



# AMCHAM POSITION PAPER

## CAPITAL MARKET DEVELOPMENTS: THE CASE OF MONGOLIA

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# OVERVIEW

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Mongolia reached upper-middle-income status (UMIC) in 2024 due to its coal-driven economic expansion in 2023. Following years of mining sector expansion, the East Asian nation attained UMIC status for the first time in 2015. That status, however, was only temporary, as a 2016 economic crisis resulted from expansionary macroeconomic policies and foreign shocks to the minerals industry. The mining sector accounts for one-fourth of GDP, 31 percent of state revenue, nearly 80 percent of foreign direct investment, and 92 percent of exports. This heavy reliance makes the country vulnerable to external shocks. In recent years, authorities have tried to develop a prudent banking and financial sector to upscale the capital market's role.

While the Mongolian Stock Exchange (MSE) sees its market capitalization rise, it plays a rather limited role in the broader financial market dominated by commercial banks. Due to amendments to the Banking Law, five systemically important banks (Khan Bank, Trade and Development Bank, Xac Bank, State Bank, and Golomt Bank) became publicly listed companies. This strategic move resulted in a substantial capital infusion of 302.5 billion MNT, according to the MSE.

In its 2024Q2 Macroeconomic Report-, the Ministry of Economy and Development reiterated that the Mongolian stock market is expanding. The same report shows that market capitalization was 11.3 trillion MNT in Q2, up 2.8 percent and accounting for 16.5 percent of GDP. During the reporting quarter, securities trading totaled 645.8 billion MNT, a 1.4-fold increase from the previous period. Corporate bonds comprised 80.9 percent of trading, 8.9 percent were stocks, 6.9 percent were asset-backed securities, and 3.3 percent were investment fund units.

The MSE's inclusion as an eligible market in the FTSE Russell's Frontier Index is a significant achievement. However, no MSE-listed companies

are included in index tracking, which consists of 271 constituents (172 from the Asia-Pacific region) as of October 31, 2024. Below are the characteristics of the FTSE Frontier Asia Pacific Index:

Dividend yield:	2.08%
Constituent sizes (Net Market Cap in USD millions):	
Average	255
Largest	3,335
Smallest	9
Median	109

Morgan Stanley Capital International (MSCI) is another highly reputable international capital market classification index. The size requirement to qualify for the MSCI Frontier Index used to be fairly high. However, it was recently reduced to having at least one company that meets a total market capitalization of 126 million USD and a floating market capitalization of 63 million USD. There are currently seven companies that meet the total market capitalization requirement. To meet the floating market capitalization requirement, either the companies' market values need to increase, or the companies need to list more shares on the MSE. There is also a 2.5 percent liquidity requirement. If the MSE were recognized as an MSCI frontier market, it would be excellent international recognition for the market and its listed companies.

In 2015, the Ulaanbaatar Securities Exchange (UBX) became the second stock exchange in Mongolia to receive a special license from the Financial Regulatory Commission (FRC) to engage in trading and settlement activities. To advance the Mongolian capital market's growth and launch new products and services, UBX, rebranded in 2021 with the slogan "Together Toward Development", is working to develop its human resources and infrastructure. Privatizing state-owned entities (SOEs) should take place through the MSE or the UBX to develop the Mongolian capital market.






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# OPPORTUNITIES

## Increase visibility to international investors

As noted above, if Mongolian companies are included in internationally tracked indices such as the FTSE Frontier Index, it would greatly increase the visibility of the local companies and market to foreign investors.

Numerous companies on the MSE could be considered for inclusion. Below is an overview of our top five banks:

	 <b>STATE BANK</b>	 <b>GOLOMT BANK</b> <small>Committed to and Investing in Excellence</small>	 <b>KHAN BANK</b>	 <b>TDB</b> <small>ХҮҮЛАЛДАА ХӨГЖИЙН БАНК</small>	 <b>XACBANK</b>
Market capitalization as of June 31, 2024 (USD million)	105.1	223.5	562.4	366.6	215.9
Dividend yield as of December 31, 2023	11.84%	9.93%	11.77%	3.08%	4.01%

The data above shows that all of the banks' dividend yields exceed the FTSE Frontier Index's dividend yield threshold, and nearly all of their market sizes are above the median size of its constituents. Other companies' stocks, such as Gobi and APU, could be considered for index inclusion.

## Partner with international markets to allow for secondary listing

Secondary listing requirements in many international markets are less stringent than primary listing requirements. However, for companies listed on the MSE to secure a secondary listing in foreign stock markets, the MSE needs to achieve recognized stock exchange status in the foreign market. To achieve this status, the MSE needs to show that its rules and regulations align with those of international exchanges and that local investor

protection laws align with international practices.

Many investors have the misconception that the U.S. over-the-counter (OTC) market is mostly for bond issuances or low-profile companies. However, as noted during an FRC [webinar](#), the U.S. OTC market's main assets are equity products, and many reputable international companies choose to list on the OTC market. The benefit of the U.S. OTC

market is that it allows MSE-listed companies' stocks to be purchased by U.S. investors. No stringent U.S. Securities and Exchange Commission requirements need to be complied with, such as having to present financial statements in accordance with U.S. Generally Accepted Accounting Principles

(GAAP) and comply with Sarbanes Oxley (SOX) requirements. Companies currently listed in the MSE's Classification I or Classification II boards can be considered for OTCQX or OTCQB on an [individual basis](#).

## Growing the issuance of bonds and other financial instruments

There have been positive developments in issuing bonds and other financial instruments on the MSE. The MSE has abolished trading fees for primary market issuers and lowered listing fees for stocks and bonds by up to 40 percent to entice more entities to join. The incentives are designed to increase market diversification and investor opportunities. The MSE has also launched new financial products, such as mutual funds and asset-backed securities, which broaden the range of options and further the growth of Mongolia's capital market.

The UBX recently registered Mongolia's first-ever exchange-traded fund (ETF), structured and issued by Invescore Capital. This milestone marks a significant development for the Mongolian financial market, introducing a diversified investment product that provides local investors with access to a broader portfolio of assets through a single security.

## Development of the OTC market

As presented during [Mining Week](#) 2024, 23 mining companies operating in Mongolia are listed on international stock exchanges, and seven mining companies collectively raised 506.49 billion MNT on the OTC market. Since the launch of the Mongolian

OTC market in September 2021, 3.16 trillion MNT in securities were registered through mid-2024, with 2.45 trillion MNT successfully raised. Notable cases are Khan-Altai Resources LLC and Huren Tolgoi Coal Mining LLC.

## Pension reform to attract institutional investors

Pension reform presents a significant opportunity to strengthen the role of institutional investors in Mongolia's financial market. According to the 2023 Mongolia Investment Climate Statement, there are areas of growth potential brought about by pension reform. These reforms are crucial not only for the financial sector's development but also for enhancing economic stability:

### 1. Increase in capital inflow

One of the direct benefits of pension reform is the potential for increased capital inflow. Improved pension funds encourage capital accumulation and provide institutional investors with the resources to invest in sectors such as infrastructure and real estate. The influx of capital into these areas

promotes economic growth and development, creating a more vibrant investment environment.

### 2. Diversification opportunities

Pension reform may also promote the diversification of investment portfolios. By increasing the flexibility of investment choices, reform could lead to increased investments in local businesses and projects. Diversified investment mitigates risk and encourages capital allocation to essential sectors for economic growth, such as technology, agriculture, and renewable energy. It is worth noting that mandatory insurance should apply for long-term investments and proper oversight of pension fund investment decisions.

## Further development of the commodity and the derivative market

Since its establishment in 2023, the commodity market has successfully traded coal, iron ore, and copper products through the Comex platform. Commodity buyers have been bearing the price fluctuation risk from the time of purchase to the actual delivery time. The lag between purchase and delivery has been as long as three months.

Ideally, buyers should be able to hedge their price volatility risk by purchasing derivatives during this period. Although the Securities Market Law and FRC regulations allow for futures derivatives, no mechanisms have been put in place. To allow for derivatives to be traded on the MSE, the Mongolian Securities Clearing Center (MSCC) or the designated centralized clearing party (CCP) needs to be well-capitalized and well-versed in its ability to calculate the initial margins (deposits) required for trades and establish mechanisms for calculating the variation margins (mark to market) to allow for risk-free settlements between the parties.

FTSE Russell market classification has 22 criteria on which stock markets are measured. The MSE fully meets 12, partially meets four, and does not meet six criteria. Two of the six unmet criteria are related to short sales and derivative transactions. If the MSE and MSCC are able to introduce derivatives to the market, it would improve the MSE's classification by meeting international standards.



# CHALLENGES

## INSTITUTIONAL INVESTORS

One of the key obstacles impeding the growth of the Mongolian capital market is the absence of institutional investors, especially pension funds. Pension funds make the provision of steady, long-term investments that can sustain the expansion and stability of the capital market possible. Without comprehensive and bold reforms to create and advance pension funds, Mongolia will have a tough time drawing in the kind of capital required to develop a strong capital market. AmCham Mongolia consistently advocates for pension reform and fully understands the significance of Mongolia's capital market.

[On September 27, 2024](#), L. Enkh-Amgalan, the Minister of Family, Labor, and Social Protection, provided an update on the government's policies and actions for the next four years, including proposed legal reforms. The Minister highlighted the severe challenges facing Mongolia's Pension Fund and the urgent need for reform to ensure its sustainability. He highlighted that the fund cannot continue to operate without decisive policy changes.

## WEAK CORPORATE GOVERNANCE OF PUBLICLY LISTED COMPANIES

Corporate governance issues are prevalent among publicly listed companies in Mongolia, often due to a high concentration of stock ownership among a few shareholders. This concentration results in poor transparency and limited market participation, which erodes investor confidence and hampers overall market growth.

The lack of diversified ownership diminishes management's accountability to a broader base of shareholders, leading to governance practices that may not align with the best interests of all stakeholders. There is potential for a law protecting minority shareholders' interests and reducing the negative impact of majority shareholders' decision-making.

## A SMALL NUMBER OF COMPANIES REPRESENT A LARGE PORTION OF THE CAPITAL MARKET

The Mongolian capital market is heavily concentrated, with a small number of companies representing a significant portion of the active market. This concentration increases the risk of market instability, as the market's performance becomes highly dependent on the fortunes of a few companies. Moreover, it limits diversification opportunities, making the market less attractive to domestic and international investors. The lack of diversification is a significant challenge for growth and resilience.

## LACK OF SUFFICIENT LISTED COMPANIES' DISCLOSURES, RULES, AND REGULATIONS IN ENGLISH

If the MSE is to increase foreign and institutional investors, it must provide sufficient disclosures in English. Listed company disclosures and all of the market's relevant rules and regulations must be available in English to allow investor confidence in the market.

## UNEQUAL TREATMENT OF FOREIGN AND LOCAL INVESTORS

With an amendment to the Company Income Tax Law dated November 10, 2023, the issue of gross capital gain calculation was remediated on July 1, 2024 (see Section 18.13). However, the law still requires foreign investors to pay a 20 percent tax and local investors to pay a 10 percent tax.

## HIGH TRANSACTION COSTS

When brokers quote fees on share transactions, the fee to buy or sell is 1.0 percent of the traded value. This 1.0 percent consists of fees paid to the MSE, MSCC, and brokers. The MSE fees range from 0.15 percent to 0.4 percent, depending on the value of the transaction. The MSCC fee is usually 0.12 percent, as almost all local brokers are members of the MSCC. For non-member transactions, the MSCC fee is 0.24 percent. The regulator portion of fees on most transactions ranges from 0.27 percent to 0.52 percent, and the remaining portion of the 1.0 percent fee quoted goes to brokers.

Broker fees for MSCC members and non-members:

	Buy/Sell		
	MSCC member (Minimum)	MSCC member (Maximum)	MSCC non-member
MSE	0.15%	0.40%	0.40%
MSCC	0.12%	0.12%	0.24%
<b>Total regulator fees</b>	<b>0.27%</b>	<b>0.52%</b>	<b>0.64%</b>
<b>Broker fee</b>	<b>0.73%</b>	<b>0.48%</b>	<b>0.36%</b>

The lowest MSE/MSCC rates compared to other exchanges in the region are as follows:

	MSE	Hong Kong (HK)	Singapore (SGX)	Shanghai (SSE)	Korea (KRX)	Vietnam (VNX)	Kazakhstan (KASE)
<b>Regulators</b>	0.27%	0.007%	0.04%	0.01%	0.003%	0.027%	0.05%
<b>Brokers</b>	0.48%	0.20%	0.18%	0.37%	0.25%	0.27%	0.50%

Significant measures must be taken to reduce the transaction costs per trade.

# WAYS FORWARD AND POLICY RECOMMENDATIONS

## 1 Strengthening market infrastructure

**Develop market infrastructure:** Investing in developing central securities depositories, clearinghouses, and other market infrastructure to ensure efficient post-trade processes is advised. This could potentially enhance market liquidity and attract more institutional investors. It may be beneficial to include actions that make it easier for individuals to invest in OTC investment instruments (e.g., investment funds, pooled funds) via stable banks, using IT applications with proper oversight and control.

**Regulatory reforms:** Continue refining the regulatory framework to align with international best practices. This includes enhancing the legal framework for investor protection, ensuring transparency in corporate governance, and adopting global standards for financial reporting and disclosure.

## 2 Promoting institutional investment

**Pension fund reforms:** Implement reforms that encourage pension funds to invest in the domestic capital market. This can be achieved by gradually increasing the equity and bond allocation limits for pension funds, fostering a stable and long-term investor base in the capital market.

**Incentives for foreign investors:** Provide targeted incentives for foreign institutional investors, such as tax breaks or streamlined regulatory approvals, to increase their participation

in Mongolia's capital market. Another action to promote longer-term investments would be the application of a capital gains tax based on the length of investment ownership, such as a higher tax rate for realized gains for a period of less than one year, slightly lower for ownership between one to five years, and a reduced rate if gains are realized after five years. These bold actions would encourage investors to commit to long-term investment.

## 3 Actively cooperate with foreign institutions to increase the visibility of the MSE, the UBX, and the companies listed on them

A key step is ensuring that our local rules and regulations align with those of foreign exchanges. In addition to translating these rules and regulations into English, authorities need to work with specific foreign exchanges and obtain legal opinion letters from reputable law firms regarding the investor protection clauses in the legal framework.

Actively working with the FTSE Russell Frontier market index team to see how companies listed on the MSE could be included as constituents within the index is also recommended.

Mongolia's capital market needs to achieve the following objectives:

### Make a broader impact:

- Increase foreign investor confidence
- Drive higher trading volumes and liquidity
- Improve the overall efficiency and sophistication of local exchanges like the MSE and UBX
- Improve operational efficiency in the capital market

### Streamline processes:

- Implement modern trading platforms and clearing systems to minimize transaction delays and errors
- Automate post-trade processes, such as settlement and reconciliation, to reduce manual intervention and improve accuracy



**Capacity building:**

- Conduct training programs for market participants, including brokers, issuers, and institutional investors, to ensure they can utilize advanced systems effectively
- Strengthen collaboration between the MSE, UBX, and regulatory bodies to ensure seamless communication and coordination

**Integration with global systems:**

- Adopt international standards such as the ISO 20022 messaging format for transactions to align with global practices
- Enable cross-border trading systems and partnerships with foreign exchanges
- Enhance transparency in the Mongolian capital market

**Disclosure standards:**

- Mandate timely and detailed financial disclosures by listed companies, ensuring compliance with International Financial Reporting Standards (IFRS)
- Introduce real-time reporting mechanisms for trades and key market data to enhance investor confidence

**Regulatory oversight:**

- Strengthen the role of regulators to monitor and enforce compliance with rules on insider trading, market manipulation, and corporate governance
- Publish annual market performance reviews and audit reports to provide stakeholders with insights into the market's health

**Investor education:**

- Launch campaigns to educate retail and institutional investors on market operations, rights, and responsibilities to encourage informed participation

**Digital platforms:**

- Develop user-friendly online platforms providing access to market data, financial reports, and trading tools, ensuring transparency for both domestic and foreign users

**4****Establish the legal framework needed for the derivative market**

For derivatives to work, standardized contracts need to be created, which are often based on internationally followed templates. Such templates require certain legal conditions to be met and apply to a specific country. One of the conditions is the existence of close-out netting provisions within the relevant legal framework. As noted in Section 4.2 of the 2018 ISDA Model Netting Act and Guide, "In most jurisdictions where there is any doubt under existing law as to the full enforceability of close-out

netting under a netting agreement, the source of that doubt lies in potentially applicable principles of insolvency law."

As such, a detailed legal review must be completed to establish such a framework. The current listing of countries that have adopted netting legislation as of September 20, 2024, is available [here](#).

**5****Tax incentives to support the capital market and foreign investors**

If there is agreement that the primary method of increasing the Mongolian capital market's liquidity is attracting foreign investors, tax policies must reflect that sentiment. Requiring foreign investors to pay double the taxes local investors pay sends the message that foreign investors are unwelcome. Tax incentives, especially for investment fund profits, need to be considered and implemented to attract institutional investors. In general, there

should be IPO incentives and policies to support domestic companies listing on exchanges.

Improve the technical and knowledge capacity of the MSCC to allow it to act as a CCP handling derivative transactions. Handling derivative transactions would increase the MSCC's capitalization, allowing it to sufficiently withhold credit/counterparty risks over margin collateral. Developing an alternative/optimal financing mechanism could reduce the transaction fees charged by MSCC and MSE.

Strengthen the role of the UBX as a platform complementary to the MSE to accelerate capital market development as they have special permission for trading and clearing. They can trade derivatives and initiate short-selling practices, which can expand market functionality. The UBX could catalyze faster growth in the Mongolian capital market by offering advanced financial instruments and promoting innovation and efficiency through fair competition with the MSE.

In conclusion, improving the institutional, regulatory, and supervisory framework remains a key priority for the Mongolian capital market's development. This Position Paper from AmCham Mongolia presents policy recommendations in a condensed form rather than a comprehensive sector overview. Advocacy efforts will follow based on the paper's main findings and recommendations.

