

Chapter 9

SECURITIES MARKET DEVELOPMENT IN MONGOLIA

by
D. Dorligsuren and J.Bolormaa*

1. Market overview

On 18th January 1991, the Mongolian Stock Exchange (MSE) was established for the purpose of privatization of state-owned enterprises and organizing securities to be traded further.

So far, a total 476 state organizations have been transformed into private companies (fully or partly privatized). As a result, 48% of the population (over 1.1 million individuals) became stockholders during February 1992 to August 1995, which developed the primary market in Mongolia.

With respect to the secondary market, stock trading started on 28 August 1995, when the MSE took an important role in activating the stock market and gave an opportunity for citizens to trade their stocks via brokerage firms.

Mongolia is currently in the process of developing a modern trading market structure and regulatory system for its emerging securities market that will be attractive to both Mongolian and foreign investors. The Government is also taking a number of steps to strengthen state-owned stock trading, to improve the regulatory framework of the Mongolian capital market and to protect public investors and shareholders.

Mongolian Stock Exchange's main indices

Indices	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
1 Listed companies	474	458	436	430	418	410	400	403	402	395
2 Market capitalization (USD million)	27.1	25.9	53.2	39.8	32.1	36.9	37.5	31.9	42.4	24.7
3 Trading value (USD million)	1.8	6.0	15.0	11.9	3.1	2.7	1.6	1.2	0.8	0.5
4 Traded volume (million)	6.8	24.8	33.7	33.1	21.4	35.1	15.9	9.8	8.1	9.1
5 Bond trading value (USD million)										
- Government bond	n/a,	0.20	n/a,	n/a,	n/a,	10.15	27.9	37.1	18.6	10.3
- Corporate bond	n/a,	n/a,	n/a,	n/a,	n/a,	n/a,	1.09	2.62	2.55	2.29
6 TOP -75 index	88.9	152.9	360.1	235	255.7	469.9	814.0	933.9	895.9	585.7

Stock market liquidity has fallen substantially. Share trading value at the MSE had increased to USD 15 million until 1997, and then fell sharply to USD 3.1 million in 1999 and USD 0.5 million in 2004. Market capitalization in 2004 averaged approximately USD 24.7 million, which was approximately

* D. Dorligsuren is a former CEO of the Mongolian Stock Exchange.
J.Bolormaa is a research specialist of the Mongolian Stock Exchange.

1.6 % of GDP. The equity market in 2004 diminished by one-thirty of that in 1997. There are many reasons for this. Firstly, the completion of privatization process based on providing vouchers caused the adverse effect on the equity turnover. That is to say, it caused the high ownership-concentration of stocks (inactive trading) and the significant decrease in the supply and demand of stocks. Listed companies have kept their stocks, which resulted in the inactive secondary market in Mongolia. To date, 476 listed companies have decreased to about 395 because of mergers and acquisitions and voluntary de-listings, 67 of which continue to be partly owned by the State and the remaining 328 listed companies have been fully owned by private stockholders. Secondly, the government policy for privatization method was changed in 1996. The government has preferred the auction method of privatization. Since 1995, many of the original stockholders have sold out their stocks. In addition, since 1996, the government has continued the privatization process by selling down its stakes in partly privatized companies by auctions run by the State Property Committee. It reduced new issuance of shares by the government through the MSE. During 1997-2004, the State Property Committee traded 56.8 million state shares at the MSE and amounted to USD 2.7 billion. This caused serious fall of trading volume and value of shares in the MSE. Thirdly, a generally unfavorable market environment caused by high interest rates, low level of household savings, high inflation and unemployment rates and the weakness of financial sector development, negatively influenced the activity of the equity market in Mongolia.

The debt securities market is in rather better condition than the equity market. Until November 2000, the government had issued its bonds directly to banks. Recently, the government has begun issuing its bonds by auctions via the MSE. The auctions have well contributed to increasing competition in the issuance market of government bonds, but most of the bonds have been placed with domestic banks. So far, there is little interest in this market for other investors. Also, there is little liquidity of government bonds. Those products are typically short-term maturity (less than 6 months). Therefore, the government bonds yield cannot be expected beyond such very short-term maturity.

Since 2001, one of construction companies "Barilga corporation" has been starting to issue its corporate bonds, which amounted to USD 4.4 million at the MSE.

The increasing bond issuance has partly compensated for the decline of the share trading value. Government bonds in 2004 reached USD 10.3 million and corporate bonds amounted to USD 2.3 million. In 2004, the bond trading accounted for 96 % of the total securities market turnover in the MSE, against the share trading did for 100 % in 1999. In this background, there were the need to compensate for the national budget deficits and the high gaps between deposit and lending rates in commercial banks.

The privatization of state-owned enterprises through investment vouchers had a negative influence on the development of the stock market in Mongolia. Firstly, the public tended to lose the confidence to the stock market. Shareholders were not able to recognize the value of shares and did not understand that the dividend is one of sources of fixed income for them, which seemed to lead many clients to much less confidence to the market. Secondly, stock market experts and professional organizations in the field of stock market are scarce in Mongolia.

2. Securities Clearing Settlement and Central Depository House

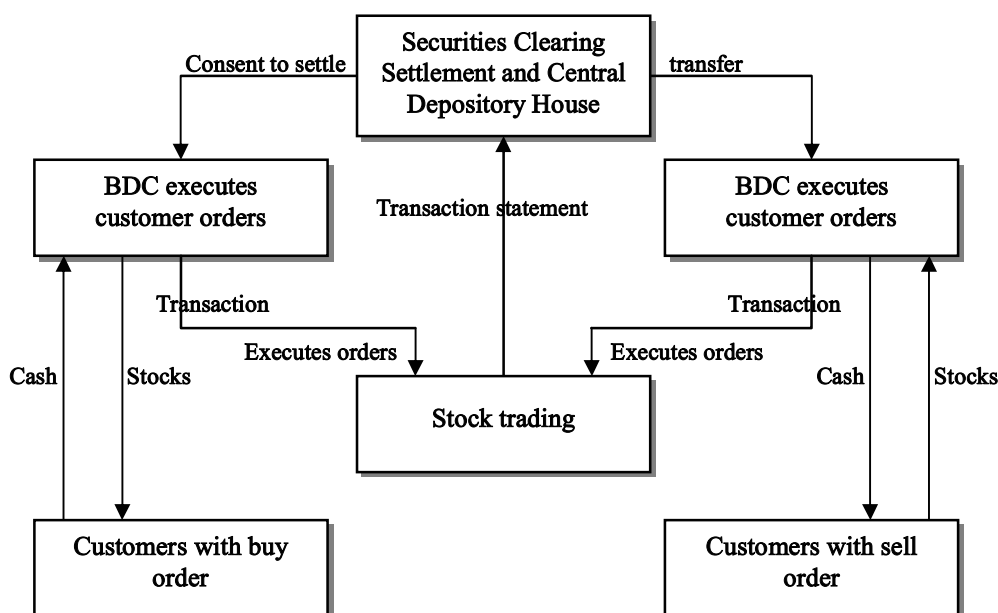
From 1992 until October 2003, the Securities Clearing Settlement and Central Depository House (SCSCDH) conducted its activities as one of departments of the MSE. In October 2003, it was reorganized into the Securities Clearing Settlement and Central Depository House as an independent organisation.

The main activities are to settle a transaction based on contract, to record the transfer of owner rights to others and to deposit stocks.

The SCSCDH adopts the delivery versus payment system for settling all securities transactions. The settlement of transactions in shares conducted in the stock exchange is effected on the next business day following the day of transaction (T+1). For bonds, however, the transaction is settled on the same day as the transaction day (T+0).

Anyone who wants to participate in the stock trading should open an account at the centralized depository and the transaction in stocks would be settled when the client places cash in the centralized depository to buy a stock. Therefore, the participant places a payment for stock on the house account at bank by transferring or paying to the cashier of the house by cash. Based on this account statement, the transfer officer places the cash on client's account at the centralized depository. The participant should place money before 10:30 of the trading day. All transfers are stopped at 10:30 and a report of the account is transmitted automatically by a computer network to the trading of MSE. The trading ends 12:00 and all transactions are transferred to the house by the network program and inspected. Thus the transaction of a stock and cash is automatically recorded on clients accounts at the centralized depository by using the computer program on that trading day. The house gives information of an account record only to broker dealer companies (BDC). When the company acquires this information, a specialist of the company inspects, receives selling client's application to take money and delivers it to the house at 9:00-10:00 and 14:00-18:00 within working hours every day. The transfer officer inspects the completeness of a document, makes this transfer and deducts client's money from the account according to his application. If the client receives by cash, money is paid out to a proxy attorney of the BDC, but if the client receives by transfer, money is transferred from the SCSCDH account to the client's account.

The BDC presents a report on money delivered to the client in 3-business days since the company received cash, to the SCSCDH.



In this case, the client can not buy shares by borrowing. Therefore, the transaction is accompanied with relatively low risk. The SCSCDH monitors that the BDC distributes cash to every client who has sold stocks.

SCSCDH activities are regulated by the regulations on clearing settlement activities and are undertaken according to internationally accepted standards (e.g. IOSCO).

The function of the Depository

The function of the depository is regulated by regulations on depository functions. The SCSCDH amends a depository record to deduct it from the depository and to amend the volume or value of stocks, and deposits the stocks in the depository based on the SEC orders. When the stocks are sold by means of the non-exchange trading, state owned shares are traded by closed auction. When the stocks are presented, donated or inherited, the house shall transfer the owner's rights according to relevant regulations and the SEC orders.

Cash and stocks are deposited on the client's account at the SCSCDH depository. In this case, the stocks are issued by non-physical form. At the end of 2004, total 2.02 billion shares held by 395 companies were deposited at the central depository of SCSCDH.

The SCSCDH has an electronic form of recording titles of securities that are held in an account to represent the holding securities. The agent holding the accounts normally provides a statement of ownership concerning this electronic form of record to the beneficiary from time to time.

The dematerialization of securities and their transfer by book entry within the central depository have many benefits: e.g., lowering the costs associated with securities settlement; improving the speed and efficiency of settlement; increasing the transparency and transfer arrangements.