Commission

Savings and credit cooperatives

SCCs remain small and underdeveloped, constituting less than one percent of the total financial sector assets. SCCs provide primarily savings and loan services to low-income and rural households. SCCs attract new customers and grow their portfolios, by speedy lending processes, acceptance of borrowers with no prior credit history, access to very small loans, and flexible lending terms, even though their lending rates are higher.

Table 2-15 Savings and credit cooperatives

	2009	2010	2011	2012	
Total assets	44.6	48.8	61.9	67.7	MNT billion
Loans outstanding	32.2	34.9	41.5	48.3	
Saving (deposits)	29.9	34.8	43.8	47.1	
NPL ratio	6.5	10.0	6.0	2.3	%

Source: Financial Regulatory Commission

NBFIs

Though there are more than 200 NBFIs, they constitute only 2 percent of the total financial sector assets. Many of their customers are low-income households. Among NBFIs, there are microfinance institutions, money changers and other types of businesses. NBFIs are predominantly located in Ulaanbaatar and other urban areas.NBFIs are not allowed to take deposits, and are thus mainly dependent on their capital base and borrowings or investments from banks or foreign institutions to fund loans. It is premature to expect them to finance from the capital market.

Table 2-16 Nonbank financial institutions

	2009	2010	2011	2012	
Total assets	96.5	128.6	205.4	245.4	MNT billion
Loans outstanding	50.0	78.1	119.0	154.4	
Shareholders' equity	68.9	92.0	138.2	162.2	

Source: Financial Regulatory Commission

2.5 Foreign direct investments

General situation

The Foreign Investment Registration and Review Department (FIRRD) of the Ministry of Economic Development collects and disseminates data for tracking foreign direct investment (FDI) in Mongolia. The data is based on companies' reporting; the accurate data, including the changes after registration, is managed by MOF's Tax Office.

Major foreign-invested entities are listed below. Some investors utilize tax havens; therefore, the investments might actually come from different countries via such nominal places.

Table 2-17 Foreign-invested entities (Top 20 of foreign share amount, 2010)

	Equity MNT bn	Foreign shares %	Investor countries	Sectors
Oyutolgoi	65	100.0	Netherlands	Mining
MD Securities	44	99.8	Virgin Islands (UK)	Trade, service
MCS mining	25	99.6	Singapore	Mining
HSBC	10	99.9	South Korea	Finance
Wagner Asia Leasing	10	100.0	USA	Trade, service
Seoul Senior Tower	8	91.1	South Korea	Health, beauty
Khan Bank	21	34.3	USA, China, Hong Kong, Japan	Finance
Gyantbaylag	7	100.0	Virgin Islands (UK)	Mining
Globalcom	5	100.0	Virgin Islands (UK)	Trade, service
Louis Vuitton	6	66.7	France	Trade, service
Credit Bank	10	40.7	Cyprus	Finance
MCS Asia Pacific	15	25.7	Singapore	Food, beverage
Shangri-La	10	38.2	Virgin Islands (UK)	Trade, service
EAM Bayan-Ulgii	4	99.7	Canada	Mining
Handy Soft Rich	3	96.7	South Korea	Trade, service
Tethys Mining	27	10.4	Switzerland	Mining
Big Mogul Coal and Energy	5	60.0	Luxemburg	Mining
Hong Kong Sunkfa	2	100.0	China, Hong Kong	Transportation
EAM Exploration	2	99.3	Canada	Mining
Santanmores	5	28.3	South Korea	Mining

Source: US Embassy

FDI increased in 2011 thanks to mining and construction projects. However, investors' sentiment was damaged by the OT dispute and the Strategic Entities Foreign Investment Law (SEFIL) passed in May 2012, and FDI drastically decreased.

Characteristics by country

Japan is ranked the fourth by number of invested companies, but remains twelfth by invested amount. Japan's investment is significant in telecommunications (e.g. Mobicom JVC), manufacturing (e.g. cashmere processing), trade (e.g. automobiles), services (e.g. software, hotels, restaurants and tourism) and other sectors.

As a neighboring country to Mongolia, China's investment is larger than any other countries. Chinese investment covers almost all sectors including mining, but primary sectors are trade, service and agro-processing. The average value per investment is relatively small.South Korea maintains close relationship with Mongolia and is ranked the second by number of invested companies. South Korea aggressively invests in the telecommunications sector.

European and American countries heavily invested in mining projects; however, FDI drastically decreased because OT investment peaked out and SEFIL discouraged investors' mind.

Table 2-18 Foreign investment by country (number of companies)

	Total	%	1990–2004	2005	2006	2007	2008	2009	2010	2011	2012	
China	6,083	49.1	1,534	532	827	876	859	299	376	434	346	companies
South Korea	2,196	17.8	632	203	274	332	302	113	117	122	101	
Russia	824	6.7	433	54	105	72	51	37	17	34	21	
Japan	525	4.2	190	29	56	60	58	35	23	35	39	
USA	292	2.4	98	19	28	27	44	11	14	36	15	
Virgin Islands	256	2.0	27	9	12	26	17	23	37	67	38	
Germany	196	1.6	102	10	18	13	13	8	7	9	16	
Singapore	188	1.5	52	9	5	10	21	4	22	31	34	
Hong Kong	167	1.3	54	9	5	10	14	10	27	20	18	
Others	1,689	13.4	569	97	175	183	172	73	129	145	146	
Total	12,416	100.0	3,691	971	1,505	1,609	1,551	613	769	933	774	

Source: Ministry of Economic Development

Table 2-19 Foreign investment by country (amount)

	Total	%	1990–2004	2005	2006	2007	2008	2009	2010	2011	2012	
China	3,727	31.7	442	228	172	340	498	613	176	1,015	243	USD million
Netherlands	3,364	23.2	5	0	0	0	4	51	233	1,817	1,253	
Luxemburg	1,145	9.0	3	2	0	3	0	1	26	477	634	
UK Virgin Islands	1,107	7.5	48	5	6	35	6	19	102	611	274	
Singapore	717	5.5	9	5	1	1	32	9	31	403	227	
Canada	491	4.2	174	2	72	0	3	1	148	72	19	
South Korea	365	2.9	85	19	16	23	42	32	39	55	54	
USA	306	2.5	46	6	37	4	6	3	14	127	63	
Russia	296	2.3	37	7	12	40	4	6	2	58	130	
Hong Kong	220	1.8	25	1	0	8	2	11	80	54	38	
Australia	201	1.6	4	12	0	0	3	1	2	82	96	
Japan	194	1.6	66	6	5	2	47	6	7	21	34	
Others	892	6.2	177	26	45	43	62	48	167	193	134	
Total	13,025	100.0	1,121	317	367	500	709	801	1,026	4,986	3,199	

Source: Ministry of Economic Development

Characteristics by sector

Looking at the number of foreign invested companies by sector, trade comprises about two thirds of the total; however, if we look at the invested amount, mining comprises more than 70percent of the total. Light industry or construction comprises only a small portion; foreign investments in such sectors are awaited for the industrial diversification.

Table 2-20 Foreign investment by sector (number of companies)

	Total	%	1990–2004	2005	2006	2007	2008	2009	2010	2011	2012	
Trade	8,487	68.4	969	522	1,112	1,505	1,515	572	731	872	689	companies
Mining	415	3.3	272	27	22	23	4	12	14	22	19	
Construction	391	3.1	327	15	14	20	4	6	0	1	4	
Tourism	312	2.5	176	57	35	23	12	1	2	6	0	
Light industry	190	1.5	167	7	14	1	1	0	0	0	0	
Food	181	1.5	172	5	2	0	0	0	0	0	2	
Animal raw material	158	1.3	149	4	4	0	0	0	1	0	0	
Transportation	130	1.0	101	7	3	1	1	2	3	9	3	
Information	108	0.9	72	7	11	7	6	2	1	0	2	
Others	1,726	13.9	1,286	58	52	15	10	10	26	214	55	
Total	12,416	100.0	3,691	971	1,505	1,609	1,551	613	769	933	774	

Source: Ministry of Economic Development

Table 2-21 Foreign investment by sector (amount)

	Total	%	1990-2004	2005	2006	2007	2008	2009	2010	2011	2012	
Mining	9,459	72.6	494	184	195	337	485	643	820	4,083	2,218	USD million
Trade	2,229	17.1	163	53	103	112	187	133	163	621	694	
Finance	184	1.4	67	10	12	22	5	3	13	24	28	
Transportation	170	1.3	21	1	0	1	0	2	3	7	135	
Construction	127	1.0	55	1	2	4	2	9	1	5	48	
Light industry	107	0.8	85	2	1	1	18	0	0	0	0	
Animal raw material	57	0.4	54	1	0	1	0	0	0	1	0	
Tourism	51	0.4	13	1	2	0	1	0	0	22	12	
Information	45	0.3	20	6	0	7	1	1	0	9	1	
Others	598	4.6	149	58	52	15	10	10	26	214	64	
Total	13,025	100.0	1,121	317	367	500	709	801	1,026	4,986	3,199	

Source: Ministry of Economic Development

New investment law

Foreign investment was one of the dominant financing channels to private investment, which was the main driver of growth for the past years. With no well-functioning capital market, the rapid decline of the FDI has significant implication on the economic outlook in Mongolia. To address this, the Government is introducing the new Investment Law.

The new Investment Law aims at providing a level playing ground to both foreign and domestic investors and ensuring stability of investment over the medium. The new Law will likely send a positive signal to the market and will help stabilize the market sentiment, according to the World Bank.

3. Fiscal and monetary policies and related laws & regulations

As introduced in the previous chapter, GOM identifies 1) fiscal discipline, 2) controlling inflationary pressure, and 3) infrastructure financing as the key policy issues for economic development. During the IMF mission in September this year, issues such as target deficit level, cutting fiscal expenditures, off-balance expenditure of DBM were discussed. For 3), GOM has aggressively been exploring opportunities for financing through government bonds since November 2012. Also with a longer-term perspective, establishment of sovereign wealth fund (SWF) is being prepared, with a view to taking full advantage of the potential revenues from rich mineral resources.

Laws and bills relevant to these policy issues are listed below.

- **Fiscal stability Law (2013)**:
  Implemented for stabilizing macroeconomic management. Stipulates that the fiscal deficit should be limited to below 2% of GDP, and official government debt should be below 40% of GDP. Current level of deficit is far higher at around 10%, which was pointed out during the IMF mission in September, while the ongoing effort of GOM toward reducing it was positively accepted by IMF.

- **Debt Management Law (in preparation)**:
  The bill was submitted to the Parliament in October this year, and is expected to pass by the end of this year for the enforcement early next year. Replacing the Foreign Grant, Loan and Aid Law with a greater

coverage, including the management of domestic and external debt (ceiling, fiscal discipline and stability, etc). Comments will be heard from public, development partners and relevant ministries.

- **Sovereign Wealth Management Law (in preparation)**:
  There have been similar attempts such as 1) Fiscal Stabilization Fund and 2) Human Development Fund, which were introduced to utilize royalty revenues from the mining sector, but are not successful. Especially, 2) is currently in capital deficit as a result of distributing the fund to the public, diverting from the initial concept of the fund. The bill is under preparation in order to renew this fund as a permanent income fund called 'Mongol Future Heritage Fund' to be submitted to the Parliament in the spring next year. The idea is supported by the President's Office, and the Sovereign Wealth Division was established under the Debt Management Department within the Ministry of Finance in March 2013. As in October 2013, the division has 6 dedicated staff members. The design of the fund assumes the followings;

  - Preparing for the period after exhausting all the reserves of mineral resources (after 2070's, according to the estimate by the Ministry of Mining), contributing 70% of the royalty revenues (MNT300-400 billion) every year.
  - Also useful for absorbing the upward pressure on MNT, to avoid Dutch disease situation.
  - Shut off from the risk of fungibility through separating from the general budget and strengthening the governance.
  - As a result, it is expected that the outstanding debt of MNT1trillion held by 2) will be repaid in 4 years, and the pool starts to grow after that.
  - The pool will be invested in domestic and foreign financial products such as debt and equity.
  - Assumes inflation at 3-5% p.a. and 4% return on a real basis.

4. Evaluation of financial & capital markets in Mongolia and major issues

4.1 Current situations of financial & capital market development

Relative size of the financial/capital markets in Mongolia is quite small compared to other countries in Asia. As shown in the figure below, sizes of the banking sector and capital markets as % of GDP are one of the smallest in the region.[1]

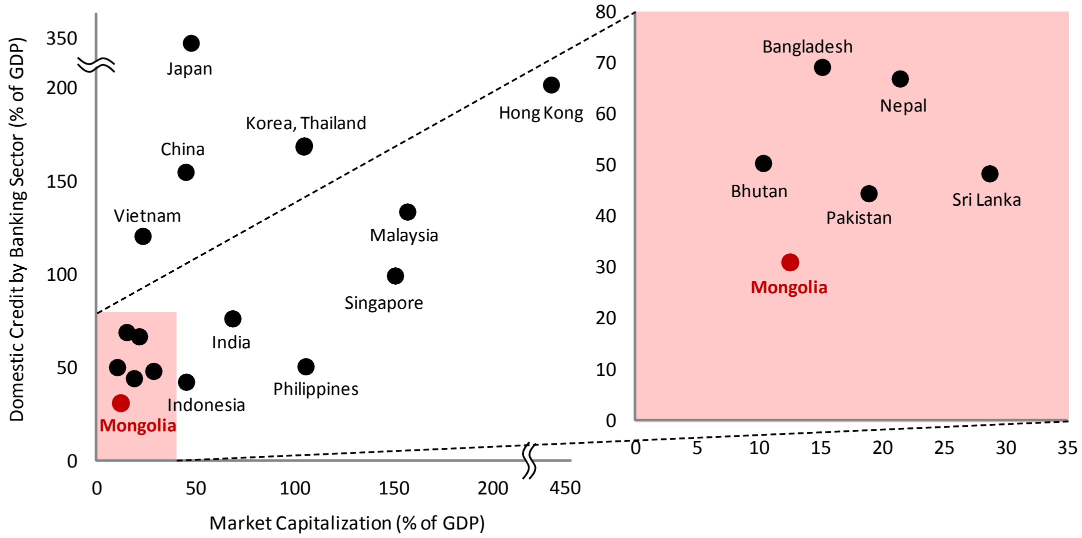
For lending institutions, there are 14 commercial banks, 162 non-banks, 195 S&Ls in Mongolia. With no requirement for capital, the loan outstanding by S&Ls grew rapidly, and their failure had become a serious social problem in 2005. Then the regulation on S&Ls was tightened, which resulted in drastic decrease of S&Ls. In addition, failure of 2 commercial banks in 2008-2009 has triggered the consolidation of the banking sector, including nationalization and mergers.

Financial sector in Mongolia can be characterized by large number of financial institutions compared to the population, as well as small size of each institution, limiting the capacity to finance large-scale projects. MDB was established in May 2011 to address this issue, and GOM has started to issue government bonds as

[1] According to the latest estimation by the World Banks, domestic credit by the banking sector (as % of nominal GDP) has gone up to near 60% as in 3Q2013, which suggests that the dot for Mongolia in Figure 4-1 is likely to have shifted upward. cf. 'Mongolia Economic Update November 2013' (p.26)

mentioned above. On the capital market side, the number of 'actively traded' listed companies and 'actively operating' security brokers are quite limited, which will be detailed in the following sections.

Figure 4-1 Sizes of financial/capital markets (% of GDP)

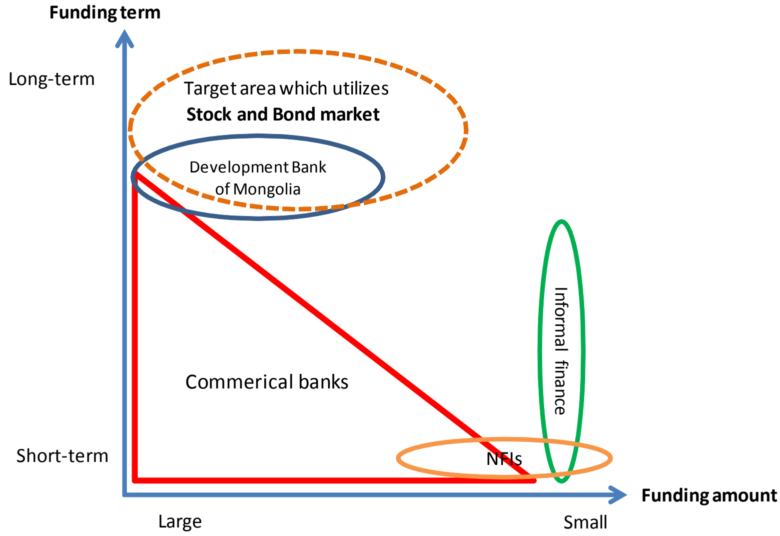


Sources: Study Team from the World Bank database

Recent development in financial sector in Mongolia has largely been driven by the commercial banks, and the presences of capital markets and non-bank sectors are rather limited. According to the Global Competitiveness Report 2012-2013 by the World Economic Forum, Mongolia's ranking for the financial/capital market development is low, with 'availability of financial services' at 111st out of 144 countries, 'financing through capital markets' at 107th and 'security market regulations' at 132nd.

Going forward, to achieve sustainable economic development led by the private sector, it will be critically important to develop basic infrastructure and diversifying the industrial structure through fostering the SMEs. And for that to take place, wide variety of financing options suitable for each business/project type should become necessary. Particularly, facilitation of longer-term finance for medium to large scale businesses is substantially missing in Mongolia, which can be filled by further development of capital markets (Figure 4-2).

Figure 4-2 Structure of financial/capital markets (image)



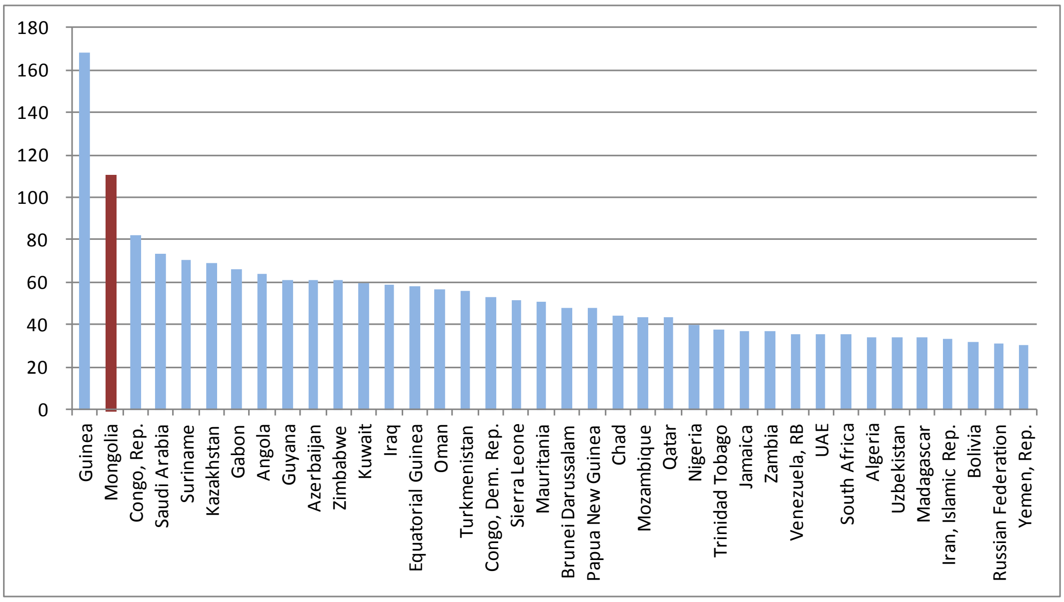
Source: Study Team

Mining countries' capital market utilization

For Mongolia, a resource-rich landlocked country with limited population, to sustain the economic growth, it is critically important to finance the mining sector projects with a view to fueling the industrial development. In the following section, the desirable financing structure is sought in comparison with other countries with similar economic conditions.

First, looking at the ratio of the mining sector production to overall GDP, following 38 countries owe more than 30 percent to the mining sector. Countries on the left hand side are more dependent on mining, including Mongolia.

Figure 4-3 Mining production to GDP (%)

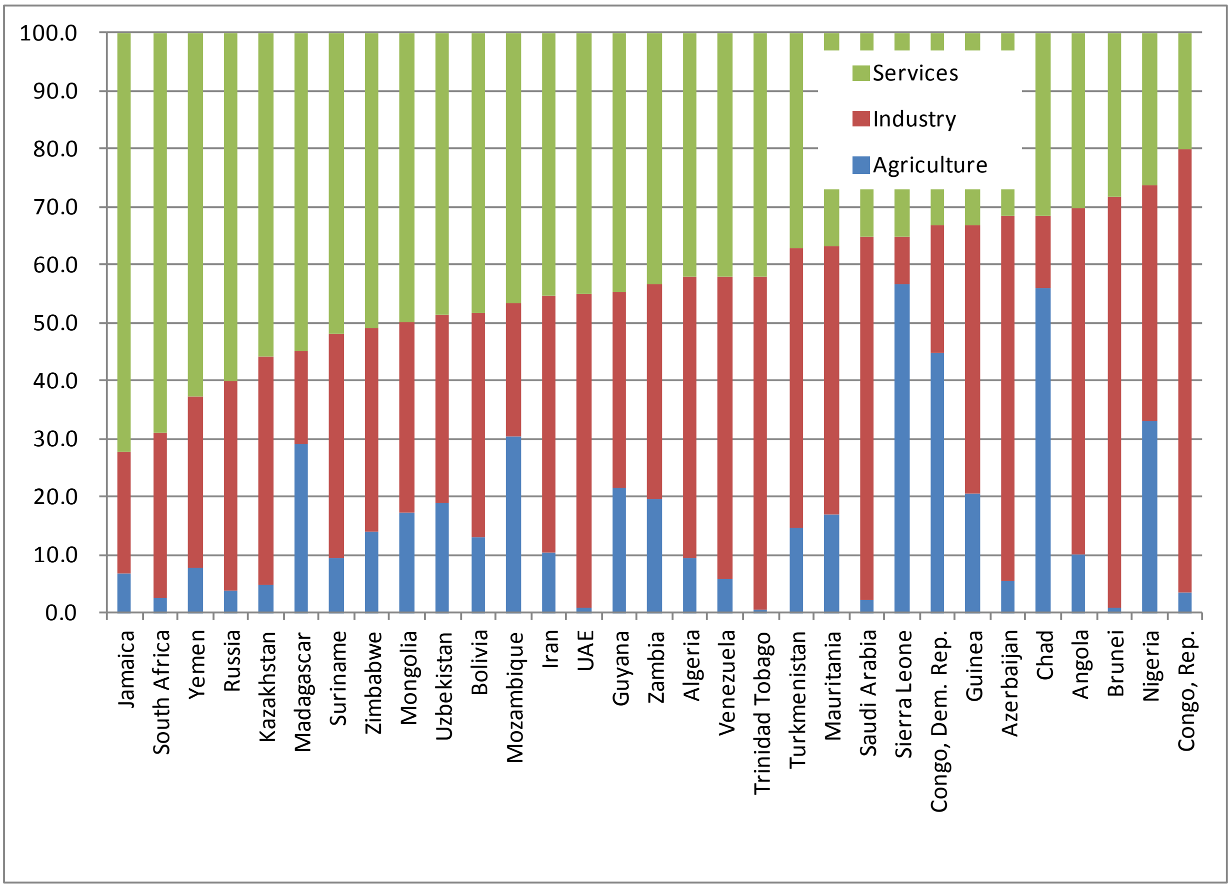


Source: International Organizing Committee for the World Mining Congresses, World Bank

(Data: 2011 or latest)

Looking at their industrial structure, while service sector including finance is developed in South Africa, etc., some countries still depend on agriculture and other industries. Mongolia is located in the middle in terms of shift towards service economy.

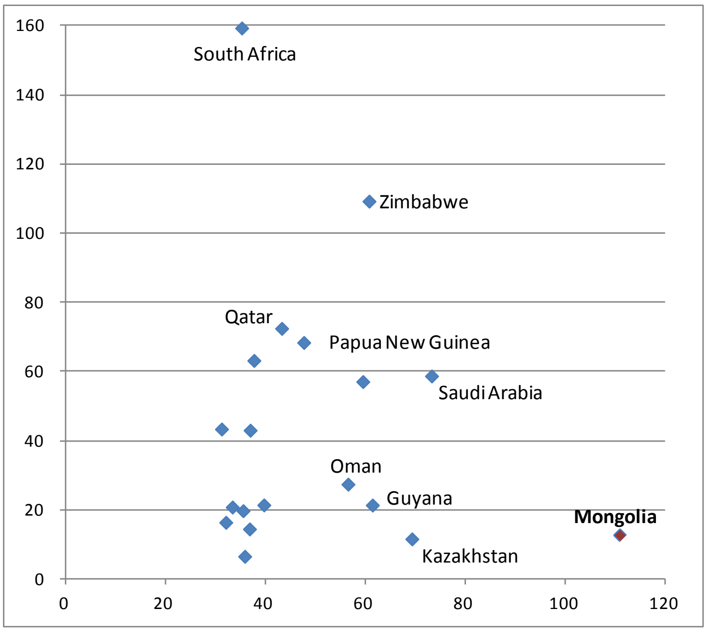
Figure 4-4 Shares of value added (% of GDP)



Source: World Bank

Looking at the sizes of the capital markets of these countries, Mongolia is small in terms of the market capitalization, although mining production to GDP is relatively high. Many countries have higher market capitalization ratio than Mongolia, implying additional room for further development in capital markets.

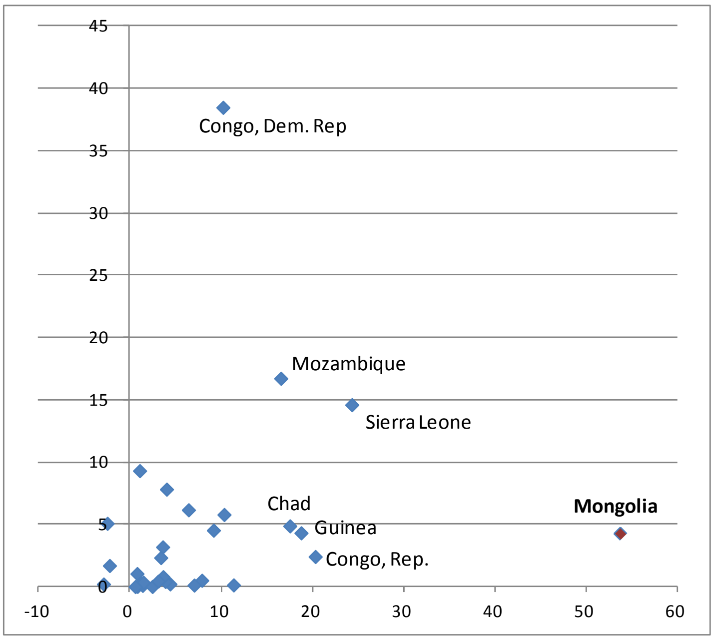
Figure 4-5 Mining production (horizontal axis) vs. market capitalization (vertical axis) (% of GDP)



Source: International Organizing Committee for the World Mining Congresses, World Bank

As to FDI and ODA inflows of these countries, Mongolia has the highest ratio of FDI to GDP, far exceeding other countries. On the other hand, African countries tend to depend more on ODA.

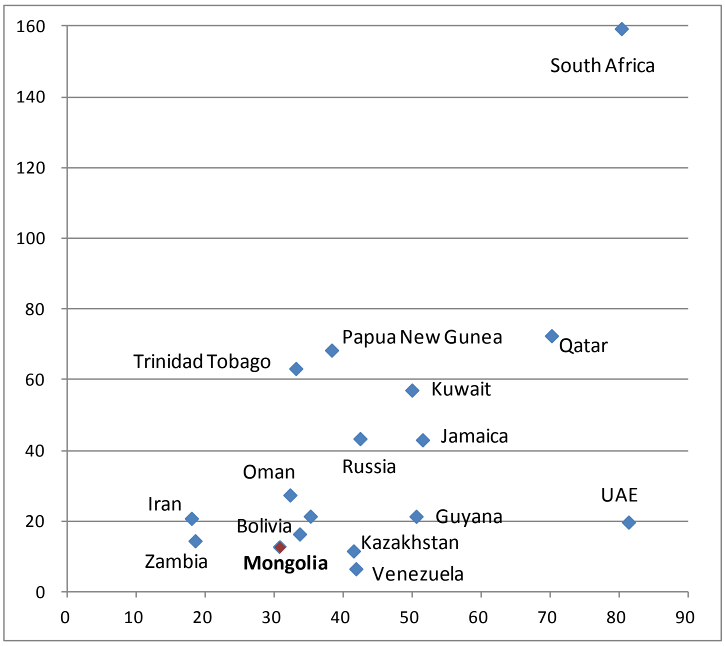
Figure 4-6 FDI (horizontal axis, % of GDP) vs. ODA (vertical axis, % of GNI)



Source: World Bank

Regarding banks' domestic credit and market capitalization, both ratios to GDP are low in Mongolia, while both are high in South Africa.

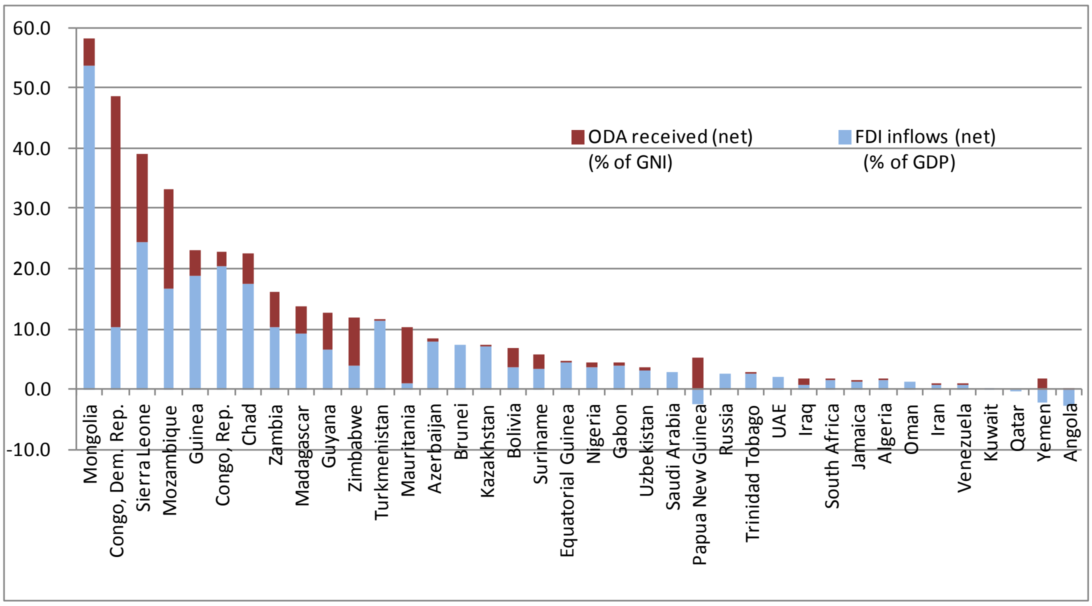
Figure 4-7 Banks' domestic credit (horizontal axis) vs. market capitalization (vertical axis) (% of GDP)



Source: World Bank

Let us now compare FDI and ODA to see mining countries' financing volume, assuming the difference is minor in their ratio to GDP or GNI. Mongolia receives money inflow of more than half of GDP, but mostly through FDI. In contrast, African countries tend to depend on ODA.

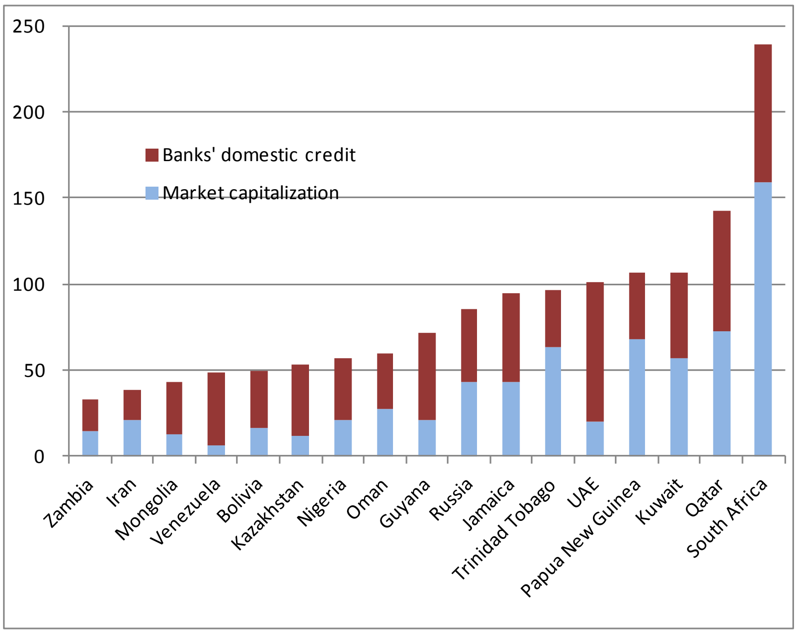
Figure 4-8 FDI (% of GDP) vs. ODA (% of GNI)



Source: World Bank

Likewise, comparing banks' domestic credit and market capitalization regarding the countries equipped with both data, Mongolia appears to be one of the most scarcely financed countries through both markets (especially through capital market).

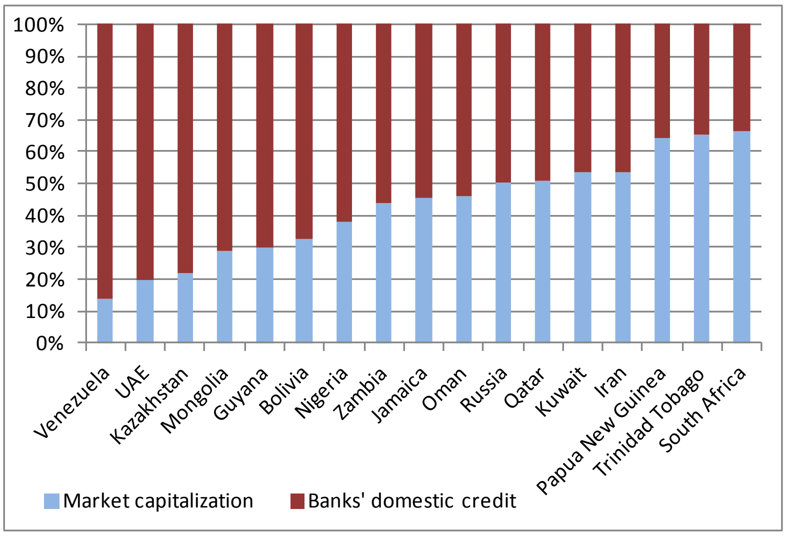
Figure 4-9 Banks' domestic credit and market capitalization (% of GDP)



Source: World Bank

In addition, comparing the relative dependency on banks' domestic credit and capital market, Mongolia tends to depend more on banks. In contrast, such resource-rich countries as South Africa, Trinidad Tobago, Papua New Guinea, Iran, Kuwait, Qatar and Russia highly utilize capital markets.

Figure 4-10 Relative utilization of banks' domestic credit and capital market (% of GDP)



Source: World Bank

Overall, Mongolia's economic activities seem to be financed through FDIs (plus overseas capital markets), rather than domestic banks or capital markets. Given some of the landlocked resource-rich countries utilizing their own capital markets more, on the other hand, there could be a potential for Mongolia to explore greater financing capacity of their capital markets.

With a view to better utilizing the revenues from the mining sector, some of the countries (Chile, Botswana, etc.) also establish and operate Sovereign Wealth Funds (SWFs). Sudden capital inflow may appreciate the currency and decrease the competitiveness of their domestic manufacturing sector (Dutch Disease). SWF can play a role in mitigating the damages of such situations through investing a part of the portfolio in overseas assets. Stable exchange rate can be one of the favorable conditions from the viewpoint of long-term investment.

4.2 Potential demands for financial/capital markets and major issues/challenges

Provided the development stage of financial/capital markets as detailed above, potential demands can be summarized as follows.

- **Foreign investors**: Investor demography in Mongolia, with relatively large share of the limited number of foreign institutional/ individual investors as well as the thin domestic investor base, is less likely to go through immediate change in the near future. Especially considering the growing attention of Western institutional investors on Mongolia as one of the strategic emerging markets, this trend is likely to be strengthened.
- **Domestic issuers**: Potential demand can be classified into the following three groups.
    - **Needs for privatizing state owned companies (SOCs)** – Currently the State Property Committee (SPC) is in the process of preparing the list of 30-40 candidates for privatization for 2014-16. Specifically, additional floating of the coal mining companies such as Baganuur and Shivee Ovoo (both under Erdenes MGL), IPO of MSE, Agricultural Commodity Exchange, MonAtom (uranium-related) and other mining-related companies, are being considered. For the IPO candidates, feasibility studies and pre-privatization restructuring are the main emphasis, whereas the possibility of re-listing is being sought by some of the 25 companies delisted so far.
    - **Financing needs by medium-sized non-mining private sector companies** – Some of the prospective sectors are on the domestic-demand oriented side, including infrastructure-related, agro/food processing, telecom and import substitution sectors such as construction materials.
    - **Financing needs by major banks** – Due to the lack of successful cases in the past, most of the banks are cautious about IPOs, and are likely to seek bond financing outside Mongolia. But greater usage of domestic capital markets is expected in the longer-term.
- **Domestic investors**: While the pace of the growth is likely to be slow, following changes are expected.
    - **Institutional investors -** Currently limited to commercial banks and insurance companies, with majority of investments are in government securities, money markets and bank deposits (for insurance companies). Assuming the expanding presence of emerging institutional investors such as pension funds, life insurance companies and mutual funds, greater role can be expected for capital markets in the long run.

- Retail investors – Given the high deposit interest rates, lack of knowledge and confidence in capital markets, fund flows into the markets are currently limited. It will become necessary, in the long run, to expand the needs for more active capital markets through guiding the investors from ‘savings’ to ‘investments’ with a view to diversifying their assets.

In order to meet these needs more efficiently, following core issues have been identified through this survey.

- Insufficient regulations and capacities at FRC to fully implement them
- Smooth and efficient implementation of the New Security Markets Law
- Insufficient operational capacity at MSE in listing examination, as well as in IT infrastructure
- Insufficient operational capacity in clearing & settlement functions
- Suboptimal disclosure & compliance capability at listed companies
- Thin investor base, both on institutional & retail sides
- Lack of liquidity and variety of products in securities/financial markets

In the following sections, specific bottlenecks are examined in detail, and the directions for overcoming these issues/challenges are explored.

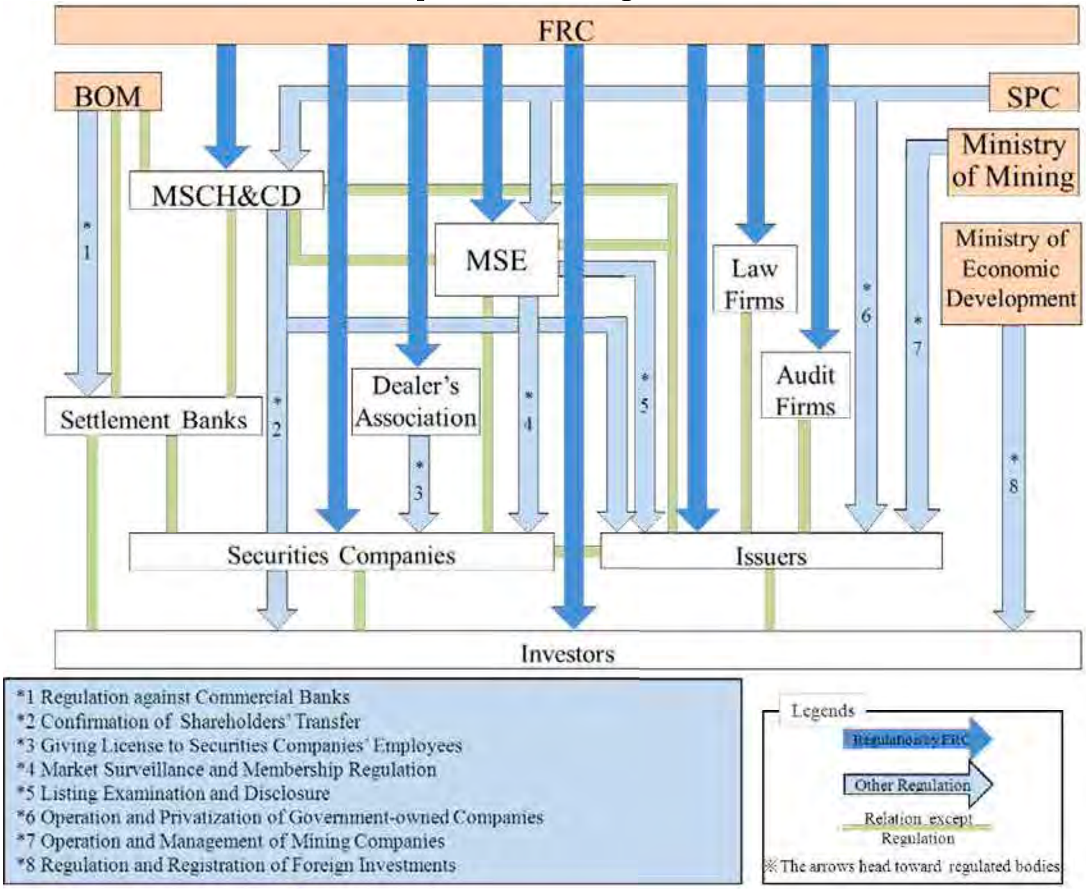
4.3 Overview and issues of relevant players and organizations

4.3.1 Regulatory Institution → Details are provided in Chapter 5

Though a detail explanation can be found in Chapter 5, the relationships between regulatory and supervisory bodies and market participants are shown in the figure below.

The FRC is the central regulatory and supervisory bodies. It conducts widespread regulatory oversight of the market infrastructure, including market participants and MSE. Furthermore, MSE and MSCH&CD are responsible for additional regulatory oversight of market participants.

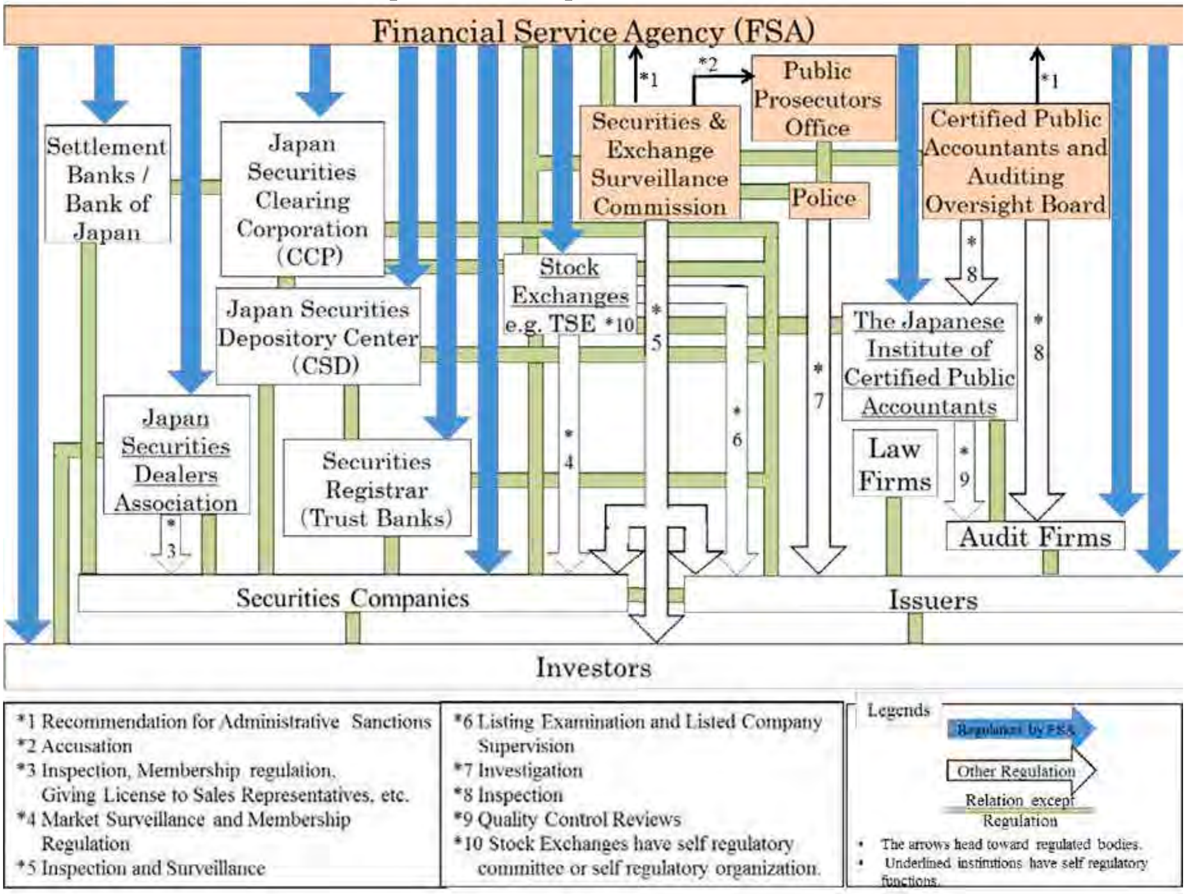
Figure 4-11 Overview of Regulatory and Supervisory Bodies and Market Participants in the Mongolian Securities Market



Source: Study Team

The following figure 4-11-2 shows an overview of regulation in the Japanese securities market. In the Japanese market, separate entities are responsible for market infrastructure and regulation according to their expertise and aptitude. In contrast, the Mongolian securities market does not feature this division of responsibilities, with FRC covering a far wider scope of regulation.

Figure 4-11-2 Overview of Regulatory and Supervisory Bodies and Market Participants in the Japanese Securities Market



Source: Study Team

4.3.2 Securities Trading Infrastructure (Exchange, Securities Settlement System, etc.)

4.3.2.1 Mongolian Stock Exchange (MSE)[2]

- **History and Overview**

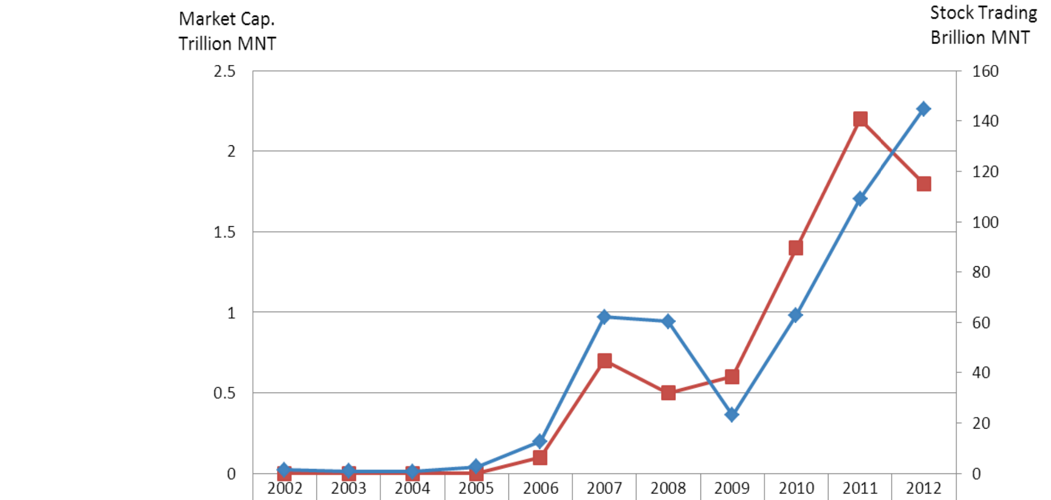
With Mongolia's shift to a market economy, MSE was established in 1991 as a venue for privatizing state-owned corporations. 96.1 million shares from 475 state-owned companies, valued at 8.2 billion MNT (7 million USD), were listed through MSE during a period from 1992 to 1995, and MSE began to function as a secondary market in 1995. Following 2000, MSE began support of IPOs by private companies as well, though only 17 companies have conducted IPOs as of October 2013.

The Mongolian stock market experienced stagnant market capitalization and trading volume until 2005, as show in Figure 4-12 below. However, the market has been rapidly developing since 2006 with the rapid rise in prices of mineral resources, a major export of Mongolia. From 2008 to 2009, the securities market was temporarily stagnant as the world suffered from simultaneous world economic downturn, though growth resumed later in 2011. Market capitalization fell on the back of Chinese economic slowdown in 2012, but as the revision of securities laws and regulations and introduction new systems is nearing completion, if smooth

[2] The description in this section, unless otherwise specified, is based on MSE's official data or study team interview to MSE.

operations begin, the market is expected to dramatically develop.

Figure 4-12 Trends in Listed Company Market Capitalization and Trading Value in the Mongolian Market



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Market Cap. In Trillion MNT	0	0	0	0	0.1	0.7	0.5	0.6	1.4	2.2	1.8
Stock Trading in Billion MNT	1.37	0.9	0.65	2.55	12.6	62.13	60.35	23.18	62.87	109.11	144.75

Source: MSE Annual Report 2012

With recent market capitalization at 1.8 trillion MNT (approx. 140 million USD) and floating shares of listed companies at approx. 6%, daily average trading value stands at 578 million MNT (415,000 USD). In light of these circumstances, trading is only conducted during the 3 hours from 10:00 a.m. to 1:00 p.m., as of October 2013. [3] Furthermore, margin trading and short selling are not available in the Mongolian market.

The composition of investors changes from year to year. In FY2012, overseas investors, primarily institutional investors, accounted for over 90% of trading volume, with the remaining coming from domestic individual investors. Figures until the 3rd quarter of FY2013 show that over 50% of trading is conducted by overseas investors.[4]

There are a total of 262 listed companies, a breakdown of which can be found in Table 4-1 below.

[3] The trading hours of other leading exchanges are: 6.5 hours (NYSE), 8.5 hours (LSE), 5.5 hours (HKEx), and 5 hours (TSE). Those for Asian exchanges are: 6 hours (Korea Stock Exchange), 4.5 hours (Stock Exchange of Thailand), and 5.5 hours (Bombay Stock Exchange).

[4] Refer to Figure 4-22 on Page 52.

Table 4-1 Breakdown of MSE-listed Issues (as of Nov. 2013)

Section	No. of Issues	Remarks
A board	36	Issues selected according to liquidity, etc.
B board	142	General issues
Temporary Removal	63	Issues for which a temporary removal has been ordered by the FRC inspector due to violations of laws and regulations, etc.
Wholly State-owned Companies	21	Issues for which trading has not started, despite being given listed company status

Source: MSE website

An index tracking the top 20 issues in terms of market capitalization and average trading volume is published daily.[5]

In 2011, the FRC, MSE, and LSE concluded a strategic partnership agreement to revitalize the Mongolian stock market. As a result of this partnership, MSE adopted LSE's Millennium IT System, which it launched operations on in July 2012. The Millennium IT System is composed of Millennium Exchange, Millennium CSD, Millennium Surveillance, and Millennium Trader. The system has brought about large changes to the Mongolian market. In addition to enabling online trading from securities companies, it also facilitates settlement within the global standard T+3 period.[6] The Millennium IT System is used at more than 30 exchanges in more than 20 different countries, including the London Stock Exchange, and its introduction is being hailed by market-related parities as bringing the Mongolian market closer to global standards.

However, trading value was greatly reduced due to confusion over new securities account procedures accompanying the introduction of the new system. Trading value fell from 144.7 billion MNT in FY2012 to 97.6 billion MNT in FY2013.

MSE operational performance and financial conditions for the most recent 3 fiscal years are shown in the following Table 4-2. In addition to consecutive corporate and government bond issuances lifting total revenues and profits in FY2011, the introduction of Millennium IT and related factors is thought to have inflated balance sheets in FY2012. Furthermore, deficit recorded in FY2012 is deemed to have arisen from depreciation and foreign exchange losses on unpaid amounts in relation to the introduction of Millennium IT.

Table 4-2 MSE Operational Performance and Financial Conditions

in thousand MNT

	2010	2011	2012
Operating Revenue	641,275	2,880,980	1,491.580
Net Income	23,207	463,509	-227,194
Total Assets	2,451,119	9,646,897	13,874,539
Total Net Assets	2,445,099	7,411,825	8,711,784

Source: MSE Annual Report 2011 & 2012

[5] The index featured 75 constituents in its inaugural year of 1997. However, this number was lowered to 20 in 2002, in light of trading conditions, etc.

[6] Before the adoption of the Millennium IT System, investors were required to pay an advance 3 business days prior to the trading day (T-3) in order to complete settlement on the trading day (T+0).

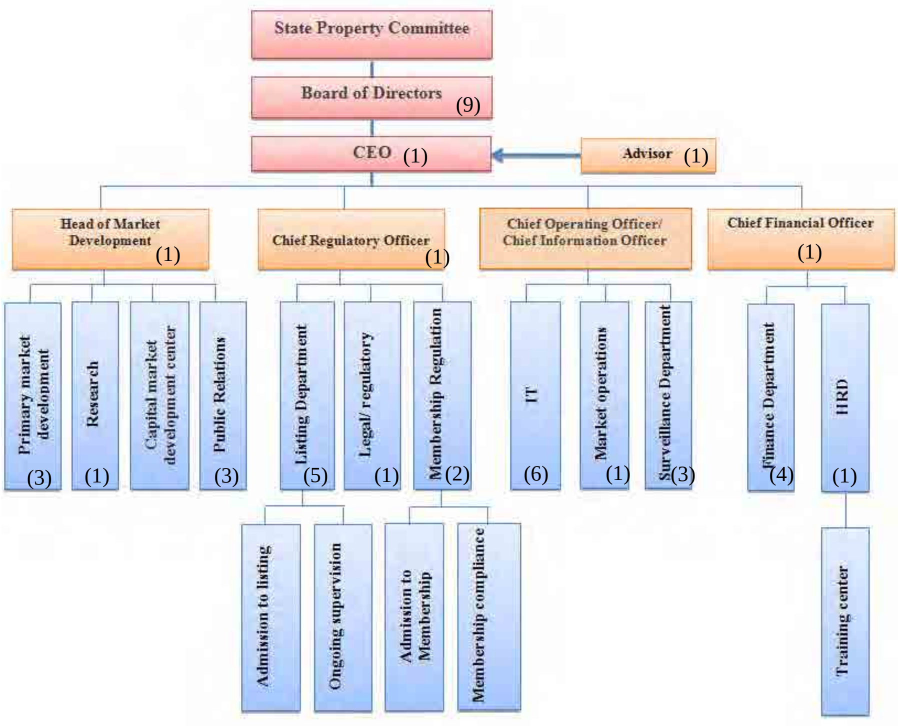
While the current strategic partnership agreement with LSE will expire in April 2014, MSE is scheduled to continue to receive support from LSE's subsidiary MIT, the developer of Millennium IT, under a two-year contract which was agreed to in September 2013.

In October 2013, MSE also concluded an agreement for cooperation in the area of index calculation with FTSE, another subsidiary of LSE which provides financial indices, with the aim of introducing a new index for MSE in the 2nd quarter of FY2014. These agreements are examples of the continuing relationship enjoyed between MSE and LSE Group.

➢ Organizational Structure

MSE, as shown in the following organizational chart, has general and fundamental functions as a stock exchange such as market operations, IT, promotion, and regulation. Regarding the regulatory function, the listing department which includes not only ongoing supervision but also listing examination consists of only 5 staff, while there are only 3 in the surveillance department, 2 in membership regulation and 1 in the legal department. In addition, there are only about 30 staff members in all who are engaged in the operations of MSE.

Figure 4-13 Organizational structure of MSE



Source: MSE web site　　　＊The figures in parentheses are the numbers of members.

Currently MSE is a state-owned body under the control of State Property Committee (hereinafter "SPC"), and board of directors is composed of officers from SPC, FRC, and Ministry of Mining, etc. In the future, MSE itself is planned to be privatized. Also, as the result of the enforcement of the securities market law (revised law) described later, MSE itself has become a self-regulatory organization (hereinafter "SRO").[7] Furthermore, as a joint project with LSE, a central counterparty clearing house (hereinafter "CCP") is planned to be founded under MSE by 2015, and the revised law already provides for that in Article 47.6.

- **Issues**

- MSE is aware of the necessity to function as a fund-raising venue and escape its position as a tool for privatization of state-owned companies. It is also aware of the regulatory changes required to do so, and the introduction of Millennium IT was the first step toward that goal. Additionally, the revision of the Securities Market Law to introduce dual-listing and custodian systems is expected to increase the number of new market participants and revitalize the market.

- The cultivation of specialized human resources is vital during these transformational periods of regulatory changes. In relation to this, LSE training seminars were held for 120 persons including market participants through the strategic partnership agreement with LSE. As the budget related to the agreement has been expended, the continuing cultivation of capable human resources for market operations in-line with the amended Securities Market Law is expected to be an area of focus. In particular, since MSE will become an SRO under the amended law, the proper execution of regulatory operations will be required. Considering the scale of regulatory personnel mentioned above will not necessarily be sufficient, the personnel structure will require reinforcement coinciding with the market's revitalization.

- Additionally, MSE is aware of post-trading issues such as settlement risk arising from the lack of a CCP and the smooth introduction of a custodian system. In relation, MSE is examining the formation of a corporate group encompassing a CCP, a central securities depository, and other entities. However, there remain problems regarding the cost of establishing a CCP and the lack of staff with an understanding of the required operations.

- Moreover, though details will be provided in the following 5.4.2.1, the disclosure obligations imposed on MSE-listed companies are extremely limited, and the details actually being disclosed are insufficient. Enhancement of the disclosure system and its proper operation are greatly expected in the future.

- Modern exchanges are expected to conduct educational activities for individual investors in order to invigorate the stock market by diversifying and expanding the investor base, and MSE is also aware of the importance of these activities. However, at present MSE only provides paid courses for experts and professionals.

- In addition to its efforts to revitalize the market, MSE must also firmly execute regulatory operations as an SRO. This may require MSE to handle these opposing goals as a single institution. Should it become listed in the future, the proper form of self-regulatory operations within a for-profit organization will need deliberations.

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[7] In order to secure market fairness and transparency, an SRO establishes self-regulatory rules and performs audit on whether the members who belong to the organization perform proper business in accordance with laws, and self-regulatory rules, etc.(excerpt from "Activities of Securities and Exchange Surveillance Commission"1997.10)
There is the merit that an SRO close to the market is able to establish rules in accordance with the actual conditions of the market to complement laws and can delicately adjust them while monitoring their effectiveness.

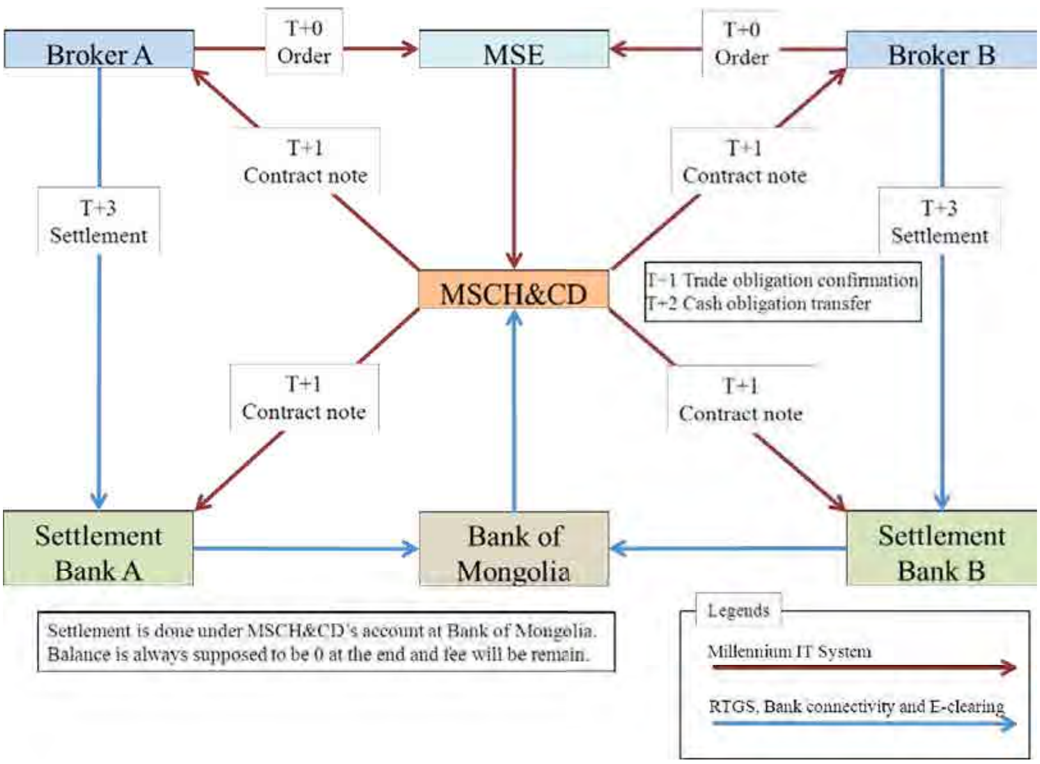
4.3.2.2 Mongolian Securities Clearing House & Central Depository[8]

➢ **History and Overview**

While central securities depository (hereinafter CSD) work in Mongolia was originally handled by MSE, MSCH&CD was set up in 2003 after the securities market law (the old law), which required to separate the CSD from the stock exchange, was enacted in 2003. The current main tasks of MSCH&CD are securities clearing, depository, and transfer of name.

The tasks are rapidly changing like MSE due to introduction of Millennium IT in 2012. While previous clearing cycle was completed on the trade day, T+0, following client payment on the third day ahead of the trade day, T-3, it was changed to be completed on the third day after the trade day, T+3, which is the standard in the world (refer to Figure 4-14). As for its timeline, a notice is issued from MSCH&CD to securities companies, and clearing banks, which is currently limited to four banks. Fund settlement then takes place through MSCH&CD's account in the Bank of Mongolia on the third day after the trade day, T+3.

Figure 4-14 Outline of settlement operations

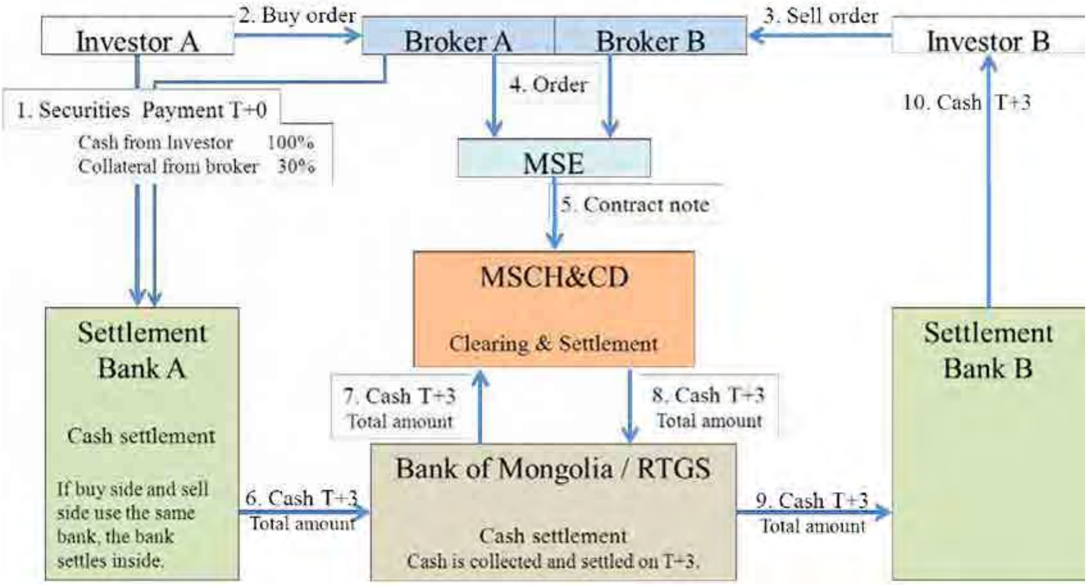


Source: MSCH&CD Presentation

On the other hand, the deposit system, which requires securities companies to deposit 30% of the bid value to settlement banks as clearing guarantee under the name for brokerage bankruptcy, remains and some people have pointed out that this system prevents large transactions from being made.

[8] The description in this section, unless otherwise specified, is based on MSCH&CD's official data or study team interview to MSCH&CD.

Figure 4-15 Settlement and Clearing Flowchart



Source: MSCH&CD Presentation

Recently, MSE, MSCH&CD, and the Dealer’s Association have engaged in discussions aiming to completely transition to a global standard where payments are made on the third business day following the trading day (T+3). The final decision on such transition will be made by FRC after consideration of risks and other factors.

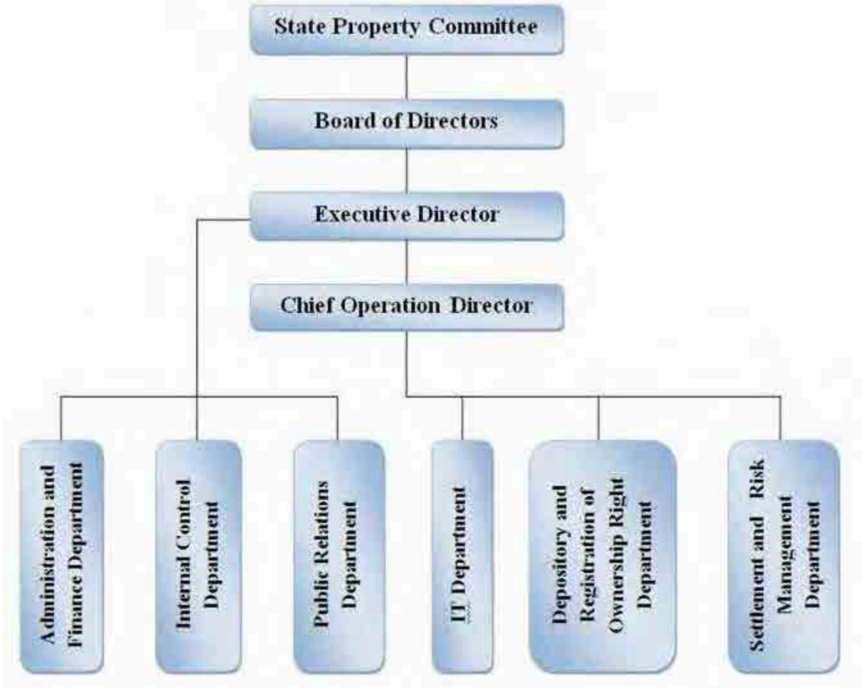
In addition, MSCH&CD is currently in charge of the investor protection fund.

➢ **Organizational Structure**

Currently MSCH&CD is a state-owned body under the control of SPC, and board of directors is composed of officers from SPC, Ministry of Finance, Ministry of Mining, Bank of Mongolia, etc. Also, as a result of the enforcement of the revised securities market law described later, MSCH&CD itself has become an SRO and they are expected to check changes of shares in its self-regulatory work. Changes in shareholdings of 5% or more have to be disclosed by listed companies as a change in main shareholders, and changes in shareholdings of 10% or more are treated as tender offers.

There is an argument in Mongolia that a clearing house should be founded independent from the CSD, and a plan in which CCP is founded under MSE is being considered. If this is achieved, MSCH&CD will only be responsible for depositary and settlement. In addition, the organization structure of MASH&CD will be as shown in Figure 4-16.

Figure 4-16 Organizational structure of MSCH&CD



Source: MSCH&CD Presentation

- **Issues**

- The introduction of Millennium IT has significant impact on MSCH&CD activities. It will result in a lot of new manual work to simultaneously operate the old system and greater burden for the back offices of securities companies. MSCH&CD are aware of the need of system audit so that they can take measures against system glitches amid sharp trading volume increase from current low levels.

- Furthermore, Millennium IT CSD, the core system of MSCH&CD, cannot be controlled or monitored directly from within MSCH&CD because the system is located inside MSE. MSCH&CD is highly aware of the necessity of improving this issue. In addition, MSCH&CD is aware of the problem concerning confirmation of the confidentiality of information, which it provides in response to requests from General Authority for State Registration or General Tax Office.

  MSCH&CD is working hard to collect information to optimize its activities through regular seminars sponsored by JASDEC, which has an MOU with MSCH&CD.

  We need to give significant consideration for the smooth conduct of CCP operations under the new organization after a CCP is set up without local expertise in the CCP business, while it is necessary to reconsider the operations of MSCH&CD so that it may be in balance with more limited responsibilities due to a new possible framework for the CSD business. Similarly, while custody and Depository Receipt systems will be established in accordance with the amended Securities Market Law, it is necessary to discuss how MSCH&CD will accommodate these systems. As MSCH&CD lacks the required personnel and knowledge, it hopes for external advisers for this task. In the meantime, while MSCH&CD has built partnerships with KSD and HKSCC, it has asked for support in the custody business from KSD and clearing business from HKSCC.

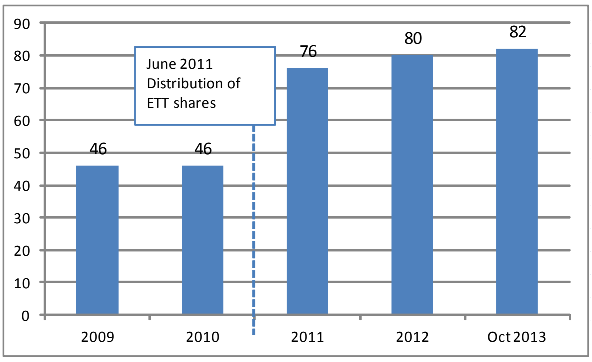
- In addition to this MSCH&CD stressed the need for support to develop regulations in coordination with settlement banks (which are regulated by BOM), because there were some cases where accurate information was not properly communicated between MSCH&CD and the settlement banks.

4.3.3 Securities companies

The history of securities companies in Mongolia goes back to 1991, when 29 state-owned securities companies were established in each 21 provinces and Ulaanbaatar City to distribute stocks of state-owned companies to the people and the MSE was established to list these companies. These securities companies were privatized later, and many other securities companies were established when stocks of Erdenes Tavan Tolgoi LLC (ETT), a state-owned coal mining company, were distributed to the people. Currently there are 82 private securities companies, which are members companies of the MSE. Member companies need to fulfil the requirements stipulated by the MSE and are permitted to participate in securities trading in the MSE. According to the 2012 annual report of MSE, there were 80 member companies, and the number of employees was 593 as of the end of 2012. This indicates that the average number of employees in a security company is about 7.4. Most of securities companies in Mongolia are micro and small firms with a few people focusing only on brokerage business. The minimum capital for a brokerage firm under the current securities market law is MNT 50 million (JPY 3 million), and this low level of the minimum capital[9] allows such small companies to participate in the securities market. The minimum capital for a securities company dealing with underwriting business is MNT 200 million.

According to the MSE' s news release on July 9, 2013[10], MSE has suspended participation in securities trading of member companies which have not fulfilled their obligation to pay annual membership fee since 2012, and lists 29 member companies that have continuously following the contract regulations of the MSE. In other words, many of micro and small securities companies are dormant in reality, as commented by some interviewees in our field survey.

Figure 4-17 The number of MSE member companies



Source: MSE's website

[9] Financial Instruments and Exchange Act in Japan stipulates that the minimum capital required for registration as a Type I Financial Instruments Business Operators is JPY 50 million.
[10] http://www.mse.mn/news/show/id/620

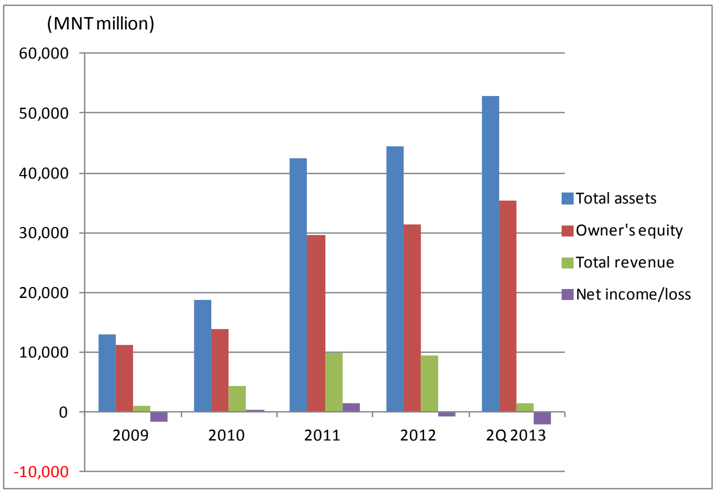
Table 4-3 MSE member companies by business and the number of employees

	End of 2011	End of 2012
Number of MSE member companies	76	80
Broders, Dealers (B/D)	46	47
B/D, Underwriters	18	17
B/D, Consulting	8	9
B/D, Underwriters, Consulting	4	7
Number of employees	538	593
Average number of employees per member company	7.1	7.4

Source: 2012 Annual Report of MSE

Figure 4-18 illustrates major financial indicators of the total MSE member companies. With increase in the number of securities companies when stocks of ETT were distributed, total assets, owner's equity, and total revenue of the securities industry increased substantially in 2011. However, total revenue has been stagnating since then, and net profit has been sluggish recently. 35 companies out of 76 in total in 2011, and 60 out of 80 in 2012 were making loss.

Figure 4-18 Major financial indicators of MSE member companies



Source: MSE's website

The big picture of Mongolian securities industry has changed for the past several years. The leading company in the industry has been BDSec which was established in 1991, but its share in terms of total assets has been getting smaller due to larger presence of TDB Capital, which was established in 2011 as a subsidiary of TDB, and rapid increase of United Securities, etc. However, BDSec 's share in terms of total revenue has been rather stable because of its broad network with individual and institutional investors both in Mongolia and abroad.

Table 4-4 Top 5 MSE member companies in terms of total assets (MNT million)

	2013/2Q			2009		
		Total assets	share		Total assets	share
1	TDB Capital LLC	12,791	24%	BDSec JSC	4,896	38%
2	United Securities LLC	10,857	21%	Eurasia Capital Mongolia LLC	855	7%
3	BDSec JSC	9,594	18%	Mongol Securities JSC	750	6%
4	Frontier LLC	1,803	3%	Ard Capital LLC	619	5%
5	Daewoo Securities	1,363	3%	Delgerkhangai Securities	552	4%

Table 4-5 Top 5 MSE member companies in terms of total revenue (MNT million)

	2013/2Q			2012			2011		
		Total revenue	share		Total revenue	share		Total revenue	share
1	BDSec JSC	363	25%	BDSec JSC	4,830	52%	BDSec JSC	4,136	42%
2	TDB Capital LLC	204	14%	MICC LLC	811	9%	TDB Capital LLC	1,071	11%
3	MICC LLC	170	11%	TDB Capital LLC	691	7%	MICC LLC	804	8%
4	SG Capital LLC	90	6%	United Securities LLC	323	3%	Eurasia Capital Mongolia LLC	622	6%
5	Daewoo Securities Mongolia LLC	80	5%	Eurasia Capital Mongolia LLC	307	3%	Frontier LLC	587	6%

	2010			2009		
		Total revenue	share		Total revenue	share
1	BDSec JSC	2,054	48%	MICC LLC	312	29%
2	MICC LLC	507	12%	Eurasia Capital Mongolia LLC	149	14%
3	Monkhan Trade LLC	402	9%	MIBG LLC	94	9%
4	Global Asset LLC	219	5%	Monet capital LLC	82	8%
5	Frontier LLC	133	3%	BDSec JSC	80	7%

Source: MSE’s website

Table 4-6 illustrates top 5 MSE member companies in terms of stock trading and bond trading. BDSec has the dominant share, about 68%, of stock trading in 2011, while TDB Capital has the largest share of bond (mainly government bond) trading. This implies that bank-affiliated securities companies could possibly gain larger shares especially in the bond market. According to our interview with a security company, the maximum brokerage fee rate a brokerage firm can receive is set at 4.5%, and the actual fee rates are determined based on such factors as relationship with customers.

Table 4-6 Top 5 MSE member companies in terms of value of stock and bond trading

(MNT million)

	stock	share	bond	share	Total	share
BDSec	148,302	68%	84,385	34%	232,687	50%
TDB Capital	71	0%	105,766	43%	105,837	23%
Monsec	3,308	2%	23,424	10%	26,732	6%
Capital Market Corporation	1,547	1%	16,570	7%	18,117	4%
Ard Capital Group	1,680	1%	11,858	5%	13,538	3%
Total (including others)	218,222	100%	245,520	100%	463,741	100%

Source: 2011 Annual Report of MSE

The following are overview of major companies in the Mongolian securities industry, mainly with those which we have conducted interviews.

- **BDSec**
  - ✓ BDSec was established in 1991, and has been the largest company in the industry. It has brokerage, underwriting, investment advisory and research businesses. It was listed in the MSE in 2006. The number of employees is about 40.
  - ✓ It was originally a state-owned company based in Tuv province. The current management acquired the company in 1998[11], and moved its headquarters to Ulaanbaatar.
  - ✓ BDSec has 44% of total foreign accounts, 25% of total local accounts, and 30% of total institutional and corporate accounts. It has been in the dominant position in the market, executing more than 50% of total equity transactions.

Figure 4-19 Market share of BDSec in terms of value of equity transactions in the MSE

Source: BDSec JSC Corporate Presentation (September, 2013)

  - ✓ It managed 12 IPOs (Initial Public Offering) out of total 17 since 2005, and 6 bond offerings out of 14 since 2001. Examples of IPO deals are Genco Tour Bureau (a major travel agency, the transaction was in 2006 and capital raised was 8 billion MNT), Tuul Songino Water Resources (a supplier of underground water in Ulaanbaatar and operator of wasterwater treatment facilities, the transaction was in 2007 and capital raised was 13.2 billion MNT), KhukhGan (a metallurgical plant operator, the transaction was in 2008 and capital raised was 3.2 billion MNT), Naco Fuel (coal processing, the transaction was in 2008 and capital raised was 300 million MNT), and Silikat (a lime concrete producer, the transaction was in 2011 and capital raised was 3.6 billion MNT).
  - ✓ The recent financial indicators are as follows. It incurred loss in 2009, but recovered thereafter. In 2013, it has been affected by stagnant stock market so far.

（MNT million)

	2009	2010	2011	2012	2Q 2013
Total assets	4,896	6,517	9,887	9,750	9,594
Owner's equity	4,836	6,319	8,745	9,469	9,262
Total revenue	80	2,054	4,136	4,830	363
Net income/loss	-467	819	1,431	1,491	-346

Source: MSE's website (the same for the following tables of other companies' financial indicators)

[11] Based on Wikipedia of BDSec.

- ✓ In 2007, it entered into a business agreement with Auerbach Grayson & Co, Inc., a New York based brokerage firm with global client base.

- **TDB Capital**
  - ✓ TDB Capital was established in December 2010 as a 100% subsidiary of TDB, the leading commercial bank, through transferring its International and Investment Banking department. It has brokerage, underwriting, asset management, investment advisory and research businesses.
  - ✓ The president of TDB Capital, Mr. R. Koppa, is also the president of TDB. Mr. Koppa came to Mongolia in 2004 in the technical assistance program to TDB by ING Bank. The CEO of TDB Capital, Mr. Onon Orkhon, is also First Deputy CEO of TDB since 2007. Mr. Onon received trainings in the Japan Center for International Finance.
  - ✓ It has been providing the latest market information through its "Weekly market update."
  - ✓ Since its establishment, TDB Capital has increased its total assets rapidly and becomes the largest company in terms of asset size as of the end of the second quarter of 2013. However, its income has not grown in such a rapid pace.
  - ✓ The recent financial indicators are as follows.

(MNT million)

	2009	2010	2011	2012	2Q 2013
Total assets			6,964	9,023	12,791
Owner's equity			6,907	8,958	12,764
Total revenue			1,071	691	204
Net income/loss			508	350	73

- **MICC**
  - ✓ Mongolia International Capital Corporation (MICC) was established in 2005. It has brokerage, underwriting, M&A advisory and research businesses.
  - ✓ Mr. Achit-Erdene Darambazar has been leading the company as CEO since 2005, when he founded the first security company dealing with investment banking services. Mr. Howard Balloch, the chairman of the board of directors, had been working for the Canadian government and served as Canada's Ambassador to China.
  - ✓ The recent financial indicators are as follows.

(MNT million)

	2009	2010	2011	2012	2Q 2013
Total assets	526	727	827	890	548
Owner's equity	524	726	797	722	528
Total revenue	312	507	804	811	170
Net income/loss	-154	2	71	-75	-195

- **Eurasia Capital**
  - ✓ Eurasia Capital was established in 2008 as a subsidiary of Silk Road Finance, an investment group focusing on Mongolia, Myanmar and Mozambique, "3M" markets. It has brokerage, underwriting, M&A advisory and research businesses.
  - ✓ Mr. Alisher Ali, chairman of the company, was Vice President of Auerbach Grayson & Co, Inc., a brokerage house in New York. He also had experience in investment banking businesses in Ernst & Young (in charge of Central Asian countries) and Credit Suisse First Boston (in Zurich and London).

- ✓ The recent financial indicators are as follows.

(MNT million)

	2009	2010	2011	2012	2Q 2013
Total assets	855	2,605	1,115	1,206	1,206
Owner's equity	803	264	1,067	1,178	1,178
Total revenue	149	21	622	307	5
Net income/loss	-341	0	2	-143	-55

- **Frontier Capital**
  - ✓ Frontier Capital was established in 2007 by Mr. Igata, a Japanese and ex-investment banker at Solomon Brothers. It has brokerage, underwriting, M&A advisory and research businesses.
  - ✓ The recent financial indicators are as follows.

(MNT million)

	2009	2010	2011	2012	2Q 2013
Total assets	296	446	2,134	2,004	1,803
Owner's equity	277	274	710	713	538
Total revenue	61	133	587	238	1
Net income/loss	-189	49	49	-58	-24

- **ResCap Securities**
  - ✓ ResCap Securities was jointly established in 2010 by Origo, China-based private equity fund listed in AIM of the London Stock Exchange, and Monnis International Co. Ltd., Mongolia's industrial holding company. It has brokerage and investment banking businesses.
  - ✓ RepCap has introduced the IT system for its back and front office developed by Nomura Research Institute in November 2013.
  - ✓ The recent financial indicators are as follows.

(MNT million)

	2009	2010	2011	2012	2Q 2013
Total assets			232	211	239
Owner's equity			187	94	96
Total revenue			33	33	46
Net income/loss			-54	-91	2

- **KDB Daewoo Securities (Mongolia) LLC**
  - ✓ KDB Daewoo Securities (Mongolia) LLC was established in May 2013 as a base in Mongolia of KDB Daewoo Securities, subsidiary of Korean Development Bank. It will start brokerage business from January 2014. It is the only company owned by a foreign securities company in Mongolia.

Figure 4-20 is an organizational chart of BDSec shown in its 2012 Annual Report. Major differences with those of securities companies in Japan include lack of internal audit department and compliance department. These departments are very important to improve business operations and compliances of securities companies in Mongolia. Also, according to its 2012 Annual Report, BDSec has established its "Back Office" in 2012. This indicates that other companies in the industry may not have such functions and operational management in the industry are not at sufficient level. According to our discussion with the industry experts, there are some reported cases in which a securities firm has executed trading without obtaining prior consent from its client. It is desirable for the whole securities industry to strengthen its operational management, compliance and internal check system so that the industry would minimize such cases and to improve its credibility.

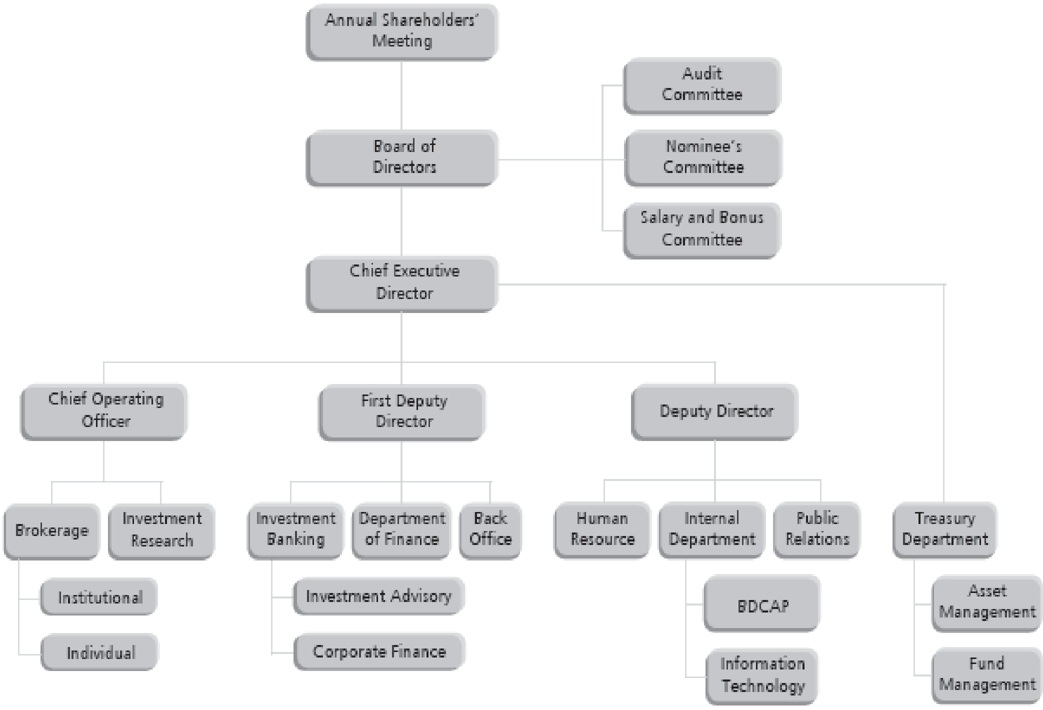
Ability to plan and develop financial products will be a very important factor for the future growth of the industry. With the implementation of Investment Fund Law in 2014, new financial products such as investment fund and mortgage-backed securities (MBS) will be allowed to be created and marketed in the Mongolian securities market, and it is hoped that such products will broaden investor’s base in Mongolia. It will be necessary for the securities companies to build up their expertise to create new and attractive financial products.

Strengthening marketing and distribution network will also be a critical. Currently many of securities companies in Mongolia are inactive and active companies seem to be dependent on limited relations with a particular foreign investor or wealthy Mongolian individual, and there are only a few securities companies that have broad marketing and distribution network with the mass market. It will be important to have such strong network with clients including potential investors, in order for new financial products other than savings to become more popular in Mongolia. In that sense, especially major securities companies should make more efforts to expand their customer base. In this respect, BDSec now conducts periodical seminars for individual investors to develop their financial knowledge, and a bank-affiliated securities company such as TDB Capital is expected to utilize branch network of bank to strengthen distribution capability.

It is reported recently that Nomura Research Institute (NRI), with its subsidiary in India, has started providing IT solutions for securities companies in Mongolia, and that Rescap Securities is the first Mongolian company which introduces the NRI’s IT system related to stock trading[12]. For many of securities companies in Mongolia, improving IT system will be required in the near future.

[12] http://www.nri.com/ja-JP/jp/news/2013/131101.aspx

Figure 4-20 Organizational structure of BDSec



Source: 2012 Annual Report of BDSec

As for entry by foreign securities companies into the Mongolian market, KDB Daewoo Securities, a subsidiary of Korean Development Bank, opened its base in Ulaanbaatar in May 2013, and there has not been any other cases reported. Considering the current situation that the largest securities company in this country, BDSec, has only about 40 employees and that most of securities companies are micro or small sized enterprises with only several employees, it will be indispensable for the industry to introduce technology and know-how of foreign securities companies through business alliances with them, or to accept more entries by foreign securities companies in the market, which will lead to vitalization of the whole industry.

In December 2013, FRC has raised the minimum capital level in order to strengthen soundness and stability of the securities industry in Mongolia. Securities companies will be required to clear the new minimum capital by July 1st, 2014 in accordance with their businesses, and when a company will not be able to clear the minimum in three-month grace period, FRC will cancel license of such company. Also, FRC examines possibility of introducing "capital adequacy ratio," which is an important indicator to measure financial soundness of securities companies. It will be necessary for the Mongolian securities industry to introduce and utilize financial soundness indicators effectively, and hence, to realize sustainable development of the industry. However, after introducing financial soundness measures, there will be restructuring and consolidation of the whole industry, including withdrawals of micro and small securities companies that cannot clear the minimum capital level[13]. Such process will be inevitable for the whole industry to become more sound and more competitive with players above a certain level of business base and financial stability. Therefore, it will be very important for the FRC, as a regulatory and supervising agency, to foresee the future

[13] As of the end of September 2013, there are 66 MSE member companies whose owners equity (which is different from capital) are less than MNT 300 million.

image of the securities industry, and to respond to the industry restructuring in a careful manner to prevent the market players from being in turmoil.

	The current minimum capital based on the present Security Market Law (article 27 and 28)	The revised minimum capital
Brokers	MNT 50 million	MNT 200 million
Dealers		MNT 300 million
Brokers & Dealers		MNT 500 million
Underwriters	MNT 200 million	MNT 1,000 million
Brokers, Dealers & Underwriters		MNT 1,500 million

There is an industry organization for the securities companies called Mongolian Association of Securities Dealers (MASD). There are 54 member companies in the MASD and the association offers training programs to its member companies[14]. However, taking into account that there are only 3 regular staffs in the association, its current activities should be very limited. It is hoped that the MASD will play more important role in the future to raise the level of the industry capability.

4.3.4 Security issuers

Table 4-7 illustrates overview of the MSE listed companies. The number of listed companies has decreased to 262 most recently.

Table 4-7 Overview of MSE listed companies

	2010	2011	2012
Number of MSE listed companies	336	332	329
- govnernment owned	51	52	52
- privately held	285	280	277
Number of listed securities	2,686	2,785	4,779
- government owned	1,854	1,881	2,088
%	69%	68%	44%
- privately held	831	904	2,691
%	31%	32%	56%
New listings	0	1	2
- government owned		1	
- privately held			2
Number of delisted companies	22	5	5
Number of companies held shareholders' meeting	159	155	209
Number of companies distributed dividend	16	28	29
Number of companies submitted financial reports	151	158	180

Source: 2011 and 2012 Annual Report of MSE

Table 4-8 is the list of companies included in MSE Top 20 Index (as of October 2013) and their market capitalization. Out of 20 companies in the index, there are 6 mining related companies, mainly in the coal

[14] According to the website of MASD, the association offers such trainings as "Fundamental training," "Brokerage training," and "For investment professionals."

mining, followed by 3 companies in the food industry and 3 companies in the hospitality industry. Market capitalization of companies in the mining industry has decreased substantially due to the domestic and external economic conditions. Tavantolgoi, which was the largest market capitalization among the MSE listed companies as of May 2011, now ranks the 2nd, while APU, a food company whose stock price has moved steadily, is the top market capitalization company as of October 2013.

Table 4-8 Overview of companies included in the MSE Top 20 Index

№	Company name	Industry	Market capitalization (MNT billion)		Change
			2011/5/18	2013/10/1	
1	APU	food	222.9	282.5	27%
2	Baganuur	coal mining	398.6	83.9	-79%
3	Bayangol Hotel	hospitality industry	16.1	20.3	26%
4	B D Sec	broker, dealer, underwriter, investment consulting	44.0	33.0	-25%
5	Gobi	textile	41.0	37.4	-9%
6	Genco tour bureau	hospitality industry	9.4	8.5	-10%
7	Mogoin gol	coal mining	34.8	9.4	-73%
8	Mongol shiltgeen	hospitality industry		8.5	
9	Mongolia development resources	real estate	23.4	8.1	-65%
10	Telecom Mongolia	telecommunication	75.8	34.1	-55%
11	Remicon	construction material manufacturing	15.1	13.8	-9%
12	Silicate	chalk refining		9.2	
13	Suu	food		27.5	
14	Tavantolgoi	coal mining and trade	416.1	168.5	-59%
15	Talkh-Chikher	food		12.9	
16	Ulaanbaatar Hotel	real estate	15.4	26.8	74%
17	Ulsyn ikh delguur		12.7	15.5	22%
18	Khukh gan	iron concentrate	19.3	13.0	-33%
19	Sharyn Gol	coal mining	123.0	76.7	-38%
20	Shivee Ovoo	coal mining	322.1	73.8	-77%

Source: MSE

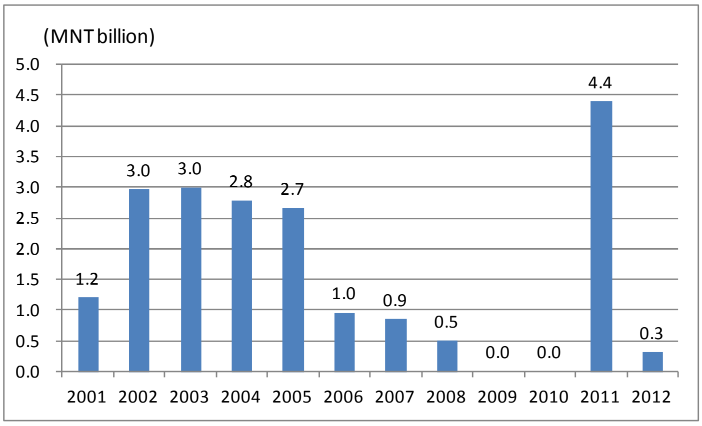
There has been only one IPO deal, an IPO of E-Trans Logistics, for the past few years due to stagnant economic condition and sluggish stock market.

E-Trans Logistics was established in 2007 and is the only privately owned cargo reloading terminal in the border town of Zamyn-Uud. It offers cargo reloading service between trucks and trains at the terminal. Its parent company, E-Trans LLC, is freight forwarder and its main business is to handle shipments between China and Russia. In its IPO transaction in 2012, E-Trans Logistics raised MNT 924 million by offering 17% shares of the company to finance its future capital expenditure. BDSec was the underwriter. Offering price of E-Trans Logistics was MNT 120, and the most recent price (closing price on November 13, 2013) was MNT 160.

In 2013, there was one potential IPO deal considered by Beren Mining. Founded in 2005, Beren Mining is a mining company that owns and operates several iron ore deposits. It commenced production in its beneficiation plant in 2007, and exports majority of its products to China. BDSec was the underwriter. According to the investor presentation material prepared by BDSec, Beren Mining planned to raise MNT 130.6 billion by offering 30% share of the company, which was regarded the biggest IPO on the MSE, but the deal has been delayed.

Figure 4-21 illustrates value of corporate bond trading on the MSE. According to the report of the Bank of Mongolia[15], there were 9 companies which issued corporate bonds on the MSE between 2000 and 2006, and many of them were construction related companies. Examples of bond issuance include Puma Group, issued MNT 1 billion in 2004, Moninjbar, a construction company issued MNT 500 million in 2005, Barilga, a construction company issued MNT 5,380 million, Niislel Orgoo, a construction company issued MNT 1.2 billion in 2002, Gobi, a cashmere clothes producer issued MNT 1 billion in 2005, Anod Bank[16], a commercial bank issued MNT 2 billion. As for conditions of these corporate bonds, the maturity ranged from 8 months to 2 years, and the monthly interest rate were set at between 1.58% and 1.8%

Figure 4-21 Value of corporate bond trading on the MSE



Source: 2012 Annual Report of MSE

The corporate bond which was traded on the MSE recently were those of Just Agro, MNT 30 billion public offered bond issued in 2011[17]. Just Agro was established in 2000, as a meat production & processing and exporter under the Just Group[18], a major conglomerate in Mongolia. It has about 40% share in the domestic meat processing market. Value of its corporate bond trading on the MSE was MNT 4.39 billion in 2011 when the bonds were issued, but decreased to MNT 0.31 billion in 2012.

There are some companies which issued corporate bonds in the international market[19]. TDB, the leading commercial bank, issued USD 25 million 5-year bonds and USD 150 million 3-year bonds in 2012, in which ING was the lead manager. Also, TDB issued USD 300 million 3-year bonds in 2012, in which Bank of America Merrill Lynch and ING were co-lead managers. The bonds are listed on the Luxemburg Stock Exchange. Development Bank of Mongolia issued USD 580 million 5-year bond in 2012, in which Deutsche Bank, HSBC and ING were co-lead managers, and the bonds are listed on Singapore Stock Exchange. Furthermore, Mongolian Mining Corporation issued USD 600 million 5-year bonds in 2012, in which Bank of America Merrill Lynch, ING and JP Morgan were co-lead managers, and the bonds are listed on Singapore Stock Exchange and Berlin Stock Exchange. Corporate bonds issued in the international market are larger in their amount and longer in their maturity. This indicates that there exist restrictions in size and in funding terms in the domestic corporate bond market.

[15] E. Tsolmon, Senior Economist, Bank of Mongolia, "Development of Bond Market in Mongolia" (2008)
[16] Anod Bank went bankrupt in 2008.
[17] The maturity of the bonds was set at 1 year and the bonds were already redeemed. Coupon rate was set at 16.2%.
[18] Just Group was the shareholder of Savings Bank, which went bankrupt in July 2013.
[19] Information on corporate bond issuances abroad are based on http://em.cbonds.com/countries/MNG.

Based on our discussions with the industry experts, potential issuers on the MSE will be state-owned companies (including those in the mining sector, MIAT Mongolian Airlines, Mongolian Railways, power plants, etc.) under the control of State Property Committee (SPC), medium-sized growing companies in such sectors as the agriculture, tourism, construction and real estate, etc., and financial institutions.

As for state-owned companies, SPC has its basic policy that stipulates percentage of the future government ownership determined by the industry and plans to sell the remaining shares to the market at an early date. SPC prepares the list of companies which will be privatized in the coming 4 years, and after being discussed within the related ministries, this list will be approved by the national parliament finally. SPC now plans to sell up to 50% share of MIAT Mongolian Airlines by 2020, and also to sell 10% of the government ownership in the mining companies in 2014. SPC also plan to privatize the MSE in the future. As for the future privatization of large-scale state-owned companies in the infrastructure sector including the railway, roads, power plants and airlines, SPC expects need for restructuring before selling their shares to the market. We believe that the Japanese experiences and know-how in the field of privatization of state-owned companies will be very helpful and valuable for SPC to carry out its privatization plan smoothly, considering that SPC does not have experiences in privatizing large-scale companies.

For the future development of the Mongolian capital market, it will be desirable that major private company groups including MCS Holding LLC (having consumer goods, real estate, telecommunications, power plant businesses under the group. Its coal mining subsidiary was listed on the Hong Kong Stock Exchange.) or Tavan Bogd Group (having Khan bank, a major hotel, travel agency, Gobi Corporations listed on MSE, etc.) would go public on the MSE. These conglomerates are facing hurdles on financing by the domestic banks which need to comply with single risk limit stipulated by the Bank of Mongolia. However, generally speaking, these major private company groups tend to have negative views on utilizing the domestic capital market as an alternative, because the market lacks liquidity, and they tend to obtain funding more efficiently by borrowing from international financing institutions such as EBRD or going public or issuing corporate bonds abroad. Furthermore, it is pointed out that these major company groups tend to be owned and managed by the founders who tend to hesitate to sell their shares to the third parties.

ETT was planned to be listed on the London, Hong Kong and Mongolian Stock Exchange, and its stocks were distributed to the people already, but the schedule of going public has been delayed significantly. Now it is hoped that ETT will go public soon after the new securities market law will be implemented, and dual listing and utilizing the custodian system will be possible. According to the Mining Law, as for the mining companies who have deposits in the designated “strategic” deposits such as ETT, 10% of these companies share should be listed on the MSE. However, this rule is not applied to the mining companies which have already been listed on the foreign stock exchanges including London and Hong Kong. There are about 60 companies listed on the foreign stock exchanges. The new Securities Market Law could possibly promote listing of such companies on the MSE.

In order to check information disclosure of the MSE listed companies, we have picked up 5 companies among the companies in the Top 20 Index, based on the industry and market capitalization, and looked into their English website to find English annual reports. As shown in the following table, the result was that we could not obtain English annual reports of any of the 5 companies. It will be very important for the Mongolian capital market to broaden international investor base in the future, which could be promoted with the implementation of the new Securities Market Law. However, it should be noted that without prompt and proper information disclosure by listed companies, international players would hesitate to invest in the Mongolian capital market. Hence, more proactive attitude toward information disclosure by the MSE listed companies should be regarded as the urgent issue.

	website in English	Availability of financial reports in English
Company A	○	×
Company B	○	×
Company C	×	×
Company D	×	×
Company E	○	×

Regulations on the MSE listed companies will be described in detail in the chapter 5.4.1.

4.3.5 Institutional investors

Table 4-9 illustrates overview of foreign and domestic investors in the MSE.

Table 4-9 Overview of foreign and domestic investors (as of the end of September 2013)

	Number of accounts				Trading volume (2013 年)	
	entity		citizen		entity	Citizen
Local investors	2,388	(0.3%)	769,037	(99.5%)	32%	17%
Foreign investors	155	(0.0%)	1,706	(0.2%)	44%	7%

Source: "Overview of MSCH&CD operations" (October 9, 2013)

Domestic entities include commercial banks and companies under major conglomerates. Commercial banks invest mainly in bonds especially the government bonds, and tend to hold to maturity rather than to buy and sell actively. Commercial banks' investments in stocks are limited due to the regulation stipulating banks' shareholding in the Banking Law. The Insurance industry is still in the embryonic stage and insurance companies are still small in size as shown in Table 4-10. The insurance companies are not regarded as the institutional investors, since their experience and know-how in fund management are very limited and they put most of their fund into bank deposits with facing FRC's regulations on fund operations of insurance companies. There is the hope that the insurance industry will be developing with enactment of the Private Pension Law and that Sovereign Wealth Fund (SWF) will be established with increase in the national revenue related to the mining industry. However, it will take some time for the insurance industry and the SWF to become important institutional investors in the Mongolian capital market.

Table 4-10 Total assets of insurance companies

(MNT million)

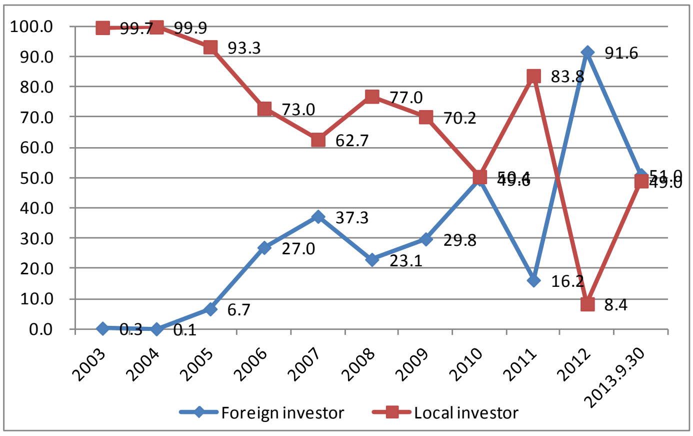
	insurance companies	2010	%		2012	%
1	Mongol daatgal	16,058	28%	1	21,274	20%
2	Bodi daatgal	5,072	9%	2	10,937	10%
3	Tenger daatgal	4,310	8%	4	7,412	7%
4	Practical daatgal	4,184	7%	3	7,728	7%
	Mandal			5	7,271	7%
5	Mig daatgal	4,104	7%	6	6,655	6%
6	Nomin daatgal	3,029	5%	9	5,993	6%
7	Ard daatgal	2,983	5%	8	6,345	6%
8	Soyombo daatgal	2,438	4%	7	6,366	6%
9	National life daatgal	2,143	4%	10	4,683	4%
10	Ganzam daatgal	2,032	4%	15	3,144	3%
11	Monre daatgal	1,695	3%	11	3,600	3%
12	Mongoltrust holding daatgal	1,678	3%			
13	Ulaanbaatar city daatgal	1,656	3%	13	3,263	3%
14	Munkh daatgal	1,527	3%	14	3,166	3%
15	Jonon daatgal	1,409	2%	18	1,646	2%
16	Grand daatgal	1,402	2%			
	Ger daatgal			16	2,584	2%
17	Monnis daatgal	1,046	2%	12	3,283	3%
18	Khan daatgal			17	2,255	2%
	Total	56,764	100%		107,605	100%

Source: 2010 , 2012 Annual Report of FRC

As for foreign entities, investment funds focusing on the frontier markets are major players in the Mongolian market. According to an industry expert, one U.S. investment fund is considered to have occupied most of the trading value by foreign institutional investors, and this comment indicates that there are not many foreign investors actively participating in the market. As of today, lack of the custodian system is regarded as barrier to entry for foreign investors. It is hoped by the Mongolian market players that investment by foreign entities will be promoted with introduction of the custodian system when the new Securities Market Law will be implemented in January 2014.

As Figure 4-22 shows, percentage of foreign investors in terms of trading volume has been fluctuating dramatically recently, reduced from 50% to 16% in 2011, but skyrocketed to more than 90% in 2012. Generally speaking, small capital market in which foreign investors have dominant share tend to be more volatile due to possible speculative activities by such foreign investors. Hence, the regulatory authority of the capital market will need to watch carefully investment activities by foreign investors.

Figure 4-22 Percentage of foreign and domestic investors in terms of trading volume



Source: "Overview of MSCH&CD operations" (October 9, 2013)

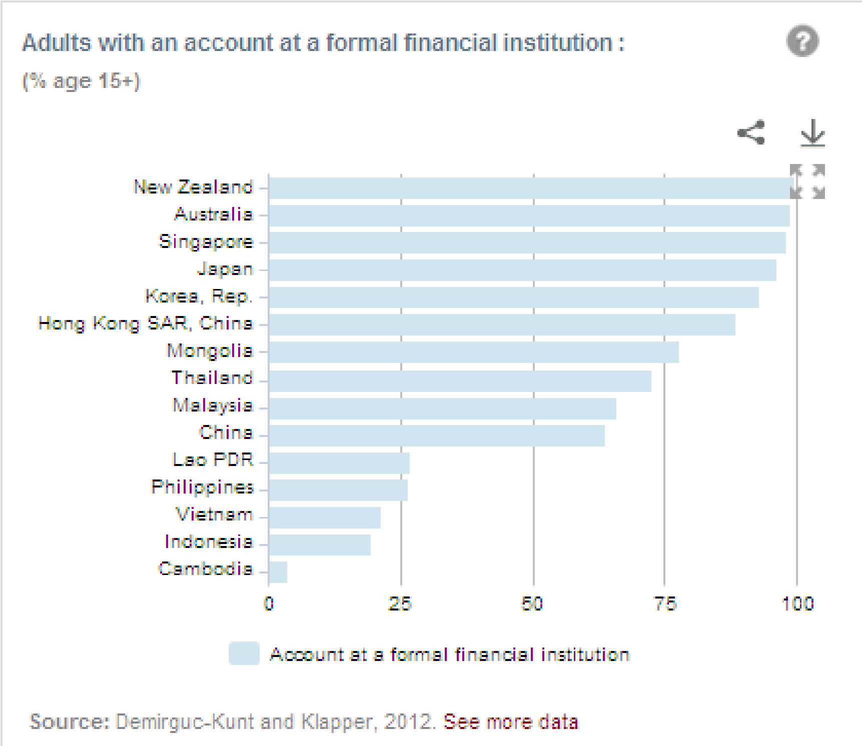
4.3.6 Retail investors

As shown in Table 4-9, the number of accounts held by Mongolian citizens reaches almost 770 thousand, and this indicates that about 27.5% of the total population in Mongolia or every household has one investment account. However, most of these local individual accounts should be inactive, although they were opened with issuing of vouchers for shares in early 1990s and distribution of ETT stocks in 2011.

Currently annual deposit interest rate of commercial banks in Mongolia is set at around 12%, which is regarded as comparatively high, local citizens tend to make deposit as the safest and the most accessible way for utilizing their surplus money. Participation by local citizens in the capital market is very limited in Mongolia except for a few wealthy individuals, because they do not have both sufficient surplus money and financial knowledge, or investing in stocks is regarded as illiquid and high risk.

We have to say that there will be limitation in increase of domestic individual investors taking into account small size of population in Mongolia. However, we think there will be still much room for increase of individual investors who participate proactively in the market, if there will be more opportunities of financial educations for local citizens and if new financial products such as investment trust fund will be marketed effectively through distribution channel of commercial banks (not through micro and small securities firms), considering the fact that percentage of adults with an account at a formal financial institution in Mongolia is quite high, 77.7%. Also, the Mongolian government may need to consider possibility to introduce preferential tax treatment for securities investment by individuals.

Figure 4-23 Percentage of adults (age 15+) with an account at a formal financial institution



Source: The World Bank

4.3.7 Other players (rating agencies, etc.)

In the process of the capital market development, role of rating agencies, which evaluate financial strength and soundness of securities issuers, tends to be heightened, and widespread use of ratings will contribute to expansion of investor base. According to the FRC, there is currently one local rating agency in Mongolia which FRC approved its business license in 2010, but this rating agency is not well-recognized by the market participants. Also, according to the FRC, international rating agencies show some interest in starting businesses in Mongolia, but their entry has not been realized yet.

5. Current regulatory framework in Mongolian financial market

5.1 Relevant organizations, its functions and organizations[20]

5.1.1 Government organizations

The following government organizations regulate and supervise the market infrastructure and market participants, and dispatches executives to MSE and MSCH & CD.

5.1.1.1 Financial Regulatory Commission (FRC)

FRC was established in 2006 as an organization to regulate and oversee more than 1,000 securities

[20] The description in this section, unless otherwise specified, is based on the official data provided by each of the organizations or study team interviews to the organizations.

companies, insurance companies, and non-banking companies, etc. based on the legislation on the Legal Status of the Financial Regulatory Commission. FRC oversees a wide scope of activities and players such as MSE, MSCH&CH, securities companies (brokers, dealers , and underwriters), issuers, investors, audit firms in securities business, as FRC handles everything other than the banking sector which is regulated by BOM. As far as the current main regulatory work is concerned, it covers the following areas;

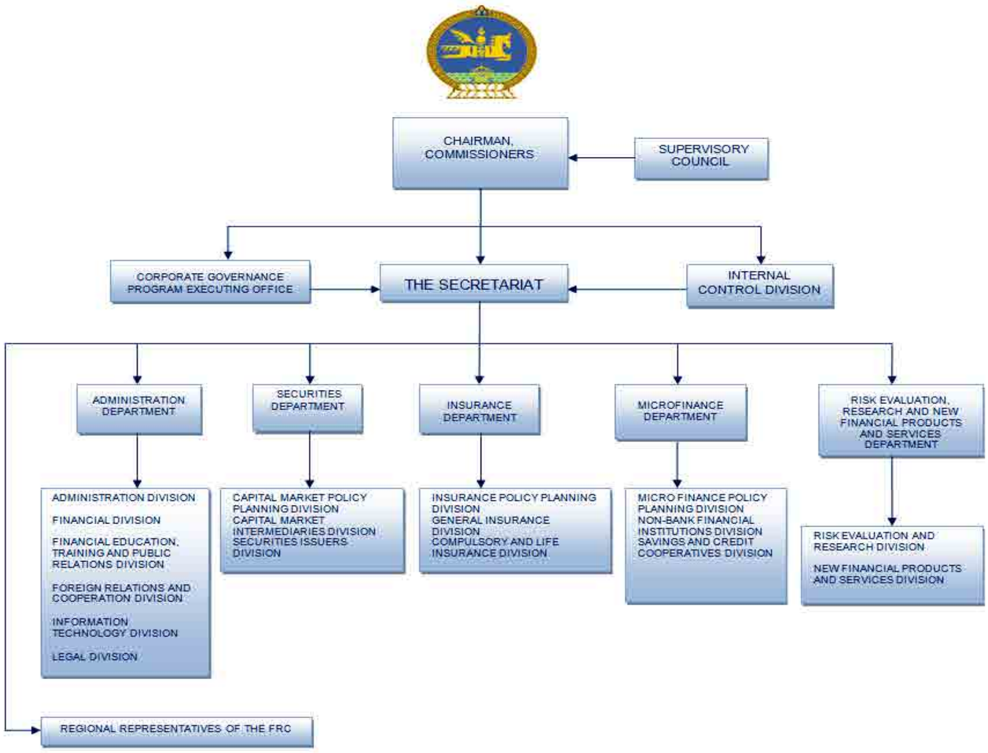
- Development of legal framework such as rules, standards and processes of the securities market
- Collection and analysis of financial statements, and financial soundness review of listed companies and securities companies
- Legal compliance monitoring in the securities market (including on-site)
- Granting, suspension, revocation, and termination of license
- Protection of rights of shareholders and investors
- Dispute resolution and prosecution
- Education or enhancement of corporate governance
- Provision of market participant training aimed at building individual investor base

FRC needs to compile detailed sub-rules and guidelines etc. to maintain its due process of FRC business, because FRC is given wide discretion and now newly regulates additional organizations such as custodians covered by the wide and comprehensive amendments to the securities exchange law. Also, as the following four items are positioned as strategic initiatives, FRC works on its capacity developments in the medium term by receiving support from donors.

- Enhancement of quality of issuers: corporate governance and disclosure
- Enhancement of quality of securities companies: thoroughly implement capital adequacy rules
- Prevention of systemic risks : enhance research and analysis capability for market monitoring
- Avoiding conflict of interests caused by privatization: enhancing liquidity and quality of listed companies

The organization structure is as shown in Figure 5-1. The Securities Department has approximately 40 staff members, only 15 of which are involved in surveillance and inspection, while the Insurance Department and the Microfinance Department have approximately 25 staff members each. We received many feedbacks in discussions with the relevant organizations that FRC does not have sufficient capacity to conduct all the activities because it is understaffed and it has not adequately built up its expertise in capital market regulations practice. As such, it is necessary to enrich personnel and improve staff retention. At the same time, FRC is aware that it needs to streamline operations in order to obtain data swiftly and accurately and conduct both inspections and policy analysis with limited and inexperienced personnel.

Figure 5-1 FRC organizational structure



Source: FRC website

The following is an overview of FRC oversight of each group of entities.

<Listed companies>
FRC is empowered to issue improvement orders as well as approve newly listed companies and delist companies. Although FRC has not taken an active stance, including delisting companies, for a long time, they decided to delist 57 companies and issued improvement orders to 36 companies which may end up being listed if improvement is not seen. FRC does not conduct checks or guidance before disclosure.

<Securities companies>
FRC conducts biannually on-site monitoring and off-site monitoring based on quarterly financial statements and monthly reporting documents (17 types of documents). We understand that local securities companies, in general, do not work on a high code of ethics and that there was a 2009 criminal case where a securities company was prosecuted for committing trades on a client account without consent.

FRC is conducting monitoring activities, such as on listed companies, based on the list compiled by a US consultant engaged through ADB assistance in 2006. FRC recognizes they will be able to efficiently exercise its monitoring activity with an IT system which scans and analyzes documents submitted by securities companies and listed companies, because they hope to upgrade the current checklist approach to a risk–based approach which enables FRC to monitor with analysis after the amended Securities Market Law is enacted.

While the current capital regulation of securities companies is as shown in Table 5-1-1, a certain number of securities companies may go out of business due to tougher capital controls as shown in Table 5-1-2, which are expected to be introduced by July 1, 2014 after the amended Securities Market Law becomes effective.

Table 5-1-1 Capital requirements of securities companies ((old) Securities Market Law)

	Requirement Criteria	Minimum Amount	Provision
Dealer / Broker	Stakeholders' Capital	50 million MNT	27.1
Underwriter	Stakeholders' Active Capital	200 million MNT	28.1
	Cash and Liquidable working capital	100 million MNT	

Source: Securities Market Law

Table 5-1-2 Capital requirements of securities companies (amended)

	Minimum Amount
Broker	200 million MNT
Dealer	300 million MNT
Broker & Dealer	500 million MNT
Underwriter	1,000 million MNT
Broker, Dealer & Underwriter	1,500 million MNT

Source: FRC

It is a priority to enhance compliance of securities companies and enforcement of regulation perspective, while we have a feedback on a 2009 criminal case where a securities company traded client assets without obtaining its consent, that there are no Chinese Walls (meaning an information barrier implemented within a firm organization to prevent the exchange of sensitive information) in place due to underdeveloped legal frameworks, and also limited expertise and poor business ethics.

＜Investors＞

Although FRC is supposed to be legally responsible for market surveillance, it has not enough human resource to fulfill this responsibility. FRC itself seems to recognize they need to take a proactive approach after the new securities market law is enacted.

In the meantime, there is no recognition of court cases regarding securities market and we had feedback that the concept of insider trading is yet to be properly understood.

5.1.1.2 State Property Committee (SPC)

SPC is in charge of the management of state-owned enterprises from corporate governance and accounting perspectives, and plans and coordinates their privatization so that the privatization of mining and infrastructure sector should be processed in due course. Although SPC used to oversee the Public-Private Partnership, its functions are now transferred to the Ministry of Economic Development. Securities market infrastructure such as MSE and MSCH&CH are also owned by SPC.

A privatization draft plan is approved in the National Parliament after the draft is designed by SPC, discussed in each ministry and cabinet approval is received following discussions in a SPC committee composed of first secretaries of each relevant ministry. There is some feedback that quite a few cases face significant amendment requests to avoid conflicts of interest in the approval process. The privatization candidate companies from 2014 to 2018 are scheduled to be selected by the end of business year 2013. Although the privatization process has recently stagnated due to elections, they are in a situation to move things forward with no major elections for the time being.

With regard to the natural resources sector, SPC re-organizes strategic companies such as Edniz and MGL to make them subsidiaries under SPC and then privatize these companies. While it considers offloading 10% of shares of a certain natural resources company via MSE in FY2014, it is considering additional offloading to reduce the government ownership ratio to 51% from the current 75% and 90% respectively at its two subsidiaries.

In addition to this, infrastructure sector, in which unlisted large companies such as railways, airline and power companies are categorized, will be privatized in due course after downsizing, and 50% of shares of MIAT Mongolian Airlines for example will be sold to the market by 2020.

SPC recognizes that they need to work with advisors and outside experts to create privatization scenarios of state-owned enterprises.

5.1.1.3 Ministry of Mining

The Ministry of Mining administers the operations of mining companies, while all relevant organizations share a mutual understanding that smooth privatization of state-owned mining companies is essential in Mongolia whose industry structure is heavily dependent on the natural resources sector. The responsibility of privatization falls on SPC.

While large-scaled mining companies are listed in the foreign markets and other small-mid size companies are listed in the domestic market for financing, the Ministry of Mining thinks that the domestic market can enjoy some benefits from this segregation scheme by company size because every mining companies with strategic mineral deposits is obliged to allocate 10% of outstanding shares for listing on the domestic market based on Article 5(5) of the mining law.

The ministry shows strong interest in creating a mining commodities market.

5.1.1.4 Ministry of Economic Development

The ministry oversees registration and investment of foreign companies and specifically handles the registration and licensing of new companies. The ministry told us that they are aware that they need to build a business-friendly investment environment in order to attract investment.

5.1.1.5 Bank of Mongolia

Clearing banks handling fund clearing for securities transaction are currently limited to only four commercial banks and these banks are regulated and monitored not by FRC but the central bank. Fund settlement among the settlement banks are conducted through the BOM system.

When two banks listed on MSE went bankrupt due to bad debt from 2008 to 2009, BOM took the initiative to write-off the bad debt by dispatching bankruptcy administrators to defaulting banks.

5.1.2. Market infrastructure

5.1.2.1 Mongolian Stock Exchange (MSE) Please refer to 4.3.2.1

5.1.2.2 Mongolian Securities Clearing House & Central Depository (MSCD&CH) Please refer to 4.3.2.2

5.1.3 Other relevant organizations

5.1.3.1 Mongolian Association of Securities Dealers

Mongolian Association of Securities Dealers is operated by three full-time employees and volunteers. Its main tasks are to issue licenses and provide training to securities industry employees. 55 of 97 securities companies are now members of the Mongolian Association of Securities Dealers as of October 2013.

FRC is internally discussing whether the Mongolian Association of Securities Dealers will become an SRO in line with the amended securities market law. FRC has internally a concern that the possible enactment of an investment fund law may allow new securities companies with high market expertise to join the industry and this may cause unfavorable effects that the association may have two categories of brokers under one roof in terms of level of expertise.

The minimum capital requirements for securities companies will be raised under the amended Securities Market Law, and are expected to narrow the field of securities companies. It is necessary to carefully monitor what impact this will have on the Mongolian Association of Securities Dealers.

Mongolian Association of Securities Dealers recognizes that it needs to expand their activity to cover inspection and monitoring of securities companies, and off-exchange trading (by opening an OTC Market) in preparing for having SRO functionalities and need to increase its human resources.

It is expected that the association needs to provide more training courses with securities employees and brokerage companies and need to be deeply involved in investment education for individual investor as its future activities.
The Association says that back-office systems and online transaction processing systems have not spread among securities companies in Mongolia yet, and that they welcome short-term support in these areas. The only two back-office systems in Mongolia consist of a system provided by Nomura Research Institute (hereinafter “NRI”) and another under development by ECM, an unlisted Mongolian company, which is supported by the Association. The NRI system charges fees for each transaction, resulting in high costs, while ECM’s system is relatively cheap. However, ECM has not received the cooperation of FRC in relation to system development.

In addition, it seems that the establishment of an OTC market is under consideration due to the high costs of using Millennium IT, and the progress made by online trading arising from factors such as only one of the four settlement banks providing a system with real-time connections.

5.1.3.2 Financial Market Association Mongolia

The Financial Markets Association Mongolia was established in 2007 as an affiliated association of the Financial Markets Association (ACI), an international organization headquartered in Paris, engaged in global financial market issues. ACI in Europe is organized to cover activities mainly in the areas of money markets, foreign exchange, derivatives as well as risk management as an association of financial market professionals, and its affiliated associations in emerging Asian countries also cover capital markets. The Financial Markets Association Mongolia consists of about 70 financial professionals from securities companies, insurance companies, as well as companies involved in risk management or asset management businesses, with two such professionals working on a full-time basis. Any professional in the financial industry is qualified for membership in the Financial Markets Association Mongolia, and many of its members appear to have joined for networking opportunities. Furthermore, most of the operational expenses are paid by the revenues from donations and grants by major commercial banks as well as membership fees.

The key objective of the Financial Markets Association Mongolia is to improve the knowledge and ethical standards of financial professionals. For education, the Association provides FRC staff with educational courses based on themes such as asset management or risk management. For the improvement of ethics, it has established a code of conduct and practice for financial professionals. Its other activities include the provision of financial education courses for journalists and the general public, and the calculation of the only consumer confidence indicator in Mongolia.

As some of the activities relating to the securities industries overlap with those of the Mongolian Association of Securities Dealers, discussions were conducted several years ago regarding an integration of the two associations. However, the Financial Markets Association Mongolia refused the idea of such integration on the grounds that it is not acting for the interests of the securities industry alone.

Still, the two associations have been cooperating to some extent, according to the Financial Markets Association Mongolia. For example, the examination which the Mongolian Association of Securities Dealers conducts for securities company staff is based upon the contents of the Financial Markets Association Mongolia.

5.1.3.3 Accounting firms and accountant association

FRC regulates audit firms which play key roles in maintaining the credibility of financial statements to be disclosed by listed companies, which are based on the accounting law, audited based on audit law and prepared on IFRS basis. Certified accountants practicing at these audit firms are licensed by Mongolia Institute of Certified Public Accountant (MONICPA). There are more than 2,500 certified public accountants in 79 accounting firms in Mongolia.

Mongolian local audit firms are divided into firms that have global networks and medium and small sized local firms. We received a feedback that local firms do not provide enough training for its accountants and its quality of audit practice is not fully satisfactory. In addition to this, we had some points to note that negative effects toward accounting credibility is caused by the fact that the social status of certified public accountants is not high enough in Mongolia and certificated accounting software by Mongolian government is not adequately available.

5.1.3.4 Law firms

When it comes to IPO, only law firms registered with FRC can conduct legal due diligence on contracts and issue third party opinions. To put concretely, they are supposed to check that IPO regulations are observed, listing companies remain compliant with listing regulations after listing, audit certificates are issued in compliance with law, and for legal gaps between Mongolian and foreign laws in foreign company listings.

Mongolian judicial circles hope to leverage opportunities such as seminars aiming at legal professionals to expand its expertize, because the number of Mongolian legal experts with securities market background are very limited and there is no clear scope of the basic responsibilities required of legal professionals amid developments going on in the Mongolian securities market.

5.2 Related laws

Important laws related to the Mongolian capital market include: (1) Securities Market Law, (2) Companies Law, (3) Investment Law, and (4) Investment Fund Law. Additionally, (5) Minerals Law is thought to have some impact. This section covers these laws, with a focus on the Securities Market Law.

5.2.1 Securities Market Law

The Securities Market Law was enacted in 2002, with a large amendment adopted in the parliament in May 2013, promulgated on June 24, and is effective from January 1, 2014. Prior to the amendment, the Securities Market Law consisted of 6 chapters and 39 articles, as shown in Table 5-3 below. The amended law is composed of 9 chapters and 90 articles, as shown in Table 5-2. This section will cover the amendment, given its extremely large scale and its aim at providing an effective regulatory environment for the further development of the securities market.

The amended law is made up of 9 chapters. They are: (1) General Provisions, (2) Issue and Trading of Securities, (3) Purchasing All or a Controlling Block of the Shares of a Company, (4) Regulated Activities, (5) Securities Market Information, (6) Securities Market Regulation, (7) Prohibited Activities in the Securities Market, (8) Supervision and Inspection of the Securities Market, and (9) Miscellaneous.

The matters contained in each chapter are as shown in Table 5-2 Amended Securities Market Law. The law forms the basis for the operation and regulation of the securities market.

Table 5-2 Structure of the Amended Securities Market Law

Chapter 1: General provisions

Article 1. Purpose of the Law Article 2. Legislation relating to the securities market	Article 3. Scope of application of the Law Article 4. Definitions of terms used in this Law

Chapter 5: Securities market information

Article 55. Primary securities market information Article 56. Secondary securities market information Article 57. Information regarding regulated entities	Article 58. Investor information Article 59. FRC information Article 60. Receiving of information by the FRC

Chapter 6: Securities market regulation

Sub-chapter 1: State regulation of securities market Article 61. The central state administrative body in charge of finance and budget matters Article 62. Organization in charge of implementing state regulation in the securities market Article 63. Authority of the FRC Article 64. Cooperation with competent regulatory bodies of foreign jurisdictions and international organizations Article 65. Issuing recommendations Article 66. Issuing instructions Article 67. The register of regulated entities Article 68. Determining suitable persons	**Sub-chapter 2: Self-regulatory organizations of the securities market** Article 69. Self-regulatory organizations Article 70. Authority of a self-regulatory organization Article 71. Registration of a self-regulatory organization Article 72. The charter and by-laws of a self-regulatory organization Article 73. Management and organizational structure of self-regulatory organizations Article 74. Relations between the FRC and self-regulatory organizations Article 75. Supervising the operations of self-regulatory organizations

Chapter 7: Prohibited activities in the securities market

Sub-chapter 1: Activities prohibited to a holder of inside information Article 76. Inside information Article 77. Holders of inside information Article 78. Prohibition on participation in trading activities using inside information Article 79. Disclosing inside information to the public	**Sub-chapter 2: Market abuse** Article 80. Prohibition on market abuse Article 81. Obligation to compensate damage

Chapter 8: Supervision and inspection of the securities market

Article 82. Demand of information Article 83. Regular supervision Article 84. Inspection of the activities of regulated entities	Article 85. Authority of the State Inspector of the FRC Article 86. Prohibition on obstruction of inspections Article 87. Emergency situations

Chapter 9: Miscellaneous

Article 88. The Dispute Resolution Board Article 89. Sanctions for violations Article 90. Entry into Force

Table 5-3 Structure of the Securities Market Law

Chapter 1: General provisions

Article 1. Purpose of the law Article 2. Legislation on securities market Article 3. Definitions of the law

Chapter 2: Issue of securities, selling and trading

Article 4. Issuer of securities Article 5. Issuing of securities Article 6. Securities documentation Article 7. Registration of securities Article 8. Publicity of prospectus on issuing of securities	Article 9. Securities selling and reporting Article 10. General obligations of securities issuer Article 11. Tender offer Article 12. Obligations of securities purchaser

Chapter 3: Protection of interests of investors

Article 13. Restrictions for the protection of interests of investor in the securities market Article 14. Disclosure of information related to securities to investors Article 15. Decision of Commission on protection of interests of investors	Article 16. Prohibited activities for an issuer and for professional institution operating in securities market Article 17. Keeping the confidentiality of inside information

Chapter 4: Participants in the securities market

Article 18. Participants in the securities market Article 19. Professional participant institutions in the securities market and their general duties Article 20. Granting of special license to professional participant in the securities market Article 21. Securities trading institution Article 22. Stock Exchange Article 23. Securities dealers center	Article 24. Securities clearing and settlement institution Article 25. Securities Depository system/organization Article 26. Securities trust fund and investment fund Article 27. Broker and dealer company Article 28. Underwriter company Article 29. Securities investment management company Article 30. Securities investment consulting company

Chapter 5: Securities market regulatory and supervisory authority

Article 31, 32 and 33 were invalidated. Article 34. Rights of the Commission Article 35 and 36 were invalidated. Article 37. Rights of the state inspectors of the securities transaction and guarantee to implement them

Chapter 6

Article 38. Penalties to be imposed to the violators of the legislation on securities market Article 39. Law enforcement date

The features and aim of the amendments to the Securities Market Law are as described in the following Table 5-4.

Table 5-4 Amended Securities Market Law features and aim[21]

Feature	Aim
１． **Implementation of segregation between legitimate ownership and beneficial ownership** In Mongolian law, a legitimate owner meant a beneficial owner and the concept of titular ownership did not exist in Mongolian law. The amendment will be introduced to cover the difference between legitimate ownership and beneficial ownership.	● The aim is to make it possible for local banks to operate "custody" businesses so that depository and relevant process are conducted in Mongolia, while the beneficial ownership of securities remained in foreign investors. ● If there are no reliable local banks which can operate custody business in a country, foreign institutional investors may not invest in the market. ● The purpose is to enable local banks to operate custody business and to accelerate investment in Mongolia from foreign institutional investors.
２． **Dual listing and depositary receipts** Although the old law mentions the possibility of dual listing, there are no rules containing details. The amended law explicitly stipulates that dual listing of both Mongolia and foreign listed companies are allowed. Also, in the amended law, the definition of eligible securities for trading will be expanded to cover depositary receipts.	● Dual listing (in Japan, it is often called a "cross listing") means that one listed company lists its shares on two markets. (eg. Toyota Motor Corporation lists on Tokyo Stock Exchange and New York Stock Exchange.) ● Depositary receipts are securities that are issued based on owned underlying security. In the case of a foreign company listing on an American market or a UK market, the company often chooses to issue and list depositary receipts. (eg. ADR (American Depositary Receipt) and GDR (Global Depositary Receipt). Bank of New York Mellon, Citibank and Deutsche Bank, etc. provide the service where they issue depositary receipts based on securities owned by them.) ● The current Mongolian securities market is not deep or large enough to fulfil the fundraising needs of companies which have profitable large mines. Therefore, a realistic solution, which is raising a part of the funds (presumably a large part of the funds) in foreign markets and raising funds in Mongolian market as well, seems to be taken and it seems that the amendment is

[21] Study team used Hogan Lovells "Mongolia Adopts An Amended Securities Market Law, July 2013" as reference to make this table.

	designed to clarify that this dual listing solution is possible. In addition to the mining law that is mentioned in a later part of this report, the provisions of the law aims at encouraging more listing for financing in Mongolia. ● The introduction of depository receipts seems to be aimed at ①facilitating dual listing of Mongolian companies by making securities listed in a foreign market feasible), and ② making it easier for foreign blue chip companies to be listed on the Mongolian market. It seems that second target is especially designed to enhance the status of the Mongolian market with more foreign company listing.
３． **Strengthening information disclosure** Requirements of issuance disclosure and periodic disclosure will be enhanced. With regard to issuer company disclosure, the details of financial statements, a list of stakeholders, plans for financing and investment, and risk management plans should be provided in a prospectus. Information disclosed in a prospectus must be audited by a certified public accountant and verified by a legal professional. While the provisions of the old law requires listed companies to disclose all the information required in the relevant laws, the new provisions in the amended law clearly defines a limited scope for listed company disclosure and obliges them to disclose facts such as the certain forms of reorganization, significant changes in shareholder composition affecting major shareholders, and other information that may affect its stock price within one business day from the occurrence. Immediate disclosure is also required for certain situations. Also, Mongolian Stock Exchange must post information on its website which its listed companies need to disclose.	● There were a lot of cases where, under the old law, listed companies did not disclose important information such as annual reports and financial statements. ● Under such circumstances, the amendment aims to improve the reliability of the market by enhancing the transparency of the capital market and enforcing listed company disclosure.
４． **Preventing unfair trading** The amended law establishes more detailed provisions that prohibit insider trading and	● It seems to be aimed at aligning with the global standard on unfair trading prevention to ensure

market abuse.	fairness and transparency and enhance reliability of the market.
5． **Enhancing supervision by FRC** The amended law defines more operations in the securities market than the old law and FRC supervises a broader range of securities businesses. Existing operations are defined in even more detail in the provisions. In addition, asset valuation companies, audit firms, and law firms need to be registered with FRC to provide their services to listed company. FRC plans to work on and announce the relevant regulations.	● It seems that FRC is going to ensure fairness and transparency in the securities market and protect investors by imposing stricter responsibilities and obligations on market participants in general.
6． **Introduction of self-regulatory organization** Stock exchanges, securities depository organizations and regulatory business organizations can be registered as self-regulatory organizations after the amendment. A self-regulatory organization will be responsible for a certain level of oversight of its market participants.	● This introduction of a self-regulatory organization is intended to implement a framework for self-regulation among its members.
7． **Implementation of a Dispute Resolution Board** The amendment mentions that a Dispute Resolution Board will be established within FRC to deal with disputes among relevant regulatory business organizations, listed companies, investors, and clients.	● Instead of taking judicial action, a Dispute Resolution Board can provide a service that offers faster, less expensive, undisclosed and more satisfactory dispute resolution.

According to the hearing with FRC, sub-rules have been divided into high priority and low priority groups, and rule creation and revision will be conducted incrementally.

According to FRC, it is necessary to establish or revise the following 34 regulations in connection with the enforcement of the amended Securities Market Law.

The following are sample provisions which are likely to be amended.

1. Regulation on record of publicly offered securities in Mongolia, initial public offering and trading
2. Regulation on opening securities trading account, disposition and transaction of the securities and cash assets from the account;
3. Regulation on custodian licensing and operations;
4. Rules on regulated activities in securities market
5. Regulations on granting, extending, suspending, reinstating, and revoking license, and actions that will be taken in case of revocation and suspension of the license;
6. Regulation on regulated entities'/market intermediaries/operation;
7. Regulation on accounting operation;

8. Regulation on determination of the cap for the service charge and fee charged by regulated entities;
9. Regulation on submitting information to FRC and informing to the public and its surveillance
10. Regulation on advertisement of regulated entities and securities issuer
11. Regulation on receiving and completing the client's order;
12. Regulation on nominating the authorized person at regulated entities and determining fit and proper person;
13. Collection, maintenance and transfer of archive documents of regulated persons;
14. Instructions on submitting information and reports to FRC;
15. Setting the fee for regulated operations payable by regulated persons;
16. Regulation on brokerage service of the securities on foreign capital market;
17. Regulation on record and trading of Depositary Receipts
18. Regulation on inside information of listed company
19. Regulation on delivering information from listed company to shareholders;
20. Regulation on buying all shares or a controlling block of share of a listed company;
21. Regulation on self-regulatory organizations
22. Regulation on adjustment in emergency circumstance of regulated legal body in security market
23. Regulation on preventing market manipulation
24. Regulation on issuing financial derivatives;
25. Code of corporate governance
26. Regulation on registering a legal body conducting legal advisory service for securities market participants;
27. Regulation on registering a legal body conducting auditing service for securities market participants
28. Regulation on registering a legal body conducting asset valuation service for securities market participants;
29. Regulation on trustee management operation of securities;
30. Regulation on conducting qualification examination of securities market and granting suspending and revoking the qualification license of individuals;
31. Regulation on investments funds;
32. Regulation on Investment Management Company;
33. Regulation on defining the financial strength ratings operation;
34. Regulation on council settling dispute.

According to the presentation materials by Hogan Lovells, the following 9 regulations are promulgated as of February 6, 2014. The number which is in parentheses following each regulation is that of the above regulation which is thought to be related.

1. Regulation on the advertisement activities by regulated entities and securities issuers (10);
2. Regulation on the information database of regulated entities (13);
3. Regulation on the licensing of regulated activities in the securities market (5);
4. Regulation on the disclosure of information to the public by securities issuers (9);
5. Regulation on the risk funds of regulated entities (NA);
6. Regulation on the insider information relating to securities and activities to be conducted by holders of such information on the securities market (18);
7. Regulation on the registration of securities (1);
8. Regulation on the activities of regulated entities (4);
9. Regulation on the licencing and operations of investment management companies (32).

5.2.2 Companies Law

The amended Companies Law was promulgated in October 2011 and effective from the following November of the same year. It is composed of 14 chapters and 100 articles. The following have been offered as points to be amended in order to bring the governance of Mongolian companies closer to the standards of developed countries: (1) Stricter responsibility for corporate managers, (2) Introduction of fines for violations of the law by companies, corporate managers, and shareholders, (3) Stricter corporate governance, and (4) Enhanced disclosure of major transactions and conflict-of-interest transactions.

Chapter 1	General Provisions（Article1-2）
Chapter 2	Legal Status of a Company（Article3-10）
Chapter 3	Establishing a Company（Article11-17）
Chapter 4	Reorganization and Liquidation of a Company and Debt-for-share Exchanges（Article18-29）
Chapter 5	Charter Capital, Shares and Other Securities of a Company（Article30-45）
Chapter 6	Dividends and Transfers Of a Company's Property（Article46-48）
Chapter 7	Redemption and Re-purchase（Article49-55）
Chapter 8	Acquisition of the Controlling Block of Shares of a Company（Article56-58）
Chapter 9	Company Management（Article59-83）
Chapter 10	Liabilities of Governing Persons of a Company（Article84-86）
Chapter 11	Major Transactions（Article87-88）
Chapter 12	Conflict of Interest Transactions（Article89-93）
Chapter 13	The Review of Financial and Economic Activities of Company（Article94-99）
Chapter 14	Miscellaneous（Article100）

Below is an outline of the governance-related regulations to be imposed on listed companies in the Companies Law.

- A public company (*) shall have a Board of Directors. (Companies Law, Article 75.2)
  * Meaning a listed company in this section.
- The Board of Directors of a public company shall have at least 9 members, and one third shall be independent members. (Article 75.4)
- The head of the audit committee shall be an independent member of the Board of Directors (Article 81.4)
- The Board of Directors shall have considered and resolved the matter of distribution of dividends within 50 days of the end of the financial year. (Article 46.5)
- In order for the general shareholders meeting to approval reports with respect to the company's annual operations and financial statements (Article 59, Paragraph 11 and Article 62, Paragraph 1, Item 9), the regular shareholders meeting shall be held within four (4) months following the end of each fiscal year of a company (Article 59.4). If this provision is violated, the board of directors will lose the authority except for calling the general shareholders meeting (Article 59.5), and all agreements, etc. entered into following such loss shall be invalid (Article 59. 6).Additionally, the FRC will announce the loss of the authority by the Board of Directors of the public company which did not call a shareholders meeting within the specified period (Article 59.7)
- The FRC will register initially listed shares and additionally issued shares of listed companies pursuant to the Securities Market Law.
- The FRC may appeal to court to issue a decision to liquidate a public company. (Article 26.6)
- Public companies must include the prices, etc. of major transactions and conflict-of-interest transactions in annual reports. (Article 84.4 and Article 89.5)

5.2.3 Investment Law

In place of the Foreign Investment Law and regulations on foreign investment on entities that operate businesses in sectors of strategic importance, the Investment Law was promulgated in October 2013 and is effective from November 2013. Direct investment from overseas began to decrease since the 3rd quarter of 2012, and the 1st quarter of 2013 has seen a decrease of 42% on a year-on-year basis. Under such circumstances, the Investment Law was newly enacted with the aim of securing stable investment from overseas.

The overview of the Investment Law is as below.

- Domestic and foreign investors are treated in the same way
- Overseas investors are classified into private investors and state-owned corporations, and there is no limit on investment by overseas private investors.
- A foreign state-owned corporation refers to a legal entity in which a foreign state directly or indirectly holds more than 50 per cent of the entity's equity. In cases where a foreign state-owned corporation acquires 25 % or more interest in Mongolian incorporated legal entities, approval is required
- The provisions regarding investment in sectors of strategic importance were deleted from the Investment Law, However, because corporations in sectors of strategic importance conduct businesses under special approval under other laws and regulations, the arrangement was established to make management by the state possible when receiving such approval from the government.
- The country has developed legal systems for protection and security of investment and introduced incentives for stable tax revenue.

Parties related to securities markets expect that direct investment to the country from overseas will revive.

5.2.4 Investment Fund Law

The Investment Fund Law was enacted on October 3, 2013 and came into effect on January 1, 2014. This law is the first comprehensive law for investment funds and provides the enabling framework. The overview of the Investment Fund Law is as below.[22]

- The law provides for the types, establishment, operation, management, accounting records, and liquidation of investment funds. It also describes investment management companies and custodian banks.
- FRC as the main regulator has authority for licensing, regulation and supervision of investment funds and investment management.
- The law provides for two types of investment funds; mutual funds (open-ended or closed-ended) and private funds.
- Investment funds may be established by investment management companies for a period of up to 10 years.
- Investment funds enter agreements to manage and keep their assets with investment companies and custodian banks.

Incomes of investment funds are exempt from Mongolian corporate income tax, but no other tax benefits have been provided for.

The law aims to pool small-lot funds to nurture new institutional investors and induce wealthy classes to

[22] Study team used Hogan Lovells's presentation "Mongolian Legislative Developments, February 6, 2014" as reference to write this overview

invest in securities through Private Funds domestically. It also aims to attract investment from overseas by providing more convenient investment schemes.

As in the case of the amended Securities Market Law, it is necessary to establish or revise the following 13 sub rules in connection with the enforcement of the Investment Fund Law, according to FRC. As of February 10, 2014, none of the regulations below have been promulgated.

1. Regulation on establishing investment fund;
2. Regulation on investment fund operation and supervision;
3. Regulation on member record-keeping of investment fund law;
4. Regulation on calling investment fund member meeting;
5. Regulation on investment fund accounting, requirement for financial report, investment fund activities and its valuation;
6. Regulation on investment fund information and advertisement;
7. Regulation on liquidating investment fund;
8. Regulation on asset/investment management operation;
9. Regulation on Custodian operation;
10. Set of detailed regulations on investment fund operation;
11. Regulation on investment fund registered in foreign countries;
12. Regulation on merger and consolidation of investment fund;
13. Regulation on defining fit and proper candidates.

5.2.5 Minerals Law

The Minerals Law aims to regulate mineral exploration, extraction, etc. within the jurisdiction of Mongolia. There is a provision related to the securities market in the Minerals Law. Article 5.6 of the law stipulates that a legal person holding a mining license for a mineral deposit of strategic importance shall trade no less than 10% of its shares on the Mongolian Stock Exchange.

Securities market-related parties consider that a legal person holding a mining license for a mineral deposit of strategic importance is a promising legal person in Mongolia, and that if such person raises funds through the securities market and even 10 % of such funds are raised in the Mongolian market, it is expected to lead to invigoration of the Mongolian securities market.

In addition, it seems that there are no penalties for violation of the article under the law.

5.2.6 Related legal systems to respond to challenges by related entity category

A series of amendments to related laws include many responses to challenges mentioned in Chapter 4. These are summarized by related entity category in Table 5-5. Although the related legal systems are summarized by category, results derived from each will impact matters in other categories.

Table 5-5 Related legal systems to respond to challenges by related entity category

Related entity	Challenges	Legal systems, etc. to respond to challenges
Investor	・Expansion of investor base	**(Overseas investors)** **Securities Market Law** ・Custody system, dual-listing, improvement of investor convenience using depositary receipts ・Strengthening of the FRC oversight, introduction of a

		self-regulatory organization, improvement of unfair trading regulations to international standard levels, improvement of confidence in the securities market through enhanced disclosure by listed companies **Investment Law** ・Development of statutory provisions and simplification of procedures with regard to investment from overseas **Investment Fund Law** ・Improvement of investor convenience via expansion of investment schemes (Other than above, international standardization of settlement cycle, i.e. change to T+3) **(Domestic investors)** With respect to the Securities Market Law, same as above. **Investment Fund Law** ・Nurturing of domestic institutional investors using schemes under the Investment Fund Law (An increase of attractive listed companies and improvement of liquidity will facilitate expansion of domestic and overseas investor bases
Listed company	・Listing of attractive companies ・Quality improvement	**Securities Market Law** ・Promotion of listing of attractive companies using dual-listing and depositary receipts. ・Quality improvement of listed companies through enhanced disclosure **Minerals Law** ・Realization of mandatory domestic listing of companies with prospective mineral deposits (Expansion of investor base and improvement of liquidity will encourage listing of attractive companies.）
Securities company	・Quality improvement	**Securities Market Law** ・Strengthening of FRC oversight, improvement of confidence in the securities market through introduction of a self-regulatory organization
Stock exchange	・Liquidity improvement	Development of trading infrastructure via introduction of a leading-edge trading system (Millennium IT)） （Liquidity improvement via expansion of investor base and listing of attractive companies）

It can be said that, in this way, the FRC took a large step toward development of the securities market through a series of amendments to related laws including the Securities Market Law. These efforts are reasonable, but it is too early to evaluate the efforts because the law is not yet enforced. It is important for the FRC to make these efforts moving forward, and Japan should consider extending cooperation for their initiatives.

5.3 Regulations and oversight related to investors

The Securities Market Law (amended) regulates and overseas investors in the following areas: (1) prohibited acts in the securities market, (2) purchase of total or controlling number of shares of a company, and (3) provision of investor information. As described in “5.2.3 Investment Law,” there are regulations related to investors other than frameworks of securities market-related laws. In this section, regulations and oversight based on the Securities Market Law (amended) are described.

5.3.1 Prohibited acts in the securities market

Articles 76 through 81 of the amended Securities Market Law prescribe prohibition of insider trading and market abuse as prohibited acts in the securities market. Article 81.1 stipulates that an offending person shall compensate any loss or damage caused to others as a result of having participated in a trade using inside information, not having disclosed to the public inside information in accordance with the proper procedures, or having abused the securities market. In addition, Article 81.2 stipulates that the income or profits acquired from using inside information or else abusing the securities market may be claimed pursuant to the Civil Code of Mongolia.

5.3.1.1 Insider trading

Article 76.1 of the Securities Market Law defines inside information as “any information that is not publicly available and that may influence the price of a security shall be deemed inside information.” On the other hand, Article 76.2 stipulates that “analysis made on the basis of information available to the public shall not be considered inside information, even when there is a possibility of it appreciably influencing the price or volume of trade of a security.”

Article 77 defines holders of inside information as “influential shareholder, governing person, or employee of the securities issuer and their connected persons” under Paragraph 1 and “a person that acquired inside information in the course of performing its official duties, or preparing, concluding or performing a contract or transaction, and its connected persons” under Paragraph 2.

There are definitions for an influential shareholder, governing person, or employee of the securities issuer and their connected persons. Article 4.1.29 stipulates that "influential shareholder" means an individual or legal entity who alone or in concert holds 5% or more of the total issued shares with voting rights of the concerned company or who exercises the voting rights of such securities on the basis of the provisions of law or contract.

Governing persons are defined in Article 84.1 as persons who participate directly or indirectly in the process of making official decisions of a company or concluding transactions or agreements such as members of a Board of Directors and executive management team of a company, the executive director, and chief financial officer.

Connected persons are defined in Article 4.1.30 as (1) family members and relatives, (2) a company in which the concerned person works as a governing person, (3) a company or legal entity in which a connected person(s) holds, either alone or in concert, 10% or more of the voting shares, (4) if the concerned person is an employer, its employees, (5) if the concerned person is a company, its parent, controlled subsidiary, or sister companies; and (6) such other persons as may be defined by the FRC.

Furthermore, according to Article 77.2, a person specified in Article 77.1 shall be considered a holder of inside information regardless of whether or not it acquired such information directly or indirectly.

Under Article 78.1, a holder of inside information shall be prohibited from the following activities: (1) participating in the trading of securities or derivative financial instruments whose price or volume of trade may fluctuate as a result of the information; (2) regardless of whether or not it is known that the information is inside information, proposing or inducing others to participate in the trading of securities or derivative financial instruments; and (3) disclosing of inside information to others otherwise than in the course of one's professional duties.

Article 78.2 stipulates that if a holder of inside information or its connected persons have participated in the trading of securities, etc. using inside information, it shall be deemed to have violated the provisions of Article 78.1 of the law

Article 79.1 prescribes disclosure of inside information. A securities issuer shall have the obligation to disclose to the public inside information in accordance with regulations adopted by the stock exchange and the FRC. In addition, in publicly disclosing the inside information, the securities issuer shall also notify the FRC and institutions conducting securities trading.

Article 79.2 prescribes methods of disclosing inside information. The inside information shall be disclosed to the public in the following ways: (1) through the websites of the securities issuer, institutions conducting securities trading and the FRC; (2) printed publications in accordance with procedures established by the FRC; and (3) through other means which enables interested persons to obtain the information without obstruction.

Under Article 79.3, the FRC shall approve the list of inside information and procedures for disclosing it.

5.3.1.2 Market abuse

Under Article 80.1 of the Securities Market Law, making fraudulent trades in the securities market, creating artificial securities prices, deceiving clients and other participants in the securities market with the intention of inducing or dissuading participation in trade, etc. are prohibited. Under Article 80.2, misleading a client or participant in the securities market as if it appears that the security is being actively traded notwithstanding that there has not been any change of ownership, or colluding to place purchase orders or enter into agreements with respect to a particular security within a certain price range shall be considered as having made a fraudulent trade.

Furthermore, Article 80.3, stipulates that, if two or more transactions have been entered into directed at increasing, decreasing, or fixing the market price for the purpose of ensuring that another person buy, not buy, order, or not order a certain security, this shall be considered as having created an artificial securities price. Under Article 80.4, the following acts or omissions shall be considered deceiving with the purpose of inducing or dissuading participants in the securities market and clients from trading: (1) issuing or publishing incorrect, misleading, or false information, projections or estimates, or failing to disclose material facts; (2) misleading a counterparty to a transaction by giving false information in relation to certain facts; and (3) misleading a counterparty to a transaction by utilizing certain methods or devices.

5.3.2 Purchasing all or a controlling block of shares of a company

Under Article 22 of the Securities Market Law, if a person intends to purchase all or a controlling block of shares of a company, the person shall make a (tender) offer (hereafter the "offer"). The offer shall be made to other shareholders by a person who intends to purchase a controlling block of shares of a company as such person's obligations specified in Article 57.1 of the Companies Law or by an investor on a voluntary basis. Before making the offer to the public to purchase the shares, the person making the offer shall inform the board of directors of the target company and simultaneously inform the FRC. The person making the offer shall deliver to the public a notice including the full name and residential address of the person, the number of shares subject to the offer and the minimum offer price per share. In the case of the offer required in Article 57.1 of the Companies Law, the person making the offer shall observe the procedures stipulated in Article 57.1 of the law and simultaneously provide all interested persons with information relating to such purchase. The period of validity of the offer shall not be less than one month and not exceed three months. The price offered to purchase the shares shall not be less than the market price of the relevant shares, and the FRC shall approve methodologies for determining the market price on the basis of recommendations from the stock exchange. The FRC shall separately establish procedures for the offer, which are listed in the amended Securities Market Law.

In addition, there is a provision that if the person making the offer has violated the procedures set out by the FRC or in the Securities Market Law, any shares purchased in violation of the law shall not carry voting rights. Furthermore, under Article 22.3, in the event that there is an increase or decrease in a controlling block of shares by 5 % or more, the shareholder holding the controlling block of the company shall notify the FRC and the stock exchange within 5 business days of such increase or decrease, and shall inform the public of the same through such shareholder's website.

5.3.3 Provision of investor information

Under Article 58, an investor shall inform the securities registrar and nominees with respect to all necessary information. The investor shall be liable for loss or damage caused to others arising as a result of failing to fulfill such obligation.

5.4 Regulations and oversight related to issuers

5.4.1 Regulations and oversight at the time of new listing

When shares of an issuer are newly listed on MSE, it is required to receive approval of MSE after listing examination, following submitting required documents to the FRC and receiving approval pertaining to registration. The listing examination criteria of the MSE are as shown in Table 5-6. (MSE Securities Listing Regulations, Rule 23, Rule 25, etc.)

Table 5-6 Listing examination criteria

No.	Requirement criteria	General	Specific *
1	Shareholder equity	more than MNT 10M	more than MNT 10M
2	Non-current asset size in the price of a security to be listed	more than 10%	more than 20%
3	Number of shareholders**	more than 50	more than 50
4	Percentage of common stock that are publicly offered**	more than 30%	more than 10%
5	Years of running a business operation**	more than 1 year	more than 3 years
6	Profit size**	Shall generate a profit. If incurred a loss, the loss size shall be no more the 30% of an equity capital	No requirement
7	Others	1. Company shall adopt and comply with its governance rules and regulations under internationally standardized practice and guidance. 2. Financial reports, securities transaction, price, trading data, influential information and operational information of the company and management shall be distributed transparently to the public and MSE as soon as possible. 3. Companies must have a specialist who is responsible for securities trading. 4. Announce and arrange the shareholders' meeting to the public within the term stated in the Law. These include meeting notes and resolution to be provided to MSE within the time frame.	
Note	* Companies that have a significant role to the sector with infrastructural and strategic importance for the economy shall be reviewed under specific listing criteria. **Requirement criteria 5 and 6 are not applicable to companies that are founded under project implementation, requirement criteria 3, 4 and 6 are not applicable to companies being privatized by the state.		

Source: MSE website

With respect to new listing, as a matter of a general policy, the MSE will list companies based checking whether numerical criteria set by MSE are met, while it also considers appropriateness of IPO, etc. It is considering relaxing the listing examination criteria in the future. Furthermore, in cases where a company listed overseas is dual-listed on MSE, MSE is considering lowering the burden on such issuers by accepting the submission of translated documents from the overseas market during MSE's listing examination.

In addition, FRC is currently reviewing the draft of a new Securities Listing Regulations made by MSE.

5.4.2 Regulations and oversight after listing

5.4.2.1 Obligations to conduct disclosure and submit documents

Disclosure obligations will be expanded upon via enforcement of the amended Securities Market Law. The current obligations and expected obligations after the enforcement of the amended law are described below. Please refer to 5.2.2 separately for the obligations imposed under the Companies Law.

＜Regulations under the old Securities Market Law＞

- An issuer of securities shall submit its semi-annual and audited annual financial statements to the FRC and the MSE on time specified by the Accounting Law (Article 10.1.3)
- An issuer shall publish its balance sheets in conformity with regulation set by the FRC (Article 10.1.4)
- A listed company shall submit the minutes of its ordinary shareholders meeting before 1 June and minutes of extraordinary shareholders meeting within 20 days after the meeting was held. (Article 10.1.5)
- An issuer of securities has obligation to disclose information specified in related laws to the investors and to the public. (Article 14.1)
- Outcomes from the shareholders meeting must be submitted to MSE within the specified timeframe as noted in the agreement (with MSE).

In accordance with these regulations, actually only annual and semi-annual reports (almost only financial statements) and results of resolutions at shareholders meetings are disclosed on MSE's websites, etc. Under these regulations measures such as delisting and fines could be taken against listed companies which failed in disclosing financial statements, but enforcement of these rules has been not strict for a long period of time. However, recently, efforts started to be made to improve MSE's reliability, and the FRC determined delisting, etc. of dozens of issues as mentioned previously.

Some of financial statements that were submitted and disclosed on the MSE website are hand-written in Mongolian causing characters unreadable due to being faint and patchy. As such, the quality of information disclosure does not reach levels where overseas investors feel secure. In this aspect, there was a certain progress that MSE made financial statements of each listed company read in the Excel format in September 2013. (But only in Mongolian. There are still companies that do not disclose financial statements.)

<Regulations under the amended Securities Market Law>

- The securities issuer shall issue notification to the FRC, MSE, and through its website with respect to the following disclosure matters within one business day of such matters arising. (Article 56.1)
  - Change to the management structure
  - Change in the shareholding structure of the influential shareholder, etc.
  - Organisational change in the issuer, its subsidiaries, affiliates, etc.
  - Seizure or confiscation of the issuer's assets
  - Cases where the issuer commences engaging in licensed activities, or where its license is suspended or revoked
  - Results of resolutions adopted at the shareholders' meetings
  - Any other circumstance that may influence the market price of the securities

- MSE shall make publicly available on its website the following information concerning securities and securities issuers. (Article 56.2) [23]
  - Securities price, and other information that might influence it
  - The issuer's operational and financial status
  - Convening of shareholders' meetings and any resolutions adopted
  - Any major and/or conflict of interest contracts and transactions concluded by the issuer
  - The percentage and number of shares and derivative financial instruments in the possession of the governing persons of the issuer

[23] After the enforcement of the amended Securities Market Law, MSE will conduct these operations as an SRO.

- Changes to the management and organisational structure of the issuer and information on the independent members of the board of directors
- information concerning influential shareholders of issuers and their connected persons
- Such other information as may be required by laws and regulations, FRC or MSE

It does not seem that disclosure of these matters is assumed to be checked in advance by the FRC or MSE. Thus, how to ensure quality of disclosure will be an issue to be cleared.

In addition, matters such as the format of disclosure and method of securing steady fulfillment of disclosure obligations (measures to be taken by the FRC or MSE against the offender) will draw attention. Also there are some concerns whether each listed company will be able to start new disclosure operations without problems on the enforcement date of the amended Securities Market Law (January 1, 2014)

5.4.2.2 Delisting

Delisting is an extreme measure for regulation and oversight over listed companies after their listing, and MSE can independently determine delisting of listed companies based on the following delisting criteria. However, until the present time MSE has delisted companies following the decisions by the FRC.

In addition to delisting, temporary removal can be imposed upon listed companies which do not meet listing criteria, etc.

The rules in the MSE Securities Listing Regulations are as follows:

<Delisting criteria>
Request for delisting (MSE Securities Listing Regulations, Rule 61)
Cases where a person with appropriate authority determines restructuring or liquidation of a listed company pursuant to the Companies Law (MSE Securities Listing Regulations, Rule 59, Paragraph 1)

Cases where a listed company which was put under temporary removal is not able to submit an application for relisting or re-registration within the specified 2-year period (MSE Securities Listing Regulations, Rule 59, Paragraph 3)

MSE conducts delisting examination in order to protect the rights of shareholders (MSE Securities Listing Regulations, Rule 62)

< Temporary Removal>

The case where a listed company meets 2 or more of the following criteria from (a) to (d) (MSE Securities Listing Regulations, Rule 60, Paragraph 1)

(a) Unable to meet the listing criteria
(b) Has violated the Securities Market Law, or has acted in violation of the responsibilities imposed under an agreement (with MSE)
(c) False contents or concealment of facts found or confirmed in disclosure information
(d) The security has been not traded for more than 1 year

Until the present, FRC and MSE have had a negative attitude toward delisting. However, in the process of attracting overseas investors in the future, there is a necessity of maintaining and improving the quality levels of listed companies. With the recognitions of such situation, FRC determined delisting of 57 companies in August 2013, and urged 36 companies to make improvements in September. If no improvements are made, there is a possibility that these companies will be delisted in 2014.

Many of companies listed in the process of privatization became family-run companies later. These companies do not comply with laws and regulations; for example, they do not disclose financial statements or hold shareholders meetings. Therefore drastic measures such as delisting and temporary removal eventually began to be used to maintain and improve quality of listed companies.

6. Assistance from other donors and possible assistance measures by the Japanese government in the future

Based on the observations and analyses above, the Study Team has listed the potential areas for future assistances to be considered by JICA, along with the tentative evaluation of the current situation, necessary measures for improvements, timeframe for achieving them, and the existing assistances by other development partners (DPs).

The task items are classified under five categories, 'regulations & supervision', 'capital market infrastructure', 'securities industry', 'issuers' and 'investors'.

Existing assistances by other DPs are shown on the right side column, based on the interviews with each organization. Generally, the World Bank has a greater emphasis on institutional design/framework, whereas EBRD and IFC focus more on the corporate governance issues for specific corporate entities as potential investment destination. Assistances from Japan include bilateral cooperation by such organizations as Japan Securities Dealers Association (JSDA), Tokyo Stock Exchange (TSE) and Japan Securities Depository Center (JASDEC) on their accounts.

The current development stage in each category has been evaluated through 1 to 5 qualitative scoring with the following criteria, based on the interviews with relevant organizations.

5: Well developed to meet the level of the most advanced capital markets on the global standard.
4: Not as developed as the level of '5', but requires no support from DPs, as the relevant efforts are self-sustaining.
3: Relevant efforts have already been made to a certain extent with visible results, but additional supports from DPs are necessary for further improvements.
2: Relevant efforts have started, but with still insufficient outcomes. More visible improvements can be expected through assistances by DPs
1: No relevant efforts have been made at all.

As for the target timeframe, 'short-term' items refer to those for completion within 1-2 years, the 'mid-term' for those within 5 years, and the 'long-term' for more than 5 years. These targets can be regarded as being linked with the 'importance' to a certain extent. e.g. The shorter the target timeframe is, the higher priority a task item should be given, meaning it does not necessarily mean the task can be completed easily in a short period of time. Given the combination of these criteria, the following evaluation can be drawn.

- ‘1 to 5 scoring’ ≒ ‘discrepancy between the target and status quo’ (i.e. the lower the score, the greater the gap)
- ‘Target timeframe’ ≒ ‘priority for completion’ (i.e. the shorter the timeframe, the higher the priority)
- ‘Target timeframe’ + ‘1 to 5 scoring’ ≒ ‘difficulty to complete the task’ (i.e. the lower the score and the longer the time frame, the greater the difficulty)

In other words, the tasks with lower scoring and shorter timeframe should be given higher propriety in sequencing the process of capital market development.

The list is based not only on the Study Team’s observations and evaluation, but also on the results of the interviews with relevant parties on the Japan side, such as Financial Services Agency (FSA), JSDA and Japan JASDEC, although it does not automatically mean their full commitment at this point. Going forward, it will become necessary that in depth discussions are made in the process of examining/evaluating the feasibility of the relevant assistances identified as a part of this survey.

Table 6-1 Evaluation of assistance needs

Category	Task item	Evaluation (1: low to 5: high)	Improvement measures & possible support	Timeframe	Direct Beneficiaries	Support from other donors
Regulations & supervision						
Related framework & procedures	Supervision & inspection of securities brokers (prudential regulations on securities companies)	2	Manual preparation & implementation support	Short term		WB: All activities in this category except for ensuring effectiveness of corporate governance & SRO oversight duplicates with KTF TA.
		1	Support to introduce financial soundness indicators such as capital adequacy ratio in Japan	Short term		
	Investigation for unfair trading	2	Manual preparation & implementation support	Mid term		
	Investment funds inspection	1	Manual preparation & implementation support	Mid term		WB KTF TA covers investment funds inspection
	SROs oversight	1	Manual preparation & implementation support	Short term		
	Listed companies supervision	2	Manual preparation & implementation support	Short term	FRC	
	Ensuring effectiveness of corporate governance	2	Manual preparation & implementation support	Mid term		IFC: Providing assistance to FRC & MSE. Evaluation based on score cards & proposals for improvements
	Establishment & operation of dispute resolution institution	1	Trainings & TAs utilizing the knowledge base of Financial Instruments Mediation Assistance Center (FINMAC)	Mid-long term		
	Development of risk based supervision	2	Manual preparation & implementation support	Mid term		Japanese government has been requested by FRC for support.
	Improvement of business processes in FRC	2	Case management cycle support and database building	Mid term		
Laws & regulations	Laws and regulations related to securitization	2		Short term		EBRD: will support for drafting rules & regulations (NO EBRD support yet)
	Review of sub rules of the Securities Market Law, the Investment Fund Law & ABS Law	2	Review, compiling manuals & support for implementation	Short term	FRC	WB: KTF TA in regard to review of sub rules of Securities Markets Law & Investment Funds Law (but ABS law not included)
	Private Pension Law	2	Japanese & other countries' experiences	Short-mid term		
	Regulations on new products (e.g. derivatives, depository receipt)	1	Manual preparation & implementation support	Mid-long term		
Others	Education of securities crimes for legal authorities	2	Training for police officers, judges, prosecutors & advocates	Mid-long term	FRC, police, judges, prosecutors, advocates	
	Investor Protection Fund	1	Sharing Japanese experiences, TA for setting up fund	Mid-long term	FRC, MSCH&CD	WB: KTF TA covers investor protection fund
Capital market infrastructure						
Stock exchange	Listing examination process	2	Manual preparation & implementation support	Mid term		
	Listed companies supervision (delisting & other measures for listed companies)	2	Manual preparation & implementation support, IT platform support	Mid-long term		WB: These are the areas encouraged to JICA to focus on as out KTF TA & MSTA do not directly deal with MSE
	Member examination & inspection (member & trading compliance)	2	Manual preparation & implementation support	Mid-long term		
	Supervision & improvement of listed companies' disclosure	1	Sharing Japanese experiences & introducing a disclosure system (TDnet)	Short-mid term		
	System management (trading rule)	2	Manual preparation & implementation support	Mid-long term		
	Business contingency plan	2	Manual preparation & implementation support	Long term	MSE	
	Organizational development for transforming to SRO	1	Manual preparation, implementation support & sharing Japanese experience regarding how SRO works	Short term		
	Development of dual listing framework	2	Manual preparation & implementation support	Short term		
	Development of ETF market	2	Feasibility study for market development	Long term		
	Development of REIT market	2	Feasibility study for market development	Long term		
	Promotion of Mongolian market (for potential investors & issuers)	2	Sharing Japanese experiences & implementation support on the measures to call potential investors/issuers to Mongolian market	Mid-long term		
Clearing & settlement	Introduce and complete exploitation of full Millennium CSD and support implementation of T+3 clearing cycle	3	Rule amendments, manual preparation & implementation supports	Mid term		
	Organizational development for transforming to SRO	1	Manual preparation & implementation support	Short term	MSCH&CD	
	Improvement of daily operation & study of future business	3	Sharing Japanese experiences & consultation	Short-mid term		
	Clearing risks prevention measures (feasibility study into creation of CCP)	2	Sharing Japanese experiences	Mid term		This will be addressed to KTF TA as this is urgent matter
	Improvement of systems stability & information confidentiality	2	Implementation of systems audit & establishing monitoring process for MIT CSD	Short-mid term	MSE, MSCH&CD	
Securities industry						
Industry association	Registration of sales representatives	2	Support for introducing registration system of sales representatives	Mid term		WB: KTF TA covers introducing registration system for sales rep (licensing regime) & establishment/operations of dispute resolution system
	Compliance including information management	2	Training for Internal Administrative Supervisors	Short-mid term	MASD	Japan Securities Dealers Association (JSDA): Conducted trainings before.
	Ethical & moral code	2	Manual preparation	Short-mid term		
	Effective operation and management of the association	2	Sharing Japanese experiences	Mid-long term		Japan Securities Dealers Association (has conducted trainings before)
	Facilitating market statistics	1	Training & TA for collecting, compiling & analyzing market data	Mid-long term		
	Investor education	2	Sharing Japanese experiences, TA for designing investor education programs	Mid term	MASD, investors	

Category	Task item	Evaluation (1: low to 5: high)	Improvement measures & possible support	Timeframe	Direct Beneficiaries	Support from other donors
Brokerage business	Framework for consolidation, new entry & exit	2	Preparing mid-long term picture of securities industry Introducing effective policy measures to speed up industry consolidation	Short-mid term	FRC	
	Clarification of licensing	2		Short term		
	Reviewing the design of brokerage fee structure	2		Short term		
	Framework of online trading	1	Preparing framework for online trading, sharing Japanese experiences	Short term	FRC, MASD	
	Standardized back-office function, front system & connection to the Millennium IT	2	Sharing Japanese experiences & guidance regarding the effective standardization	Short term	Brokers/dealers	
	Developing financial products for retail investors	2	Sharing Japanese experiences	Short-mid term		
	Improving the function of compliance, internal audit department	2	Sharing Japanese experiences	Short-mid term		
	Improving IT infrastructure	2	Sharing Japanese experiences	Short-mid term		
Custodian business	TA for sub custodian banks	1	Sharing Japanese experiences	Mid term	Custodian banks	FSA: Organized a lecture by Mitsubishi UFJ Trust & Banking
Investment banking	Clarification of businesses scope for brokerage vs. investment banking, necessity of fire wall.	1		Mid term	FRC, banks & security firms	WB: KTF TA covers the development of policy framework in regard to brokers/investment banks (as a part of the legal framework that was envisaged to be done under the TA)
	Improving the function of compliance, internal audit department	2	Sharing Japanese experiences	Short-mid term		
Credit rating	Enhancing recognition of credit ratings	1	Support for improving the quality of regulations for credit rating agencies Seminar on roles and functions of credit rating Review of the current credit rating model & development of a localized one.	Mid-long term	FRC, credit rating agencies & investors	
Issuers						
Government (Ministry of Finance)	Primary market of government bonds (regular issuance, primary dealer system, etc.)	2		Short-mid term	MOF, BOM *	ADB: Providing TAs (auction system, extending the tenor, etc. Will cover primary dealer system) US Treasury: Long term expert is currently based in MOF. WB: TA to the UB Municipality on municipal bond issuance
	Secondary market of government bonds	2		Short-mid term		
	Development of benchmark yield curve	2		Short-mid term		
State-owned companies (SOCs)	Selection of potential SOCs for privatization	2	Clarifying criteria for privatization & preparing time frame Assessment of the rationale for privatization through P/L analysis & case studies	Short-mid term	SPC, SOCs, FRC	
	Pre-privatization restructuring of SOCs	2	Sharing Japanese experiences & process consultation	Short-mid term		
	Scheduling for public offerings	3	Sharing Japanese experiences & process consultation	Short-mid term		
Listed companies	Enhancement of information disclosure	2	Implementation support	Mid term	Listed companies	WB: Under the Multi Sector TA, the legal consultant has already drafted the rules relating to disclosures by listed companies
	Enhancement of corporate governance	2	Sharing Japanese experiences	Mid-long term		
	Enhancement of internal controls	2	Sharing Japanese experiences	Mid-long term		IFC: Covering the corporate governance issues
Others	Issuance of MNT-denominated bonds by international organizations	2		Short-mid term		Being considered by ADB & EBRD.
	Information disclosure by listed companies	1	Seminar on information disclosure	Short-mid term	Listed companies	
	Enhancing recognition of dual listing & depository receipts	2	Seminar on dual listing (cost/benefit, procedures, etc.) for better understanding by the market participants	Short term	FRC, issuers & investors	
	Encouraging utilization of capital markets by growing small and medium sized private companies	2	Seminar on financing through capital markets (e.g. workshop on the benefit of listing)	Short-mid term		
Investors						
Institutional investors: commercial banks	Improving fund management skills	2	Sharing Japanese experiences	Short-mid term	Commercial banks	
Institutional investors: insurance & pension funds	Designing pension fund system	2	Support for designing pension fund system	Mid term	FRC	
	Establishment of legal environment for pension fund	2	Sharing Japanese & other countries' experiences	Mid-term		
	Improving skills for fund management, ALM & risk management	1	Sharing Japanese experiences Seminar for Insurance companies on capital markets investing, ALM, VaR, risk appetite, loss limits, governance, etc.	Mid-long term	Insurance & pension funds	
Institutional investors: mutual funds (MFs)	Proliferation of MFs	1	Handbook, seminars, workshops designed to promote MFs as new institutional investor class - enable them to compete with Banks (deposit products) Capacity building module for newly established companies	Mid-long term	MFs	
	Improving fund management skills	1	Sharing Japanese & other countries' experiences	Mid-term		
Institutional investors: others	Establishment of SWF	2	Introducing experiences in other countries, transferring fund management skills	Mid-long term	MOF, SWF	WB & IMF: Provide support to MOF through MSTA & other sources. Work coordinated by MOF division.
	Management of state-controlled funds (pension, health etc.)	1	Feasibility study of allocating certain percentage from the capital pool to capital markets, through the analysis of risk-return profile	Mid-long term		
Retail investors	Investors education	1	Sharing Japanese experiences Online courses that can create mass education effort Development of advocacy materials, TV ads, etc.	Mid-long term	Retail investors	
	Encouraging the shift of retail investors from savings to investments	1	Support for the introduction of preferential measures (including tax incentives) for promoting investment by retail investors Sharing Japanese experiences	Mid-long term		WB: KTF TA envisage providing some assistance in regard to promoting investor education. But there should be no problem for JICA to be involved in view of the amount of work that needs to be done. Can collaborate with JICA in this respect.

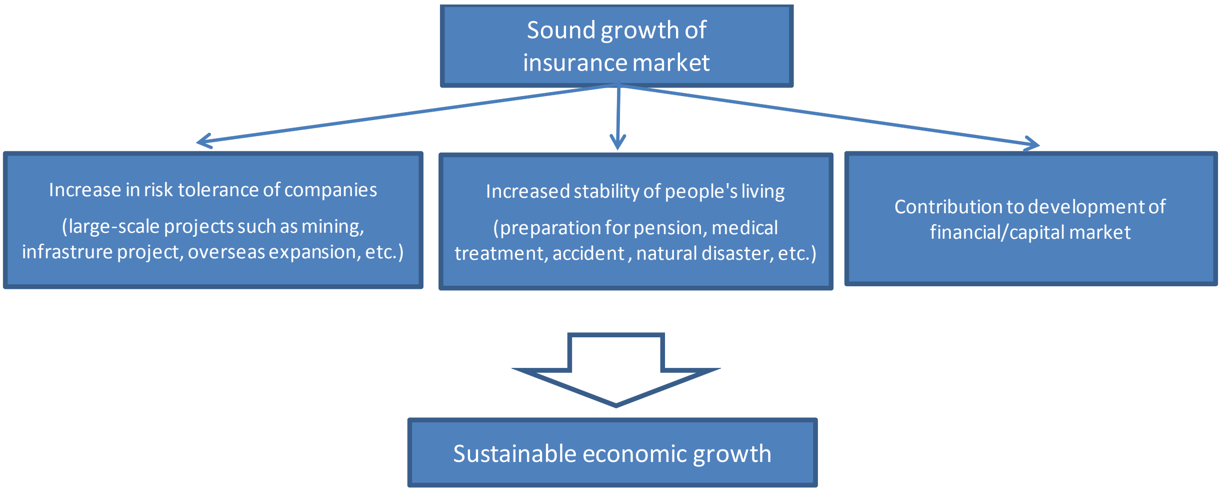
*: According to law, this is FRC mandate.

7. Current situation and major issues of insurance industry in Mongolia

Development of the insurance industry is a key to strengthen the financial and capital market of a country. Part of premium income for insurance companies is accumulated as reserve fund for future payment of insurance claim, and generally this accumulated reserve fund is invested in the capital market. Hence, as the insurance industry grows and its size of invested assets becomes larger, the industry contributes to development of the capital market. In particular, life insurance companies which sell long-term insurance products are expected to be suppliers of long-term funds in the financial and capital market.

Enhancement of the insurance industry is also indispensable for a country to achieve long-term and stable economic growth. "Insurance" plays a role to mitigate various risks involved in businesses and people's living, and it can be said that insurance has an effect on facilitating economic activities. In addition, insurance is regarded as necessary to obtain financing in such large projects as the mining and the infrastructure related projects ongoing in Mongolia.

Figure 7-1 Importance of development of insurance industry



Based on the report[24] by the United States Agency for International Development (USAID), there is a link between strengthening the insurance industry and economic growth in developing countries. It further elaborates its analysis that "1) countries are much more likely to experience sustained growth if their insurance markets develop well; 2) insurance market development is closely related to improved financial sector performance; and 3) insurance markets do not develop adequately without both public and private sector investment in their infrastructure." In additions, the report points out such key findings as:

- Life insurers (and to some extent non-life insurers) can be important source of long-term finance, due to their success in marketing savings products and the nature of their liabilities.
- Insurance facilitates investment in infrastructure and high-risk / return activities, by generating sources of long-term finance, and helping measure and manage high-risk exposures.
- By mobilizing substantial funds through savings products, and investing them in bonds and stocks, insurers help stimulate the growth of debt and equity markets.
- As institutional investors, insurers pressure equity markets to adopt stronger corporate governance

[24] USAID "Assessment on How Strengthening the Insurance Industry in Developing Countries Contributes to Economic Growth" (2006)

measurers and greater transparency.

These analyses have important implications for future development of the insurance industry in Mongolia.

In this chapter, we summarize current situation and major issues of the insurance industry in Mongolia, and then, bearing the current assistance from other donor organizations in mind, we consider possible assistance measures by the Japanese government in the future.

7.1 Current situation of insurance industry in Mongolia

Establishment of the first insurance company in Mongolia, Mongol Daatgal[25], dates back to 1934. Under the socialist system, Mongol Daatgal had been the only insurance company which was state-owned, but with transition to a market economy started in 1990s, several private insurance companies were established, and Mongol Daatgal was privatized in 2003. As of today, there are 17 private insurance companies in Mongolia.

7.1.1 Regulatory framework and supervision of insurance industry

The first Law of Mongolia on Insurance was enacted in 1997, and the law was revised in 2004 to make it closer to the international standards. In the same year, the Law of Mongolia on Insurance Intermediaries, which stipulates roles and functions of insurance agents, brokers and loss adjusters, was also enacted, and the regulatory framework for players in the insurance industry was established. Recently, with the progress of automobile society in Mongolia, the Law on the Driver's Insurance, i.e. compulsory automobile liability insurance, was passed in October 2011. Civil Code in Mongolia, established in 2002, also includes basic matters related to insurance including contract, product types and insurance coverage.

After the revision of the insurance law in 2004, the following regulations were formulated one after another.

- List of forms of voluntary ordinary insurance (2006)
- Conditions for investments to be financed from insurance paid-in capital and reserve funds (2006)
- Regulation on establishment of an insurance reserve fund, its expenditure and control (2006)
- Giving permit to auditors to carry out auditing of insurers (2006)
- Guideline on determining qualified body to act as an insurer and criterion of insurer and insurance intermediaries (2007)
- Guideline on insurance accounting (2007)
- Regulation on setting forms and contents of financial reports and accounting documents of insurance intermediaries (2007)
- Methodology for estimation of insurance rate and insurance premium rate (2007)
- Regulation on solvency requirement for insurers and its supervision (2007)
- Amount of regulatory service fees to be collected from insurance companies and insurance intermediaries (2007)
- Regulation on establishment of standard fees and terms and conditions to provide information and documents for fee from insurer to insured (2007)
- Regulation on conducting inspection on insurer's operations (2007)
- Code of ethics to ensure prudent operations of insurers and insurance intermediaries (2007)
- Regulation on issuing the license to engage in actuarial activities, standard valuation of actuary,

[25] "Daatgal" means insurance in Mongolian language.

examination and reporting by actuary (2007)

- Regulation on conducting off-site monitoring and evaluation on insurer (2008)
- Guidelines on issuing reports, data and complaints from insurers and insurance intermediaries (2008)
- Regulation on conducting insurance training and examination (2008)
- Regulation on estimation of long-term insurance premium (2008)
- Solvency requirement for long-term insurers and oversight procedures (2008)
- Amount to be invested from the paid-in capital and reserve fund of long-term insurer and its requirements (2008)
- Terms and conditions for foreign insurer and insurance intermediary opening, or carrying on business on the territory of Mongolia through its branch and representative office (2008)

FRC is the regulatory and supervisory agency of insurance industry, and its Insurance Department is the responsible department. Insurance Supervision Service of Ministry of Finance used to be the supervisory organization, but the role was shifted to FRC in 2006 when FRC was established. As for the government's policy making for insurance businesses, Financial Market and Insurance Division, Financial Policy and Debt Management Department of Ministry of Finance is also key stakeholder in decision-making.

There are three divisions in the FRC Insurance Department, Non-Life Insurance Division, Life Insurance Division and Policy Planning Division. Total number of staffs in the Insurance Department is 17 as of today.

7.1.2 Current situation of insurance industry

As illustrated in Table 2-10, the banking sector is very dominant in the financial sector in Mongolia and presence of the insurance sector is minor, comprising a little less than 1% of the total assets of the financial sector.

The following table shows development stage of the Mongolian insurance industry compared to other Asian countries, etc. Regarding insurance penetration, calculated as % of premiums to GDP in 2012, Mongolia is the lowest among the Asian countries. Also, insurance density, which is premiums per capita in USD in 2012, is the lowest in Mongolia, and it is much lower than that of Indonesia which has similar GDP per capita (USD3,593.7) with Mongolia (USD3,627.2), and is at the same level with Vietnam which has lower GDP per capita (USD1,752.6). In sum, we can say that Mongolia is in very early stage of development of insurance industry compared with other Asian countries, and then, there will be substantial room for further growth.

Table 7-1 Insurance penetration (% of premiums to GDP) and insurance density (premiums per capita) in the Asian countries, etc.

	premium as a % of GDP in 2012			premiums per capita in USD in 2012		
	Total	Life	Non-ilfe	Total	Life	Non-ilfe
Taiwan	18.19	15.03	3.16	3,760	3,107	653
Hong Kong	12.44	11.02	1.42	4,544	4,025	519
Korea	12.12	6.87	5.25	2,785	1,578	1,207
Japan	11.44	9.17	2.27	5,168	4,143	1,025
Singapore	6.03	4.43	1.60	3,362	2,472	890
Thailand	5.02	2.95	2.70	266	157	110
Malaysia	4.80	3.08	1.72	514	330	184
India	3.96	3.17	0.78	53	43	11
China	2.96	1.70	1.26	179	103	76
Indonnesia	1.77	1.24	0.53	65	46	19
Vietnam	1.42	0.63	0.78	22	10	12
Philippines	1.40	0.90	0.49	36	23	13
Mongolia	0.57			20	* USD1=MNT1,377.5	
Africa	3.65	2.53	1.12	67	47	21
World	6.50	3.69	2.81	656	373	283

Sources: Swiss Re. sigma "World insurance in 2012"(No 3/2013), and presentation material of MIG Insurance

According to Swiss Re, factors influencing insurance demand are illustrated in the following table. It should be noted that, in general, external factors including economic conditions, culture, demography, etc. of a country also have an effect on insurance demand, in addition to efforts by insurance industry and its supervisory agency.

Table 7-2 Factors influencing insurance demand

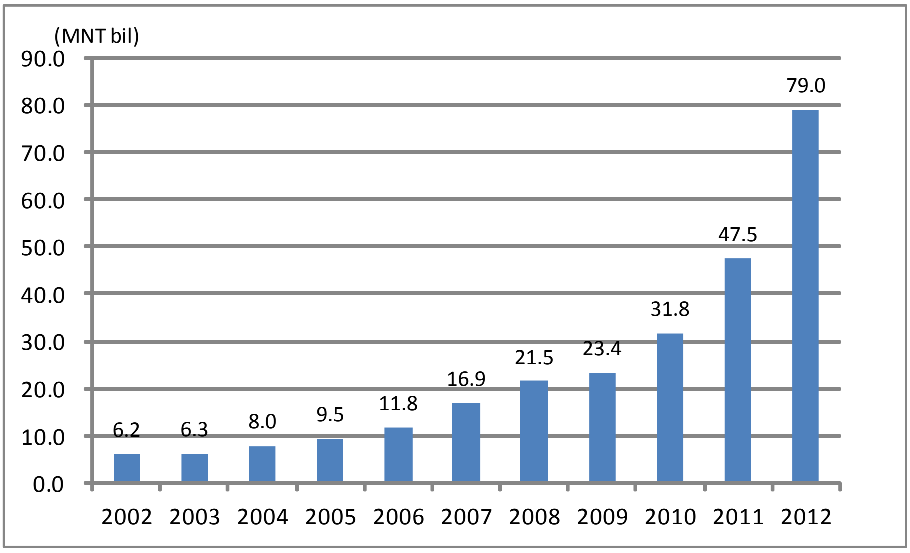
General factors	Specific factors
Economic growth	Products offered
Wealth distribution of income	Distribution channels
Religion, culture	Risk awareness
Education	Insurance regulation
Property rights, legal certainty	Trust in insurance
Non-life insurance	**Life insurance**
Compulsory insurance	Economic stability (e.g., inflation, currency)
Natural catastrophe exposure	Savings rate
Public role in health and workers compensation insurance	Demography
	Tax benefits
Claims awards	Pension system

Source: Inter-American Development Bank "Insurance Market Development in Latin America and the Caribbean" (2007)

Figure 7-2 shows the amount of "Gross Written Premium" in the Mongolian insurance industry from 2002 to 2012. Gross written premium has been increasing steadily in recent years, and in 2012, when the compulsory automobile liability insurance started, it rose dramatically from MNT 47.5 billion to MNT 79.0 billion.

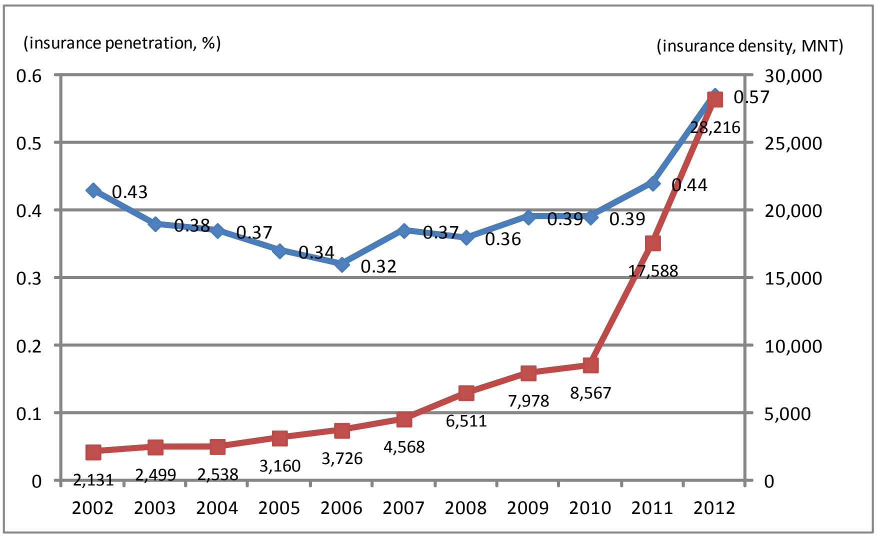
Figure 7-3 illustrates insurance penetration and insurance density in Mongolia for the past ten years. With rapid increase of insurance premiums recently, insurance penetration rose from around 0.4% to 0.57% in 2012, and premiums payment per capita increased by three times to MNT 28,216 in the recent two years.

Figure 7-2 Change of gross written premium



Source: presentation material of MIG Insurance

Figure 7-3 Insurance penetration (% of premiums to GDP) and insurance density in Mongolia



Source: presentation material of MIG Insurance

Table 7-3 shows insurance premiums by type of insurance product. Insurance products with large composition are property insurance, auto vehicle insurance, aviation insurance, and liability insurance. Also, share of driver's liability insurance increased sharply in 2012, with introduction of the compulsory automobile liability insurance. These five insurance products comprise 85% of the total insurance premiums. Back in 2001, there were only three categories, which were property insurance, liability insurance and accident insurance, but type of insurance products has broadened for the past ten years. It should be noted that share of life insurance products such as life-term insurance and pension is still very small, and this is in contrast to the situation of other Asian countries where life insurance market is larger than non-life insurance market.

Table 7-3 Insurance premiums by type of insurance products

(MNT mil)

	2001		2009		2010		2011		2012		2012/2009 average growth rate
property insurance	3,216	62%	6,450	28%	8,247	26%	12,427	26%	18,717	24%	43%
auto vehicle insurance			4,771	20%	6,914	22%	11,880	25%	15,343	19%	48%
aviation insurance			3,083	13%	2,343	7%	5,282	11%	8,570	11%	41%
liability insurance	1,427	28%	3,079	13%	4,657	15%	6,056	13%	7,514	10%	35%
accident and treatment expense insurance	527	10%	2,677	11%	3,750	12%	5,538	12%	6,201	8%	32%
drivers liability insurance			1,828	8%	2,071	7%	3,026	6%	16,298	21%	107%
financial insurance			612	3%	1,299	4%	1,631	3%	1,975	2%	48%
construction insurance			395	2%	1,369	4%	354	1%	1,756	2%	64%
transport insurance			375	2%	766	2%	1,071	2%	1,393	2%	55%
life-term insurance			60	0%	192	1%	174	0%	327	0%	76%
health insurance			55	0%	92	0%	229	0%	308	0%	77%
livestock insurance			14	0%	69	0%	222	0%	441	1%	220%
agriculture insurance			1	0%	0	0%	0	0%	0	0%	-100%
accumulation insurance			0	0%	1	0%	85	0%	125	0%	647%
pension			0	0%	1	0%	23	0%	35	0%	
Total	5,170	100%	23,400	100%	31,769	100%	47,997	100%	79,004	100%	50%

Sources: FRC annual reports 2010 & 2012, presentation material of MIG Insurance

Regarding main users of insurance products, i.e. major clients of insurance companies, the number of retail customers has increased with introduction of the compulsory automobile liability insurance. As for corporate clients, large companies in such industries as mining, construction & real estate, telecommunication and aviation, are typical major customers. For example, in a mining project, not only a project itself, but also heavy machineries and workers on the site should also be covered by insurance products, and hence, such project could be regarded as good business opportunity for insurance companies.

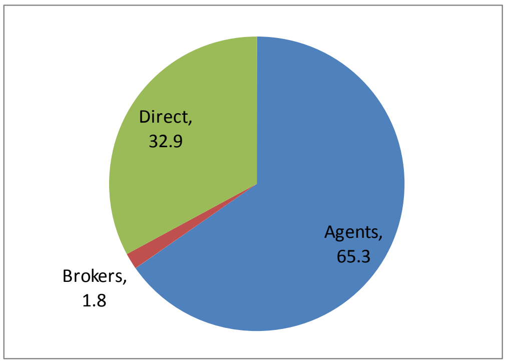
Table 7-4 shows the number of license holders of insurance market in Mongolia. There are 17 insurance companies in Mongolia as of today, sixteen non-life insurers and only one life insurer. The number of insurance companies has not changed very much for the past several years, but the number of branches has increased significantly, and the number of insurance agents (mainly individuals) and insurance brokers has also increased. This indicates that distribution channels of insurance products have been expanding with growth of the insurance market. It should also be mentioned that insurance companies have strengthened their sales channels through business alliances with major commercial banks recently, after commercial banks were allowed to conduct insurance brokerage businesses in the revised banking law enacted in 2011. As a result, agents and brokers are playing important roles in distribution channels of insurance products, as illustrated in Figure 7-4.

Table 7-4 The number of license holders of insurance market

	2007	2008	2009	2010	2011	2012	2013/6
Insurers	15	16	18	17	17	18	17
branch offices	91	120	129	138	188	213	N.A.
Insurance agents	690	1,167	1,676	2,061	2,057	2,357	3,227
Insurange brokers	2	4	5	9	8	17	20
Insurance loss adjusters	0	0	2	6	9	9	11
Insurance actuaries	0	9	10	12	13	15	N.A.

Sources: FRC annual reports 2010 & 2012, presentation material of MIG Insurance

Figure 7-4 Distribution channels of insurance products (2012)



Source: presentation material of MIG Insurance

There are industry associations established in each category of the insurance market: Mongolian Insurers Association (MIA) for insurance companies, Association of Mandatory Insurers for insurance companies distributing the compulsory automobile liability insurance, Mongolian Insurance Broker's Association for insurance brokers, Association of Loss Adjusters for loss adjusters, and the Society of Actuaries of Mongolia for actuaries.

Table 7-5 is ranking of the Mongolian insurance companies based on the total assets. The largest company is Mongol daatgal, the former state-owned insurer, but its market share had decreased from about 75% ten years ago to 20% due to more competition in the industry. Bodi daatgal is the second largest with about 10% share, followed by Practical, Tenger, Mandal, Mig, Soyombo, Ard and Nomin, each having 6-7% share. National life, ranked tenth, is the only life insurer in Mongolia. These top ten companies occupy around 80% share of the total assets of the all insurance companies.

The total assets of the Mongolian insurance companies were MNT 107.6 billion as of the end of 2012. This amount is far smaller than total assets of Trade and Development Bank of Mongolia (MNT 2,698.8 billion as of September 2012), the largest commercial bank and those of Xac Bank (MNT 939.1 billion), the fourth largest bank. There is no listed insurance company in Mongolia and no insurance company with rating by international credit rating agency.

Among the top ten insurance companies, there are insurers under major local business groups, such as Bodi daatgal under Bodi Group with Golomt Bank, Tenger daatgal under Tenger Financial Group with Xac Bank, and Nomin daatgal under major retailer, Nomin group.

There are a couple of insurance companies with foreign shareholders. Mongol daatgal is currently 100% owned by Millennium Security Management Limited, an investment company managed by Mr. Gromov, Russian business tycoon who is also the Chairman of Chinggis Khaan Bank. Also, one of major shareholders of Ard daatgal is UK-based Whittington Group, which focuses on investment in the insurance sector in emerging countries and has 22% share of the company. Lastly, Mandal General Insurance used to be a joint venture between local business and Mongolia Growth Group, which is listed in Toronto Stock Exchange and develops real estate business in Mongolia. Shares of Mongolia Growth Group were transferred to the local partner based on the original agreement. There is no subsidiary or representative office of foreign insurance company in Mongolia as of today.

Table 7-5 Ranking of insurance companies based on total assets

(MNT million)

	insurance companies	2010	%		2012	%
1	Mongol daatgal	16,058	28%	1	21,274	20%
2	Bodi daatgal	5,072	9%	2	10,937	10%
3	Tenger daatgal	4,310	8%	4	7,412	7%
4	Practical daatgal	4,184	7%	3	7,728	7%
	Mandal			5	7,271	7%
5	Mig daatgal	4,104	7%	6	6,655	6%
6	Nomin daatgal	3,029	5%	9	5,993	6%
7	Ard daatgal	2,983	5%	8	6,345	6%
8	Soyombo daatgal	2,438	4%	7	6,366	6%
9	National life daatgal	2,143	4%	10	4,683	4%
10	Ganzam daatgal	2,032	4%	15	3,144	3%
11	Monre daatgal	1,695	3%	11	3,600	3%
12	Mongoltrust holding daatgal	1,678	3%			
13	Ulaanbaatar city daatgal	1,656	3%	13	3,263	3%
14	Munkh daatgal	1,527	3%	14	3,166	3%
15	Jonon daatgal	1,409	2%	18	1,646	2%
16	Grand daatgal	1,402	2%			
	Ger daatgal			16	2,584	2%
17	Monnis daatgal	1,046	2%	12	3,283	3%
18	Khan daatgal			17	2,255	2%
	Total	56,764	100%		107,605	100%

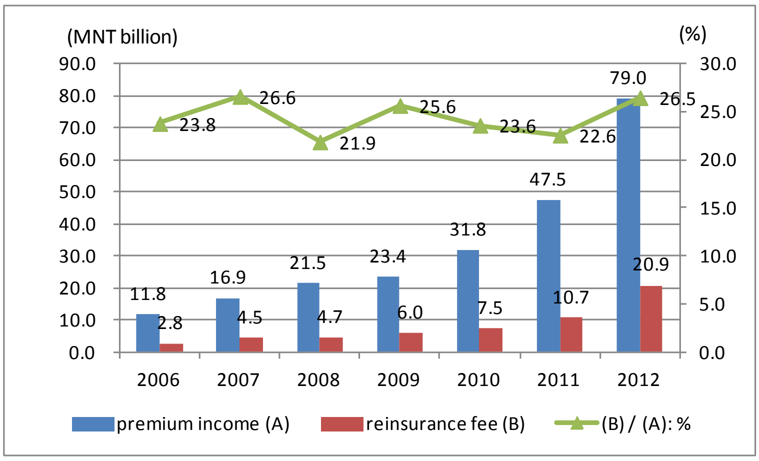
Sources: FRC annual reports 2010 & 2012

Foreign insurance companies have been involved in insurance businesses in Mongolia as reinsurers. According to the insurance law in Mongolia, local companies or projects in Mongolia must make insurance contracts with insurers licensed domestically by FRC. Foreign insurers which do not have local license can participate in insurance business opportunities indirectly through reinsurance transactions. Reinsurance is also beneficial for local insurers, which need to transfer certain amount of risks under the current capital level and can enlarge underwriting capacity by doing so. For example, in case of insurance for large-scale mining projects or aviation insurance, local insurers with insufficient financial base and poor underwriting knowhow have limitation in retaining all the risks, and hence, reinsurance transactions are necessary. In some cases, an insured company requires a local insurer to be reinsured by an international player in order to ensure future claim payment ability of its insurance contract.

Figure 7-5 illustrates utilization of reinsurance by the Mongolian insurers, calculated as % of reinsurance fee to premium income. About 25% of premium income has been paid out to reinsurers as reinsurance fee, but degree of reinsurance utilization varies from company to company. Based on our interview with major local insurers, some company pays as much as 40% of premium income for reinsurance, and other company enters into Treaty Reinsurance[26] agreement with a large global reinsurer.

[26] Form of reinsurance agreement is classified into Facultative Reinsurance and Treaty Reinsurance. In Facultative reinsurance, an insurance company (or ceding company) negotiates with a reinsure separately for each insurance policy that is reinsured. In Treaty Reinsurance, a reinsurer is obliged to accept reinsurance of all contracts within the scope determined by a ceding company and the reinsurer in their treaty reinsurance agreement.

Figure 7-5 Utilization of reinsurance by insurance companies in Mongolia

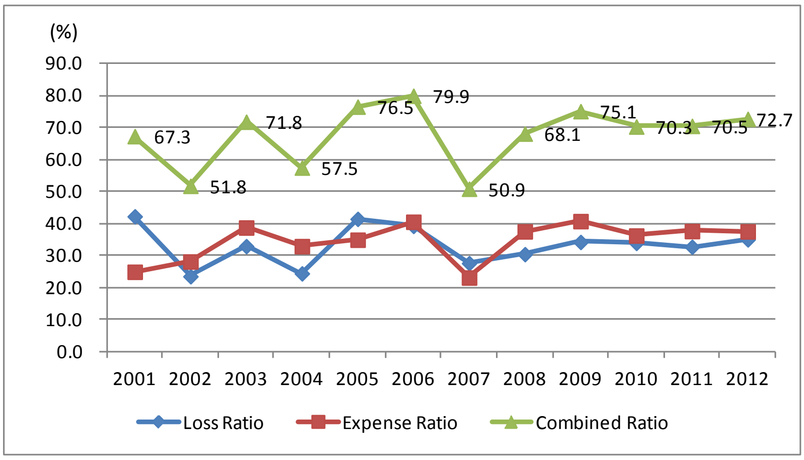


Sources: FRC annual reports 2010 & 2012

According to websites of local insurance companies and our interviews with them, global reinsurers such as Munich Re or Hannover Re are regarded as important players in the reinsurance market in Mongolia. Japanese major non-life insurance companies also have some reinsurance businesses in Mongolia in projects which a Japanese company is involved with.

Figure 7-6 shows combined ratio, which is the sum of loss ratio and expense ratio and indicates profitability of an insurance company. Combined ratio of the Mongolian insurers has been hovering around 70% in recent years. Comparing with combined ratios of other countries in the OECD report, it can be said that the Mongolian insurance companies have maintained sound profit level[27]. As a result, the accumulated profit (loss) of the insurance industry as a whole turned to be positive in 2009, and the insurance reserve fund has been increasing steadily, as shown in Figure 7-8. Total outstanding of insurance reserve fund reached to MNT 48.2 billion as of the end of 2012, and this amount was equivalent to 45% of the total assets (MNT 107.6 billion) of the industry.

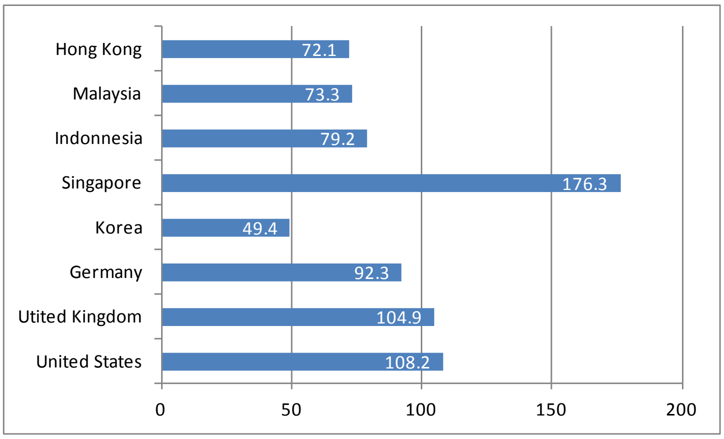
Figure 7-6 Combined ratio of the insurance industry in Mongolia



Source: presentation material of MIG Insurance

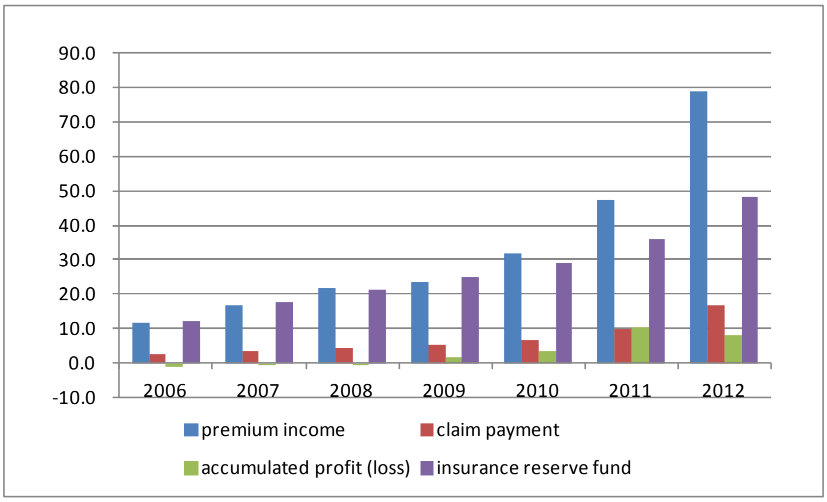
[27] Combined ratio of Japan was included in the 2012 edition of OECD report, and 232.3 for non-life insurers in Japan in 2011was the highest number among the countries surveyed.

Figure 7-7 Combined ratios of non-life insurers of other countries (2012)



Source: OECD "Global Insurance Market Trends 2013"

Figure 7-8 Major financial items of the insurance industry in Mongolia



Source: FRC annual reports 2010 & 2012

As for solvency margin ratio[28], which indicates financial soundness of insurance company, FRC sets 150% at a minimum level. In its annual reports, FRC does not disclose solvency margin ratios of each insurance company. To illustrate by examples based on our interviews with local insurers, the ratios for company A and company B were 184.5% and 329% respectively as of the end of 2012.

Regarding fund management of insurance companies in Mongolia, they were only allowed to either make bank deposits or invest in the government bonds and corporate bonds until 2013. However, since bond market is still very immature and yield of the government bonds are lower than term deposits with annual interest rates of 15-18%, most of funds have been deposited in commercial banks in practice. Regulations on investment by insurance companies have been eased since 2014, and now insurance companies can make investments in the capital market including equity market (with limitation of 10% of total assets) and also provide loans with collateral on real estate (with limitation of 20% of total assets). With such change of regulations, some insurance companies start considering to diversify their investment activities. As illustrated

[28] Solvency margin ratio (%) = Solvency margin (ability to pay in which capital and other reserves are included) / (Risk total x 50%). In Japan, a solvency margin ratio of at least 200% is seen by FSA as an indicator for a healthy condition.

in Table 7-6, insurance companies in these countries are highly involved in their capital markets through investments in bonds and equities.

Table 7-6 Investment portfolio of insurance companies (2011)

	Japan*		Korea*		Malaysia		Singapore		Thailand		UK		USA	
	life	non-life	life	non-life	life	non-life	life	non-life	life	non-life	life	non-life	life	non-life
bond	55.4	33.7	48.2	38.1	55.1	60.5	57.8	36.8	70.6	31.2	67.4	48.1	74.7	66.4
equity	5.4	24.2	6.3	6.6	18.3	6.7	22.8	9.7	3.9	25.1	14.8	14.7	3.8	21.1
others	39.2	42.1	45.5	55.3	26.6	32.8	19.4	53.6	25.5	43.7	17.8	37.3	21.5	12.5
	*: 2010		*: 2010											

Source: OECD "Global Insurance Market Trends 2012"

7.2 Major issues of insurance industry in Mongolia

7.2.1 Capacity building of FRC and revision of the current laws and regulations

FRC Insurance Department, although its staffs are very limited, has been making a lot of efforts to develop legal framework for the insurance industry in the short term, and this should be evaluated. In order to achieve sustainable development of the insurance industry, FRC is now preparing for a roadmap of the insurance industry in cooperation with Ministry of Finance (the 1st draft will be prepared by April 2014), planning to shift from Solvency I to Solvency II by 2018 and to introduce risk-based capital regulation, raising the minimum capital of insurance company from the current MNT 2 billion to MNT 5 billion by 2016, and examining possibility of national reinsurance scheme (discussed later).

According to FRC Insurance Department, more than half of the current 17 staffs do not have sufficient knowhow and experience of the insurance business, and based on our interviews with local insurers, needs for capacity building of FRC staffs are strongly emphasized very often. Therefore, capacity building of FRC should be regarded as one of the most urgent and important issues for development of the insurance industry.

In addition, MIA and insurance companies have requested amendments of the current laws and regulations, including to reduce overlapping and to modify some critical regulations (such as regulatory service fees charged to premium income of insurance companies, amount of insurance reserve fund based on regulated calculation, etc.), and FRC needs to take the appropriate responses and actions to such request. Lastly, it is hoped that communication and collaboration among FRC, associations and insurance companies should be enhanced further to tackle with various issues in the industry.

7.2.2 Amendment of the compulsory automobile liability insurance system

The compulsory automobile liability insurance system has started on a full scale since 2012, after the law of the driver's insurance was passed in October 2011. According to the Association of Mandatory Insurers, recent participation rate of the compulsory automobile liability insurance is 83%. The insurance obliges the owner and the driver of an automobile to enter into an insurance contract, and the insurance compensate a victim for damages to lives, health and property due to insurance event[29]. Insurance fee is determined by type

[29] The compulsory automobile liability insurance in Japan is different in that the insurance does not cover a property damage accident without any victim who is dead or injured due to the accident.

and use of automobile, and the base insurance fee is fixed at MNT 33,000 per year as stipulated in the law. Table 7-7 shows performance of the compulsory automobile liability insurance until 2012. The number of insurance contracts and premium income has increased steadily, and this insurance has now about 20% share of the total premium income in the industry. However, it should be noted that ratio of claim payment to premium income is almost 10% point higher than the industry average and the ratio jumped dramatically in the fourth quarter (i.e., the winter season) in 2012. Based on our interview with the Association of Mandatory Insurers, premium income was MNT 14.5 billion, and claim payment was MNT 7 billion with the number of insurance event of 17,300 in 2013. Ratio of claim payment to premium income has worsened to about 48% with rapid increase of traffic accidents.

Table 7-7 Performance of the compulsory automobile liability insurance

(MNT million)

	2011	2012	1Q	2Q	3Q	4Q
number of contracts	30,051	373,480				
premium income (A)	3,026	16,298	1,867	7,426	4,056	2,949
claim payment (B)	971	4,791	430	766	1,035	2,560
number of insurance events	2,627	9,521				
(B) / (A)	32%	29%	23%	10%	26%	87%
total premium income (C)	47,997	79,004				
total claim payment (D)	10,072	16,917				
(D) / (C)	21%	21%				

Source: FRC annual reports 2012

In such circumstances, private insurance companies selling the compulsory automobile liability insurance are making losses from this insurance business, and some insurers are now considering possibility to withdraw from this business, based on our interviews with local insurance companies. It could be possible that some insurance companies will actually stop selling the compulsory automobile liability insurance under the condition that it will not be easy to raise the current insurance fee since approval of the parliament is needed. If this happens, people’s trust in insurance product and insurance company would be damaged seriously, and the compulsory automobile liability insurance system itself could be endangered depending on the number of or size of withdrawing insurers. Further, such situation would have negative effect on the current discussion on possible introduction of other compulsory liability insurance products for the professionals including doctors and construction business.

7.2.3 Penetration of insurance products and insurance education

With introduction of the compulsory automobile liability insurance system, the number of insurance policyholders has increased. However, people’s level of understanding on insurance products is still low in general, and insurance tend to be regarded as similar function with tax by people in Mongolia. In addition, private insurance companies, which are much smaller than commercial banks, do not gain high reliability.

In the field of life insurance, which has better market penetration in the other Asian countries, there is only one life insurer in Mongolia, and although there seems to be some non-life insurance companies considering possible start-up of life insurance business, no new entrant has been observed. It is said that people in Mongolia do not highly evaluate the current national pension or medical insurance system, and hence, development of life insurance business by private insurers should be expected.

Private insurance companies have been making their efforts to improve insurance literacy of the people in

Mongolia, but taking their weak financial base into account, there should be limitations to continuing such activities. Also, although MIA has provided training programs for staffs of insurance companies, it does not have sufficient financial resources to implement insurance education for the people.

7.2.4 Capacity development of insurance industry

7.2.4.1 Establishment of general insurance rating organization / function

There is currently no organization or function in Mongolia that collects and analyzes various insurance data and calculate appropriate premium rate on behalf of the whole insurance industry. Except for the compulsory automobile liability insurance, insurance data are not collected and are managed by each insurer. Law of large numbers is fundamental in the insurance business. Hence, unless a certain amount of risk pool is collected and analyzed with an actuarial expertise, appropriate premium rate reflecting risk involved will not possibly be derived. Therefore, we can say that in the early stage of development of insurance industry, function or organization of insurance premium rating is vital. Some insurance companies build up risk management system with a certain level, but it seems that they do not set premium rate nor develop an insurance product based on professional analysis of insurance data by an actuary. There are 17 insurance companies in the still very small market, and there seems to be downward pressure for insurance companies to compete on insurance fee, which does not reflect inherent risk. Such situation could possibly lead to distressed condition of the whole insurance industry.

FRC is currently collecting financial information of insurance companies and basic data of their insurance businesses, but with limitation of detailed insurance data and lack of actuaries in FRC, it appears to be difficult for FRC to have function of data bank and premium rating.

7.2.4.2 Human resource development of actuaries

Actuary, specialized statistician who compute insurance risks, premiums, reserves, and capital requirements, is very important professional in the insurance business. In Mongolia, there are currently 15 actuaries licensed by FRC, which indicates that among 17 insurance companies, there are companies without any actuary. Furthermore, based on our discussion with the industry experts, current skill level of these actuaries are much lower compared to the international standard, and it seems that role and position of actuary is not well recognized inside insurance companies. Without actuary, it will be impossible to calculate appropriate insurance premium, develop insurance products and conduct proper risk management, and hence, it is crucial for the Mongolian insurance industry to build actuarial resources promptly.

7.2.4.3 Establishment of national reinsurance scheme

Mongolian insurance companies have actively conducted reinsurance transactions with foreign insurers to transfer risks. This implies that part of premium income outflows to foreign countries. According to a large mining company, local insurers do not have sufficient knowhow on analyzing and underwriting risk involved in a large mining project, and it needs to make reinsurance to foreign insurer a precondition, considering their insufficient financial base. Also, in reality, there seems to be some illicit acts in which a local company makes insurance contract directly with a foreign insurer, according to an industry expert. In order to improve such situation and to control outflow of premium income, FRC and MIA now examine the possibility to launch national reinsurance scheme, i.e., to establish a local reinsurance specialized company. Funding and organizational management of such local reinsurance company needs to be considered carefully and sufficiently.

7.2.4.4 Industry consolidation and establishment of insurance policyholder protection fund

Minimum capital for insurance company will be raised from the current MNT 2 billion to MNT 5 billion by the end of 2016, with an annual increase of MNT 750 million. FRC intends to strengthen financial base of insurance companies and consolidate the industry. One top management of a local insurer commented his forecast that the number of non-life insurers will reduce to 5-6 form the current 16 in the medium term. In a consolidation process, there would be companies which go out of business. Insurance policyholder protection fund should be examined for such a situation.

Currently, there is no foreign insurance company licensed in Mongolia. Entry of foreign insurance companies, which have advanced knowhow on underwriting, risk analysis, product development and fund management, and strong financial base, could contribute to consolidation and development of the Mongolian insurance sector in the medium to long term.

7.2.4.5 Enhancement of fund management knowhow

Insurance industry is expected to become a domestic institutional investor and to lead development of the capital market in Mongolia. Major insurance companies aims to increase income from their investment in the medium to long term. However, most insurance companies do not have experience in investment other than bank deposit, due to the former regulation on investment activities by insurance companies, and they need to enhance fund management knowhow in the future.

7.2.4.6 Launch of trade insurance business

The government of Mongolia has initiated a policy to promote export-oriented and import-substituting businesses to improve its trade balance. In relation to this government initiative, Development Bank of Mongolia (DBM) is now considering possible launch of trade insurance (export credit insurance) business. According to DBM, it will establish a subsidiary or a new department in the bank which specializes in trade insurance business by the end of 2014 at the earliest, and it has conducted preparatory work including research on products, operation and legal matters of trade insurance business, and check of necessary amendments to the current DBM law. Also, DBM will consider possibility to provide insurance for a foreign company having project in Mongolia in cooperation with foreign export credit agencies in the future. However, trade insurance will be the un-experienced business field for DBM, and considering that there are public entities specializing trade insurance business and different from the government development banks in Japan and in Korea, it will be very important for DBM to strengthen its knowhow in this field for its smooth operation.

7.3 Assistance from other donors for the insurance industry in Mongolia

Assistance from other donors for the insurance industry in Mongolia has been quite limited compared with other sectors in the financial industry, and has mainly focused on development of micro insurance, according to discussions with FRC, Ministry of Finance, the industry associations and insurance companies.
The following is current assistance from other donors based on our discussions with them.

7.3.1 World Bank

World Bank and the Mongolian government initiated the Index-based Livestock Insurance Project (IBLIP) [30] in 2005 to help herders to build their resilience against climate-related risks such as extreme weather events like dzuds. Following the pilot project success in specified provinces from 2006 to 2009, the project has now expanded to all provinces and is operated by the government, World Bank and five local insurers (Mongol, Practical, Tenger, Bodi, Monre), etc.

In addition, World Bank is working on a research project on feasibility of national reinsurance scheme for Ministry of Finance.

7.3.2 UN Development Program (UNDP)

UNDP has been working on capacity development for micro insurance market in Mongolia since 2009, and the project will end in May 2014. Purpose of the project is 1) micro insurance education, 2) development of micro insurance product, and 3) capacity building of stakeholders in the insurance industry. As a part of the project, UNDP plans to hold 2-day seminar in Ulaanbaatar in April 2014, and the seminar will cover a broad range of topics including micro insurance, regulatory environment, risk management, compulsory insurance, potential of life insurance business, and "inclusive insurance" (better market penetration of insurance mainly for low-income people).

7.3.3 KOICA

Based on request by FRC to KOICA, it assists FRC by sending one actuary, who had worked for a Korean life insurer for long time, to FRC Insurance Department. He will be mainly involved in capacity building of actuaries in FRC in his dispatch term of one year.

In addition, KOICA sent one IT expert with a background of Korea Insurance Development Institute to the Association of Mandatory Insurers for six months in 2013, in the IT project that all the related government agencies and insurance companies in the compulsory automobile liability insurance will be connected with an IT network.

7.3.4 GIZ

GIZ will have the "inclusive insurance" project for 2 years staring from December 2013, but details of the program have not been determined yet according to FRC.

7.4 Possible assistance measures by the Japanese government in the future based on experience and knowhow in Japan

In this section, based on our observation of major issues that the Mongolian insurance industry is now facing, we consider possible assistance measures by the Japanese government in the future based on experience and knowhow in Japan. Table 7-9 at the end of this chapter summarizes assistance needs including comments or

[30] Under general insurance contract, when an insurance event occurs, loss adjuster visits the place of the event to assess loss amount in general. However, in case of herders who live far from Ulaanbaatar and are scattered all over the country, conducting loss assessment for each insurance event is costly and time consuming. This is the reason why index-based insurance, in which claim payments are based on estimates of livestock mortality rates, has been introduced.

suggestions being made during our interviews.

7.4.1 Capacity building of FRC

Necessity of capacity building of FRC is the common theme emphasized by not only FRC itself but also other stakeholders such as insurance companies, industry associations and donors, and this should be regarded as one of the most important issue for future development of the insurance industry in Mongolia. Japanese assistance could be considered in such area as capacity building of FRC's supervision and inspection of insurance companies. For example, preparation of insurance inspection manual and introduction of risk based supervision could be supported through knowhow and technical assistance by FSA.

7.4.2 Amendment of the compulsory automobile liability insurance system

In introducing the compulsory automobile liability insurance system in Mongolia, the General Insurance Association of Japan (GIAJ) provided knowhow through holding seminar in Ulaanbaatar. It has been more than 2 years since the system started, and it can be said that some issues have come up in the system. In Japan, the compulsory automobile liability insurance system started in 1955 with establishment of the Automobile Liability Security Law, and there have been some amendments of the system up to now. Possible assistance could be considered by utilizing knowhow and experience of GIAJ and General Insurance Rating Organization of Japan (GIROJ), which has been playing important role in calculating standard premium rates.

When providing some assistance in the compulsory automobile liability insurance system, further assistance by KOICA needs to be checked since it already sent one Korean expert for its IT network project in 2013.

7.4.3 Penetration of insurance products and insurance education

People's understanding and recognition on insurance cannot be possibly achieved overnight, and continuous efforts in the medium to long term should be made in this field. In Japan, insurance education has been provided by private insurance companies as well as the industry associations such as Japan Institute of Life Insurance in life insurance and GIAJ in non-life insurance field. Hence, possible assistance could be considered by utilizing knowhow of these organizations. As for life insurance, of which market penetration is still very low in Mongolia, training seminars in Japan held by the Foundation for the Advancement of Life & Insurance Around the World (FALIA) and Oriental Life Insurance Cultural Development Center (OLIS) will be helpful for staffs of FRC and insurance companies.

Also, policy incentives in Japan such as tax preferential measures (e.g., deduction of insurance premium payment from income tax) would be informative in Mongolia to improve market penetration of insurance.

Future assistance programs by GIZ need to be checked, assuming that its inclusive insurance project will cover issues related to penetration of insurance products.

7.4.4 Capacity development of insurance industry

7.4.4.1 Establishment of general insurance rating organization / function

In Japan, General Insurance Rating Organization of Japan (GIROJ) has been playing very important role in data bank function and calculating the standard premium rates for various non-life insurance products on behalf of the whole insurance industry. We believe such organization / function is also indispensable for the future sound growth of insurance industry in Mongolia, and possible assistance could be considered by utilizing knowhow of GIROJ. It should be added that GIROJ and GIAJ have been working on establishing insurance rating organization in Indonesia since 2013 and similar cooperation could possibly be conducted in Mongolia.

7.4.4.2 Human resource development of actuaries

Actuary is a very key player for sustainable development of the insurance industry, and continuous efforts in the medium to long term should be made to build actuarial resources with high expertise. Currently KOICA is sending one actuarial expert to FRC, and its future assistance program needs to be checked, when Japan provides some support. Also, seminar in Japan held by the Institute of Actuaries of Japan (IAJ) will be helpful for Mongolian actuaries with a certain level.

7.4.4.3 Industry consolidation and establishment of insurance policyholder protection fund

The Japanese insurance industry has experienced industry consolidation through bankruptcies of life insurance companies and mergers of large non-life insurance companies. Also in Japan, the law on insurance policyholders protection fund was legislated in 1996, and insurance policyholders protection corporations were established in 1998 for life and non-life insurance respectively. In Mongolia, establishment of insurance policyholder protection fund is being examined to prepare for future industry consolidation, and Japanese assistance could be considered by utilizing knowhow of FSA, the insurance policyholders protection corporations and the industry associations on legal framework and operation of such fund.

7.4.4.4 Enhancement of fund management knowhow

The Japanese major life insurance companies are known as big institutional investors with large managed funds in the global financial market, and both life and non-life insurers in Japan have profound knowhow on fund management as institutional investors. Knowhow and technical assistance by the Japanese life and non-life insurers could be considered to enhance fund management capability of Mongolian insurers.

7.4.4.5 Launch of trade insurance business

In Japan, Nippon Export and Investment Insurance (NEXI) has been supporting Japanese companies' export and overseas investment activities as the public agency. Ministry of Economy, Trade and Industry of Japan conducts "training seminar on trade insurance" for smooth establishment of trade insurance system and capacity building of human resources in Asian countries, and NEXI works together for this seminar. Participation in this seminar will be helpful for DBM to start its trade insurance business smoothly.

7.4.5 Organizations working on international cooperation in the Japanese insurance industry

In Japan, there are several organizations including the industry associations, which have been working on international cooperation for the development of insurance industry in emerging countries in Asia including Mongolia. Table 7-8 is the overview of these organizations and their programs. Overall, these organizations gave us positive comments on future possible assistance to the insurance industry in Mongolia.

Table 7-8 Overview of organizations working on international cooperation in the Japanese insurance industry

	The General Insurance Association of Japan (GIAJ)	The Life Insurance Association of Japan	The Institute of Actuaries of Japan (IAJ)	The Foundation for the Advancement of Life & Insurance Around the world (FALIA)	Oriental Life Insurance Cultural Development Center (OLIS)
Establishment	1917	1908	1899	1970	1967
Objective / Function	(1) Enhancement of Communication with Consumers (2) Improvement of the Quality of Business Processes and Customer Inter-relations (3) Development of the Business Infrastructure, and Requests and Proposals (4) Contribution to Safety and Security in Society and the Community **(5) Contribution to the Global Community**	(1) Research and study of theories and practices relating to life insurance (2) Public relations relating to life insurance (3) Statement on life insurance (4) Other functions considered necessary to attain the purpose of the Association	(1) study and research of actuarial science (2) education of actuaries (3) administration of the qualifying actuarial examination system **(4) facilitation of professional and cultural exchanges with overseas actuarial organizations**	**(1) invitational seminars in Japan** **(2) overseas seminars** **(3) dispatching of information regarding Japanese insurance business**	Mission: to contribute widely to the sound development of life insurance business through mutual understanding cultivated by deepening knowledge about life insurance and bringing up capable personnel. Activities: **(1) Education and training at home and abroad** **(2) Promotion of international mutual understanding** (3) Scholarship and promotion of education (4) Other activities to achieve the goals of this foundation
Member companies	27	43	4,801 people	established by The Dai-ichi Mutual Life Insurance Company	established by The Kyoei Life Insurance Company (currently under the Prudential group)
International cooperation	- exchanges and cooperation with overseas insurance markets (MOUs with the insurance associations of 11 countries)	- information exchange with the overseas insurance associations	As a full member of IAA (International Actuarial Association), IAJ has contributed to the IAA by active participation in a number of its committees. In August 1999, held the first in Asia IAA Conference in Tokyo.	mentioned above	mentioned above
	- international seminars with participants from the East Asian region such as the Insurance School (Non-Life) of Japan (ISJ	- accepting mission from overseas			
seminar in Japan	2 / year - General course - Advanced course		1 / year (one week) - ASEA:Actuarial Seminar of East Asia	3 / year (one week) - Product development strategy - Individual life insurance marketing - Information technology - Asset Management - Policy administration	2 / year - sales channel (Spring 2014) - risk management (Fall 2014)
seminar overseas	1 or 2 (one or two days) / year			1 or 2 (one or two days) / year	2 or 3 (one or two days) / year
Relation with the Mongolian insurance industry	**- Seminar on liability insurance, risk management, etc. in UB in Sep 2010** **- MOU with Mongolian Insurers Association in Dec 2010** **- cooperation on introduction of compulsory auto liability insurance** **- participation in General course in Japan**	No particular	No particular	**- Seminar on product development strategy of life insurance in UB in Sep 2012** **- participation in seminar in Japan**	**- participation in seminar in Japan**
Website	http://www.sonpo.or.jp/en/	http://www.seiho.or.jp/english/	http://www.actuaries.jp/english/index.html	http://www.falia.or.jp/	http://www.olis.or.jp/e/index.html

Sources: websites and brochures of these organizations

Table 7-9 Assistance needs in the insurance industry

Category		Task item	Improvement measures & possible support	Timeframe	Direct Beneficiaries	Support from other donors
Regulations & supervision						
	Related framework & procedures	Supervision & inspection of insurance companies	Preparation of insurance inspection manual	Short term	FRC	
		Development of risk based supervision, shift to Solvency II	Manual preparation & implementation support	Mid term	FRC	
		Human resource development, and improvement of business processes in FRC	Overall capacity building and database building	Short-mid term	FRC	KOICA: building actuarial resources in FRC
	Laws & regulations	Amendments of the current laws and regulations related to the insurance industry	Reducing overlap, appropriate actions to requests on revision of regulations by insurance companies (e.g., modification of insurance reserve calculation)	Short term	FRC, insurance companies	
	Others	Amendment of the compulsory automobile liability insurance system	Sharing Japanese experiences & preparing action plans for amendment	Short-mid term	FRC, insurance companies	KOICA: support for building IT network among stakeholders
		Examination of introducing tax preferential measures for insurance premium payment	Sharing Japanese experiences	Short-mid term	FRC, insurance companies, policyholders	
		Standardization of insurance contract	Preparation of draft of insurance contract by insurance product	Short term	insurance companies, policyholders	
Insurance market infrastructure						
	Insurance rating function	Establishment of general insurance rating function / organization	Sharing Japanese experiences & consultation	Short-mid term	FRC, insurance companies	
	National reinsurance scheme	Establishment of national reinsurance scheme	Feasibility study	Short-mid term	FRC, MOF, insurance companies	World Bank: research on possible business activity, organizational structure, operational management, etc.
	Others	Insurance policyholders protection fund	Sharing Japanese experiences & TA for setting up fund / organization	Mid term	FRC, MOF, insurance companies	
		Launch of trade insurance business	Sharing Japanese experiences & seminars	Short-mid term	DBM	
Insurance industry						
	Mongolian Insurers Association (MIA)	Training of staffs of insurance companies, establishment of training institute	Sharing Japanese experiences	Short-mid term	MIA, insurance companies	
		Insurance education for people	Sharing Japanese experiences, TA for designing education programs	Short-mid term	MIA, policyholders	GIZ: inclusive insurance project from 2014 to 2015
		Facilitating market statistics	Training & TA for collecting, compiling & analyzing market data	Mid term	MIA, AMI	
		Effective operation and management of the association	Sharing Japanese experiences	Long term	MIA	
		Ethical & moral code	Manual preparation	Mid term	MIA	
	Insurance companies	Framework for consolidation	Preparing mid-long term picture of insurance industry	Mid-long term	FRC, insurance companies	
		Improvement of basic operation (underwriting, claim payment, etc.)	Training	Short-mid term	insurance companies, policyholders	
		Building actuarial resources	Overall capaicty building of actuaries	Short-mid term	insurance companies, Society of Actuaries	
		Enhancement of fund management knowhow	Sharing Japanese experiences & seminars	Mid term	insurance companies	
		Developing insurance products	Sharing Japanese experiences	Mid term	insurance companies	
		Developing micro insurance market	More penetration of micro insurance product	Short-mid term	insurance companies, policyholders	World Bank: Index-based Livestock Insurance Project from 2005 UNDP: capacity development of micro insurance market from 2009 to May 2014 GIZ: inclusive insurance project from 2014 to 2015
		Building risk management system & skill	Sharing Japanese experiences & seminars	Short-mid term	insurance companies	
		Improving function of compliance	Sharing Japanese experiences	Mid term	insurance companies	
	Insurance brokers	Capacity building	Sharing Japanese experiences & seminars	Long term	Insurance brokers	
	Insurance agents	Capacity building	Sharing Japanese experiences & seminars	Long term	Insurance agents	
	Loss adjusters	Capacity building	Sharing Japanese experiences & seminars	Long term	Loss adjusters	