



"The urgent task to improve the Capital Market for future IPO's of SOEs"

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The urgent task to improve the Capital Market for future IPO’s of SOEs

As you see below, FTSE Russell has provided the interim update on Mongolian Equity Market. The news has been updated at the website on the Mongolian Stock Exchange.

According to the website at MSE, since 2012, Mongolia has been placed on the FTSE Watchlist for the possible promotion to the Frontier Market status.

However, MSE has received an official letter recently from FTSE Russell providing an interim update on the assessment of the Mongolian equity market. According to the letter, FTSE Russell intends to announce the removal of Mongolia from the FTSE Watchlist, absent tangible progress on removing the main obstacles listed below before the end of August 2017:

- all trades are required to be fully pre-funded;
- an effective Delivery versus Payment (DvP) mechanism to minimize counterparty exposure is not in place; and
- there are no global custodians operating in the market.

To be considered as a Frontier Market, immediate cooperative efforts of market regulators and participants are required to resolve these issues.

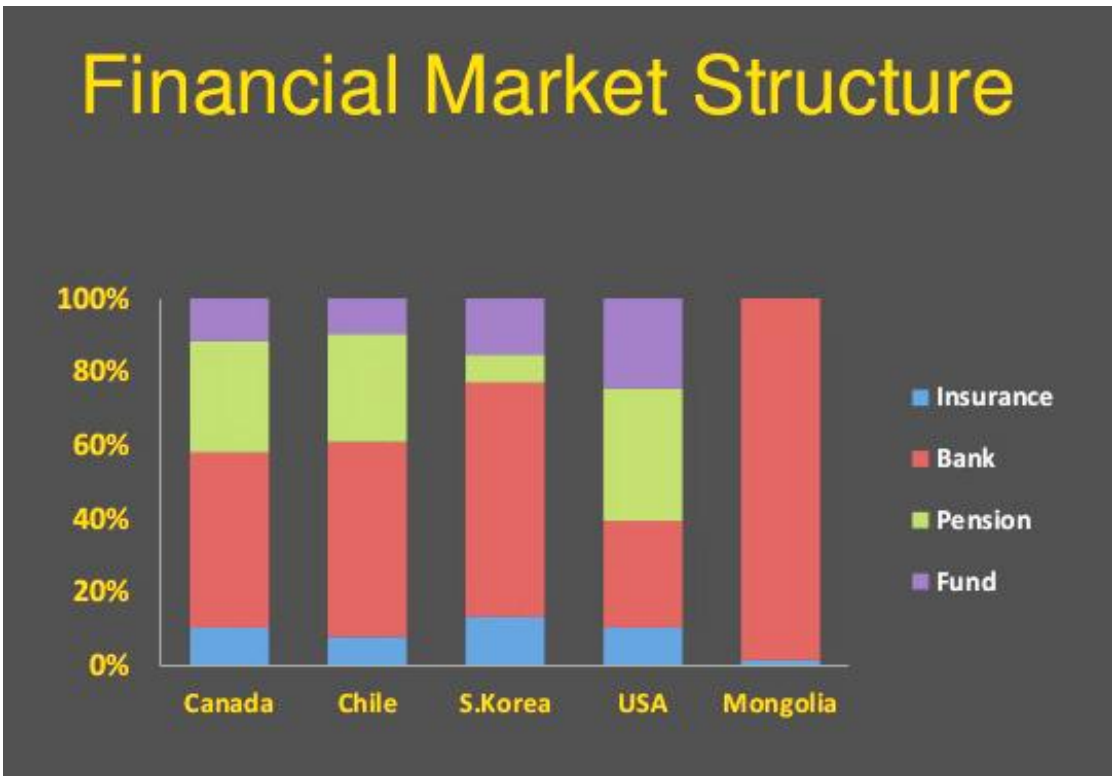
We believe it is extremely important for Mongolian capital market to comply with the criteria written at FTSE Russel as their index has a significant impact to the institutional investors in the world and it will take a massive efforts going forward to be included in the index in a future.

Note: The FTSE Russell, based In London, operates 250,000 indices calculated across 80 countries and its products are commonly used by institutional investors worldwide to benchmark and analyze their investment performance.

As FTSE is an important index for global institutional investors some passive investors (like country fund) will invest automatically based on the index, keeping the MSE as a watchlist is extremely important for ETT or other Mongolian companies to successfully be able to raise capital globally in a future especially at a time when Government is seriously thinking of raising fund through doing IPOs of big state owned enterprises.

Remember that at MSE, at this moment, there are almost no institutional investors have invested in a past. However, with FTSE and MSCI index to officially adding Mongolia to their index, it is very possible for global passive fund managers to start looking at us.

As you see below, Mongolian Stock Market is so tiny that it has been difficult to raise money at the stock exchange although the Government had a plan to privatize the shares of big state owned enterprises like Erdenes Tavan Tolgoi. The financial market structure in Mongolia is too dependent on banking system. However, the more healthier developments of Insurance, pension, capital market and the fund are expected in a future.



If the capital market grows as everyone in Mongolia hopes, there should arise an enormous opportunities in the capital market as you see below as well.

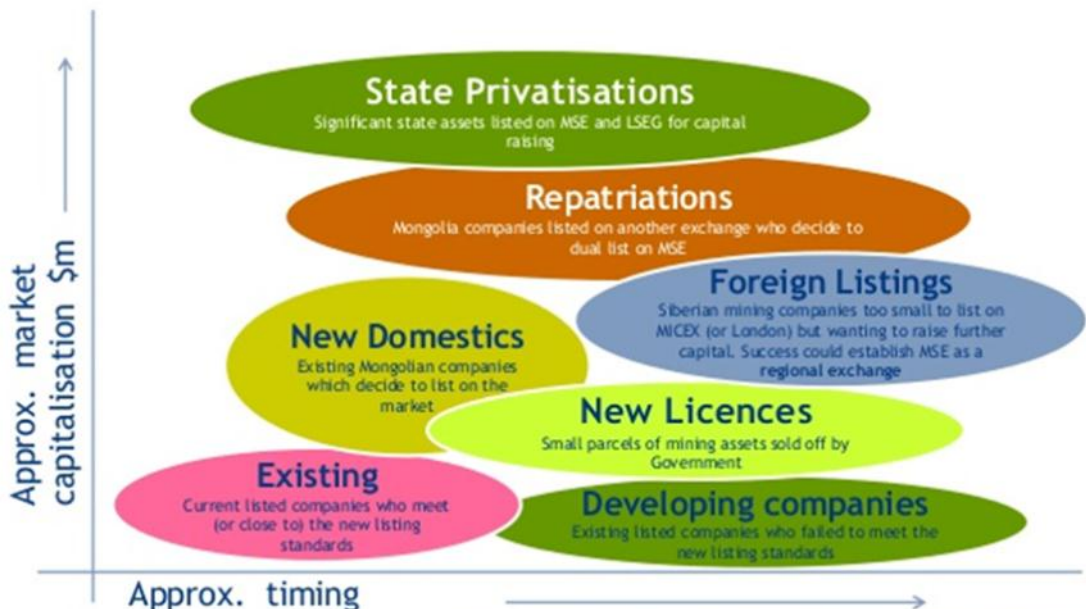


MSE - Enormous Potential



London
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Increasing the quality of the companies on the market is key to attracting new investors. There are seven categories of companies that we will target





Therefore, the immediate coordinated actions led by Government are required to keep the status as the watch list.

To understand the actions required, I suggest you to see the below FTSE quality of markets criteria (watch list) as at March 2017.

FTSE QUALITY OF MARKETS CRITERIA (Watch List) as at March 2017											
CRITERIA	DEV WATCH	Poland	ADV EMG WATCH	SEC EMG WATCH	China A	Kuwait	Romania	Saudi Arabia	FRONT WATCH	Nigeria	Mongolia
World Bank GNI Per Capita Rating, 2015		High			Upper Middle	High	Upper Middle	High		Lower Middle	Lower Middle
Credit Worthiness		Investment			Investment	Investment	Investment	Investment		Speculative	Highly Speculative
Market and Regulatory Environment											
Formal stock market regulatory authorities actively monitor market (e.g., SEC, FSA, SFC)	X	Pass	X	X	Pass	Pass	Pass	Pass	X	Pass	Pass
Fair and non-prejudicial treatment of minority shareholders	X	Pass	X		Not Met	Pass	Pass	Not Met		Restricted	Pass
No or selective incidence of foreign ownership restrictions	X	Pass	X		Not Met	Pass	Pass	Restricted		Pass	Restricted
No objection to or significant restrictions or penalties applied to the investment of capital or the repatriation of capital and income	X	Pass	X	X	Not Met	Pass	Pass	Restricted	X	Restricted	Pass
Free and well-developed equity market	X	Pass	X		Pass	Restricted	Not Met	Not Met		Restricted	Not Met
Free and well-developed foreign exchange market	X	Pass	X		Not Met	Restricted	Restricted	Not Met		Not Met	Not Met
No or simple registration process for foreign investors	X	Pass	X		Not Met	Restricted	Restricted	Not Met		Restricted	Restricted
Custody and Settlement											
Settlement - Rare incidence of failed trades	X	Pass	X	X	Pass	Pass	Pass	N/A	X	Pass	N/A
Custody-Sufficient competition to ensure high quality custodian services	X	Pass	X	X	Pass	Pass	Pass	Restricted		Pass	Not Met
Clearing & Settlement - T+2 / T+3	X	T+2	X	X	T+0	T+0, T+2	T+2	T+0	X	T+3	T+0
Settlement - Free delivery available	X	Pass			Not Met	Not Met	Restricted	Not Met		Not Met	Not Met
Custody - Omnibus account facilities available to international investors	X	Restricted	X		Pass	Not Met	Not Met	Not Met		Not Met	Not Met
Dealing Landscape											
Brokerage - Sufficient competition to ensure high quality broker services	X	Pass	X	X	Pass	Pass	Pass	Pass		Pass	Pass
Liquidity - Sufficient broad market liquidity to support sizeable global investment	X	Pass	X	X	Pass	Pass	Not Met	Pass		Restricted	Not Met
Transaction costs - implicit and explicit costs to be reasonable and competitive	X	Pass	X	X	Pass	Pass	Pass	Pass		Not Met	Not Met
Stock Lending is permitted	X	Pass			Not Met	Not Met	Not Met	Not Met		Not Met	Not Met
Short sales permitted	X	Pass			Not Met	Not Met	Restricted	Not Met		Not Met	Not Met
Off-exchange transactions permitted	X	Pass			Not Met	Not Met	Not Met	Not Met		Restricted	Not Met
Efficient trading mechanism	X	Pass			Pass	Pass	Pass	Pass		Restricted	Restricted
Transparency - market depth information / visibility and timely trade reporting process	X	Pass	X	X	Pass	Pass	Pass	Pass	X	Pass	Restricted
Derivatives											
Developed Derivatives Market	X	Pass			Not Met	Restricted	Restricted	Not Met		Not Met	Not Met

Shading indicates a change from September 2016
 N/A - Mongolia and Saudi Arabia operate a pre-funded settlement cycle and hence do not experience failed trades

You can see the number of criteria required and the number of Frontier countries which are in the watch list.

If you see the performance of Mongolia, as you see the far right of the column, some criteria are not met.

Those are followings

1. Free and well-developed equity market
2. Free and well-developed foreign exchange market
3. Custody-Sufficient competition to ensure high quality custodian services
4. Settlement - Free delivery available
5. Custody - Omnibus account facilities available to international investors
6. Liquidity - Sufficient broad market liquidity to support sizeable global investment
7. Transaction costs - implicit and explicit costs to be reasonable and competitive
8. Stock Lending is permitted
9. Off-exchange transactions permitted
10. Developed Derivatives Market



To meet those criteria, we want to comment what actions should be done one by one.

1. Free and well-developed equity market

MSE at this moment may be a free market. But it can not be said that the market is well developed. The well-developed market should be established based on the rule of laws, ethics and trust from market participants.

2. Free and well-developed foreign exchange market

I think MSE is doing relatively well on this. However, at some points in the past, the FX market was controlled by BOM. And, some funds have complained about the freeness of the trades.

3. Custody-Sufficient competition to ensure high quality custodian services

I do not think this is well managed in Mongolia. Unless this is secured, no institutional investors will come in this market.

4. Settlement - Free delivery available

Same as above. This is still not good. Mongolia has invited London Stock Exchange to improve this together with the Custody in the past. But, it is unfortunate that this has not happened yet.

5. Custody - Omnibus account facilities available to international

Investors

6. Liquidity - Sufficient broad market liquidity to support sizeable global investment

The liquidity has been a big issue since we have come to Mongolia 10 years ago. The biggest problem is the high concentration ratio of the small number of insiders at every stock. Perhaps it is a good idea to make a listing maintenance rule and enforce listed companies to comply with the rule.

7. Transaction costs - implicit and explicit costs to be reasonable and competitive

The transaction costs are higher because of the high trading cost because of the fat bid/ask spread, high commission costs by brokers and the expensive costs for financial regulatory commission, Mongolian stock exchange and the costs for CDH.

Each item should be carefully studied and try to be minimized.

8. Stock Lending is permitted

In case the stock lending is permitted, it will increase the liquidity of the stock market. So, it is positive for MSE to increase the liquidity.

9. Off-exchange transactions permitted

This is particularly important for foreign investors who trade in remote places. For instance, for US and European investors, being able to trade outside of the trading hours in Mongolia will benefit.

10. Developed Derivatives Market

Developed Derivatives Market means the availability of derivative products like index futures, index options and convertible bonds and warrants etc. Definitely having those derivative products will help increase the liquidity of the market. So, it will be important for Mongolia to start offering those products in a few years.

I hope Government will take actions to meet those criteria following our comments asap.

Otherwise, It might be most likely that FTSE Russell index might close the door for big State owned companies in Mongolia to tap into the global financial market.

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