Study of Developing Corporate Bond Markets in Mongolia

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Abstract

Mongolia's dependence on mineral exports left the country vulnerable to the 2012 commodity price decline, triggering a balance of payments crisis and fiscal distress. While initial macroeconomic easing provided temporary relief, it exacerbated public debt, weakened external balances, and eroded bank asset quality. By 2016, facing a full-blown crisis, Mongolia turned to the IMF for support. This research investigates the potential of corporate bond markets as a catalyst for the financial sector and economic recovery in Mongolia. Building on the ongoing IMF-supported Extended Fund Facility program, the study analyzes the current status, challenges, and future development path for corporate bond markets in Mongolia. It also examines the feasibility of establishing a viable corporate bond market, exploring key obstacles and required support mechanisms, including identifying factors hindering corporate bond issuance, assessing regulatory and technical assistance needs, addressing legal and institutional roadblocks, and proposing solutions for overcoming shortfalls in market infrastructure and investor confidence. The research draws on comprehensive financial sector, macroeconomic, and policy assessments. Findings target critical stakeholders, including the Financial Regulatory Commission and Mongolian Stock Exchange, to inform policies and strategies for unlocking Mongolia's potential through a vibrant and inclusive corporate bond market.

Keywords:

corporate bond, capital markets, financial markets, Mongolia

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STUDY OF DEVELOPING CORPORATE BOND MARKETS IN MONGOLIA

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Mongolia's dependence on mineral exports left the country vulnerable to the 2012 commodity price decline, triggering a balance of payments crisis and fiscal distress. While initial macroeconomic easing provided temporary relief, it exacerbated public debt, weakened external balances, and eroded bank asset quality. By 2016, facing a full-blown crisis, Mongolia turned to the IMF for support. This research investigates the potential of corporate bond markets as a catalyst for the financial sector and economic recovery in Mongolia. Building on the ongoing IMF-supported Extended Fund Facility program, the study analyzes the current status, challenges, and future development path for corporate bond markets in Mongolia. It also examines the feasibility of establishing a viable corporate bond market, exploring key obstacles and required support mechanisms, including identifying factors hindering corporate bond issuance, assessing regulatory and technical assistance needs, addressing legal and institutional roadblocks, and proposing solutions for overcoming shortfalls in market infrastructure and investor confidence. The research draws on comprehensive financial sector, macroeconomic, and policy assessments. Findings target critical stakeholders, including the Financial Regulatory Commission and Mongolian Stock Exchange, to inform policies and strategies for unlocking Mongolia's potential through a vibrant and inclusive corporate bond market.

Key words: corporate bond, capital markets, financial markets, Mongolia

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List of Abbreviations

ABS	Asset-backed securities
ADB	Asian Development Bank
AHLFP	Affordable Housing Loan Finance Procedure
AQR	Asset Quality Review
BoM	Bank of Mongolia
CAR	Capital adequacy ratio
CBB	Central bank bills
CGF	Credit Guarantee Fund
CIT	Corporate income tax
DBM	Development Bank of Mongolia
DIC	Deposit Insurance Corporation
D-SIBS	Domestically systemically important banks

EFF	Extended Fund Facility
EMTN	Euro Medium Term Note
FPO	Follow-on public offer
FRC	Financial Regulatory Commission
FX	Foreign exchange
GATE	Guarantee and Acquisition toward Tokyo market Enhancement
GDP	Gross domestic product
GoM	Government of Mongolia
HSBC	Hong Kong and Shanghai Banking Corporation
ICOR	Incremental capital-output ratio
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPO	Initial public offering
JBIC	Japan Bank for International Cooperation
JICA	Japanese International Cooperation Agency
JSC	Joint stock company
LLC	Limited liability company
MASD	Mongolian Association of Securities Dearlers
MCSD	Mongolian Central Securities Depository
MIK	Mongolian Mortage Corporation
MMC	Mongolian Mining Corporation
MNT	Mongolian currency togrog
MoF	Ministry of Finance
MPC	Monetary Policy Committee
MSCC	Mongolian Securities Clearing House
MSE	Mongolian Stock Exchange
MSX	Mongolian Securities Exchange
NBFI	Non-bank financial institutions
NPL	Non-performing loan
NSO	National Statistics Office
PoM	Parliament of Mongolia
RMBS	Residential mortgage backed securities
ROA	Return on asset
ROE	Return on equity
RR	Reserve requirement
SCC	Savings and credit cooperativevs
SME	Small medium enterprise
SML	Securities Market Law
SPC	Special purpose company
TDB	Trade and Development Bank of Mongolia
USD	U.S. dollar
VaR	Value at risk
VAT	Value-added tax

1. Introduction

As mineral commodities account for up to 90 percent of total exports, the sharp decline in commodity prices from 2011 and on adversely impacted Mongolia's balance of payments and fiscal position. Easing of macroeconomic policies cushioned the economy from external shocks for a while; however, it came t the cost of increasing public debt, weakening the balance of payments and reducing banks' asset quality. By the end of 2016, Mongolia was facing an economic crisis as a large fiscal deficit and domestic currency depreciation pushing government debt to nearly 90 percent of GDP.

The Mongolian authorities approached the International Monetary Fund (IMF) for assistance as the economic crisis escalated. On 24 May 2017, the Executive Board of the IMF approved a three-year extended arrangement under the Extended Fund Facility (EFF) program for Mongolia. The program aims to "stabilize the economy, restore confidence, and pave the way for economic recovery" (International Monetary Fund, 2017). Under the program, the following actions will be taken: discipline fiscal policy, improve the central bank's independence, governance, and focus on core responsibilities, strengthen the financial sector, foster economic diversification and inclusive growth, and protect the most vulnerable in society.

Within the financial sector reforms, a comprehensive diagnosis of the banking system will be made to assess the financial soundness and resilience. Then, based on the assessment, recapitalization and restructuring will be made. Alongside the restructuring, the regulatory and supervisory framework will be strengthened.

In that context, this study focuses on the role that corporate bond markets could play in Mongolia's financial sector. Based on a comprehensive assessment of the financial sectors, macroeconomic conditions and direction of short-, medium-, and long-term financial policies, the research team collected and analyzed the current status, challenges and recommendations for improving the pathway to developing corporate bond markets in Mongolia.

In conducting this study, the research team has focused on the following aspects of developing a corporate bond market:

- Why are corporate bonds missing as a financial instrument for funds raising in Mongolia?
- Whether a corporate bond market is feasible in Mongolia
- If there is feasibility, what types of support is required to develop the market further in terms of regulatory, technical assistances and more
- What are the shortfalls or obstacles in the development of the corporate bond and how these challenges could be addressed or resolved?

To address these, the research team worked in coordination with an expert, who was vetted and chosen by the Japanese International Cooperation Agency (JICA) based on their skillsets and knowledge. With that purpose, this study is mainly addressed to the relevant entities such as Financial Regulatory Commission (FRC), Mongolian Stock Exchange (MSE), etc.

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

2.1. General situation of the macroeconomy

Since the implementation of the IMF's EFF program, the Mongolian economy has continued its recovery in 2018 due to relatively high commodity prices and foreign direct investment in mining. The resolution of the disruption of coal export transportation contributed to the increased production of coal and crude oil.

Gross domestic product (GDP) increased by 8.1 percent in the last quarter of 2018 and 6.9 percent during the year. From the demand side, the increase in gross capital formation and household consumption have boosted economic growth while net exports had a negative impact. From the supply side, increased production in mining, services, manufacturing and agricultural sectors greatly contributed to economic growth. Investments increased by 12.1 percent year over year with a majority of it being contributed by foreign direct investments into the mining sector and recovery in business loans issued by commercial banks from the second quarter of 2018. Most of the business loans were issued to the mining, construction and trade sectors.

Inflation increased to 8.6 percent in the last quarter of 2018, exceeding the target level set by the Monetary Policy Committee (MPC). The surge is attributable to the change in prices of meat and solid fuel. The price of meat increased contrary to its seasonal cycle as there was an increase in demand for exports and cost of transportation. As for the price of solid fuel, it reached a historical peak of 64.6 percent following the regulation to combat air pollution by restricting the burning of unprocessed coal.

Economic growth and tighter fiscal policies have led to an overall budget surplus in 2018. Government expenditures declined by 5.5 percent in 2018.

2.2. Bond market

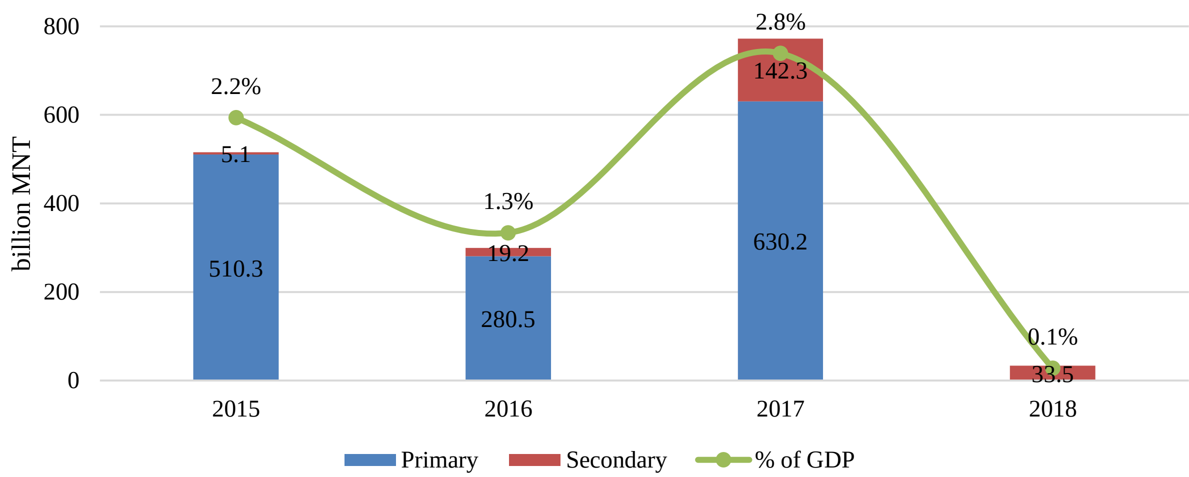
In Mongolia, government bonds account for a majority of the total bond market. The corporate bond market is comparatively small with most Mongolian companies preferring to seek financing from either banks or abroad. Of the corporate bonds issued, most have a maturity of one year or less and the longest term is two years.

2.2.1. Government bonds

Government bonds in Mongolia have one of the following three types of maturity: short-term (less than one year), medium-term (12-60 months), and long-term (over 5 years). These bonds may be purchased through private placement or public auction. Information regarding upcoming auctions are available on the BoM, MoF, and MSE sites. These competitive auctions are conducted through the MSE where only licensed securities brokers are allowed to participate. This implies that other investors such as commercial banks, foreign investors and individual investors must place orders through brokers. Generally, the main investors of government securities have been commercial banks. Only recently has foreign and individual investors have begun to participate in these government bond auctions, attracted by high interest rates.

Relative to interest rates on Central Bank Bills and bank deposits, the yield of government bonds tends to be lower due to its creditworthiness and tax exemption. Corporate income tax exemptions are applicable to interests on bonds issued by the Government of Mongolia, provincial government or the Development Bank of Mongolia.

Figure 1. Value of government bonds issued on MSE, billion MNT



Source: MSE, NSO

In 2018, a total of 332.5 thousand shares of government bonds worth 33.5 billion MNT was traded on the secondary market at the MSE. Under the IMF program, government securities were not issued in 2018 in order to decrease the burden of public debt.

2.2.2. Corporate bond

The MSE only started trading corporate bonds in 2001 and as such, it remains undeveloped and relatively small. A large majority of Mongolia's corporate bond market is dominated by private placements. As it can be observed in the table below, most public offerings of corporate bonds are in the construction industry.

Table 1. List of public corporate bonds since 2001

№	Bond issuer	Bond name	Maturity /month/	Interest	Total value /MNT	Date of listing	Industry
1	Barilga Corporation JSC	"Shine Zuun - 210"	10	19,6%	5,335,680,000	2001	Construction
2	Niislel Urguu JSC	Niislel Urguu	12	19,7%	1,200,000,000	2002	Construction

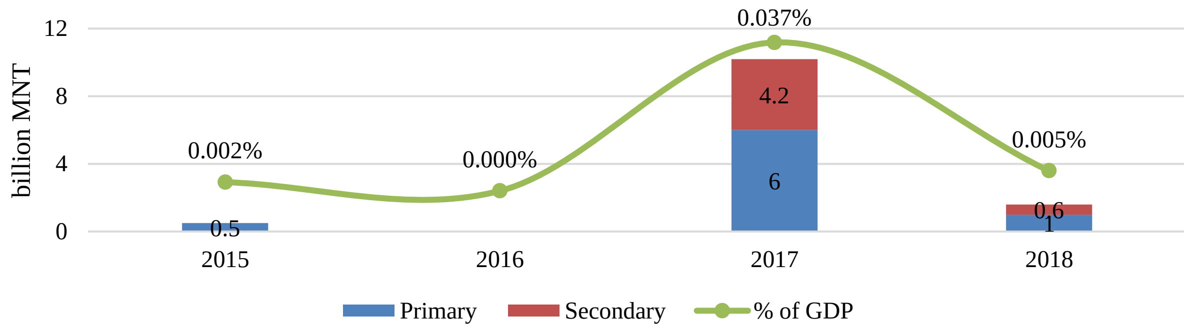
3	Puma Group	Puma Bond	12	21,6%	1,000,000,000	2004	Construction
4	MSC Electronics	"MCS Electronics Bond /MNT/	18	19,0%	872,640,000	2004	Electronics
5	MSC Electronics	MCS Electronics Bond /USD/	12	11,0%	605,000,000	2004	Electronics
6	Anod Bank	Anod Bond	24	19,6%	209,490,000	2004	Bank
7	Altan Khot Corporation	Ikh Barilga	8	19,8%	996,920,000	2002	Construction
8	Gobi JSC	"Gobi"	12	19,2%	1,000,000,000	2005	Cashmere
9	Ikh Barilga	Ikh Barilga	8	19,8%	1,300,000,000	2003	Construction
10	Moninjbar	Buteen Baiguulalt	18	21,6%	500,000,000	2005	Construction
11	Monfresh Juice	Monfresh bond /USD/	12	11,0%	182,811,800	2007	Food & Beverage
12	Moninjbar	Buteen Baiguulalt	24	11,2%	502,000,000	2008	Construction
13	Just Agro	Mongol meat	12	16,2%	4,394,540,000	2011	Meat
14	Erchim Engineering	Erchim Bond	12	18,5%	457,750,000	2015	Energy
15	Suu JSC	Suu Bond	12	17,5%	6,000,000,000	2017	Food (Dairy)
16	Minj property (at MSX)	Park town	13	17%	1,000,000,000	2018	Construction

Source: MSE, MSX

One of the most recent public issuances was by Suu JSC. The “Suu bond” was issued on 29 June 2017 to raise 6 billion MNT with a nominal price of 100,000 MNT, term to maturity of one year and an annual coupon rate of 17.5 percent.

The latest issuance of corporate bond was the Park town bond by a construction company on the Mongolian Securities Exchange. The MSX was only recently established and has already had its first corporate bond issuance in 2018.

Figure 2. Value of corporate bonds issued, billion MNT



Source: MSE, MSX

In 2018, a total of 6.3 thousand shares of corporate bond valued at 631.6 million MNT was traded on the secondary market. These 6.3 thousand shares were remnants of the "Suu bond" which completed repayment in June 2018.

2.2.3. Private placement corporate bonds

As private placement corporate bonds are not regulated except in a broad scope by the Securities Market Law and FRC regulations regarding debt securities, there is no consolidated database or record of private placement issuances. FRC regulations dictate that private placement bonds cannot be advertised, otherwise, it will have to be registered as a public bond and go through the required procedure which is listed below. The Securities Market Law indicates that private placement bonds must have less than 50 investors (Article 4.1.21). Thus, the total value of private placement issuance in Mongolia is an estimate based on willingly publicized information by security companies who participated in the private issuances. The estimated value of private placement issuance in Mongolia during 2018 is around 20 billion MNT. In 2018, there were 8 IPO issuances, an all-time record number of IPOs, and the total value of these issuances were around 51 billion MNT. Thus, considering the volume of IPOs in 2018, the private bond market is a relatively large, unregistered market.

Private placement has been becoming more popular in recent years as a way to raise funds in the short term. Most of the issuers of these bonds tend to be start-ups or business without enough transaction history with banks or just need the funds as soon as possible. Private placement is easier for these companies than applying for a bank loan as the bank loan approval process can take a few months. Or, the companies may not have the required level of collateral. In some cases, companies have placed equity shares as collateral. The annual coupon rates of these private placements have ranged from 16-20%.

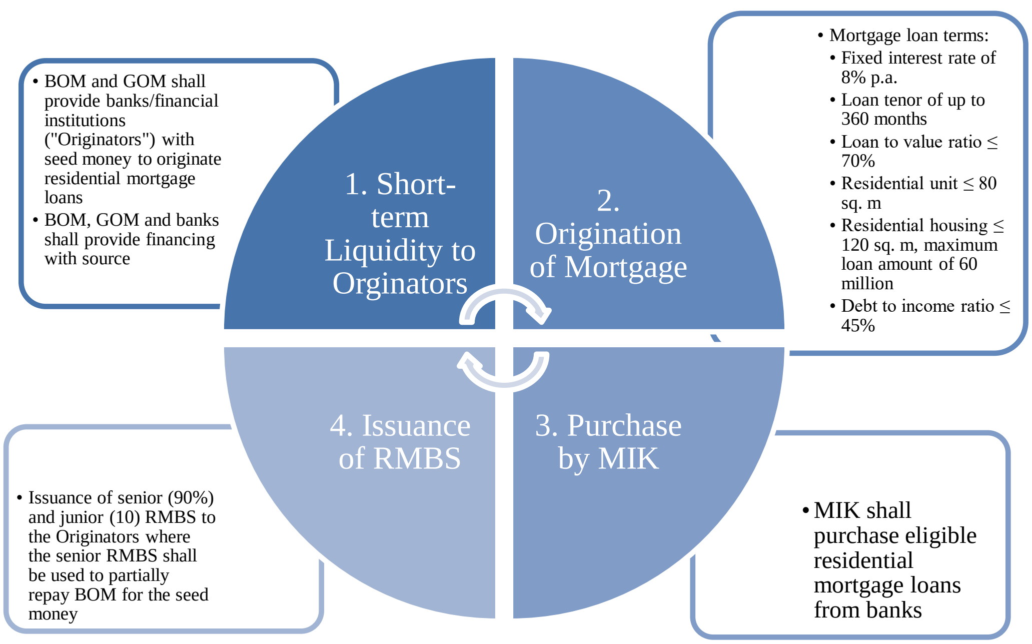
In the Mongolian bond market, there have been financial arrangements which have been mistook or misconstrued as private placement bonds and should be noted. Companies looking to raise funds are able to advertise through an intermediary company on social media such as Facebook. This intermediary company lists the expected returns and the third-party guarantor if there is any. In the case there is no company providing a guarantee, an affiliate company of the intermediary provides it. In this arrangement, an individual loan agreement is made with each investor until the required amount of funds is raised and, in the case, that there is a third-party guarantor, a tri-party loan agreement is made for each individual investor. There is no limit on how many loan agreements can be signed with a company. Economically, these transactions are very similar to bonds; however, it is legally termed as a "loan agreement." As such, the only governing rule of law is the Mongolian Civil Code. If these financial transactions contained the term "bond," the procedure falls within the scope of FRC's regulation and supervision. Article 281 of the Civil Code provides the scope of a loan contract and Article 458 outlines a warranty contract which is for the third-party guarantor. In essence, this financial arrangement is a tri-party loan agreement. ass

2.2.4. Asset-backed securities

The issuance of asset back securities became legal when the Asset Backed Securities Law of Mongolia became effective from 1 January 2011. On 14 March 2012, the Mongolian Mortgage Corporation HFC LLC (MIK HFC) was granted a special license to issue asset backed securities by the FRC.

In 2013, the Government of Mongolia (GoM) and the BoM initiated a price stabilizing program which included a subsidy scheme for mortgage financing to create a stable environment for mortgage financing. Under the program, commercial banks are granted soft loans to fund the issuance of subsidized interest rate mortgage loans or refinance their existing loans with the subsidized interest rate mortgage financing. Based on this, MIK HFC, BoM and 14 commercial banks signed an agreement to participate in this program on 14 June 2013.

Figure 3. Mortgage loan financing system



Source: MIK HFC

On 30 October 2013, the first special purpose company (SPC) was established, MIK Asset One LLC, a wholly owned subsidiary. This SPC purchased the subsidized interest rate mortgage loans bearing an interest rate of 8 percent from the commercial banks and in return, issued residential mortgage backed securities (RMBS), which are collateralized by the cash flows and collaterals of mortgage pools. Under the fiduciary management license, BoM holds 90 percent (senior tranche) of the RMBS issued by the SPCs and the remaining 10 percent (junior tranche) is owned by commercial banks[1]. As of 21 December 2018, 19 SPCs have been established, of which 18 have purchased mortgage pools and issued RMBS.

The terms and conditions of the RMBS are:

Issuer	"MIK Asset SPC" LLC
Originators	Banks
Subscribers	• Senior and junior RMBS issued to the originators as purchase consideration of mortgages • Originators shall transfer the senior RMBS to BOM and GOM as part repayment of the soft loan

Tranches	• Senior RMBS which is 90% of total RMBS:
	  ○ Senior RMBS I – 25%
	  ○ Senior RMBS II – 50%
	  ○ Senior RMBS III – 15%
	• Junior RMBS which is 10% of total RMBS

RMBS tenor	Up to 30 years

Indicative coupons	• Senior RMBS (quarterly)
	  ○ Senior tranche I – 1.0% annually
	  ○ Senior tranche II – 4.5% annually
	  ○ Senior tranche III – 13.0% annually
	• Junior RMBS (quarterly) 10.50%
	• Senior and junior RMBS should be paid quarterly

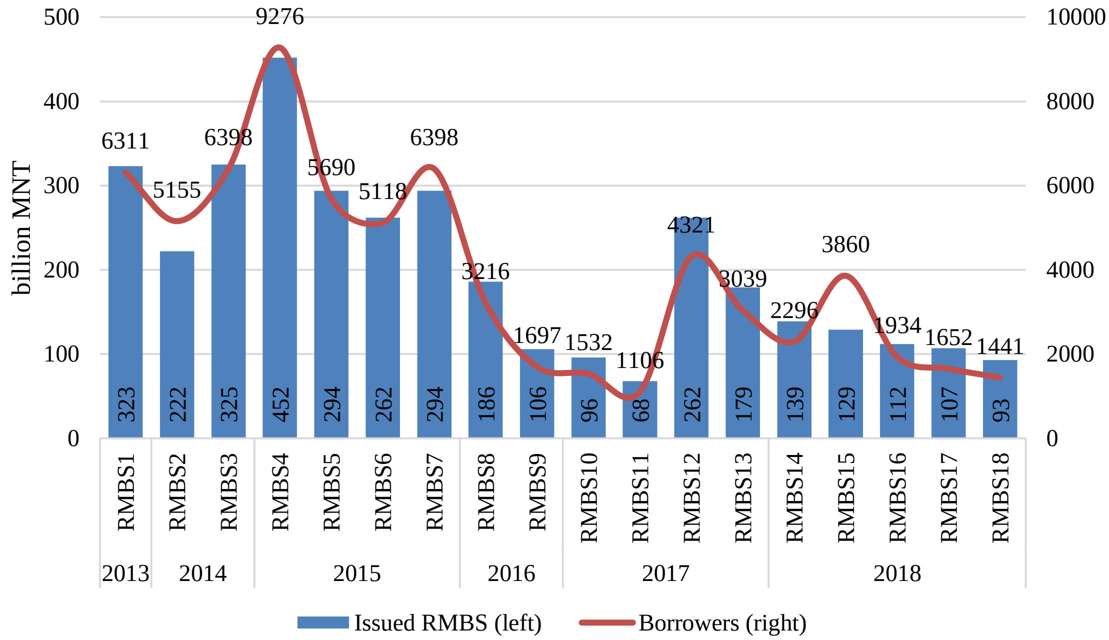
Principal payment	• Senior RMBS will be paid first • Junior ROMBS will be paid after senior RMBS are paid in full

Source: MIK HFC

As of 2018, a total of 3.6 trillion MNT RMBS has been issued through the 18 SPCs. And in 2018 alone, through the securitization of RMBS 14 to 18, a total of 580 billion MNT worth of RMBS was issued. As of the end of 2018, the outstanding RMBS is 2.9 trillion, around 9 percent of GDP. RMBS outstanding as a percentage of GDP have remained stable around 9 percent over the past three years.

[1] For more information, please refer to the MIK site or the Government Housing Program.

Figure 4. Total number of borrowers and amount per RMBS



Source: MIK HFC LLC

2.2.5. International market bond issuances

There have been a number of international issuances of government and corporate bonds. The Mongolian government has issued a total six bonds on the international market, of which four are still outstanding.

Table 2. Government bonds issued on international market

№	Bond Name	Amount	Currency	Coupon (%)	Issue date	Maturity (years)	Bond Rating (S&P/ Fitch)
1	Chinggis 500	500 mil	USD	4.125	12/5/2012	5	B/B
2	Chinggis 1000	1000 mil	USD	5.125	12/5/2012	10	B/B
3	Dim sum	1000 mil	CNY	7.5	6/30/2015	3	B-/B-
4	Mazaalai	500 mil	USD	10.875	4/6/2016	5	B/B
5	Khuraldai	600 mil	USD	8.75	3/9/2017	7	B-/B-
6	Gerege	800 mil	USD	5.625	10/26/2017	5.5	B-/B-

Source: Government Strategy of Debt Management 2019-2022

The very first issuance of a Mongolian bond on the international market was in 2007 by the Trade and Development Bank (TDB) of Mongolia. TDB issued a 75 million USD three-year bond with a coupon rate of 8.625%. This senior unsecured bond was under the Euro Medium Term Note (EMTN) program arranged by ING Bank. It opened the possibility for Mongolian banks and companies to enter into the international capital market. Since 2007, TDB has been the leading corporate bond issuer. Other notable corporate bond issuances on the international markets have been by the Development Bank of Mongolia (DBM), the

Mongolian Mortgage Corporation (MIK), the Mongolian Mining Corporation (MMC) and others. Currently, there are five outstanding corporate bonds on the international market.

Table 3. Corporate bonds outstanding on the international market

№	Company Name	Amount	Currency	Coupon (%)	Issue date	Maturity (years)
1	DBM (Samurai bond)	30 bil	JPY	1.52	12/25/2013	10
2	DBM	500 mil	USD	7.25	10/23/2018	5
3	TDB	500 mil	USD	9.375	5/19/2015	5
4	MMC	440 mil	USD	9.25	4/15/2019	5
5	MIK	300 mil	USD	9.75	1/19/2019	3

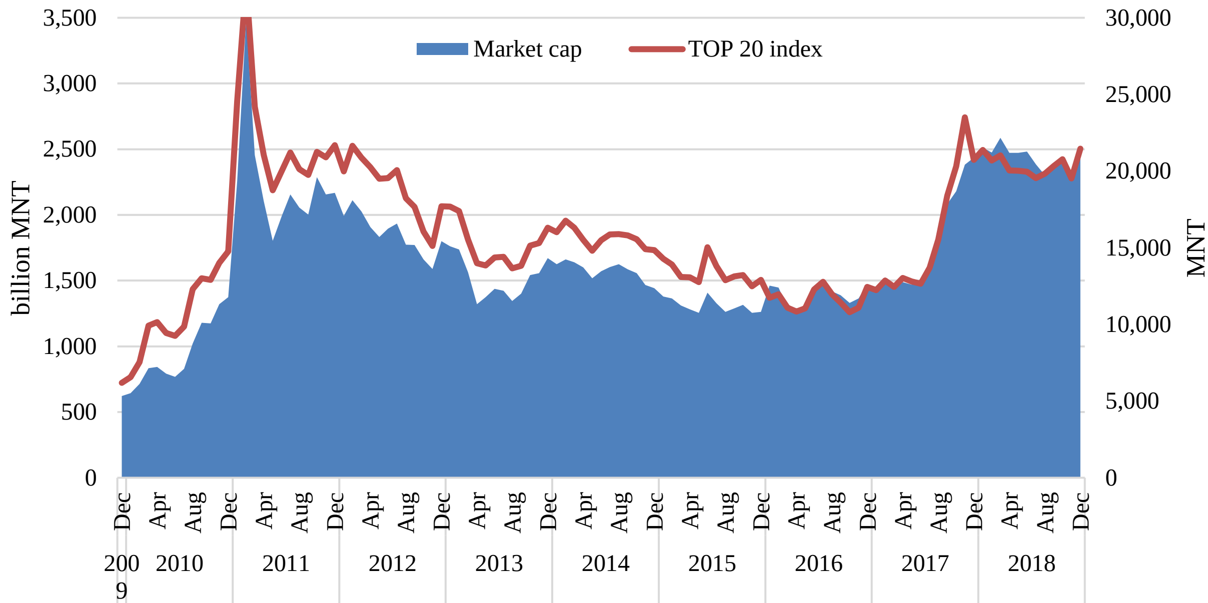
Source: Khan Bank Daily Report

The Samurai bond by the Development Bank of Mongolia is government guaranteed. Under the Guarantee and Acquisition toward Tokyo market Enhancement (GATE) facility, the Japan Bank for International Cooperation (JBIC) signed a set of agreement to provide guarantee for yen-denominated foreign bonds issued by the DBM in the Japanese bond market. JBIC provides guarantee for around 90 percent of this privately placed bond, which explains the low coupon rate. The other joint arrangers were Nomura Securities Co., Ltd. And Daiwa Securities Co., Ltd. With Mizuho Bank, Ltd. As the bond administrator. The GATE facility guarantee is based on the Mid-term Action Plan agreed upon by the two countries in 2013.

2.3. Equity market

The Mongolian Stock Exchange (MSE) was established in 1991 to assist in privatization of state-owned enterprises. The MSE has been rapidly growing this past decade. As of the end of December 2018, it has 217 listed companies with a combined market capitalization of 2.5 trillion MNT (948.7 million USD). This is an increase of 2.9 percent year-over-year. The MSE performed considerably better the previous year due to boosted economic growth and a record number of initial public offerings (IPOs).

Figure 5. MSE market capitalization (LHS) and average TOP 20 Index (RHS)



Source: MSE Monthly Report

On the other hand, the TOP 20 Index closed the year at 21,466.76, or an increase of 3.5 percent year-over-year.

Table 4. Value of equity trades in billion MNT

	2015	**2016**	**2017**	**2018**
Primary	27.3	6.3?	1.3	31.4
Secondary	3.1	42.7	75.1	178.6
Total	*30.4*	*49.0*	*76.4*	*210.0*

Source: MSE, FRC

Table 5. Information on listed securities

	2016	**2017**	**2018**
Total listed companies	227	218	217
Of which:			
State	34	31	29
Private	193	187	188
Number of securities listed	8,001,043,400	11,232,171,351	11,396,054,507
Of which:			
State	3,975,554,635	3,975,394,457	3,986,710,485
Private	4,025,488,765	7,256,776,894	7,409,344,022
New companies listed	1	2	6
Of which:			
State	-	-	-
Private	1	2	6

Total number of newly listed securities	4,324,263	153,904,814	1,091,660,016
Number of companies that issued additional securities	2	3	3
Number of shares listed due to additional issue	15,387,765	3,074,305,471	22,871,536
Companies with amendments in number of shares		1	3
Number of additionally listed shares due to stock split		5,153,544	803,246,689
Delisted companies	9	11	7
Number of shares delisted	128,799,600	2,235,878	1,753,895,085

Source: MSE

2.3.1. Listed securities

All listed companies and its securities on the MSE are categorized into three tiers. Each tier comes with criterions for the issuer as well as for the securities. Over the years, the number of listed companies have been declining. In 1995, there were 474 companies listed on the companies, whereas as of the second quarter of 2019, there are 199 companies.

2.3.1.1. Tier 1

Currently there are 14 companies classified under Tier 1.

Table 6. MSE Tier 1

№	Symbol	Company name	Industry
1	APU	APU	Food & Beverage
2	AIC	Ard Insurance	Financial Services
3	BNG	Bayangol Hotel	Hospitality & Tourism
4	BDS	B D Sec	Financial Services
5	GOV	Gobi	Light industry (Cashmere)
6	NEH	Darkhan Nekhii	Light industry (Fur & Leather)
7	LEND	LendMN	Financial Services
8	MNDL	Mandal Insurance	Financial Services
9	MMX	Makhimpex	Food & Beverage
10	MIK	Mongolian Mortgage Corporation	Financial Services
11	MNP**	Mongolian post	Transportation & Logistics
12	SUU	Suu	Food & Beverage
13	TTL**	Tavantolgoi	Mining
14	TCK	Talkh-Chikher	Food & Beverage

* 100 percent state owned; ** partially state-owned

Source: MSE

The main criterions set for the issuer to be listed are that the company have stable operations in its main industry for a minimum of 3 years prior to the date of listing application; most recent three years of financial reports prepared in accordance with IFRS and verified by an auditing firm along with an audit report; have no less than 5 billion MNT in sales revenue or 1 billion MNT in net profit from company's main operations; no changes to the two-thirds of the management team within the past two years and no material changes to the controlling shareholders within the most recent year; and be compliant with the corporate governance principles, both domestically and internationally. For mining companies, there is additional criteria of: must have a minimum of 10 years operations proved or probable reserves as evaluated by an independent specialized expert; must have sufficient working capital for running operations; no less than 30 percent of the asset structure be equity; no less than 5 billion MNT worth of net tangible assets.

As for the securities, the following criterions must be met: the market capitalization of the issuer shall be no less than 10 billion MNT; public free float shall be no less than 25 percent and this minimum may be waived for foreign listed issuers seeking secondary listing on the MSE and the issuer had more than 20 billion MNT market capitalization; number of shareholders shall be no less than 100; and there shall be no restrictions on the free movement and trading of the securities.

2.3.1.2. Tier 2

The requirements to be listed as a Tier 2 company is similar to Tier 1; however, the minimums are set slightly lower. For instance, number of operational years and years of financial reports are 2 rather than 3. The issuer should also have sufficient working capital to run its business operations for at least 12 months after the listing or must have a net profit of no less than 100 million MNT. The issuer shall comply with corporate governance principles and in the case, they are not in compliance, explain. Mining companies also follow a less strict criterion of having a minimum of 5 years operational proved or probable reserves, no less than 30 percent of asset be equity and no less than 1.5 billion MNT worth of net tangible assets.

Table 7. MSE Tier 2

№	**Symbol**	**Company name**	**№**	**Symbol**	**Company name**
1	ADL	Aduunchuluun	23	MSH	Mongol shiltgeen
2	ITLS	Itools	24	MCH**	Telecom Mongolia
3	ADB	Ard credit	25	MIB	Moninjbar
4	AARD	Ard financial group	26	MFC	Monos khuns
5	EER	Arig gal	27	NKT	Naco tulsh
6	ATR	Atar-Urguu	28	JLT	Nogoon hugjil undesnii negdel
7	BAN**	Baganuur	29	OLL	Olloo
8	BTG**	Bayanteeg	30	RMC	Remicon
9	BEU	Berkh Uul	31	TAH	Takhi Ko
10	GHC	Gan khiits	32	TEX	Technicimport
11	HRM	Hermes centre	33	TUM	Tumen shuvuut
12	GTL	Gutal	34	BUK	UB-BUK
13	DZG	Darkhan Hotel	35	UBH	Ulaanbaatar khivs
14	DHU	Darkhan Khuns	36	UID	Ulsyn ikh delguur
15	JTB	Genco tour bureau	37	MDR	Frontier Land Group
16	SUL	Juulchin duty free	38	HBO	HBOil
17	MIE	Materialimpex	39	HSR	Khasu Mandal
18	MRX	Merex JSC	40	ADU	Khuvsgul altan duulga
19	BDL**	Mogoin gol	41	HGN	Khukh gan
20	MBW	Mongol Basalt	42	SHG	Sharyn Gol
21	MNH	Mongol nekhmel	43	SHV**	Shivee Ovoo
22	UYN	Mongol savkhi	44	ETR	E Trans logistics

* 100 percent state owned; ** partially state-owned Source: MSE

For the securities to be listed on Tier 2, the market capitalization of the issuer shall be no less than 1 billion MNT and public free float shall be no less than 25 percent.

2.3.1.3. Tier 3

For Tier 3 companies, there are no requirements for period of exchange trade or business operations. As the companies in this tier are likely to be highly risky, these stocks are only offered to institutional and professional investors. However, non-professional investors are allowed to invest in the securities listed on Tier 3 if the investor notifies its broker, in writing, that he or she made the investment decision understanding that the securities are being offered to professional investors.

Table 8. MSE Tier 3

№	Symbol	Company name	№	Symbol	Company name
1	AAR	Autozam	71	HBJ*	Mongolyn hurungiin birj
2	AOI**	Autoimpex	72	MNS	Monnoos
3	ATI	Agrotechimpex	73	MUDX	MUDIX
4	ALD	Azyk	74	NDS*	Nalaikhyn dulaany stants
5	ALA	Altai	75	NUR	Niislel Urguu
6	AZH	Altain zam	76	NIE	Noyot Khairkhan
7	ANO	Anod bank	77	TGS	Nomin Khishig
8	ABH	Ar Bayankhangai	78	NXE	Nekheesgui Edlel
9	ARJ	Arvijikh	79	HJL	Orkhon hugjil
10	CND	ASBI	80	ORD	Orkhondalai
11	NOG	Achit alkaby	81	ULZ	Ulzii-Dundgobi
12	BZO*	Baganuur, zuun umnut busiin tsakhilgaan tugeekh suljee	82	ONH	Undurkhaan
13	BRC	Barilga Corporation	83	OEE	Urgun Khereglee
14	BAJ	Bayalag Sumber	84	SIL	Silicate
15	VIK	Bayan Aldar	85	GFG	Silk net
16	BTL	Bayantalbai	86	SSG	Sonsgolon Barmat
17	BHR	Binse	87	SOR	Sor
18	BSKY	Bluesky Securities	88	SOH	Standart agriculture group
19	BOR	Bornuur	89	ALI	Standart Noos
20	BRO	Boroogiin Uildver	90	BBD	Standard property group
21	BHL	Buunii hudaldaa	91	ARH	Selenge Ar khuvch
22	BHG	Bukhug	92	SES	Selenge sureg
23	BUN	Bulgan Undarga	93	TAV	Tav
24	BLC	Buteelch Uils	94	TVL	Tavilga
25	HZB	Gan Kherlen	95	TAL	Talyn Gal
26	HML	Global mongolia holdings	96	TMZ	Tumriin Zavod
27	JGL	Goviin Undur	97	TLP	Tulpar
28	GNR	Gonir	98	TUS	Tushig Uul
29	GTJ	Guril tejeel Bulgan	99	TEE	Teever Darkhan
30	GUR	Guril	100	ACL	Teever-Achlal
31	DBL	Davaanbulag	101	HUN	Uvs Khuns
32	DZS*	Dalanzadgad DTsS	102	CHR	Uvs Chatsargana
33	DAR	Darkhan guril tejeel	103	UDS*	Ulaanbaatar dulaany suljee

34	DSS	Darkhan Selengiin tsakhilgaan tugeekh suljee	104	UTS*	Ulaanbaatar tsakhilgaan tugeekh suljee
35	DTU*	Darkhan Metallurgical Plant	105	UNS	Ulaansan
36	DUS*	Darkhan us suvag	106	HMK**	Khanyn Material
37	DAH	Darkhan Khuvun	107	TVT	Khar tarvagatai
38	DDS*	Darkhany dulaany suljee	108	AMT	Khar khorum properties
39	DAS*	Darkhan dulaany tsakhilgaan stants	109	HHN	Kharkhorin
40	DZU*	DZUZG	110	HSX**	Khishig Uul
41	DAZ	Dornod autozam	111	CHE	Khorgo Khairkhan
42	DIM	Dornod Impex	112	AHH	Khorin Khoyordugaar Baaz
43	DRN	Dornod	113	SDT	Khot development
44	DES	Dornod Khudaldaa	114	HUV	Khuvsgul Geology
45	DRU	Durvun-Uul	115	HUZ	Khuvsgul usan zam
46	DSH*	Dulaan sharyn gol	116	HVL	Khuvsgul
47	DKS*	Dulaany tsakhilgaan stants II	117	HHS	Khuvsgul khuns
48	DGS*	Dulaany tsakhilgaan stants III	118	HUT	Khuduugiin Teever
49	DSD*	Dulaany tsakhilgaan stants IV	119	HBT	Khungun beton
50	DMA	Devshil Mandal	120	HSG	Khusug Trade
51	HCH	E-Monie	121	HTS	Khutuliin cement shokhoi
52	SUN	Euroasia Capital Holding JSC	122	DAO	Khurtai
53	JGV	Juulchin Gobi	123	HBZ	Khunnu menegment
54	BLG	Zavkhan Bayalag	124	HAH	Khuns-Arkhangai
55	ZSB	Zoos bank	125	HRD	Khurd
56	INV	Invescore NBFI JSC	126	HRL	Kherlen Khivs
57	INT	Ingettolgoi	127	TSA	Tsagaantolgoi
58	IBA	Ikh Barilga	128	SIM	Shim
59	BAZ	Lux Zanadu group	129	NRS	Shinest
60	MNG	Mandalgobi impex	130	DLH	MND
61	MNB	Mon Nab	131	ERDN	Erdene Resource Development Corporation
62	MBG	Mon It Buligar	132	EAZ	Erdenet Autozam
63	MOG	Mongeo	133	IND	Erdenet-Zandan
64	ERS	Mongol Alt	134	SVR	Erdenet Suvarga
65	MDZ	Mongol diesel	135	EUD*	Erdenet us, dulaan tugeekh suljee
66	KEK	Mongol Keramik	136	TAS	Erdenet Khuns
67	MSC	Mongol Securities	137	EDS*	Erdenetiin dulaany tsakhilgaan stants
68	MVO	Mongol shevro	138	BOE	Erchim Bayan-Ulgii
69	MTZ*	Mongolian railway	139	ECV	Ereentsav
70	HAM	Mongoliin khugjil undesnii negdel	140	ESG	Esgii Gutal

* 100 percent state owned; ** partially state-owned Source: MSE

2.3.1.4. Delisted companies

The MSE may delist securities under the following circumstances:

1. There has been a decision by the court or a competent authority appointing a liquidator or a nominee as stated in the Bankruptcy Law, Banking Law and the Securities Markets Law;
2. The liquidity of the securities has fallen and it has become clear that the issuer is no longer able to meet the listing criteria set by the MSE;
3. Upon consecutive failure by the issuer to meet its ongoing obligations and duties as stated in the law, regulations and contracts, and failed to pay the annual listing fee for more than 2 years;
4. More than one year has elapsed since the suspension of the securities trading and the trading has not resumed or the causes for suspension have not been rectified;
5. Other grounds stated in the law and rules of the MSE.

2.3.2. Initial Public Offerings

In 2018, there was six IPOs: LendMN, Mongol Basalt, Erdene Resources Development Corporation, Mandal Insurance, Ard Insurance, and Tumen Shuvuut.

Table 9. List of IPOs

№	Ticker	Name of JSCs	IPO Amount		Listed date
			Volume	Amount /MNT/	
1	MRX	"Merex" JSC	26,000,000	2,600,000,000	2014-01-14
2	ETR	"E-Trans logistics" JSC	7,700,000	924,000,000	2012-04-09
3	HGN	"Khuh gan" JSC	30,395,272	3,195,456,280	2008-07-30
4	NKT	"Nako Fuel" JSC	1,180,195	270,264,655	2008-06-24
5	RMC	"Remicon" JSC	50,480,202	5,048,820,200	2008-05-19
6	HRM	"Hermes Centre" JSC	23,562,900	2,356,290,000	2008-05-16
7	OLL	"Olloo" JSC	5,820,299	582,029,900	2007-09-12
8	HBO	"Hai Bi Oil" JSC	4,000,000	400,000,000	2007-05-02
9	BDS	"BDSec" JSC	7,500,000	750,000,000	2006-06-22
10	JTB	"Jenco Tour Bureau" JSC	78,895,885	8,259,239,676	2006-01-17
11	MSH	"Mongol Shiltgeen" JSC	1,000,000	800,000,000	2005-05-25
12	MIK	"MIK Holding" JSC	3,106,398	37,276,776,000	2015-12-21

13	ITLS	Itools JSC	13,387,980	1,338,798,000	2017-09-27
14	LEND	LendMN JSC	200,000,000	5,000,000,000	2018-01-26
15	MBW	Mongol Basalt JSC	16,925,100	6,431,538,000	2018-04-05
16	ERDN	Erdene Resources Development Corporation JSC	3,898,000	2,494,720,000	2018-04-04
17	MNDL	Mandal daatgal JSC	1,560,754	7,491,619,200	2018-05-07
18	AIC	Ard daatgal JSC	7,500,000	5,250,000,000	2018-06-13
19	TUM	Tumen Shuvuut JSC	50,000,000	10,000,000,000	2018-08-16

Source: MSE

2.3.3. Securities on Mongolian Securities Exchange

Currently, there is only one security company trading on the MSX, And-Energy JSC (ticker: AEL). AEL was founded in 2011 to provide a full set of services in the field of electrical wiring, installation and automation. In September 2014, led light manufacturing became the main business of the company. The company issued its IPO on 1 November 2017 and raised 1.59 billion MNT. At the end of 2018, AEL was trading at 40 MNT.

In 2018, MSX listed its first corporate bond, the “Park Town bond.” The issuer, Minj Property LLC was established in October 2011 as a construction company in Darkhan.

2.4. Banking sector

The Mongolian financial system continues to be dominated by commercial banks. As of the end of 2018, there were 14 commercial banks, accounting for 95 percent of total financial system assets. The top three banks (Khan Bank, Trade and Development Bank and Golomt) account for around 68 percent of the banking system’s total assets or around 22.5 trillion MNT. It can be observed that the Mongolian banking sector is highly concentrated, which poses risk if one of the systemically important banks should encounter financial/operational difficulties or fail.

Table 10. Commercial bank assets

№	Commercial bank	Ownership		2018 (bln MNT)		
		Foreign	Domestic	Assets	Liabilities	Equity
1	Khan Bank	64%	36%	9,089.68	8,106.06	983.62
2	Trade and Development Bank	78%	22%	7,286.29	6,355.01	931.28

3	Golomt Bank	8%	92%	6,091.23	5,570.06	521.18
4	State Bank	state-owned		2,991.79	2,783.63	208.16
5	Ulaanbaatar City Bank	0%	100%	1,631.18	1,471.04	160.14
6	XacBank	71%	29%	3,077.67	2,847.49	230.18
7	Arig Bank	0%	100%	144.39	106.31	38.08
8	Capitron Bank	0%	100%	818.19	737.17	81.02
9	Credit Bank	100%	0%	111.89	95.75	16.14
10	Bogd Bank	0%	100%	180.96	129.06	51.90
11	Chinggis Khan Bank	0%	100%	527.38	486.20	41.17
12	TransBank	0%	100%	501.84	424.63	77.22
13	National Investment Bank	3%	97%	267.29	264.70	2.59
14	Capital Bank	0%	100%			

Source: commercial banks' website, BoM

Box 1. Liquidation of Capital Bank

In 2019, the Bank of Mongolia announced the liquidation of Capital Bank on April 8th – which decreases the number of commercials banks in Mongolia to 13. This decision was made following an Asset Quality Review conducted by the Bank of Mongolia under the IMF EFF program.

According to N. Batsaikhan, chief examiner at BoM, the volume of Capital Bank's low-grade credit was 208 billion MNT, around 80 percent of its total credits. In total, Capital Bank had 256 thousand saving accounts by individuals and enterprises. Deposit and savings accounts of Capital Bank up to the amount of 20 million MNT each is insured by the Deposit Insurance Corporation, therefore, 99.5 percent of current account holders and depositors are fully protected from losses. The insured and deposit accounts of Capital Bank have been transferred to Khan Bank.

A total of 340 billion MNT of government money were placed at Capital Bank. The Minister of Finance stated that 104 billion MNT of Pension Insurance Fund, 134.9 billion MNT of Health Insurance Fund, 52 billion MNT of Development Bank, 47 billion MNT of SME fund, 4 billion MNT of University of Health, 2 billion MNT of University of Education.

2.4.1. Basel framework

The Basel standards are aimed at improving the resilience of the global banking system, promoting confidence in prudential ratios, and encouraging a predictable and transparent regulatory environment for internationally active banks. Thus, the Basel frameworks act as a set of standards for prudential regulation of banks to ensure financial system stability.

The New Basel Capital Accords (Basel II) provides a more detailed capital adequacy framework to align capital adequacy assessments to key elements of risks faced by banks and to provide incentives for banks to enhance their risk measurement and management capabilities. The three pillars of the Basel II framework are minimum capital requirements, supervisory review and market discipline.

Pillar 1 consists of regulatory capital requirements for credit, operational and market risk. Mongolia implemented the standardized approach for credit risk in 2005. The BoM provides a guideline within the scope of the Basel framework on the methodology of calculating risk weights of assets used for the credit risk assessment. These methodologies are then implemented by commercial banks themselves and is monitored by the BoM. The basic indicator approach for operational risk was adopted by Mongolia in 2010. According to Mongolia's 2014 "Medium term banking supervisory strategy," Pillars 2 and 3 were supposed to be adopted in 2016 and 2017, respectively. However, there have been delays and implementation strategy for Pillar 2 only began in 2018. Additionally, the definition of capital from the Basel II is currently still being used by Mongolia; however, there are plans to renew the definition.

The Basel II framework was amended in 2009 to become the Basel II.5 framework. In this framework, the market risk standards were enhanced as well as securitization. Mongolia adopted the market risk standard in 2010. The only revisions made to the standard was in reference to the foreign exchange risk assessment using VaR methodology by adjusting multiplier, stressed VaR estimates and so on.

The Basel III framework was developed in response to the deficiencies identified after the financial crisis of 2008. The framework aims to strengthen bank capital requirements by increasing banking liquidity and decreasing bank leverage. Mongolia adopted the concept of domestically systemically important banks (D-SIBs) and imposed additional 2 percent capital surcharge on them in 2011. The remaining standards have not been adopted; however, according to the medium-term strategy, most will be adopted in 2018 or 2019. Elements of Basel III framework were expected to be adopted in 2018 and was agreed upon within the IMF's EFF program. Then, during the 5th review, the adoption of new prudential regulations with elements from Basel II/III were reset from end of December 2018 to June 2019. The new prudential regulations include definition of capital, more sensitive credit risk weights, capital buffers and implementation of Pillar 2 of Basel II.

The medium-term strategy mentioned previously is from 2014 to 2019; so hopefully, a new strategy will be released soon with updated implementation dates of the Basel II/III frameworks.

2.4.2. Macro prudential

The Bank of Mongolia introduced a number of macro prudential measures and limits this past year. The following table lists the requirements/limits set by the Bank of Mongolia and the performance of the top six commercial banks on these prudential ratios as of the fourth quarter of 2018.

Table 11. Prudential ratios of banks

	Tier 1 ratio	**Capital adequacy ratio**	**Liquidity ratio[2]**	**Foreign currency open position (each currency)**	**Foreign currency open position (total)**
Limit	>9%	>14%	>25%	< ±15%	< ±40%
Khan Bank	18.1	22.1	53.2	7.7	7.9
TDB	16.0	19.6	42.3	-3.9	-3.9
Golomt Bank	11.1	14.6	36.7	-2.1	-5.3
State Bank	10.3	15.6	29.5	1.6	2.2
UB City	11.9	16.1	37.1	-11.8	-11.8
XacBank	10.1	16.0	29.5	-1.3	-3.2
Arig Bank	43.5	43.7	45.2	-2.2	-2.2
Capitron Bank	16.5	17.4	49.6	9.1	9.9
Credit Bank	56.8	58.3	89.8	6.0	6.2
Bogd Bank	57.4	57.1	88.0	8.4	8.8
Chinggis Khan Bank	12.9	12.9	35.3	-9.0	-9.4
TransBank	24.2	24.2	33.7	8.6	8.8
National Investment Bank*	-0.7	-0.7	32.7	-14.5	-33.8

Source: financial statements of commercial banks'

The BoM updates the reserve requirement (RR) ratio bi-weekly and supervises the banks' compliance with the RR. Assessment of the domestic and foreign currency RR is made based on the average maintained reserves which allows for banks to comply with the requirement in the beginning or end of the period without effect on the short-term interest rate.

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[2] Liquidity ratio is calculated as the liquid assets divided by the total liabilities. Liquid assets equal to the sum of cash in hand, balances placed with the BoM, balances placed with other banks and financial institutions, precious metals, BoM and government bonds, government-backed Development Bank of Mongolia bonds minus the balance of transfer delays in the clearing account. Total liabilities are estimated as the sum of current and savings account, funding from other banks and financial institutions, other funding and other liabilities minus the transfer delays in the clearing account.

During the March 2018 meeting of the Monetary Policy Committee, the reserve requirements on domestic and foreign currency liabilities were set at 10.5 and 12 percent, respectively.

2.4.3. Financial soundness

The IMF conducted a Financial System Stability Assessment on Mongolia in 2011. Similar to that assessment, the following indicators were calculated by the research team.

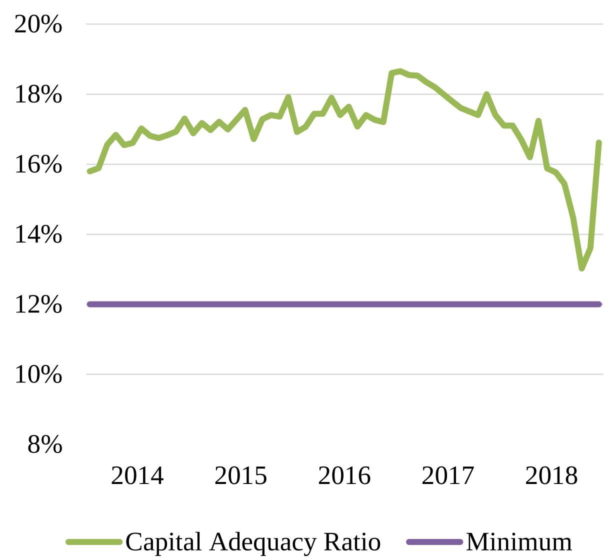
Table 12. Financial soundness indicators

	2013	2014	2015	2016	2017	2018
Capital adequacy						
Regulatory capital to risk-weighted assets	15.7	16.7	17.4	18.6	17.4	13.0
Regulatory Tier 1 capital to risk-weighted assets	11.3	12.1	12.4	12.9	13.3	9.3
Capital (net worth) to assets	6.6	9.5	11.3	11.6	10.9	9.9
Asset quality						
Non-performing loans (NPL) to gross loans	5.3	5.0	7.5	8.5	8.5	10.4
NPL, incl. past due loans, to gross loans	6.4	7.2	14.8	15.8	14.6	15.3
Provisions to NPL	83.5	78.4	77.8	79.3	88.3	87.2
Provisions to NPL (incl. past due loans)	69.1	54.9	39.3	42.6	51.6	59.2
NPL net of provisions to capital	6.8	6.3	7.9	7.4	4.3	7.0
NPL (incl. past due loans) net of provisions to capital	15.2	18.9	43.0	38.0	30.3	32.8
Sectoral distribution of lending						
Agriculture	2.1	2.5	2.1	2.3	2.3	1.9
Construction	13.6	13.2	13.1	16.0	14.1	8.8
Manufacturing	10.1	10.6	11.1	10.5	10.2	8.5
Mining	12.4	9.1	10.0	6.2	7.6	7.2
Real estate activities	16.5	17.8	13.1	10.8	9.3	10.7
Wholesale and retail trade	16.3	14.5	14.4	14.1	13.8	14.1
Other	29.0	32.3	36.2	40.1	42.7	48.8
Earnings and profitability						
Return on assets (before tax)	2.7	1.5	1.2	0.8	0.7	-0.3
Return on equity (before tax)	20.4	11.3	8.9	6.9	7.0	-3.2
Spread between reference loan and deposit rates	5.3	7.0	5.8	6.6	6.1	4.9
Liquidity						
Liquid assets to total assets	19.8	19.3	15.3	20.3	17.1	17.9
Liquid assets to short-term liabilities	35.5	30.2	23	27.9	22.9	23.3
Foreign currency loans to total loans	27.3	23.1	23.9	19.0	21.3	16.0
Foreign currency deposits to total deposits	25.1	28.7	27.1	32.5	22.6	22.7
Deposits to loans	47.6	46.7	54.5	65.2	71.2	71.4

Source: BoM, researcher’s calculation

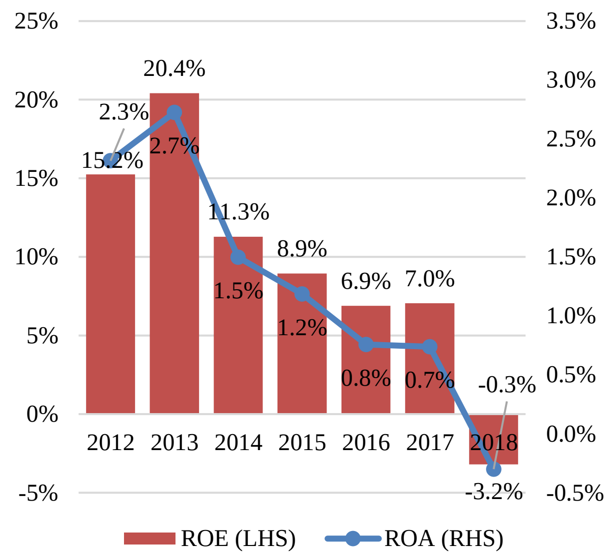
One of the main reasons for the spike in non-performing loans in 2018 was due to reclassification. Following the Asset Quality Review (AQR) conducted by the Bank of Mongolia under the IMF EFF program, capital shortfalls among commercial banks were identified. In addition to requiring banks to increase their capital, the BoM implemented a stricter classification of non-performing loans which became effective end of 2018.

Figure 6. Capital adequacy ratio of bank sector



Source: BoM

Figure 7. Return on asset and equity of bank sector



Source: BoM

2.5. Nonbank sector

2.5.1. Non-bank financial institutions

As of the end of 2018, there were 539 non-banking financial institutions. The following services are provided by NBFIs:

- Lending (492)
- Foreign currency trading (257)
- Investment and financial consultancy and/or information (31)
- Trustee service (30)
- Remittance (25)
- Factoring services (2)
- Guarantees (18)
- Investment in short-term financial instruments and guarantees to MSMEs or issuing payment instrument, respectively (9)

Table 13. NBFI indicators relative to banking sector

Indicator	2017	2018
Total assets (billion MNT)	969.2	1284.9
Relative to banking sector (%)	3.4	3.9
Outstanding loan (billion MNT)	638.0	869.2
Relative to banking sector (%)	4.8	5.4
Total equity (billion MNT)	758.2	977.4
Relative to banking sector (%)	24.1	30.0
Total share capital (billion MNT)	595.4	740.8
Relative to banking sector (%)	81.7	83.8

Source: FRC

2.5.2. Savings and credit cooperatives

By the end of 2018, there were 279 licensed SCCs, a decrease of 3.8 percent from the previous year. SCCs provides its members with additional services beyond its main activities such as project financed on-lending (113), leasing (3), and insurance (3) as well as assistance in complying with regulations and acquiring authorizations.

In 2018, SCCs had a total asset of 200.2 billion MNT, an increase of 30.7 percent from the previous year. Of this increase, 60.6 percent is attributable to increases in loans. 21 SCCs have assets more than 1 billion MNT, 123 has between 100 million and 1 billion MNT and the remaining 135 had assets less than 100 million MNT.

2.6. Insurance sector

Currently, there are 18 insurance companies operating in Mongolia. Of which, one is a life insurer, two are reinsurers and the rest are non-life insurers. Kublai Reinsurance (previously named “And Reinsurance”) received its special license to operate on 29 June 2018.

Table 14. Insurance sector assets (billion MNT)

№	Insurance companies	2013	2014	2015	2016	2017	2018
1	Soyombo Insurance	6.7	9.0	9.3	9.8	10.1	10.1
2	MIG Insurance	7.5	10.3	10.4	11.5	16.1	17.4
3	Mongol Insurance	25.6	32.7	27.9	30.4	33.2	37.6
4	Munkh Insurance	3.5	4.2	4.3	4.3	4.8	5.8
5	Ger Insurance	2.9	3.9	5.0	5.6	6.2	6.6
6	Practical Insurance	7.9	8.3	9.0	11.2	13.4	16.2
7	Ulaanbaatar City Insurance	4.8	5.2	5.7	5.6	6.1	7.1
8	Nomin Insurance	6.6	7.6	7.6	10.5	11.6	15.4
9	Bodi Insurance	12.6	12.7	11.0	12.3	16.7	29.5
10	Tenger Insurance	9.7	11.3	12.7	16.7	19.3	23.6

11	Gan Zam Insurance	4.1	5.1	5.7	7.0	7.3	7.4
12	Monre Insurance	4.4	5.6	5.8	6.4	6.7	9.0
13	Ard Insurance	7.1	8.7	8.8	9.5	11.7	21.0
14	National Life Insurance	5.6	6.5	8.3	7.5	7.8	8.9
15	Mandal Insurance	8.8	9.4	9.8	17.3	21.5	33.8
16	Khan Insurance	4.0	6.4	5.8	7.8	8.9	12.5
17	Agricultural Reinsurance	-	-	26.1	35.0	43.4	48.6
18	Kublai Reinsurance	-	-	-	-	-	21.6
19	Monnis Insurance	4.5	5.5	-	-	-	-
Total assets		126.4	152.5	173.2	208.4	244.7	331.9
y-o-y growth		17.5%	*20.7%*	*13.6%*	*20.3%*	*17.4%*	*35.6%*
% of total financial system		*0.6%*	*0.7%*	*0.8%*	*0.8%*	*0.8%*	*0.9%*

Source: BoM, FRC

The total assets of the insurance market reached 331.9 billion MNT, an increase of 35.6 percent from 2017. Of this total, 21.2 percent (or 70.2 billion MNT) was accounted for by reinsurance companies, general insurance accounted for 76.2 percent (252.9 billion MNT), and life insurance accounted for 2.7 percent (8.9 billion MNT). The insurance industry has been growing over the years, especially since 2012 when the Law on Driver's Liability Insurance was passed and went into effect. Article 5.1 made it mandatory for every driver to be insured. In addition to this, the emergence and surge of reinsurance contributed to the most recent 35.6 percent increase the insurance industry.

Total insurance premium income was 178.7 billion MNT at the end of 2018, an increase of 23.8 percent year-on-year. Of which, 175.5 billion MNT was general insurance, 1.4 billion MNT long-term insurance and 1.7 billion MNT reinsurance.

3. Current legal framework

3.1. Relevant organizations, its functions and structures

There are two financial regulators in Mongolia: the Bank of Mongolia and the Financial Regulatory Commission. The BoM is responsible for supervision of banks while the FRC is responsible for supervision of other financial institutions including insurance companies, security companies, credit and savings cooperatives and non-banking financial institutions.

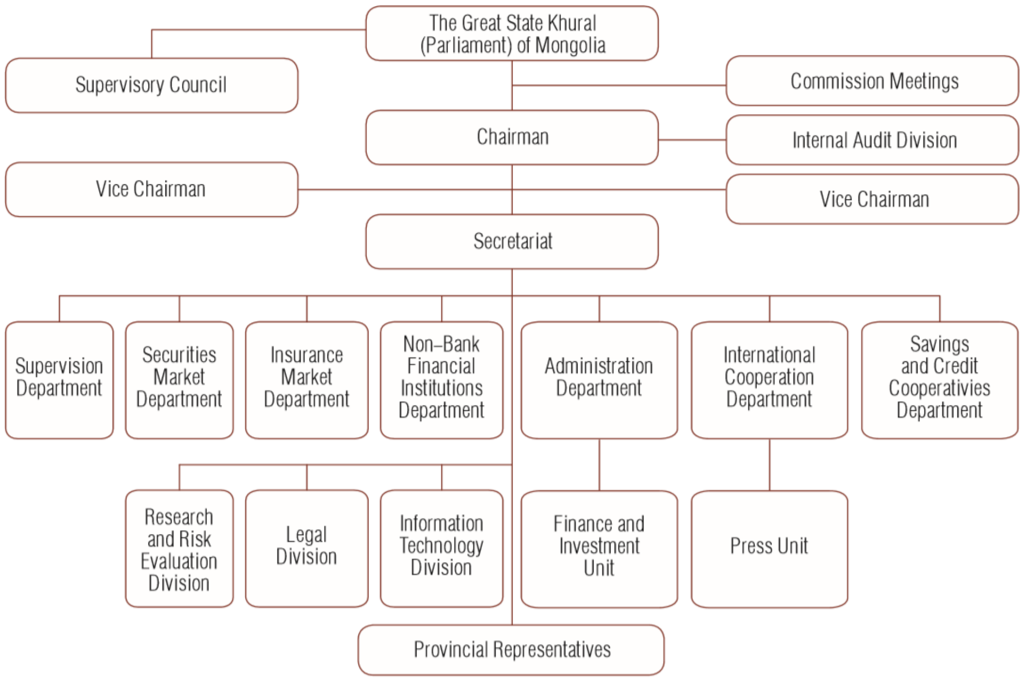
3.1.1. Financial Regulatory Commission

The FRC was established in 2006, replacing the former Securities Commission, as the supervisor and regulator of the non-bank sector. Non-bank sector includes non-bank financial institutions, insurance companies, intermediaries, securities firms, and savings and credit cooperatives. In addition to regulating the financial market, the FRC is also responsible for ensuring the rights of individual financial market clients such as securities holders, domestic and foreign investors and insurance policyholders, as well as protecting them against financial malpractice. In order to perform these tasks, there are four core tasks: regulation, supervision, licensing and implementation and enforcement of legislation.

Licenses are issued to the following:

i. Stock exchange
ii. Securities clearing house
iii. Central securities depository
iv. Broker and dealer company
v. Underwriter company
vi. Investment consultant company
vii. Custodial services company
viii. Investment management company
ix. Trustee company to the securities
x. Agricultural commodity exchange
xi. Agricultural and commodities exchange broker
xii. Asset-backed securities company
xiii. Insurance company
xiv. Insurance loss-adjuster company
xv. Insurance intermediary company
xvi. Non-bank financial institution
xvii. Savings and credit cooperative
xviii. Professional participant in securities market
xix. Insurance representative
xx. Insurance auditor
xxi. Actuary

Figure 8. FRC organizational structure



Source: FRC

In accordance with the General Administrative Law (GAL), the FRC adopted a couple of regulations, which are listed below.

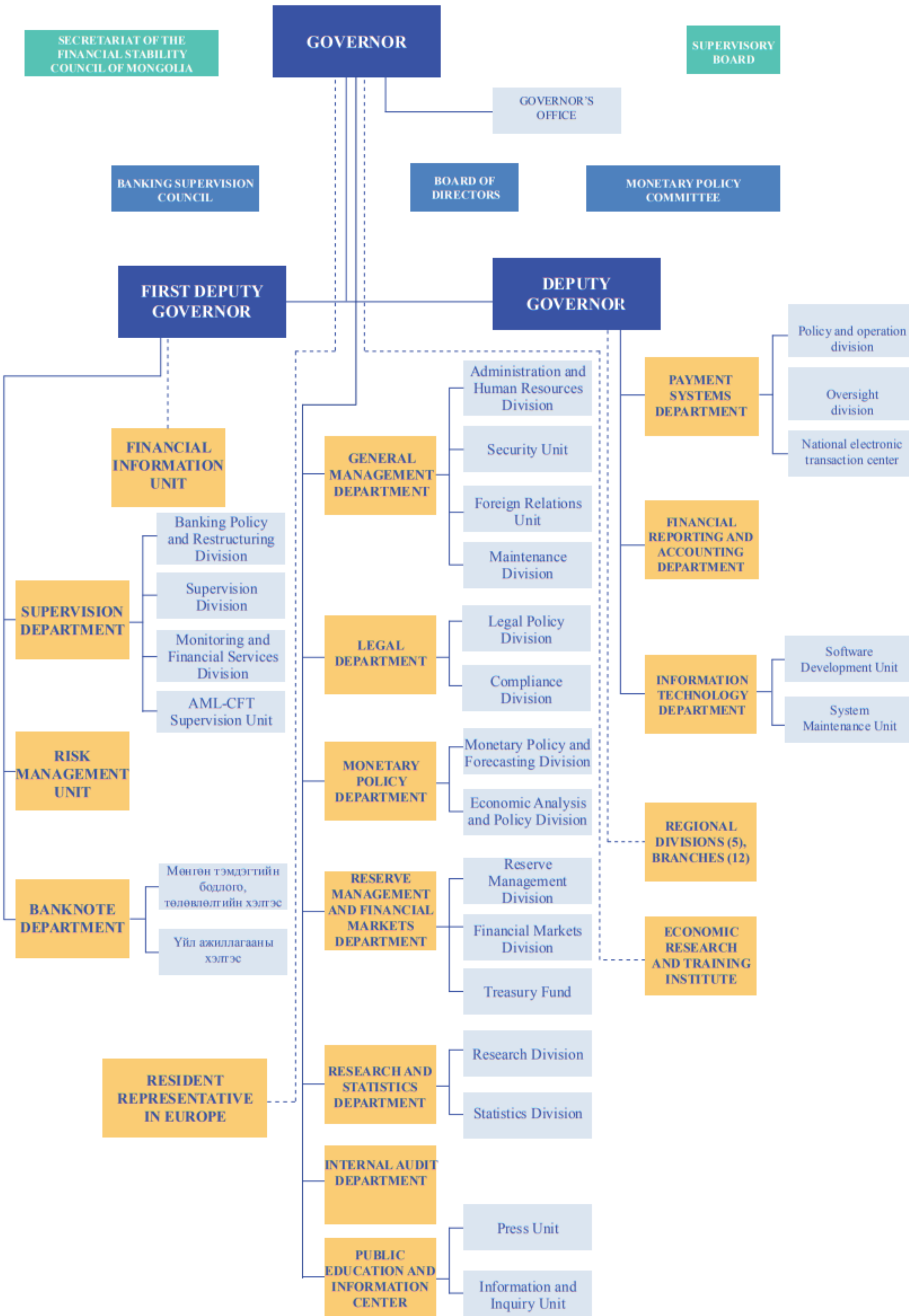
Regulation	**Adoption date**
Regulation on the registration of securities to be issued to a foreign legal entity registered in Mongolia by a legal entity registered in a foreign commercial organization	2018.01.19
Procedures for submitting and monitoring information from regulated market capitalists	2018.04.17
Requirements for National Union of Savings and Credit Cooperatives	2018.05.21
Volunteer Insurance Type	2018.06.05
Guidelines for Defining Proper Person	2018.06.25
Regulation on mortgage insurance	2018.06.25
Regulation on the use of credits for calculating the driver's insurance premium	2018.06.06
Driver's liability insurance formal application form. contract standard and model	2018.06.25
Procedure for placing account of driver's insurance fund. centralizing financing and transferring fund assets	2018.06.25
Conditions and Requirements for the Savings and Credit Cooperative	2018.07.10
Criteria for Prudential Ratio of Savings and Credit Cooperatives	2018.07.10
Procedure for distributing drivers to insurers who fail to comply with the contractual obligations of the driver's liability	2018.07.10
Procedures on distance and on-site inspection of persons responsible for reporting money laundering and terrorist financing	2018.11.29
Procedure for announcing the announcement of shareholders meeting of a joint stock company	2018.12.26

Source: FRC

3.1.2. Bank of Mongolia

The main objective of the Bank of Mongolia is to ensure the stability of the national currency. Within this objective, the BoM is tasked with promoting the balanced and sustainable development of the national economy by maintaining the stability of money, financial markets and the banking system. As such, it implements national monetary policies and supervises the activities of the commercial banks.

Figure 9. BoM organizational structure



Source: BoM

The table below listed the regulations and decisions made by the BoM in 2018:

№	Title of regulatory act	Date	Content
Monetary Policy Formulation and Implementation			
1	Setting reserve requirement ratio	2018.03.23	Required reserve ratio for liabilities in domestic and foreign currency were set at 10.5 and 12.0 percent, respectively
2	Revision of regulation on setting, calculating and controlling reserve requirement	2018.03.29	Bank's regulation on setting and estimating reserve requirement is revised.
3	Determination of premium on reserve requirement	2018.03.29	Premium on reserve requirement were set at 50 percent of the interest rate on overnight deposit facility of the Central Bank
4	Liabilities to be deducted from reserve requirements	2018.03.29	To fulfill the mandate of monetary policy and to build foreign exchange reserves, liabilities equivalent to the amount of concessional loans issued by banks would be deducted from reserve requirement calculations, in its original currency denomination.
5	Regulation on operations of monetary policy committee	2018.05.17	It regulates the relations pertinent to publicly informing the function, principles, meetings and decision-making procedures of the Monetary Policy Committee.
6	Regulation on Central Bank Repo Financing	2018.07.09	Implementing monetary policy, managing liquidity surplus or shortage in money market and delivering interbank market interest rates to the intended level.
7	Regulation on methodology to calculate bank interest rates and transparency of interest rate, fees and payments	2018.07.23	Determine the principles in calculating bank interest rates, and ensure transparency of interest rate and payment information, to protect the interests of customers
8	Approval of the methodology for calculating debt service-to-income ratio	2018.06.20	This methodology will be used to calculate the debt service-to-income ratio on consumer loans issued by banks.
9	Setting the policy rate and an upper limit on the debt service-to-income ratio	2018.01-2018.05	2018.01-Reduce policy rate by 1 percentage point to 10 percent; 2018.02 - Maintain a policy rate of 10 percent and set a 70 percent upper limit on the debt service-to-income ratio of consumption loan; 2018.03 - Maintain a policy rate of 10 percent; 2018.04 - Increase policy rate by 1 percentage points to 11 percent; 2018.05 - Maintain a policy rate of 10 percent;
10	Amendment to the regulation on trading Central Bank bills	2018.03.29	
11	Amendments to regulation on long-term swap arrangements	2018.03.09	
Within the framework of issuing credit to banks to support their liquidity			
12	Regulation on issuing collateralized credit to banks, by the Bank of Mongolia.	2018.06.15	To regulate the issuance of collateralized credit to banks and actions to support their liquidity.

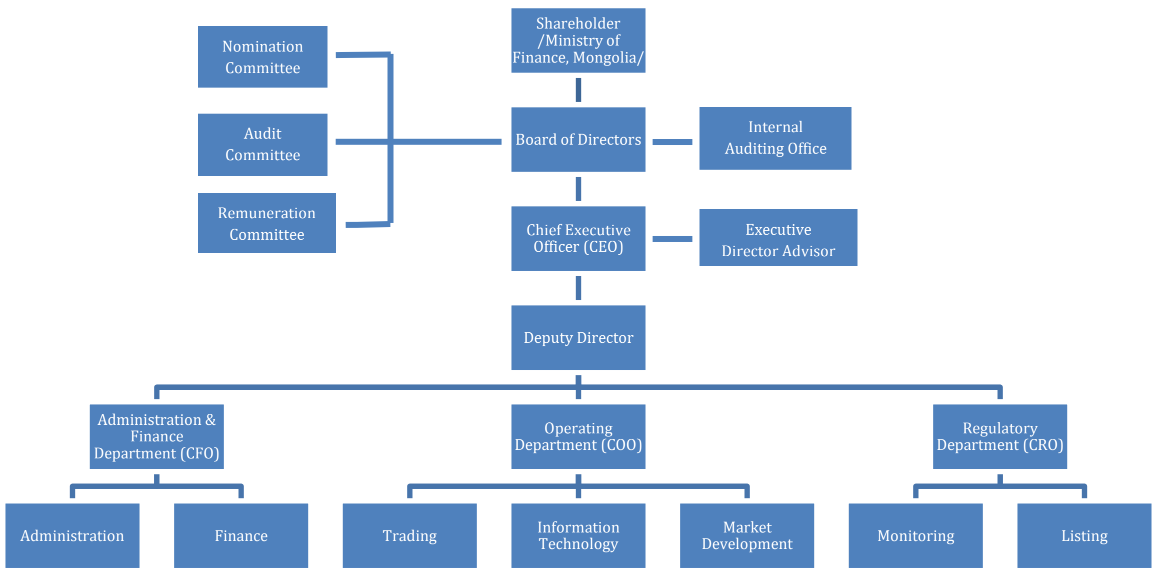
Supervision of banking activities			
13	Decree on determining the percent for the Risk Protection Fund	2018.02.09	Regulates custodian protection against potential risks in the financial system
14	Banking Supervision Committee regulation	2018.03.26	Regulates composition and operation of the Bank supervision committee as stated in the Banking law
15	Regulation on bank recapitalization and resolution plan	2018.10.17	
16	Bank liquidation regulation	2018.11.30	Regulates procedure on issuing decision of bank liquidation, appointment of the liquidator, its terms of execution, liquidation of bank, settlement of liabilities and termination of the liquidator.
17	Bank resolution regulation	2018.12.06	Regulates procedure on issuing resolution order, implementation, termination of the resolution plan and communication procedure with other authorities in order to strengthen the stability of the banking system as set out in the Banking Law.
18	Regulation on the operations of the bank provisional administration and commissioner	2018.12.07	Regulates implementation of provisional administration, appointment and termination of commissioner and measures taken to ensure normal functioning of banks.
19	Regulation on licensing banks	2017.06.29	Regulates procedures of approving, licensing and refusing to license banks
20	Regulation on off-site supervision of the Bank of Mongolia of a bank on combating money laundering, financing of terrorism and mass destruction weapons	2018.11.27	Regulates relations concerning how banks are implementing guidelines and recommendations approved by the Bank of Mongolia.
21	Guidelines on the implementation of risk-based principles for combating money laundering and terrorism financing.	2018.02.06	Regulates risk-based approach to the Bank's anti-money laundering and terrorism financing activities
22	Amendment to regulation on bank’s prudential ratio and its monitoring	2018.08.03	Regulates bank’s prudential ratio
23	Regulation on implementing the Bank's prudential governance	2018.08.02	To implement the Bank’s principle on prudential governance
24	Regulation on electronic money	2018.02.13	Regulates the procedures to be followed for electronic money and related activities.
25	Regulation of the large-value payment system	2018.03.30	Create a reliable payment system for its participants
26	Regulation on Transaction Card of National Electronic Transaction Center	2018.05.10	Regulates operations, confidentiality, leverage, and continuity of card payment system

Source: BoM

3.1.3. Mongolian Stock Exchange

The Mongolian Stock Exchange was established in January 1991 to implement state privatization during the country's transition to market economy from a planned economy. Secondary market trading commenced in 1995, government securities trading in 1996, corporate bonds in 2001 and the first IPO was launched in 2005. Since then, the MSE has become more active in recent year as the public's awareness of the market has increase. In 2018, the first insurance companies were listed, paving the way to increasing the participation of domestic institutional investors.

Figure 10. MSE organizational structure

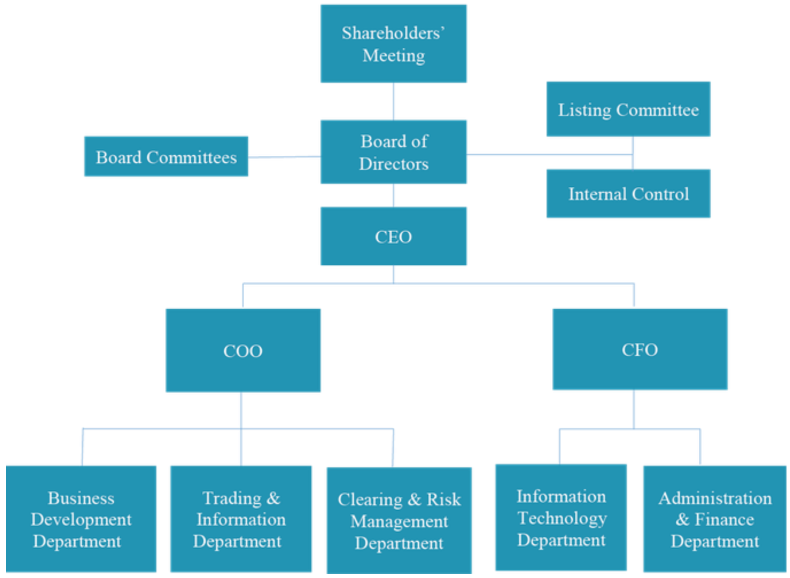


Source: MSE

3.1.4. Mongolian Securities Exchange

The Mongolian Securities Exchange was established on 1 May 2015 with the aim to provide securities exchange services in Mongolia. MSX is Mongolia's first private securities exchange. Its trading and clearing licenses were acquired from the FRC on 3 July 2015.

Figure 11. MSX organizational structure



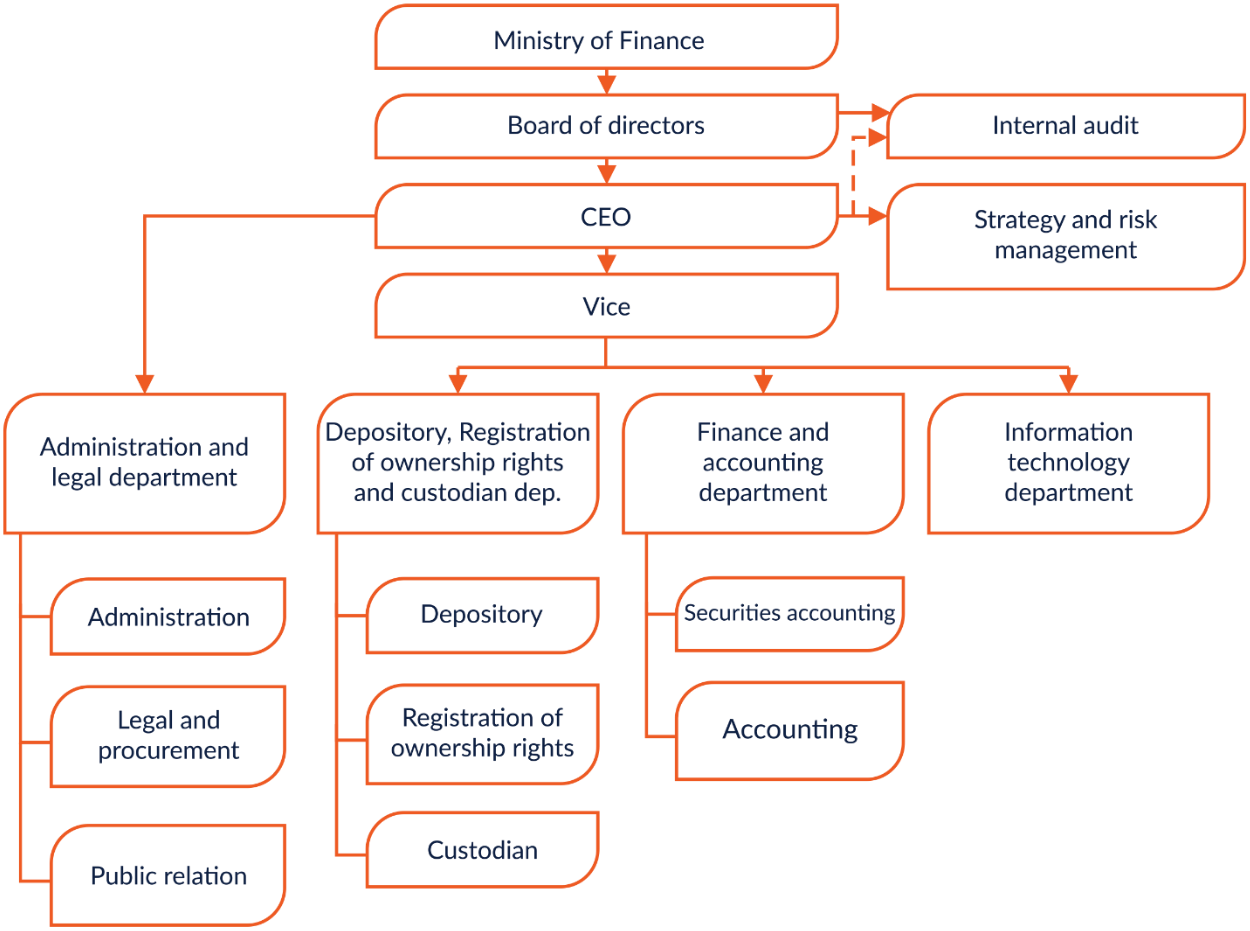
Source: MSX

3.1.5. Mongolian Central Securities Depository & Mongolian Securities Clearing House

When the MSE was established, there was a Settlement and Depository Department within the institution. In 2003, this department separated from the MSE to form the Mongolian Securities Clearing House and Central Depository Co., Ltd (MSCH&CD) with the goal of securities registering, depository, clearing and settlement. The MSCH&CD was then divided into two companies – the Mongolian Central Securities Depository (MCSD) and the Mongolian Securities Clearing House (MSCC) by the GoM's resolution No. 147 on 15 April 2016.

The MCSD is responsible for registering and transferring securities certified ownership rights, performing OTC securities clearing and settlement, updating central depository information database and implementing custodian services in accordance with international standards.

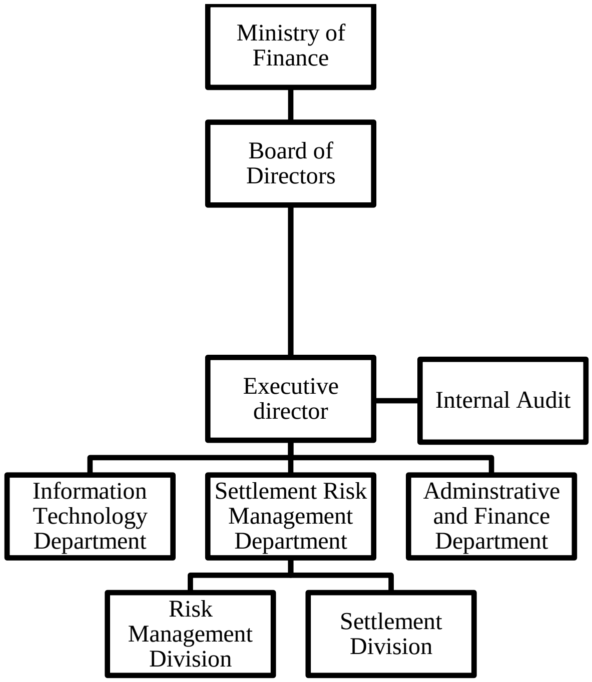
Figure 12. MCSD organizational structure



Source: MCSD

The MSCC is responsible for properly executing securities settlement and payment operations in accordance with international standards. The securities trading procedure is able to be conducted due to the collaboration of a number of institutions such as the securities companies, MSE, MCSD, MSCC, clearing banks and so on.

Figure 13. MSCC organizational structure



Source: MSCC

3.2. Related laws

As the Mongolian economy has advanced, a number of key legislations and regulations have been amended within the past two decades in a means to keep the legal environment up to date with the current business environment. Some of the important legislations related to the Mongolian capital markets include the Company Law, Securities Market Law and Banking Law. In this section, these laws will be briefly covered and summarized with a focus on any articles or sections related to bonds and/securities as this report mainly pertains to the development of the corporate bond market in Mongolia.

3.2.1. Securities Market Law

On 24 May 2013, the Parliament of Mongolia approved an amendment of the Securities Market Law ("Revised Securities Market Law"). The revised law seeks to align the framework for securities regulation in Mongolia with international best standards. Some key features of the revised law are:

1) **Distinction between legal and beneficial ownership**: Under the new definitions, a "nominal owner" of securities is defined as a regulated entity who is registered as depositor/custodian of a given security and who is not the beneficial owner of such security; whereas, a "beneficial owner" is defined as the 'real' owner of the security who is entitled to enjoy the rights and benefits attached to such security
2) **Increased liquidity and capital raising opportunities**: Tradable securities have expanded to include derivatives, depositary receipts and warrants – with these securities being permitted to being trade over-the-counter. Derivatives is defined as options or futures agreements as well as such other financial instruments that are permitted to be traded on the regulated market.

   a) **Depositary receipts**: Provides a basic regulatory framework for the issuance of depositary receipts.
   b) **Dual-listing**: Specifically allows for the dual listing of Mongolian-listed companies abroad as well as the listing of foreign-listed companies in Mongolia.
3) **Protection of investors during IPOs and takeovers**: Provides detailed procedure for IPO and imposes stringent requirements on issuers and their advisors in terms of disclosure requirements, update obligations and sanctions for non-compliance. Distinguishes between the primary and secondary securities market.
   a) **Disclosure during IPOs**: Increased disclosure requirements – stipulating that prospectuses now must include detailed financial information, lists of related parties, a business plan for the capital raised through the IPO and risk management plan. Additionally, the issuer and "governing person" are liable for losses resulting from any misinformation and information contained in prospectus must be verified by authorized auditors and legal professionals.
   b) **Takeover regulations**: Shortening of takeover offer period from 6 months to 1-3 months. Increased disclosure and reporting obligations on parties acquiring a controlling block or all the shares in a listed company and sets out minimum requirements relating to the offer. The offer must not be less than the market price and will be calculated based on the methodology provided by FRC.
4) **Increased monitoring and enhanced regulation of market participants**: At least 14 activities will require FRC license including securities trustee services, securities registrars, custodial and credit rating services. Additionally, the FRC will issue a series of regulations and rules concerning the issuance, extension and termination of licenses, risk management, service fees, etc.
5) **Prevention of insider dealing and market abuse**: Prohibition of insider dealing and market abuse in order to protect investors' interests
6) **Increased market transparency and reporting/disclosure requirements**
7) **Increased monitoring and efficient regulation:**
   a) **FRC**: May now issue binding 'instructions' to licensed market participants, issuers or self-regulating bodies, instructing them to take or refrain from taking certain actions for the purpose of implementing securities legislation or protecting investors.
   b) **Self-regulating bodies**: Introduction of self-regulating bodies which includes associations comprising of licensed market participants and licensed individuals, the MSE, the securities settlement organization and the central securities depository.
   c) **Dispute resolution body**: Establishment of a dispute resolution body at the FRC to resolve disputes among regulated entities, issuers, investors and/or customers.

3.2.2. Banking Law

On 18 January 2018, the Parliament of Mongolia approved a several amendments to the "Banking Law" of 2010. The amendments will take effect from 1 April 2018 with commercial banks given a grace period until 1 January 2019 to comply with the provision of the amended Banking Law. Some of the key features of the amendments are:

1) **Disclosure of beneficial owners**: Introduction of the concept of beneficial ownership and imposition of obligation to disclose identity of beneficial owners of banks to the BoM. Beneficial owner is defined as an owner entity that (i) directs and manages the operations of the relevant bank, (ii) implements such

powers through a representative, or (iii) indirectly holds shares in the bank through one or more related entities with rights to benefit from the shares or operations of the bank.

2) **Restriction on bank activities**: From 1 April 2018, commercial banks can no longer establish subsidiaries or affiliate companies. Banks can no longer engage in activities of investment transactions and services executed on behalf of customers.
3) **Corporate governance rules**: Revision of provisions for criteria for a bank's governing persons such as its board members and the executive director. Introduction of criteria for bank's influential shareholders – influential shareholder is defined as (i) the entity that owns 5 o more percent of the bank shares on its own and/or jointly with a related party or (ii) the shareholder who is able to influence the bank's policies and decisions or bank's management.
4) **Bank resolution and restructuring**: Introduction of a comprehensive set of measures which ensures preparation and prevention, early intervention, resolution of a failed bank; and financial viability in relation to failed banks,
    a) **Preparation and prevention**: Banks are required to prepare and submit to the BoM stabilization plans (or 'living wills') that set out risk assessments by taking into account their activities and economic conditions and specify response plans aimed at maintaining the solvency and liquidity of a relevant bank
    b) **Early intervention**: BoM may take a wide range of measures if a bank breaches or is likely to breach laws and regulations. These measures include, among others, a warning, the imposition of a demand, the issuance of instructions, implementation of stabilization plans, and the suspension or termination of authority of board of directors or executive management.
    c) **Bank resolution**: The following tools may be utilized to restructure a failed bank:
        i) Transfer of assets and liabilities
        ii) Establishment of a special purpose bank (i.e. bridge bank)
        iii) Change the structure and size of the share capital
        iv) Conversion of debt into equity
    d) **Financing of bank resolution**: BoM must establish and manage the Stabilization Fund for the purpose of improving financial conditions of a bank, stabilizing its operations, and implementing restructuring tools. Stabilization Fund consists of fees payable by commercial banks and will be equal to 1.3 percent of the total deposits of the banking system as a whole.
    e) **Liquidation of bank**: Detailed regulations on the liquidation procedure, the order of payment to be made from a failed bank's assets, and criteria for voiding certain transactions entered into by failed bank.
    f) **Remedies for shareholders**: Those affected by administrative decisions by the BoM for the purpose of rescuing trouble banks or initiating liquidation proceedings may file claims to a competent court.

3.2.3. Company Law

The Company Law was amended in 2011 to improve the governance of Mongolian companies and to bring it up international standards. The amendments brought forth stricter corporate governance[3], introduction of violation fees and increased disclosure. Some of the relevant features of the law are under Chapter 5. Some of these articles are covered more in depth in Section 3.4.

3.2.4. Other legislations

In accordance with the IMF's reform agenda for the banking and financial sector, amendments to the Law on Central Bank, Banking Law, Law on Bank Deposit Insurance, Law on Combatting Money Laundering and Terrorism Financing and Law on Stability of the Banking System was drafted in collaboration with the public and relevant government agencies, non-government entities, banks and financial institutions, before being approved by the Parliament of Mongolia.

Amendments and drafts and proposals

Law on Bank Deposit Insurance

Amendments to the Law on Bank Deposit Insurance was passed by the Parliament on 8 February 2018. The amendment covered issues such as specification of an insurance incident, estimation of applicable insurance premiums, options of disbursing insurance to depositors through bank accounts, minimizing the time period to initiate insurance disbursement, and enabling sufficient time period for depositors to make claims, and clearly defines the role and responsibilities of the Deposit Insurance Corporation in case of bank resolution.

Law on Ensuring Banking Sector Stability

The Law on Ensuring Bank Sector Stability was approved by the Parliament on 22 June 2018 to ensure banking and financial sector stability, protect the rights and interest of bank's customers and depositors and support the long-term and stable economic growth of Mongolia. The conceptual framework of the draft law intends to ensure the strengthening of restricting policy measures in the banking industry and banking and financial capacity building.

The law imposes term demand for bank to meet its minimum capital adequacy ratio, obliges bank to meet capital requirement by its shareholder and other investor, requires shareholder and investor of a bank to assume bank loss, and regulates process, condition and procedure involving bank recapitalization request and forms, activities, management and disposing of state-invested funds. The law also has provisions regarding the supervision of recapitalized bank and liabilities in case of breach.

[3] A Corporate Governance Code was adopted by the FRC in 2007. The Code was developed specifically to be used by publicly trade companies, i.e. joint stock companies, and can also be used by limited liability companies and other legal persons upon making custom adjustments.

Pursuant to the provisions of the reformed laws, the Bank of Mongolia issued several regulations and by-laws pertaining to monetary policy, banking supervision, payment system and bank recapitalization to ensure their implementation in practice.

Mongolian Mortgage Corporation relevant laws

MIK HFC has a fiduciary management license which was issued by the FRC under the Law on Asset-Backed Securities. In accordance with this license, MIK HFC is able to issue RMBS through SPCs. During this process, the FRC monitors the activity from a regulator's standpoint while BoM, commercial banks and the Board of the SPCs from an investors' perspective. The following are the main laws and regulations which are applicable to MIK HFC:

- The Constitution Law
- Civil Law
- Law on Securities Market
- Law on the Asset-Backed Securities
- Company Law
- Procedure on mortgage financing
- Regulation on mortgage loan procedure
- Regulation on issuing, registering and licensing of asset backed securities

In accordance with the revised and newly incorporated Corporate Income Tax Law, asset-backed securities issuance tax on SPC has increased. Additionally, on 5 December 2018, the government approved an AHLFP, which aims to provide policy support for first-time homeowners, housing of ger area households, expired building usage permit holders, and citizens that want to connect to municipal infrastructure. On 6 June 2018, the FRC approved the Mortgage Insurance Procedure which regulates the relationship between insurer and insurance provider to provide mortgage borrowers with life, health, and mortgage collateral insurance, and the ensuing compensation of such liabilities in the case of an insurance event.

Listed below are a series of laws and regulations with unofficial English translations:

1. Banking law (2010): https://www.mongolbank.mn/documents/regulation/banking_law_eng.pdf
2. Credit Information (2011): https://www.mongolbank.mn/documents/law/zeeliinmedeeleleng.pdf
3. Law on deposits, loans and banking transactions (1995): https://www.mongolbank.mn/documents/law/Law_on_banking_transactions.pdf
4. Regulation on asset classification, provisioning and its disbursement (2017): https://www.mongolbank.mn/documents/regulation/control_check/20170630_A193e.pdf
5. Regulation on setting and monitoring prudential ratio to banks (2010): https://www.mongolbank.mn/documents/regulation/supervision/20071030e.pdf
6. Regulation on mortgage lending process (2008): https://www.mongolbank.mn/documents/regulation/money/bankipotek_eng.pdf
7. Temporary regulation on issue of guarantees by banks (2000): https://www.mongolbank.mn/documents/regulation/supervision/20000920e.pdf
8. Revised Company Law (2011): https://www.mrpam.gov.mn/public/pages/16/company%20law_ENG.pdf

9. Revised General Tax Law (2008): https://www.mrpam.gov.mn/public/pages/16/general%20tax%20law_ENG.pdf
10. Law on Investment (2013): https://www.mrpam.gov.mn/public/pages/16/investmentlaw_ENG.pdf
11. Foreign Investment Law: http://mse.mn/uploads/laws/d1c33d9a546a127fdd0a060df5dbe685218c75dc.pdf
12. Economic Entity Income Tax Law (2006): https://www.mrpam.gov.mn/public/pages/16/Business%20entity%20income%20tax%20law_ENG.pdf
13. Value-added tax Law (2006): https://www.mrpam.gov.mn/public/pages/16/ValueAdded%20Tax%20Law.pdf
14. Revised Securities Market Law (2013): http://mse.mn/uploads/laws/27aba6dbc709e17d808f9abe4b9a40511f70dfdb.pdf
15. Law on Insurance (2004): http://www.amcham.mn/wp-content/uploads/2014/06/law-on-insurance.pdf
16. Law on Social Insurance (1994): http://legal-policy.mn/uploads/files/1437032964-93805169.pdf
17. Law on the Driver's Insurance: http://ami.mn/amimn/images/pdf/huuli/JDHuuli/TLOTD.pdf
18. Bankruptcy Law (1997): http://lehmanlaw.mn/wp-content/uploads/2016/04/Bankruptcy1997.pdf
19. Civil Law (2002): https://www.ebrd.com/downloads/legal/securities/mongcc.pdf
20. Law on Cooperatives (1998): http://lehmanlaw.mn/wp-content/uploads/2016/04/Cooperatives1998.pdf
21. Law on NBFIs (2002): http://legal-policy.mn/uploads/files/1437032838-95574687.pdf

Other relevant laws in Mongolian:

1. Law on Investment Fund (2013): http://frc.mn/legal/detail?id=54
2. Law on Asset-Backed Securities (2010): https://www.legalinfo.mn/law/details/571
3. Law on Savings and Credit Cooperatives (2011): http://frc.mn/legal/detail?id=50
4. Law on Loan Guarantee Fund (2012): http://frc.mn/legal/detail?id=6023
5. Law on insurance intermediaries (2004): http://frc.mn/legal/detail?id=3790
6. Other legislation can be found on Mongolia's legal database: https://www.legalinfo.mn/

3.3. Regulations and oversight related to investors

There are not a lot of regulations or oversight restricting investors except that participation in the trading and buying of Mongolian securities, government bonds and corporate bonds must be conducted through a brokerage firm. With a broker account, anyone can participate in the primary and secondary market trading.

3.4. Regulations and oversight related to issuers

On the other hand, there are several regulations and oversight related to issuers of securities, debt instrument, derivates and other financial instruments. In this section, some of the regulations regarding issuers are highlighted in key legislations.

Table 15. Criteria of stock exchanges for debt securities

	Mongolian Stock Exchange	Mongolian Securities Exchange
Operation year	At least 2 year	At least 3 year (financial year)
Financial reports	At least 2 year /IFRS/	At least 3 year (2 year in special cases)
Sales revenue of last year	-	-
Net profit of last year	No less than 100 million MNT	-
Working capital	Sufficient for at least 12 months after the listing	-
Compliance with the corporate governance principles	+ /Explanation if not in compliance/	-
Market capitalization	No less than 1 billion MNT	-
Public free float	No less than 25%	-
Number of shareholders	No less than 50	-
Securities can be traded	No restrictions on the free movement and trading of the securities such as being pledged or sealed and shall be freely transferable and tradable	-
Nominal value of bond	-	No less than 500 mln MNT
Shareholders' equity	-	No less than 1 billion MNT

Source: MSE and MSX

Other criteria for Debt Securities (MSE, Listing rules, Article 14)

If the issuer fails to meet the criteria specified in Article 14.1 of these Rules, the issuer shall meet any of the following criteria:

1. The issuer shall have conducted its main operations for no less than 3 years and holds sufficient **collateral assets to guarantee full repayment** of the principal and interest payments for the debt securities;
2. Fully guaranteed by the **Government;**
3. The debt securities offered to the public shall be **insured by more than 80%** of its total value.

The debt securities shall meet the following criteria:

1. There shall be no restrictions on the free movement and trading of the securities such as pledge and seal and shall be freely transferable and tradable;
2. The value of the debt securities offered to the public shall meet the conditions set out in Article 16.4 of the Securities Markets Law.

In case of convertible securities, the shares for future conversion shall be listed on the Exchange and shall meet the requirements and conditions set out in Article 39 of Company Law.

The issuer may be required to provide collateral for the property and property rights or provide guarantee by an independent third party in case the Exchange considers the debt securities to have potential adverse impact on the rights and interests of the investors.

Table 16. Listing fees, million MNT

<table>
<tr><th colspan="2"></th><th>Tier I</th><th>Tier II</th><th>Tier III</th></tr>
<tr><td rowspan="2">Listing application review fee</td><td>For initial and additional listing of securities</td><td colspan="3">2</td></tr>
<tr><td>Listing amendment and delisting</td><td colspan="3">1.5</td></tr>
<tr><td>Initial listing fee</td><td>Corporate bond</td><td colspan="3">The fees shall be calculated based on the total proceeds from the offering and shall be 0.1% / no less than MNT 2 500 000 /</td></tr>
<tr><td colspan="2">Annual listing fee</td><td>1.2-50</td><td>1.2-50</td><td>0.5-25</td></tr>
</table>

Source: MSE

Table 17. Discount and exemption of regulation fees

<table>
<tr><th></th><th>I Classification</th><th>II Classification</th><th>III Classification</th></tr>
<tr><td>Listing application review fee</td><td colspan="3">-</td></tr>
<tr><td rowspan="2">Initial listing fee</td><td colspan="3">Up to 20 %</td></tr>
<tr><td colspan="3">Discount condition:
• The issuer issuing additional securities in Board I;
• Issuing securities along with an upgrade on the Board where it is listed;
• Listing securities without raising capital such as payment of dividends by securities, mergers and acquisitions
• Listing the securities of a state-owned enterprise or a private company that operates on a strategically important industry with significant potential benefits to the Mongolian economy
• Listing of securities of an issuer that have operations directed towards implementing the UN Sustainable Development Goals</td></tr>
<tr><td>Annual listing fee</td><td>10%</td><td>-</td><td>-</td></tr>
</table>

Source: MSE

Listing fees of Mongolian securities exchange

A listing fee for debt securities is 0.1 percent of the value of listed debt security.

3.4.1. Company Law provisions

Article 4. Public company

4.3. Unless otherwise provided in the company charter, a public company may issue shares and other securities through open or closed subscription.

Article 5. Limited liability company

5.2. A limited liability company shall issue shares, options to acquire shares, and securities convertible into shares, only by means of closed subscription, and can issue other securities through open or closed subscription.

Article 25. Exchange of a Company's Debts for Shares

25.1. A company's securities and debts other than shares may be exchanged for shares and such exchange shall be called an exchange of debt for shares.

25.2. Unless it is otherwise specified in an agreement entered into with a creditor or other persons dealing in business, the consent of the creditor and other persons dealing business shall be obtained for any debts-for-shares exchange.

25.3. The Board of Directors (in its absence, the executive body) of a company shall prepare a proposal draft with respect to any proposed exchange of debts for shares and submit such resolution to a meeting of its shareholders for consideration and such matter shall be resolved by a majority of votes of the shareholders eligible to vote who attend the meeting.

25.4. The draft proposal to exchange debts for shares shall indicate the debt to be exchange, the number and per share price of the shares to be issued, purpose, the terms and procedure of the exchange, and proposed amendments to the company charter.

25.5. The exercise of options to acquire shares, or the conversion of securities convertible into shares pursuant to the terms of such securities, shall not be considered to be an exchange of debt for shares.

25.6. A shareholder has the preemptive right to purchase the shares that have been issued to exchange the company debt for shares.

Article 39. Securities Convertible into Shares

39.1. A company may issue preferred shares and bonds that are convertible into a specified number of common shares under specific conditions.

39.2. In the case of preferred shares or bonds that are convertible into common shares, the company must also issue securities convertible into shares.

39.3. The terms for issuance of securities convertible into shares shall specify the type of such securities, the number of common shares into which such securities may be converted, the conversion price, and the period of time in which such conversion may be in effect.

39.4. The conversion price of securities convertible into common shares of a joint stock company may not be less than the average trading value of the specific class of shares in the past month prior to the day of the issuance.

39.5. If securities convertible into shares are issued, holders of common shares shall have a preemptive right to acquire any convertible securities in proportion to the number of common shares held by such holders in accordance with the procedures specified in Article 38 of this law.

Article 41. Bonds

41.1. A company may issue bonds secured by its owners' equity subject to terms to pay interest and to redeem the bond after the expiration of a state period.

41.2. Unless otherwise provided in a company charter, the Board of Directors (in its absence, the shareholders meeting) shall make the decision to issue bonds set forth in Article 41.1 of this law.

41.3. The decision specified in Article 41.2 of this law shall specify the number, type, maturity date, issue price, interest rate, time for interest payments, and redemption price of the bonds and other relevant terms.

41.4. A company may issue bonds that mature once in whole, on a series of specified dates in parts.

41.5. Bonds issued by a company may be guaranteed by another company.

41.6. A company may redeem its bonds prior to their maturity if so provided in the decision to issue bonds.

41.7. The decision to redeem bonds set forth in Article 41.6 of this law shall be issued by the Board of Directors (in its absence, the shareholders meeting).

Article 42. Resolution to Issue Securities

42.1. Unless otherwise provided in the company charter, the decision to issue authorized shares or other securities and bonds specified in the company charter shall be adopted by the Board of Directors (in its absence, the shareholders meeting) and the decision shall specify the type and number of such securities and the terms and conditions of their issuance.

Article 55. Determination of the Market Value of Property and Property Rights

55.7. In the case of redemption of shares by a joint stock company pursuant to Article 53 of this law, the market value of the shares shall be determined on the basis of an evaluation by an independent valuation or audit organization.

55.8. The market value of publicly traded and other securities shall be determined in consideration of the average price for the preceding six (6) months as recorded in the securities trading organization and other trading official records.

3.4.2.Securities Market Law provisions

Article 16. Company debt instruments

16.1 A company that has met the criteria determined by the FRC and the stock exchange may issue debt instruments for public offer.

16.2 The FRC shall issue regulations for registration of company debt instruments for public offer.

16.3 Company debt instruments for public offer may be secured in order to ensure repayment.

16.4 The total value of debt instruments issued by a company shall not be greater than the relevant company's net asset value. The total value of debt instruments being issued with a third-party guarantee shall not be greater than the total sum of the amount of the relevant company's net asset value and the total guarantees issued by the third party.

3.4.3. Tax framework

Mongolia has been undergoing an extensive tax reform over the past year. As a result, key tax laws such as the General Law on Taxation, Corporate Income Tax Law, Personal Income Tax Law and VAT Law have been amended. The new tax laws will take effect on 1 January 2020. Some of the key changes have been highlighted and summarized below.

3.4.3.1. Corporate Income Tax Law

	Old	New
CIT rate	✓ Up to 3 billion MNT taxable income – 10% ✓ Excess of 3 billion MNT – 25%	✓ Up to 6 billion MNT taxable income – 10% ✓ Excess of 6 billion MNT – 25% ✓ CIT rate is 1% for business entities with annual turnover under 300 million MNT
Other special tax rates	✓ Direct and indirect transfer of land rights, mineral exploration and mining rights and other covered rights: withholding tax rate at 30% on gross basis ✓ Interest tax rate on debt instruments issued by Mongolian listed company: • Residential taxpayer: 10% • Non-resident taxpayer: 20% withholding	✓ Withholding tax rate at 10% ✓ 5% for both resident and non-resident taxpayer. Mongolian listed company excludes business entities holding exploration and mining license in mineral, oil and uranium industry
Tax credit and exemptions	✓ Investment fund income is exempt from tax. A 90% tax credit is available to business entities with annual turnover under 1.5 billion MNT and operating in one of the following industries: • Agriculture and livestock production and related auxiliary activities • Food production • Manufacture of garment and textiles • Manufacture of building materials ✓ Limited foreign tax credit to countries with available tax treaty with Mongolia	✓ No investment fund tax exemption. A 90% tax credit is available to entities with annual turnover under 1.5 bullion MNT excluding the entities operating in the following sectors: • Transportation, exploration, mining and sale of mineral and radioactive minerals • Importing alcoholic beverages and tobacco, planning and manufacturing tobacco • Manufacture of petroleum products, import, wholesale, and retail of all types of fuel,

		exploration, mining and sales of oil A 50-90% tax credit is available to companies with principal management and operations in remote areas (more than 500 km away from Ulaanbaatar) ✓ Domestic CIT law provides unilateral foreign tax credit irrespective of tax treaties in place
Loss carryforward	From 2-8 years	4 years
Deductible expense	Listing approach	Criteria based approach
Interest deductibility rules	Thin capitalization restriction of 3:1 debt to equity ratio	Combination of 30% EBITDA restriction and 3:1 thin capitalization restriction
Capital gains earned by non-resident	10%/25%	20% on gross capital gains

Other provisions in the CIT law of note for capital markets are:

Article 9. Asset income

9.1 and 9.4. Asset income includes interest income from debt security /bond/ shall be taxed.

Article 17. Tax rate and tax amount

17.2.6. Tax rate for corporate bond interest income is **10%;**

(**From 2020**, it will be **5%** for companies having **no mining license**)

17.2.10. If Mongolian commercial banks issue bonds in international or domestic market, buyer shall pay interest income tax of **10%**

(**From 2020,** tax rate will be 5 **%**)

3.4.3.2. Value-added Tax Law

In the old VAT law, there have been uncertainties about whether loan interest of non-banking transactions is exempt from VAT or not. Article 13.5.5 under the old law state that "service of granting of a loan" was exempt from VAT while Article 13.5.7 said that an interest of bank, NBFIs and savings and loan entities is VAT exempt. Under the new law, Article 13.5.7 has been amended to include corporate loan interest in its exemptions

3.4.3.3. Personal Income Tax Law

	Old	New
Tax residency	✓ Under the old law individuals are liable to pay PIT on their income. Mongolia divides individual taxpayers into two separate groups, a resident and non-resident taxpayer.	✓ The new law has re-defined the tax residency as follows: An individual shall be Mongolian resident taxpayer if any of the following two criteria are met:

	A resident taxpayer of Mongolia is taxable on his/her worldwide income. The legislation defines a permanent resident taxpayer as: • an individual who possesses a residential home in Mongolia; or • an individual who resides in Mongolia for 183 or more days in a given calendar year. ✓ A nonresident taxpayer of Mongolia is subject to tax on the income earned in the territory of Mongolia in a tax year and is defined as: • an individual who has no residential home in Mongolia and has resided in Mongolia for less than 183 days in a tax year.	• an individual who resides in Mongolia for 183 or more days in a given consecutive 12-month period. • If income earned in Mongolia and/or Mongolian sourced income is more than 50% of an individual's worldwide income ✓ The first criteria will need to be checked first. ✓ A resident taxpayer of Mongolia is taxable on his/her worldwide income while non-residents shall be taxed on Mongolian sourced income only.
Tax rates	✓ All resident entrepreneurs are generally taxed at 10% on their profits from operating income.	✓ A resident individual entrepreneur may elect 1% gross tax instead of 10% tax on the taxable income from business operations if annual turnover is under MNT50 million. ✓ Mongolia keeps its current 10% tax rate for most of the income including employment income, operating income, capital gains, passive income of dividend, interest and royalties and other indirect income for resident tax payers. Current 20% withholding tax shall remain for nonresidents.
Source	✓ Old PIT law largely employs a language that says non-resident are taxed for income earned in or within the territory of Mongolia.	✓ The new law introduced a 'Mongolian-source' rule that intends to cover broader income source by non-resident, similar to CIT laws. It almost serves as a catch-all provision in the laws. ✓ The definition for 'Mongolian-sourced income' covers all income types set out in the PIT law and refer to Mongolian source rule in the CIT Law

Other notable provisions of the PIT law are:

Article 13. Asset income

13.1 and 13.5. Asset income includes interest income from debt security /bond/ shall be taxed.

Article 23. Tax rate and tax amount

23.2.4. Tax rate for interest income is **10%**;

(**From 2020,** tax rate will be 5 **%**)

4. Market assessment and major issues

4.1. Issuer

As an issuer of corporate bonds, either publicly or through private placement, there are a number of costs and impediments. The following costs and impediments are associated with public corporate bond issuance unless otherwise stated. Currently, there is no regulation or procedure outlined for private placement.

4.1.1. Cost of issuing

The costs associated with the issuance of bonds goes beyond that of the fee paid at the exchange and interest payments. There are hidden costs such as marketing, underwriting, auditing, consultation/advisory fees, and etc.

Table 18. Criteria of stock exchanges for issuing bond

	MSE	**MSX**
Operation year	At least 2 year	at least 3 year (financial year)
Financial reports	At least 2 year /IFRS/	at least 3 year (2 year in special cases)
Sales revenue of last year	-	-
Net profit of last year	no less than 100 million MNT	-
Working capital	sufficient for at least 12 months after the listing	-
Compliance with the corporate governance principles	+ /explain if it is not in compliance/	-
Market capitalization	no less than 1 billion MNT	-
Public free float	no less than 25%	-

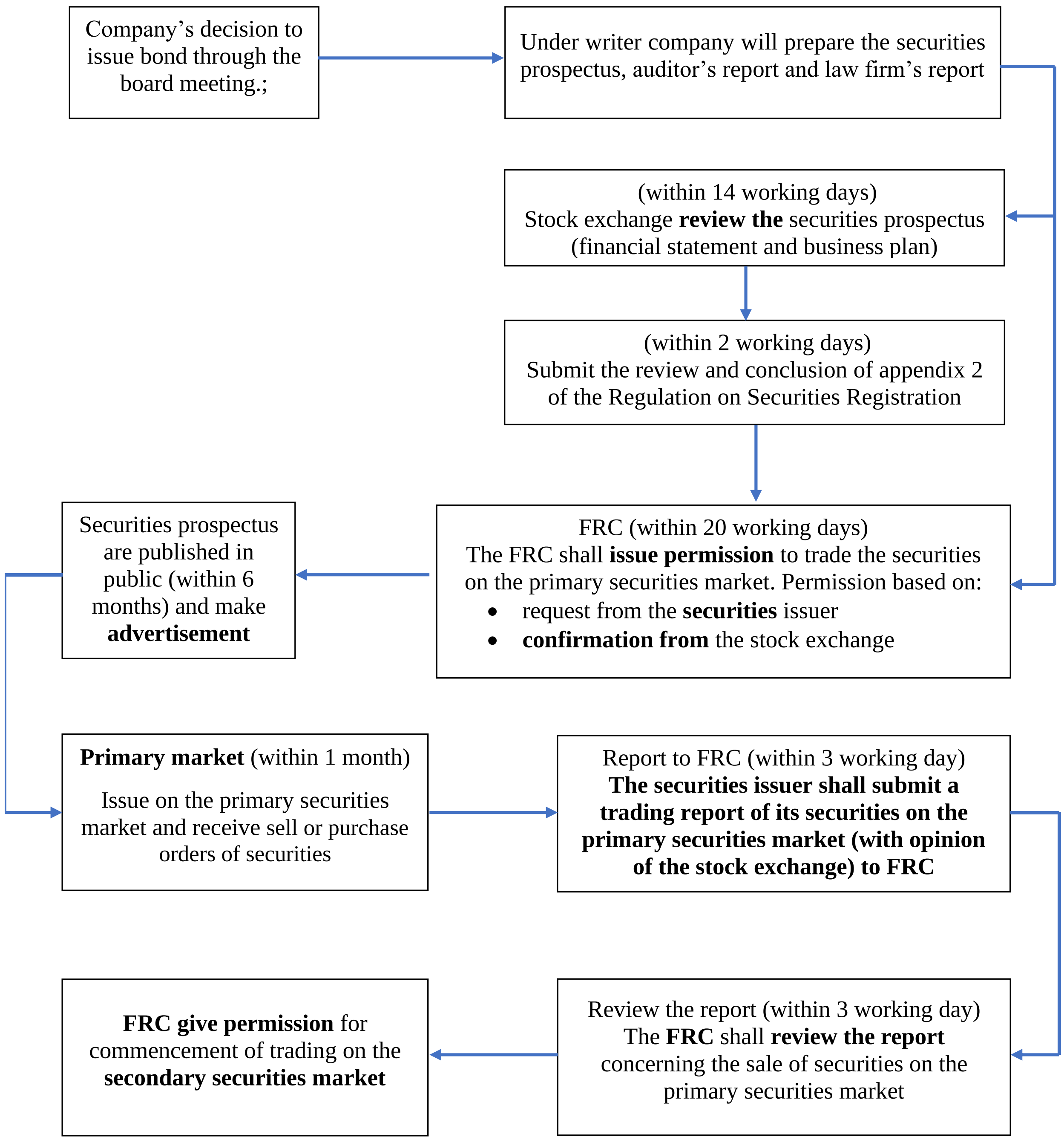
Number of shareholders	no less than 50	-
Securities can be traded	no restrictions on the free movement and trading of the securities such as being pledged or sealed and shall be freely transferable and tradable	-
Nominal value of bond	-	no less than 500 mln MNT
Shareholders' equity	-	no less than 1 billion MNT

Source: MSE, MSX

4.1.2. Impediments to issuing

The largest impediment to the issuance of public corporate bond is its cumbersome approval procedure. The process requires large volumes of document filing, filling out of applications and man-hours. Additionally, there are instances where investors have their money tied up in other ventures (such as loans, project financing, etc.), thus, causing a shortage in availability of funds.

Figure 14. Approval procedures for corporate bonds and private placement



Following documents will be required:

1. The application form /According to application – FRC03101/;
2. The securities prospectus that is according to the requirement of the related stock exchange

a. The name, permanent address, postal and contact address of the securities issuer, its industry/business activities, and whether it is registered with the stock exchange;
b. The state registration number and registration number and the registration date of the securities issuer;
c. The full name of any influential shareholder, and if a legal entity, the name, state registration number, and the number and percentage of shares held by it and its connected persons;
d. Information concerning the structure, organization, and governing persons of the securities issuer, and information concerning the number and percentage of shares held by such governing persons;
e. Information concerning the amount of the share capital of the securities issuer, the number, type and par value of securities that were previously authorized, issued, and redeemed, the net asset value10 and information concerning the securities issuer's tangible and intangible assets;
f. The securities issuer's financial statements, and an auditor's report in relation to the same;
g. Details of the contracts and transactions having a value of an amount equal to 5% or more of the share capital of the securities issuer, and information on performance and/or current status of the same;
h. Details of the connected persons of the securities issuer;
i. The number, type and par value of securities being publicly offered, the conditions and procedures for any public offer and/or trade of these, the conditions and procedures for distributing dividends, and in the case of debt instruments, the details of the maturity term, and the conditions and procedures for payment of the principal and interest;
j. The rights and obligations attaching to the securities being publicly offered;
k. A business plan specifying the use of the capital to be raised by the issuance of the securities;
l. If a security is convertible into shares, the conditions and procedures for such conversion;
m. Risks for the security issuer's operations and risk management plans;
n. The regulated entities and other professional service providers involved in the public offer of the securities and the rights, obligations and liabilities provided in the contracts entered into therewith;
o. In respect of debt instruments, information regarding any guarantees for repayment and/or pledged property;
p. Property valuation reports prepared within the past one year; and
q. Such other information considered by the FRC as necessary to include in the prospectus.

3. Decision of board meeting that accept the issuance of security and make change, documented in force
4. Legal opinion obtained in accordance with Article 4.2.2 of this regulation
    a. Whether the company established and registered in compliance with the law
    b. Whether the Board of Directors, executive management, authorized officials of company are met and comply with requirements those specified in "Corporate Governance Code of Mongolia" issued by the Commission, involved in crime and their management skills and experience

c. Whether the charter of the company, and other internal procedures are in compliance with "Corporate Governance Code of Mongolia" adopted by the Commission and relevant legislation
d. Whether a purchase, supply and loan agreements established with others and other agreements that is considered to have major importance on operation of securities issuer are in compliance with the relevant legislation;
e. Large amount of agreements, and agreements with conflict of interest are established within the last three year according to the procedures prescribed by law
f. Validity of operating license, license, copyrights, patents, trademarks and its expiration, cancellation
g. Whether the existence of objective conditions that may affect issuers' operation such as performance obligation committed to another body
h. Validity of ownership rights of securities, real estate, and other property and whether its committed to provide performance obligation
i. Information contained in the application for securities registration and securities prospectus are documented in force
j. Determine the supervisory body of company that issues securities based on the information of the company's parent, subsidiary, or affiliate company respectively

5. Valuation, audit opinion obtained in accordance with the requirements of stock exchange
6. If independent experts or professionals issued valuations or opinions about the securities in accordance with Article 10.8 of the Securities Market Law, then that prospectus must be included
7. Receipt of payment of regulatory services fees and state stamp duty

4.2. Intermediaries

4.2.1. Securities' companies

As all transaction on the MSE must be made through brokers or dealers, the companies listed below are the only ones with the license to make trades. Some of the companies provided additional services such as underwriting and advisory. Some of the companies also are trading members at the MSX.

Table 19. List of securities companies

№	Ticker	Company	Business activities				MSX
			Broker	Dealer	Under-writing	Investor Advisory	
1	ACE	"ACE&T Capital Securities Company" LLC	✓	✓	✓	✓	
2	ALTN	"Altan Khoromsog UtsK" LLC	✓	✓			
3	APS	"Asia Pacific Securities" LLC	✓	✓			
4	ARD	"Ard Capital UtsK" LLC	✓	✓	✓		
5	ARGB	"Argai Best UtsK" LLC	✓	✓			

6	BATS	"Bats UtsK" LLC	✓	✓			✓
7	BDSC	"BDSec UtsK" JSC	✓	✓	✓	✓	
8	BLAC	"Blackstone International UtsK" LLC	✓	✓			
9	BLMB	"Bloomsbury Securities" LLC	✓	✓	✓		
10	BSK	"Blue sky securities" JSC	✓	✓			
11	BULG	"Bulgan Broker UtsK" LLC	✓	✓			✓
12	BUMB	"Bumbat-Altai UtsK" LLC	✓	✓	✓		✓
13	BZIN	"Mirae Asset Securities Mongolia UtsK" LLC	✓	✓	✓	✓	
14	CAPM	"Capital Market Corporation UtsK" LLC	✓	✓	✓		
15	CTRL	"Central securities" LLC	✓				
16	DCF	"DCF"" LLC	✓	✓			
17	DELG	"Delgerkhangai Securities" LLC	✓	✓			✓
18	DRBR	"Darkhan Broker UtsK" LLC	✓	✓			
19	ECM	"Eurasia capital holding UtsK" JSC	✓	✓	✓	✓	
20	FCX	"FCX UtsK" LLC	✓	✓	✓		
21	GATR	"Gatsuurt Trade UtsK" LLC	✓	✓			
22	GAUL	"Gauli Securities" LLC	✓	✓	✓		✓
23	GDEV	"Granddevelopment" LLC	✓	✓			
24	GDSC	"Goodsec UtsK" LLC	✓	✓	✓	✓	
25	GLMT	"Golomt Capital BC" LLC	✓		✓	✓	✓
26	GNDX	"Gendex UtsK" LLC	✓	✓			
27	HUN	"Hunnu Empire UtsK" LLC	✓	✓			
28	INVC	"Invescore capital" LLC	✓	✓	✓		✓
29	LFTI	"Lifetime Investment Securities Company" LLC	✓	✓	✓		✓

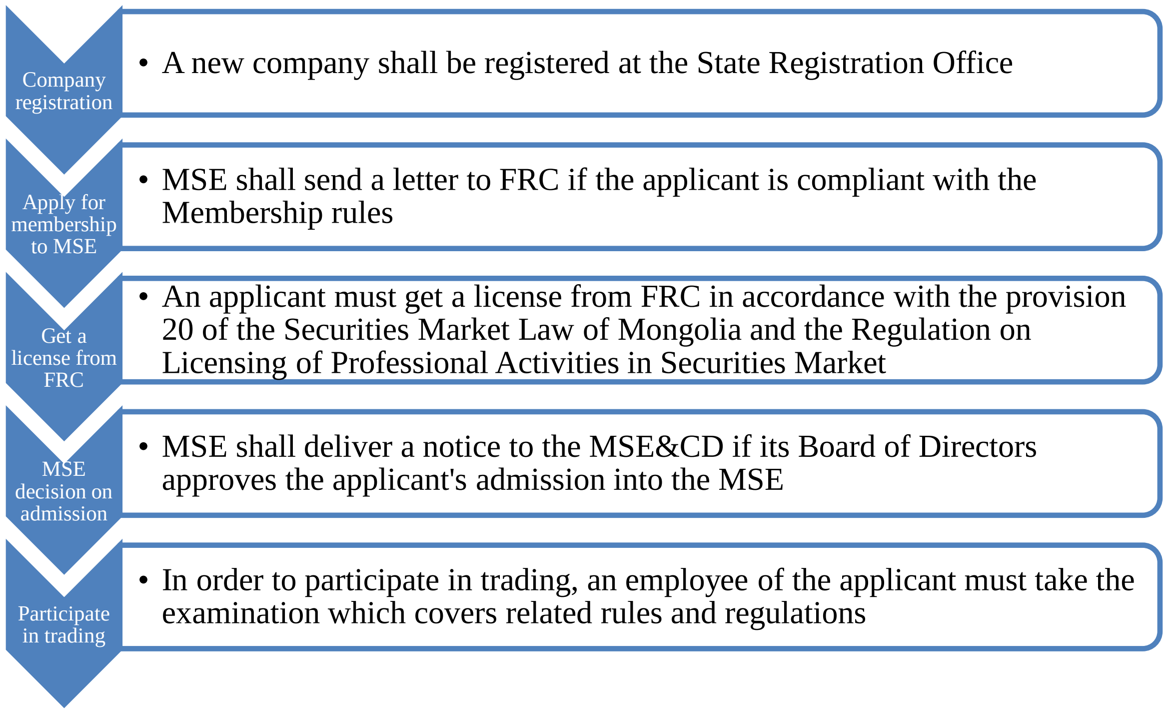
30	MERG	“Mergen Sanaa UtsK” LLC	✓				
31	MIBG	“MIBG” LLC	✓	✓	✓		
32	MICC	“MICC” LLC	✓	✓	✓		
33	MNET	“Ard Securities UtsK” LLC	✓	✓	✓	✓	
34	MONG	“Mongol Securities” JSC	✓	✓			✓
35	MSDQ	“Masdaq Unet Tsaasnii Company” LLC	✓	✓			
36	MSEC	“Monsec UtsK” LLC	✓	✓	✓		✓
37	NOVL	“Novel Investment UtsK” LLC	✓	✓		✓	
38	NSEC	“National Securities SC” LLC	✓	✓	✓	✓	
39	SANR	“Sanar UtsK” LLC	✓	✓			
40	SECP	“Secap UtsK” LLC	✓	✓	✓	✓	
41	SGC	“SG Capital UtsK” LLC	✓	✓	✓	✓	
42	SILS	“Silver Ligth securities” LLC	✓				
43	STIN	“Standard Investment UtsK” LLC	✓	✓	✓	✓	
44	TABO	“Tavan Bogd UtsK” LLC	✓				
45	TCHB	“Tulgat Chandmani Bayan UtsK” LLC	✓				
46	TDB	“TDB Capital UtsK” LLC	✓		✓		
47	TNGR	“Tenger Capital UtsK” LLC	✓	✓	✓	✓	
48	TTOL	“Apex Capital” LLC	✓	✓			
49	UNDR	“Undukhaan Invest UtsK” LLC	✓	✓			✓
50	ZGB	“ZGB UtsK” LLC	✓	✓			
51	ZRGD	“Zerged UtsK” LLC	✓	✓			✓

Source: MSE, MSX

4.2.1.1. Becoming a member on MSE

The general requirements of a company wishing to become a member of the MSE are compliance with FRC and MSE rules and regulations such as minimum amount of share capital and current asset requirement, work experience, adoption of a regulation on trading, development of a business plan, and settlement of a collateral asset and appropriate amount in the payment guarantee fund as according to the FRC.

The following procedure is followed for a company to be able to trade on the MSE.



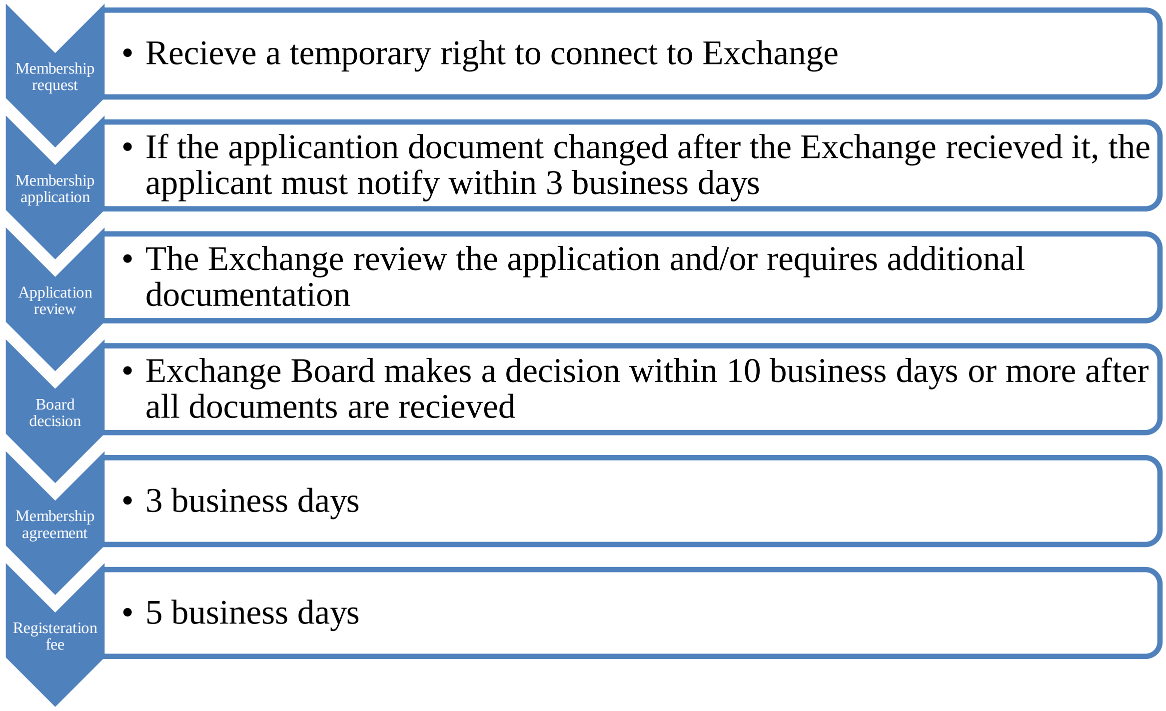
Upon the submission of the application, an application processing fee of 500,000 MNT is due to the MSE and 5 days prior to the signing of the membership agreement, there is a one-time, first time membership fee is 15 million MNT. Additionally, first time members will get a discount on their first year's membership fee.

Annual membership fees are dependent upon the company's business activities. Broker, dealer, underwriting has a membership fee is 2 million MNT while members with a broker, dealer or both licenses must pay 1.5 million MNT annually. The per user fee for trading system use is 195,000 MNT. Members of the Mongolian Association of Securities Dealers (MASD) receive a 10 percent discount from annual membership fees. And if a member conducts 5 percent or more of the total value of the trading executed at the MSE, the member will get up to a 10 percent discount on the next year's membership fee.

4.2.1.2. Becoming a member on MSX

The general requirements to become a member of the MSX is similar to that of the requirements necessary for the MSE. Members of the MSX should follow the rules and regulations set by the FRC and under the Securities Market Law. Additionally, the member cannot be involved in any improper business ethics or illegal activities. Member companies should have a minimum of 5 employees with the necessary qualifications.

As for the capital requirements, it depends on the business. For underwriters, the minimum capital requirement is 1 billion MNT, dealer is 200 million MNT and broker is 100 million MNT. The following figure illustrates the process of applying for a membership at the MSX.



The first-time membership fee is 3 million MNT, which must be paid within 5 business days of becoming official members. The annual membership fee is 1 million MNT which can either be paid within the first month of the year or payment can be spread out over the four quarters and paid within the first 10 days of the respective quarter.

4.2.2. Insurance companies

In the case of Mongolia, there has only been one instance of an "insured bond" on the public market. "Erchim Bond" was issued by "Erchim Engineering LLC" in 2015 on the MSE. The underwriters of the bond were "Golomt Bank" and "Golomt Securities" and "Soyombo Daatgal" LLC was its insurer. On the other hand, there have been instances where insurance companies have provided credit guarantee in those loan agreements mentioned previously, which have been confused by some as a private placement corporate bond. However, due to the nature of the transaction, the procedures and agreements of insurance companies providing a credit guarantee is confidential and thus, unavailable to the public.

Legally, there is no regulation or legislation that provides guidelines for providing credit guarantee for a bond nor is there any which prohibits the activity. Due to this uncertainty, the professional industry is divided on the legality of providing insurance for bonds. When discussed with insurance companies about whether they would be willing to provide insurance or a credit guarantee for bonds, there has been a wide variety of answers. Large insurance companies did not seem to want to be involved in this procedure without a clear guideline provided by the FRC. Some smaller insurance companies have provided credit guarantees, but those agreements are confidential and inaccessible by the public.

4.2.3. Credit Guarantee Fund

The Credit Guarantee Fund was established in 2012 to provide SMEs the opportunity to access financing, who otherwise would have been unable to receive loans from financial institutions due to insufficient collateral. The industries the program and fund has served are manufacturing, services, agriculture and trade. The fund provides guarantees up to 60 percent of the loan amount with a maximum limit of 500 million MNT.

The cost of the guarantee depends on the loan:

	ADB project loan	Basic guarantee/other loan
Application fee	50,000 MNT	10,000 MNT
Fee	1% from the guarantee outstanding	Depending on the duration of the loan, 1-3% of the guarantee will be charged once

Source: CGF

As of the end of 2018, the total assets of the fund were 70.3 billion MNT. The guarantees outstanding were 51.1 and the outstanding of loans with guarantees were 101.2. The percentage of non-performing of guarantees outstanding was 14.2 percent in the fourth quarter of 2018.

	2016	**2017**	**2018**
Total assets (billion MNT)	6.5	23.3	70.3
Guarantee outstanding	25.3	25.9	51.1
Loans outstanding with guarantees	61.4	59.4	101.2

Source: FRC

Of the guarantees granted, 81.5 percent were small businesses and the remaining were individuals. Of the guarantees provided by the fund, the average amount of guarantee provided per loan is 189.9 million MNT. The average per guarantee for a business is 216.2 million MNT and 123.6 million MNT per individuals.

4.2.4. Deposit Insurance Corporation

The Deposit Insurance Law was adopted in 2013 and laid out the foundation for the establishment of the Deposit Insurance Corporation of Mongolia to ensure protection of depositors' interests and promote financial stability. The corporation is state-owned. Commercial banks pay a premium on a quarterly basis, which is then accumulated in the fund.

Any person or entity who has a current or savings account at any of the commercial banks are eligible for deposit insurance for up to 20 million MNT for each depositor at each bank. Reimbursements, in the case of an insured event such as the liquidation of bank by the Bank of Mongolia, is made through a selected bank and process can take up to 3 years. The reimbursement amount is calculated as the total insured deposits in the bank with accrued interest less the amount of loans past due by 90 days and its accrued interest as of the date of the insured event.

The following deposits are not eligible for deposit insurance:

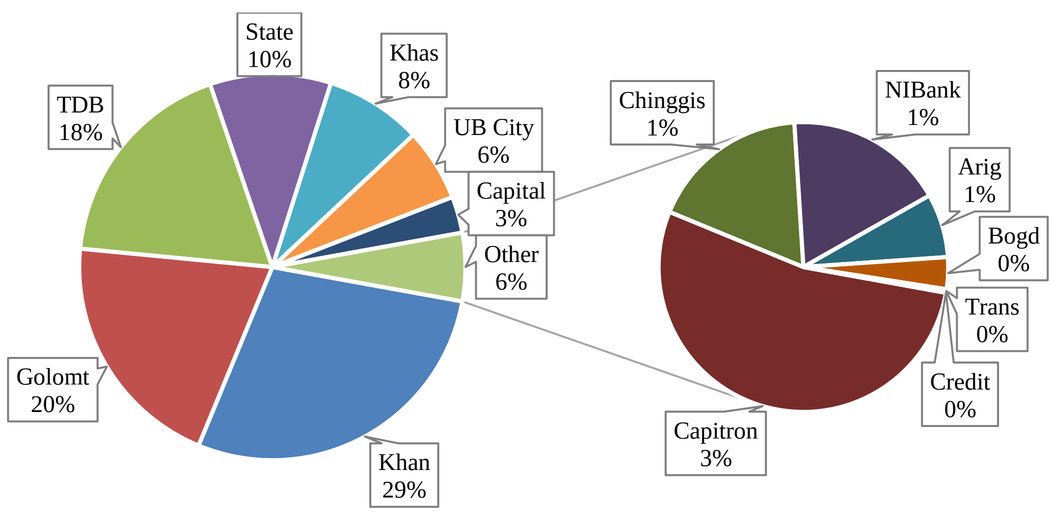
- Anonymous or numbered bank accounts or accounts under assumed names
- Anonymous deposit certificates and other anonymous financial instruments
- Deposits which are not repayable at par

And the deposits of the following depositors are not eligible for deposit insurance:

- Banks
- State bodies and organizations, municipal bodies and organizations and other forms of local self-governing organizations
- Health insurance funds, pension funds, and social insurance funds
- Related parties of banks as defined in Article 3.1.2 of Banking Law
- Auditors and auditing organizations that audited financial statements of the bank within three years prior to the occurrence of an insured event
- An entity which received a loan on more favorable terms compared to other depositors in terms of type of transaction, risk level, creditworthiness, and collateral type
- An entity which has enjoyed a lower interest rate for a loan compared to other depositors
- A depositor who has received interest payments at a rate at least 50 percent higher than the average interest rate received by other depositors upon occurrence of an insured event, according to the statistical information of the Bank of Mongolia. Uninsured deposits are not eligible for reimbursement when bank is liquidated

A total of 36.1 billion MNT was collected from commercial banks in 2017. The figure below breaks down the percent of the total collect fee each bank contributed.

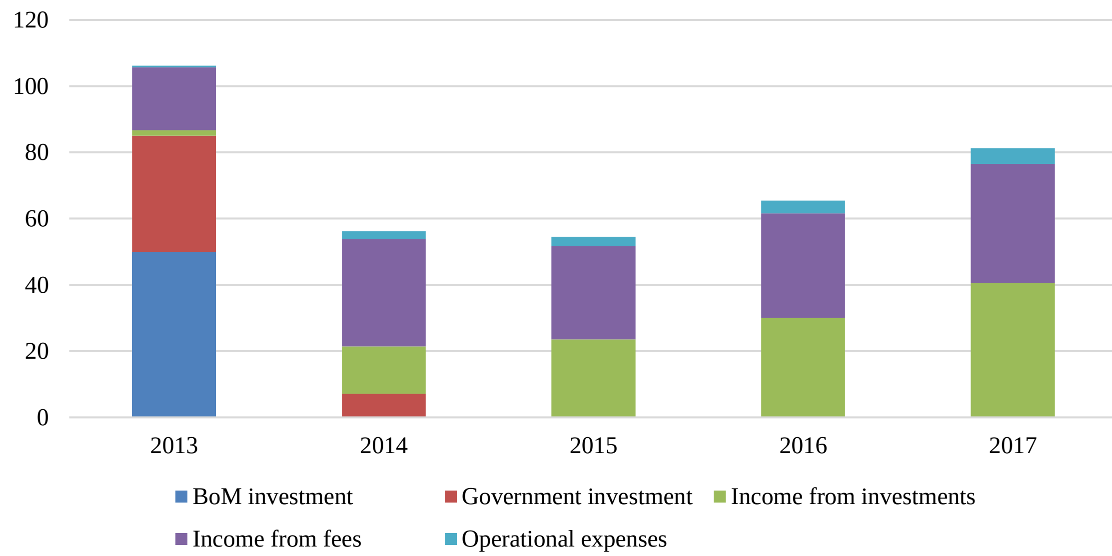
Figure 15. DIC collection fee by bank



Source: DIC

These fees collected from the commercial banks are then invested into Central Bank bills and government bonds. The interest collected from these bonds in 2017 were 38.7 billion MNT. The maturity of these bonds tends to range from a week to 10 years. The Central Bank bills held have maturity of less than 3 months.

Figure 16. Income by type, billion MNT



Source: DIC

4.3. Investor

For an individual or enterprise to participate in trading, an account at a securities company must be opened. This securities company acts as a broker to fulfill the clients' orders. The procedure for opening an account at a securities company is standard. The following documents are required:

- For individuals
  - Identification document if a Mongolian citizen;
  - Passport for foreign individuals and residence card if citizen of a foreign country;
  - Open an account at the securities company in person (in the case unable to visit, a legal representative may be sent)
- For minors
  - Child's birth certificate
  - Identification document if the child is above the age of 16
  - Document confirming the child's representative /identification card of the Child Representative/
- For legal entities
  - Legal entities registered in Mongolia:
    - Account opening request letter /addressed to the MCSD, MSCC, clearing bank/ (1 copy each)
    - Account application form /by the approved form of the company/ (2 copies)

- Certified true cope of State Registration Certificate issued /to be notarized, and for foreign investment company shall be made “Foreign Investment JSC and LLC’/ (2 copies
- Certified true copy of Corporate Charter registered in the State Registration Authority /to be notarized/ (2 copies)
- Company’s Board Resolution (in its absence, the Shareholders’ meeting resolution) designating an Authorized Company Representative who can sign on behalf of the company /original copy/ (2 copies)
- Authorized Company Representative’s authorized signature /to be notarized and stamped/ (4 copies)
- Authorized Company Representative’s identification document (4 copies)

- Foreign legal entities:

Four accounts are opened to participate in securities trading, the table below explains the various accounts.

No	**Organization account opened at**	**Account**	**Who opens the account**	**Asset to save**	**Account usage**	**Cash deposits into account**	**Expense transactions from account**
1	Securities company	Securities account	In-person /opens instantly/	Securities	To participate in securities trading; to store securities	No cash transfers are available	No cash transfers are available
2	Clearing bank[4] for securities settlement	Joint settlement account for security trading	In-person /opens instantly/	Cash assets	To execute securities settlements in the secondary market	To deposit cash in order to buy securities in the secondary market’ the cash will be placed into the account if you sold securities	To receive cash in any of your bank accounts by sending online money request application /can be conducted in person as well if securities company office is visited/
3	MCSD	Depository account	Securities company opens for you	Securities, dividends, payme	Central securities registration	To receive dividend payments if the JSC decided to	To make expense transactions by visiting the securities company office and

[4] As of 2018, there are four clearing banks: Khan Bank, Golomt Bank, Trade and Development Bank and Xacbank.

			/opens in 1-2 business days/	nt from liquid ated assets		distribute through the MCSD; to receive payments from the liquidation of the JSC	providing a money request application
4	MSCC	Securities settlement account	Securitie s company opens for you /opens in 1-2 business days/	Cash assets	To execute securities settlement s in the primary market	To deposit cash in order to buy securities in the primary market; to receive coupon payments due and bond principal at maturity	To make expense transactions by visiting the securities company office and providing a money request application

Source: TDB Capital

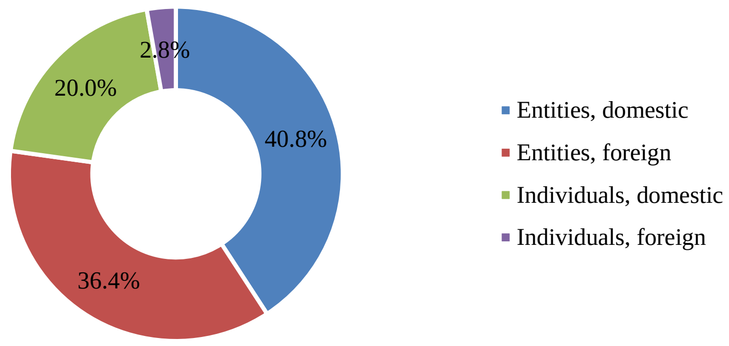
The process of trading is as follows:

1. Open an account a securities company, which will also require an account at a clearing bank for securities settlement → the securities company then opens an account for you at the MCSD and MSCC
2. For primary trading, cash is deposited into your MSCC account while for secondary trading, it's deposited into your clearing bank account
3. Making trading orders on primary market: order is placed at securities company and the securities company provides trade information and executes the trade through the MSE → the MSE then exchanges information with the MCSD and MSCC → once the trade has been executed, the MSCC conveys the information back to the MSE and securities company
4. Making trading orders on the secondary market: order is placed at the securities company → the securities company checks your balance at the clearing bank to ensure sufficient funds before conveying the order information to the MSE → the trade execution is similar to the primary market trading but with the addition that the MSCC relays information to the clearing bank as well
5. In receiving your securities, the MCSD updates its database and conveys the message to the securities company which provides you with the securities

Since trading on the secondary market was allowed, a total of 1,304,371 accounts and 160,805 escrow accounts have been opened. Of the 1.3 million accounts, 1,299,268 accounts are domestic investors, 2,198 foreign investors, 2,712 domestic enterprises and 193 foreign enterprises. The number of newly opened accounts jumped in 2018, relative to previous years. In 2018, 398,255 new accounts were open while in previous years it was 19,544 (2017), 80,994 (2016), 19,715 (2015), and 10,540 (2014).

At the end of 2018, domestic investor comprised a large portion of all trading of shares, government securities and corporate bond on the secondary market.

Figure 17. Trading by type of investor

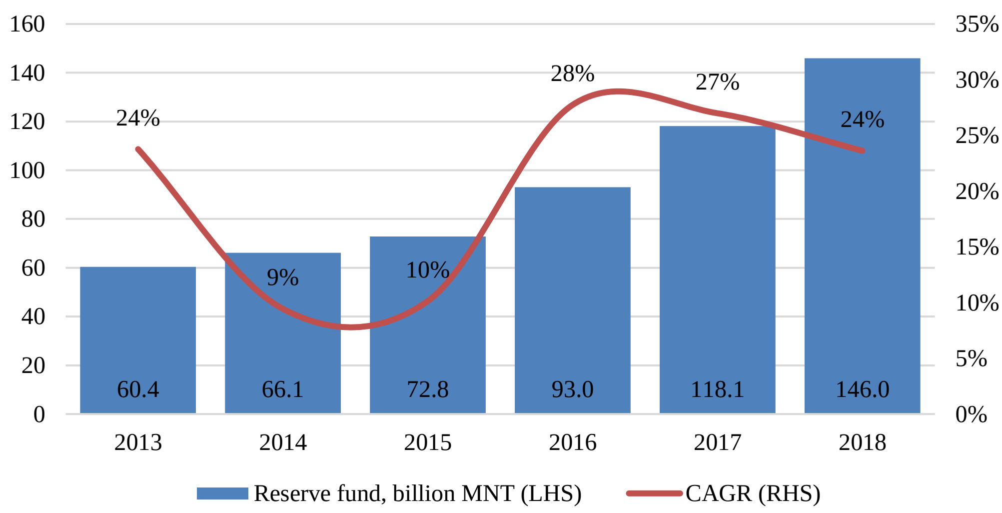


Source: FRC

4.3.1. Insurance companies

According to Article 14 of the Law on Insurance, an insurance company may use up to 30 percent of its reserve fund to purchase bonds and securities as a long-term investment.

Figure 18. Insurance sector reserve fund



Source: FRC

However, insurance companies are relatively risk adverse, which implies that unless the investments are into very secure financial instruments, the likelihood of an insurance company as a corporate bond investor is low. On the other hand, if the corporate bond market was more regulated and safeguard by regulations, insurance companies may be more willing to invest.

The FRC passed a package of insurance regulations in January 2019. Among the 17 new regulations, the FRC placed an upper limit on the types of financial instruments the reserve fund could be invest into. They are as follows:

<table>
<tr><th colspan="2">Type</th><th>Upper limit</th></tr>
<tr><td colspan="2">Bank deposits</td><td>100%</td></tr>
<tr><td colspan="2">Bank certificate of deposit (CD)</td><td>80%</td></tr>
<tr><td colspan="2">Government debt instruments</td><td>100%</td></tr>
<tr><td colspan="2">Central bank bills</td><td>60%</td></tr>
<tr><td colspan="2">Financial leasing</td><td>10%</td></tr>
<tr><td colspan="2">Asset backed securities</td><td>60%</td></tr>
<tr><td colspan="2">Investment fund</td><td>20%</td></tr>
<tr><td colspan="2">Provincial debt instruments</td><td>60%</td></tr>
<tr><td colspan="2">Corporate debt instruments</td><td>20%</td></tr>
<tr><td rowspan="2">MSE equity</td><td>Tier 1</td><td>10%</td></tr>
<tr><td>Tier 2</td><td>5%</td></tr>
<tr><td colspan="2">Deposits in NBFIs (must be independent of said insurance company)</td><td>20%</td></tr>
<tr><td colspan="2">Collateralized savings loan /only applicable to long-term insurer/</td><td>30%</td></tr>
</table>

Source: FRC

Thus, based on these new regulations from the FRC, up to only 20 percent of the reserve fund can be invested into corporate bonds.

4.3.2. Investment/trust funds and pension funds

Some other potential investors of corporate bonds are asset management funds and pension funds.

4.3.2.1. Asset management companies

As of August 2019, there are 20 licensed asset management companies:

1. "Bat Capital Management SC" LLC
2. "Silk Road Asset Management" LLC
3. "Exponential Fund Management SC" LLC
4. "Bodi Invest" LLC
5. "Rhinos Asset Management Mongolia" LLC
6. "Virtus Asset Management SC" LLC
7. “National Asset Management SC” LLC
8. "DBM Asset Management" LLC
9. "Gerege Management SC" LLC
10. "Golomt Asset Management SC" LLC
11. "Glacier Asset Management SC" LLC

12. "Master Investment Management" LLC
13. "Ulaanbaatar Asset Management SC" LLC
14. "Nomad Capital Management SC" LLC
15. "Ard Management SC" LLC
16. "Mongolia Wealth Management SC" LLC
17. "TB Asset Management" LLC
18. "UAN Partners" LLC
19. “Ochun” LLC
20. “Truss Chain Management” LLC

4.3.2.2. Public Pension Fund

The Law on Social Insurance outlines the following sources of income and how it may be spent:

Article 10. Social insurance fund sources of income

> 10.1 Income for the social insurance fund shall come from the following sources:
>
> > 10.1.3 bank interest on deposits of the uncommitted balance and income from trade of securities;

Article 11. Social insurance fund spending

> 11.3 The fund can be invested into Government Bonds and Central Bank Bills or deposited in commercial banks.
>
> 11.4. The Parliament shall approve the amount of the fund in the Budget Bill annually.
>
> 11.5. The minister of Social Protection, Bank of Mongolia and National Committee of Social Insurance shall decide together the amount of deposit at commercial banks.

Based on these provisions cited in the Law of Social Insurance, the social insurance fund can only be invested in government bonds, central bank bills, and commercial bank deposits. In other words, the fund cannot be invested into other financial instruments such as corporate bonds. As for source of income, interest from bank deposits are available for the Social Insurance Fund and “income from trade of securities.” These “securities” are only government bonds and central bank bills.

Table 20. The interest income from bank deposits and securities, MNT billion

	2012	**2013**	**2014**	**2015**	**2016**	**2017 (exp)**	**2018 (apr)**
Deposit at GB and CBB	188.1	108.1	90.0	140.0	57.0	57.0	57.0
Interest income	3.3	12.9	0.0	10.8	4.4	4.4	16.7
Deposit at banks	163.0	245.0	532.0	470.0	510.0	570.0	740
Interest income	14.3	26.0	44.5	51.8	55.5	67.1	83.2

Source: Budget Presentation at Parliament 2015-2018 /www.parliament.mn/

In the Budget Bill **2019**, the planned interest income from bank deposits and securities is 68.6 MNT billion. It was also approved that up to 100 MNT billion can be spent for buying long term Government bond (1 year or more).

4.3.3. Cost of investing

The main costs associated with investing are pretty standard. As any trading has to be conducted through a brokerage company, the main costs are account opening fee, maintenance fee, commission/transaction fees.

For instance, to open an account at a brokerage, there is an opening fee of merely 5000 MNT and transaction fees are usually between 1.5-3 percent of trade. In addition to brokerage fee, an account must be opened at the MCSD. Besides these fees and commission, the time required for either an individual or an enterprise to register and open these accounts needs to be considered. As for the settlement or transfer of bonds or notes, there is a service fee of 2500 MNT.

4.3.4. Impediments to investing

Some of the biggest impediments to investment is trustworthiness. Most investors are unsure about whether or not they can trust the financial statements given by the companies and even in the instance where it is audited, can the auditing be trusted. The bond market in Mongolia is also very limited with very few players.

5. Outlook

5.1. Projections of economic growth and financial requirements of domestic financial markets

It is difficult to be accurate about the future growth of financial markets, but we can make some assumptions and use simple approaches to see how Mongolia's bond market is likely to grow in the coming years. In order to project forward the size of the domestic bond markets, HSBC, for example, uses a combination of historical market growth and an IMF forecast of nominal GDP growth (HSBC, 2015 "Asian Fixed Income Handbook: A Guide for Investors"). This approach was used by research team.

Table 21. GDP and total asset of financial system

	2014	**2015**	**2016**	**2017**	**2018**
GDP at current prices, MNT bln	22,227	23,150	23,943	27,167	31,201
Nominal GDP growth	15.9%	4.2%	3.4%	13.5%	14.8%
Total asset of Financial system, MNT bln	23,381	22,483	26,538	30,231	34,956
Total asset growth	8.6%	-3.8%	18.0%	13.9%	15.6%
Total asset / current GDP	105%	97%	111%	111%	112%

Source: NSO, BOM and FRC

From the table above, it can be deduced that the total asset of the financial system generally follows the GDP growth and has maintain a GDP ratio of around 110 percent for the past five years. So, in order to forecast the general size of the financial system in Mongolia, we can assume that its total asset will trend in the same manner as nominal GDP growth.

According to IMF forecast, Mongolia's GDP at current prices may grow from 32 trillion MNT at the end of 2018 to 65.4 trillion MNT by the end of 2024, in other words, double in six years. Thus, assuming nominal GDP growth will keep its pace at 12.2% between 2025 and 2028, we can forecast that the total asset of the entire financial system could grow 3.2 times to reach 113.9 trillion MNT by 2028.

Table 22. GDP and total asset of financial system forecasts, at current prices, MNT trillion

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
GDP at current prices	36.8	41.4	46.4	51.8	58.1	65.4	73.3	82.3	92.3	103.6
Nominal GDP growth rate, percent	14.5	12.5	12.0	11.7	12.2	12.4	12.2	12.2	12.2	12.2
Total asset of financial system at current prices	40.5	45.6	51.0	57.0	63.9	71.9	80.7	90.5	101.5	113.9

Note: Forecasts of GDP at current prices and its growth rate between 2019 and 2024 are from IMF World Economic Outlook in April 2019. In addition, we assume that growth of nominal GDP will be constant at 12% (average of last five years) between 2025 and 2028 and total asset to GDP ratio will remain constant at 110% between 2019 and 2028.

Source: researcher's calculation based on IMF World Economic Outlook data and NSO data

To estimate growth of financial requirements of the domestic financial market, we used a top-down approach instead of a bottom-up approach as it is very difficult to obtain long-term investment plans of the government and major businesses.

According to the collected NSO data (table below), total investment accounts for 41.3 percent of GDP on average during the period between 2010 and 2018. Of this, the government sector investment accounts for 7.5 percent on average. The national account data also shows that an additional 3.6 units of capital, on average, was used to produce an additional unit of output (Incremental Capital-Output Ratio).

Table 23. Total investment share of GDP, public investment share of budget expenditure and ICOR, 2010-2018

	2010	2011	2012	2013	2014	2015	2017	2018	Average
Total private investment, % of GDP	42.1	58.2	55.9	53.3	35.2	26.4	25.7	31.4	41.3
Public investment, % of budget expenditure	19.2	25.6	25.3	24.2	24.8	19.6	24.9	18.3	22.1
Incremental Capital-Output Ratio	1.3	2.2	2.7	4.1	2.6	6.6	7.8	2.2	3.6

Source: researcher's calculation based on IMF World Economic Outlook data and NSO data

Based on these past trends and long term forecasts by IMF, we estimate that the total and private sector financing requirements of the domestic market as follows:

Table 24. Financing requirement forecasts

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Gross national savings, tln MNT	10.2	11.1	12.8	12.8	14.6	16.9	19.1	21.4	24.0	27.0
Total investment, tln MNT	14.5	15.6	17.3	17.1	17.8	20.0	24.8	27.8	31.2	35.0
Of which, public investment, tln MNT	2.6	2.7	2.8	3.1	3.4	3.9	4.6	5.2	5.8	6.4
Required private investment, tln MNT	12.0	12.9	14.5	14.0	14.3	16.1	20.1	22.6	25.4	28.6

Note: Forecasts of total investment and gross national savings between 2019 and 2024 are from IMF World Economic Outlook in April 2019. For further forecasts in the period of 2025 to 2028, we assume that the shares of savings and investment of nominal GDP will remain on the corresponding averages (26.0% and 33.8%) of the last five years. For the public investment, we simply assume that it is public investment-budget expenditure ratio will remain at 22.1 percent (average ratio as shown at Table 23) for 2019 to 2028. To estimate private sector investment, we subtract public investment from total investment.

Source: researcher's calculation based on IMF World Economic Outlook data and NSO data

5.2. Projections of corporate bond market size

From 2010 to 2018, total private investment in current prices increased three times while bank loan for businesses increased fourfold and non-bank financial institute loan for businesses increased by eight times. However, private investment through equity and corporate bond financing has been negligible and less than 0.01% of GDP as shown in the table below.

Table 25. Private investment through domestic financing, billion. MNT

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total private investment	3,516	6,380	7,803	8,724	6,047	4,718	3,801	7,098	11,978
Bank loan for business	2,688	5,157	4,659	7,730	7,360	5,548	6,126	6,293	11,773
NBFI loan for business	78.1*	119*	157.8*	223.7*	303.1*	251	307	394	625
IPO and FPO	0.4	22.0	0.9	0	2.1	19.6	6.3	1.3	30.4
Newly issued corporate bonds	0	4.4	0	0	0	0.5	0	6.0	1.0

*-total loan instead of business loan data which is not available.

Source: NSO, BOM, FRC, MSE and MSX

Central Asian countries have underdeveloped financial systems where private bond market sizes are almost non-existent while the size of local currency denominated corporate bond market in transition economies of Eastern Europe are between 15% and 34% of GDP (Burger, Warnock, & Warnock, 2015). In East Asian developing countries, the size of corporate bond market is larger than 2% of GDP and has been growing for the last 18 years as shown in the table below.

Table 26. The depth of local currency corporate bond market (outstanding as a percentage of GDP)

	2000	**2003**	**2006**	**2009**	**2012**	**2015**	**2018**
Indonesia	1.4	2.3	1.8	1.5	2.2	2.2	2.8
Philippines	-	-	1.7	4.4	5.0	6.1	7.5
China	-	0.8	3.0	8.0	14.0	24.1	28.8
Thailand	4.4	7.3	10.4	12.3	14.2	18.3	21.2
Malaysia	35.2	36.6	31.7	40.5	41.3	43.1	48.6
Viet Nam	-	-	1.0	3.1	1.5	1.2	2.0

Source: Asian Bonds Online (https://asianbondsonline.adb.org/data-portal/)

To estimate the projected size of the corporate bond market, we should consider several important factors such as institutional development, interest rate gap among domestic financial institutions, limitations on issuing government bond and tax on interest income of corporate bond.

- Academic literature, such as Claessens, Klingebiel, and Schmukler (2003) and Burger and Warnock (2005), show that the main determinant of the size of the bond market is the protection of creditor rights in a country. Creditors are willing to purchase arm's length securities' products such as corporate bonds, only when they are convinced that their claims will be repaid without too much difficulty. Based on the study of corporate bond market development in Asian 10 countries from 1995 to 2014, Kowalewski and Pisany (2017) finds that institutional quality and macroeconomic factors are strongly associated to the depth of the market. The higher the demand for bank loans, the more the financial institutions and corporates issue bonds. According to the Global Competitiveness Report 2017-2018, Mongolia's overall rank is 101 out of 137 countries (WEF, 2018). In particular, the rank of Financial market development was very low, 129. Especially, sub-pillars such as Regulation of securities exchanges (rank is 131), Availability of financial services (129), venture capital availability (129), Soundness of banks (126) are the weakest.
- Interest rates gap among domestic financial institutions has been constant for the last few years in Mongolia as shown in the table below. For example, the interest rate gap between banking loan and corporate bond was 1.1 percentage point in 2015 while it was 1.2 percentage point in 2018.

Table 27. Average interest rates, in domestic currency

	2015	2016	2017	2018
Banking loan	19.6%	19.7%	19.5%	18.2%
Banking deposit	13.0%	13.3%	12.9%	12.4%
Government bond, long term	16.4%	15.7%	16.8%	-
Corporate bond/private placement	18.5%	-	17.5%	17.0%

Source: BoM, MSE, MSX

- Whether the Government issues bonds or not and in terms of size, is there any limit on issuing a government bond are important issues as governments compete with corporates in the bond markets. In the Government Strategy of Debt Management 2019-2022, it states that the government shall not issue foreign currency bonds except for re-financing while local currency bonds will be issued mainly for citizens not for banks. The government projects the domestic government outstanding to be 1.9 trillion MNT in 2019, 1.7 trillion MNT in 2020, 1.5 trillion MNT in 2021 and 1.2 trillion MNT in 2022.

- Tax credit/exemption on interest income of corporate bond can incentivize investments as well. According to the new regulation under the tax reform approved by the Parliament in May 2019, interest income on debt instruments issued by a Mongolian listed company without exploration and mining licenses in the extractive industry is subject to a 5 percent tax. Previously it was 10 percent. The interest income of commercial bank loans and debt instruments funded by domestic and foreign sources is subject to a 5 percent tax rate as well. These incentives can have a positive effect on the development of the corporate bond market.

Considering the above-mentioned factors and making the following assumptions, we are able to forecast the corporate bond market size:

a. Retained earnings ratio (net income to asset ratio) to be 4%, within the range of 3 to 6% (Alves & Pereira, 2017). According to the 2015 Business Census by NSO, total asset of private businesses was 15.7 trillion MNT in 2010 and 41.1 trillion MNT in 2015. We assumed that the annual growth of total business asset in current prices follows the nominal GDP growth. Using forecasts of IMF, retained earnings of businesses were projected.
b. Bank loans for business to GDP ratio was 30.7% in 2018. We assume that this ratio gradually decreased from 24% to 18% (its average between 2012 and 2018) over the next four years and maintain the ratio until 2028.
c. Business loans from non-banking finance institutions has increased drastically for last three years. However, due to strong competition from the banking sector, we assumed that the amount of NBFI loans will increase by 10 percent annually.
d. New equity shares will gradually increase from 0.1% of GDP to 0.55% between 2019 and 2028.
e. We may subtracted a), b), c) and d) from the aggregate required private investment to estimate the total demand for corporate bond market size.

The projections based on these assumptions and calculations are shown in the table below.

Table 28. Forecasts for financing requirement through, trillion MNT

		2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
1	Required private investment	12.0	12.9	14.5	14.0	14.3	16.1	20.1	22.6	25.4	28.6
2	Retained earnings of private businesses	2.6	3.0	3.3	3.7	4.1	4.7	5.2	5.9	6.6	7.4
3	Bank loans for business	8.8	9.1	9.7	10.4	10.5	11.8	13.2	14.8	16.6	18.6
4	NBFI loans for business	0.7	0.7	0.8	0.9	1.0	1.1	1.2	1.3	1.4	1.6
5	New equity share issues	0.04	0.06	0.09	0.13	0.17	0.23	0.29	0.37	0.46	0.57
6	Demand for corporate bond	-	0.01	0.61	-	-	-	0.24	0.24	0.33	0.47

Source: researcher's calculation based on IMF World Economic Outlook data and NSO data

As shown in the last row of the table, the demand for corporate bond will fluctuate. For instance, it will be high in 2021 as required investment considerably increases while it is expected to be zero for the next three years as economic growth is slowing down – however, demand is projected to increase gradually.

The projection for financing requirement through corporate bond includes project bonds. It is difficult to separately estimate the amount of project bond as we do not have any disaggregated sector projection of gross output. However, we can try to estimate it using a historical trend. As listed in Table 1 in Section 2, there have only been 16 public corporate bonds issued. Of this, 8 of the public corporate bonds can be identified as short-term (less than one year) project bonds because they were issued by construction companies for mainly financing current construction projects. If we assume this trend will continue into the future, we can estimate that the demand for corporate project bond will be approximately half of the total estimated demand for corporate bond projected in the last row of Table 28. As for the maturity of the estimated project bonds (or even corporate bonds), we cannot say anything based on the currently available information.

5.3. Potential SME financing

According to the new Law of Promoting Developing Small-Medium Enterprise of Mongolia (2019), a business is defined to be SME if its number of employees are less than 200, annual sales turnover is less than 2.5 billion MNT and its activities are in manufacturing, wholesaling, retailing, trading and service sectors. A detailed break-down of the SME definition is in the table below.

Table 29. Classification of SME in Mongolia

Category	Number of employees	Annual sales turnover
Micro	Up to 10	Up to MNT 300 mln.
Small	From 10 to 50	From MNT 300 mln to MNT 1 bln
Medium	From 50 to 200	From MNT 1 bln to MNT 2.5 bln

Although there is no official number of SMEs in Mongolia, it can be calculated that SMEs account for at least 85 percent of total enterprises by considering only 2.9 percent of total enterprises having more than 50 workers and 13 percent are operating in other sectors. The main sources of SME financing are bank loans and NBFI loans. If we assume all business loans issued by NBFI as SME loan, total SME loan issued in 2018 is around 2,566 billion MNT, 21 percent of the total financial sector loan.

Table 30. Bank and NBFI SME loan, billion MNT

	2014	**2015**	**2016**	**2017**	**2018**
Loan issued by banks	827	580	532	1102	1941
Outstanding loan by banks	906	779	698	809	1196
Loan issued by NBFI	-	251	307	394	625

Source: BoM and FRC

In a recent study of SME financing (BOM 2017), 56 percent of surveyed SMEs used external financing instrument for their business. Of those, 81 percent receive loans from banks, 7 percent from NBFI, 6 percent get subsidized loans and the remaining from informal sources such as family or friends. About 64 percent of them reported using loans for current asset, 24 percent for equipment and building, 9 percent for business expansion and 2 percent for training workers. In total, 65 percent of surveyed SMEs reported planning to get additional funding and out of those, 5.3 percent need more than 500 million MNT.

	Issued date	**Bond interest rate**	**SME bank loan interest rate in current month**
Park town bond	2018.12	17	18.6
Suu bond	2017.06	17.5	23.1
Erchim bond	2015.08	18.5	26.5 (average of max and min rate)

Source: TDB capital and BoM

If one compares the interest rates of average SME loans and corporate loans, issuing bonds would be a cheaper source of financing as shown in the table above. However, it is important to consider the cost of issuing bond by enterprises as discussed in Chapter 4.

6. Recommendation

This report tries to provide a snapshot of the current situation of the capital market in Mongolia, specifically its domestic corporate bond market. Based on the procedures and costs which issuers, intermediaries and investors encounter in accessing the domestic corporate bond market, the following impediments and lack of building blocks were observed.

The private corporate bond market is barely regulated or supervised. As there is a no centralized registration of these bonds, the actual volume of the market is unknown. The lack of regulation also does not assist issuers or investors in issuing bonds at a cheaper rate. Due to the high bank deposit rates, the latest public corporate bond had a coupon rate of 17 percent whereas most private placement bonds in recent months have even higher coupon rate of over 20 percent. As such, high interest bank deposits are the main hinderances issuers face in attracting investors.

The some of the main cited reasons by companies for issuing private placement rather than public bonds is the time consuming, costly process of issuing public bonds or the companies are unable to receive a bank loan due to a lack of transactional history or insufficient collateral. Companies turn to bonds as a quick and cheap source of financing; however, in Mongolia, the current procedure of issuing a public bond can take up to a year, by which time, the situation of the market has changed and its long after the needed investment.

From the investor side, there is a severe lack of institutional investors. The Social Insurance Fund is restricted in the financial instruments in which they can invest, which does not include corporate bonds. There is also a lack of trust in non-bank institutions and companies. With this deep trust in banks, commercial banks are highly liquid and do not have any incentives to offer other financial and debt instruments, such as long-term CDs. The lack of credit rating agencies also contributes to the lack of trust in corporates. If a credit rating agency was established, it could allow for more transparency and trust in the capital market.

The FRC could help alleviate some of these impediments by streamlining the process for bond issuance, providing regulations and guidelines on allowing “insured bonds,” establishing at least a registration of privately placed corporate bonds so as to help create a history for frequent issuers. A database of private placement bonds could help issuers lower the coupon rate if they have a good track record of making back on time and it could help investors also assess the market themselves and perhaps become a professional investor who is able to invest in these businesses.

However, it should be noted that the corporate bond market will not flourish just by addressing some of these impediments. The capital market itself as a whole and in a broad sense need to be reformed and refined further before the corporate bond market can take off. Thus, the development of the corporate bond market may take several years or decades before it can become a source of financing for companies and an investment possibility for investors.